

Corporate Cooperation: “Doing the Right Thing” or “Assisted Suicide”?

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A. *Opening Observations*

It is a sad commentary on the current state of our chosen profession of white collar defense that many federal practitioners today are more skilled and experienced in conducting internal investigations, negotiating plea deals and litigating sentencing issues than in trying cases. This is a foreboding development, of course, for many reasons. The main one is that the fairness and effectiveness of our judicial system depend upon occasional trials of the government’s decision to indict a particular type of case. However, with the increasingly strong pressures being brought to bear on corporations to cooperate with the government in cases of suspected criminal activity, the formulaic response of many defense lawyers is to counsel the board of directors on an extremely conservative approach of appeasing the government by conducting internal investigations, self-reporting, waiving the privilege, separating any officers or employees implicated in the activity and denying them legal support. The government, emboldened by such passive defense, has become far more aggressive than ever in pursuing white collar prosecutions, especially in the area where “fraud” can be alleged, in cases that were formerly dealt with by civil suits filed by class action lawyers or regulatory proceedings commenced by the SEC or other agencies. Society, of course, would suffer the consequences of such unrestrained prosecutions. Imagine an executive branch effectively unchecked by the requirements of unanimous jury verdicts or the “beyond a reasonable doubt” standard of proof in criminal cases.

While it is still possible for a white collar defense lawyer to fight a criminal case and bring it to trial, it is usually on behalf of an individual client rather than the corporation itself due to the admittedly enormous pressure on the corporation to cooperate with the government and cut its losses.² From the self-interested perspective of

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² *The American Lawyer* reported in the Fall of 2007 that more than half of 68 indicted chief executive officers it had studied in an analysis of major Corporate Fraud Task Force cases chose to go to trial rather than plea (only three of those were acquitted). David Borio, No Surrender, *Litigation 2007* (a Supplement to *The American Lawyer* and *Corporate Counsel*), Fall 2007, at 14.

The same analysis considered approximately 120 companies that had been the subject of federal investigation over the lifetime of the Corporate Fraud Task Force. *Id.* at 37-40. Only 14 of those companies were indicted, allowing the fair inference that the balance cooperated in one way, shape or form. The 14 indicted companies were Americable International, Inc.; American International Group, Inc.; AOL; Arthur Andersen; Beacon Rock Capital, LLC; Computer Associates; Dantone, Inc.; KPMG; Micrus

our bar, this can be enormously frustrating, especially for those lawyers with the expertise and resources to handle the large cases. The expense incurred in fighting such cases to the finish can only be borne by substantial corporate clients or the wealthiest of individuals. Even for those clients, the usual decision is to cooperate because of the government's leverage. Corporations, for reasons discussed below, are generally urged by their counsel to cooperate and cut a deal. Individual officers and employees who are implicated are generally cast off and, even where there are indemnification provisions, find it difficult to finance an expensive defense in a complicated prosecution.³

Of course, more important than our professional desire to try cases is what this dearth of trials means for the representation of clients and the integrity of our system. The corporate rush to cooperate rather than fight is a phenomenon that feeds upon itself. When the deck is already so stacked with reasons to cooperate, and the consequences of a conviction so potentially lethal, it is almost too much to hope that future boards of directors and the lawyers who advise them will buck the trend and fight, even when presented with a tenuous government case. But where is our society left if the government's case goes regularly untested by an adversarial process, including cross-examination, a stringent burden of proof, and the requirement of unanimous jury verdict? And what about the economic impact and other costs of corporate cooperation – astronomic fines even for cooperators, collateral damage from ensuing civil litigation, the usual loss suffered by the companies' shareholders when the stock plunges in value, the fear and loss of morale instilled in the companies' officers, directors and employees, to name the obvious ones? What can be said about a board's exercise of its fiduciary duty of care for its shareholders when it settles too easily and does not mitigate the damage? What can be said of its lawyers' ethical obligation to zealously represent their client if they give the safe and standard advice to cooperate without a real evaluation of the pros and cons of that course of action?

While in the post-*Enron* era, it is hard to imagine that the reluctance of corporate clients to fight a case and risk a trial will abate any time soon, we thought this conference would be an opportune time to consider these questions. Why is the rush to cooperate at the corporate level so endemic? What set of circumstances might allow a corporation rationally to buck the trend? Could the costs of cooperation (monetary and otherwise) ever be so great as to justify running the risk of indictment on a set of defensible facts? Put another way, is there any cause for hope?

Corporation; Milberg Weiss; Monsanto Company; PNC ICLC Corp.; PurchasePro.com; and Reliant Energy. Elsewhere in that publication, however, it was observed that even “most” of the 14 “quickly reached deferred prosecution agreements deals in which they paid fines, admitted wrongdoing, and pledged to stay out of trouble in exchange for a government promise that at the end of a specified period, the corporation's record would be wiped clean.” Andrew Longstreth, *Resisting Arrest, Litigation 2007*, at 76. One of the holdouts, Reliant Energy, is discussed below in section D.

³ While most state corporate statutes authorize indemnification of an individual employee's attorney's fees and expenses after vindication and even advancement of those costs as they are incurred, not all corporations enact articles of incorporation or by-laws granting all their employees both rights. And, even where such rights are granted, corporations can delay or refuse payments for various reasons, effectively depriving their employees of effective representation.

B. *Why is the Corporate Herd Rushing to Cooperate?*

As any white collar defense lawyer now knows, this question is depressingly easy to answer. Broadly described, it is a web of standards of conduct – common law and code provisions on the fiduciary duties of corporate directors, pronouncements by the SEC and DOJ, and the Federal Sentencing Guidelines – that has resulted in the increasingly common and often premature advice to tell a corporate client to cooperate quickly and completely as soon as any misconduct comes to light. When faced with the expansive scope of the doctrine of vicarious liability, which effectively robs a corporation of substantive defenses when its employee commits a crime, the reflexive decision to cooperate rather than defend is understandable.

1. *The Risk of Personal Liability for Board of Director Members*

The decision whether or not to cooperate is theoretically made by members of the board of directors, each of whom could face personal liability should he or she fail to exercise a duty of care in handling allegations or evidence of wrongdoing. Due care generally can be described as imposing an objective standard of conduct on the directors to act “in a manner the director reasonably believes to be in the best interests of the corporation.” Model Bus. Corp. Act Ann. § 8.30(a)(2) (I2002). While the overwhelming majority rule is that liability will not be visited on directors for breach of their duty of care unless such breach arose as a result of gross negligence,⁴ few could be expected to run the risk of that hair splitting when faced with the dire consequences. Even so-called “shield statutes” that enable corporations to enact by-laws exempting directors from liability for breach of the duty of care may not protect directors if they ignore “red flags” or otherwise act so as to call their good faith into question.⁵

The influential Delaware Chancery Court recently went so far as to suggest the possibility that Board members might risk violating that duty of care by not cooperating with the government on evidence of wrongdoing. *In re Caremark International Inc. Derivative Litigation*, 698 A.2d 959 (Del. Ch. 1996). The court first made the obvious observation that the Federal Sentencing Guidelines provide “powerful incentives for corporations today to . . . detect violations of law, *promptly to report violations to appropriate public officials when discovered*, and to take prompt, voluntary remedial efforts.” *Id.* at 969 (emphasis added). It then went on to remark that “[a]ny rational person attempting in good faith to meet an organizational governance responsibility would be bound to take into account this development and the enhanced penalties and the opportunities for reduced sanctions that it offers.” *Id.* at 970. The court considered this in ruling on a proposed settlement and evaluating the strength of shareholders’ claim of breach of fiduciary duty against the directors. The claim arose from the corporation’s indictment for violations of federal anti-kickback laws, its guilty

⁴ See Kevin Abikoff, *Corporate Governance, Avoiding and Responding to Misconduct* (2007), § 6.03[1] at 6-7 & note 5.

⁵ *Id.* at 6-7.

plea and payment of \$250 million in fines and penalties. *Id.* at 967 (“The claim is that the directors allowed a situation to develop and continue which exposed the corporation to enormous legal liability and that in so doing they violated a duty to be active monitors of corporate performance.”). The Court ultimately approved the settlement, never commenting explicitly on the corporation’s evident decision not to cooperate in the more than two year pre-indictment period.

The *dicta* in the opinion suggest that the directors’ decision not to cooperate with the government in an investigation could, under certain circumstances, expose them to personal risk in lawsuits brought against them. Presumably even the threat of such suits must have a strong effect on the directors’ decision about how best to defend their corporation and the interests of its shareholders. This growing pressure on corporate directors was recently described in a treatise on derivative lawsuits:

While the business judgment rule remains a fixture in corporate law, it would appear that its parameters are being altered, especially in the context of board examinations [of] (or failure to examine) allegations or evidence of misconduct. It is true that the substantial discretion that directors are owed in making business decisions and the procedural safeguards that the courts have instituted to protect those decisions have resulted in few successful shareholder actions. Directors should be wary, however, of relying too heavily on the comfortable layer of protection that courts have afforded them in the past.

There has been a constant and steady evolution from the ostrich-like belief that what a director does not know will not harm him or her to a common-law requirement (driven by developments in other areas of the law) that directors must put in place appropriate systems and ensure that they are properly informed, especially in the context of allegations or evidence of misconduct. The consequences of failure – with the development of the duty of good faith – are more profound than ever before because they carry the risk of personal liability (without the benefit of either exculpation or indemnity).

The board that conducts proper discovery, investigates and remediates potentially improper conduct will be much less likely to face liability, whether that liability comes under the guise of a breach of care, loyalty or good faith.⁶

This message plainly has not been lost on corporate directors and the law firms who advise them on deciding how to proceed when they are made aware of even arguably criminal conduct.

⁶ *Id.* at § 6.04.

2. *The SEC's Seaboard Decision and its 2006 Financial Penalties Statement Make the Value of Cooperation Clear*

Since many white collar investigations involving publicly held companies have parallel SEC investigations, the SEC's views on corporate cooperation can be as important as those of the Department of Justice.

In October 2001, the SEC used the report it issued on its investigation of wrongdoing at the Seaboard Corporation to set out 13 non-exclusive factors that it would take into account in determining whether a company deserved leniency with respect to the penalties the Commission would seek for violations of the securities laws. The significance of cooperation was made very plain, leaving *Seaboard* a major factor in the trend toward corporate cooperation.

The eighth of the factors puts the questions:

Did the company promptly, completely and effectively disclose the existence of the misconduct to the public, to regulators and to self-regulators? Did the company cooperate completely with appropriate regulatory and law enforcement bodies?

Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions, Exchange Act Release No. 34-44969 (Oct. 23, 2001), available at www.sec.gov/litigation/investreport/34-44969.htm.

The eleventh similarly asks:

Did the company promptly make available to [SEC] staff the results of its review and provide sufficient documentation reflecting its response to the situation? Did the company identify possible violative conduct and evidence with sufficient precision to facilitate prompt enforcement actions against those who violated the law? Did the company produce a thorough and probing written report detailing the findings of its review? Did the company voluntarily disclose information our staff did not directly request and otherwise might not have uncovered? Did the company ask its employees to cooperate with our staff and make all reasonable efforts to secure such cooperation?

Id. at *8.

Assessment of these factors plainly ties into the SEC's decision on what penalties to seek from corporate defendants, as it explained in the statement it issued later in January 2006 on the imposition of financial penalties. Statement of the Securities and Exchange Commission Concerning Financial Penalties, 2006-4 (Jan. 4, 2006), *available*

at www.sec.gov/news/press/2006-4.htm. Unsurprisingly, it cited cooperation as a fact that would be key in determining whether to impose a penalty on the corporation:

Effective compliance with the securities laws depends upon vigilant supervision, monitoring, and reporting of violations. *When securities law violations are discovered, it is incumbent upon management to report them to the Commission and to other appropriate law enforcement authorities.* The degree to which a corporation has self reported an offense, or otherwise cooperated with the investigation and remediation of the offense, is a factor that the Commission will consider in determining the propriety of a corporate penalty.

Id. (emphasis added).

3. *The McNulty Memorandum Places Strong Emphasis on Cooperation*

The Department of Justice, of course, explicitly advises corporations in the form of the McNulty Memorandum (named after its author, former Deputy Attorney General Paul J. McNulty) that cooperation is a consideration in whether and how the Department will employ its prosecutorial discretion:

In conducting an investigation, determining whether to bring charges, and negotiating plea agreements, prosecutors must consider the following factor[] [among others] in reaching a decision as to the proper treatment of a corporate target: the corporation's timely and voluntary disclosure of wrongdoing and its willingness to cooperate in the investigation of its agents

Undated Memorandum from Paul J. McNulty, Deputy Attorney General, to Heads of Department Components, United States Attorneys (released Dec. 12, 2006) ("McNulty Memorandum")(available at www.usdoj.gov/dag/speeches/2006/mcnulty_memo.pdf).

4. *The Federal Sentencing Guidelines Incentivize Corporations to Cooperate*

Significant amendments to the portion of the Federal Sentencing Guidelines governing the sentencing of organizations were made on November 1, 2004 and form the parameters of any corporate sentence today. Set out in Chapter 8 of the Guidelines, titled "Sentencing of Organizations," the Guidelines contain explicit incentives for a corporation apprised of possible criminal wrongdoing to cooperate.

Determining the appropriate fine is by far the most complicated aspect of the Guidelines analysis. In almost all cases, this will key off a so-called "culpability score" (unless the corporate entity is found to have operated primarily for a criminal purpose or by criminal means, in which case the culpability score analysis is abandoned, and the Guidelines dictate simply that the fine be "set sufficiently high to divest the

organization of all its assets.”⁷). Initially, the Judge is charged with establishing a “base fine,” determined by measuring the greatest of the organization’s gain from the offense, the loss caused by the offense, or a figure from a table that provides for increasing fines depending on the seriousness of the offense.⁸ Depending on the entity’s culpability score, the Judge can sentence it to pay anywhere from 5% to 400% of that base fine, a potentially enormous sum in most cases.⁹

Explicitly inspired by the Sarbanes-Oxley Act and its understandable agenda of preventing criminal conduct at the corporate level, the amendments place a premium on the degree to which a corporation self-reports, cooperates and/or accepts responsibility for the conduct involved. If it does, the company can have its culpability score reduced one, two, or five levels, depending on where its conduct falls in the spectrum of cooperation.¹⁰ Significantly, a corporation will be denied a three-level reduction for an effective compliance and ethics program if, after becoming aware of a possible offense, it “unreasonably” delays reporting the offense to appropriate governmental authorities.¹¹

5. *The Expansiveness of the Vicarious Liability Doctrine Can Leave a Corporation Defenseless*

Under the doctrine of vicarious liability, a corporation may be held liable for the crimes of its officers, directors, employees and other agents. This is so even if the individual involved was acting directly contrary to corporate policy and procedures, and even when management was unaware of the misconduct and affirmatively deceived about it. *See, e.g., United States v. Twentieth Century Fox Film Corp.*, 882 F.2d 656, 660 (2d Cir. 1989) (“Fox’s compliance program, however extensive, does not immunize the corporation from liability when its employees, acting within the scope of their authority, fail to comply with the law and the consent decree”); *United States v. Automated Medical Labs., Inc.*, 770 F.2d 399, 407 (4th Cir. 1985) (the fact that many of the corporation’s employees’ actions were “contrary to corporate policy does not absolve AML of legal responsibility for their acts”) (citation omitted); *United States v. Cadillac Overall Supply Co.*, 568 F.2d 1078, 1090 (5th Cir. 1978) (a corporation’s conviction was affirmed although acts of “managers in joining the non-solicitation and account balancing arrangements were in direct opposition to instructions given by the president of the corporation and outside the scope of their authority”); *United States v. Sun-Diamond Growers*, 964 F. Supp. 486, 491 n.10 (D.D.C. 1997) (“even if Mr. Douglas had acted against corporate policy or the corporation’s express instructions or even if Sun-Diamond

⁷ Federal Sentencing Guidelines Manual, at Ch. 8, introductory comment. (2007); *see also* § 8C1.1.

⁸ *Id.* at § 8C2.4.

⁹ *Id.* at § 8C2.6.

¹⁰ *Id.* at § 8C2.5 (g).

¹¹ *Id.* at § 8C2.5 (f)(2).

had derived no benefit from Mr. Douglas' actions, Sun-Diamond could still be criminally responsible for Mr. Douglas' acts") (citations omitted); 10 William Meade Fletcher, et al., *Fletcher Cyclopedia of the Law of Private Corporations* § 4942 (perm. ed. rev. vol. 2001) ("merely stating or publishing instructions and policies is not sufficient to insulate a corporation from liability, and a corporation may be held responsible for acts of its agents even where they violate such policies. Further, the existence of a compliance program, however extensive, does not immunize the corporation from liability when its employees, acting within the scope of their authority, fail to comply with the law.") (footnotes omitted).

Thus, as the case law almost universally holds, the only two factors needed to trigger application of the doctrine are that the corporation's agent (be that a director, officer, employee or agent) acted within the scope of his or her duties, and that the employee acted with the intention, at least in part, to benefit the corporation.

And these requirements are read broadly. As to the first, "within the scope of duties" prong, it is enough that the employee was engaged in some job-related activity when engaged in the criminal conduct. The second, "benefiting the corporation" prong, requires only a minimum of intended benefit to the corporation, strictly what would be needed to insulate a corporation from criminal liability where its agent's actions are "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." *Automated Med. Labs.*, 770 F.2d at 407 (emphasis in original). For example, a company can be criminally liable for the acts of a salesperson who receives a kickback for selling at an unauthorized discount. It does not matter that the discount is unauthorized; the salesperson is nominally acting within the scope of his duties – selling – and with the intention of benefiting the corporation since the corporation profits from the sales.

While there is an increasing chorus of prominent voices calling for a fresh look at the wisdom of vicarious liability,¹² it is unlikely that the courts will soon overturn decades of precedent, and the possibility of Congress' pre-empting them by passing ameliorative legislation and appearing to be "soft on corporate crime" is remote, given the post-*Enron* hue and cry over corporate crime. As long as the doctrine of vicarious liability stands, corporations faced with evidence of employee wrongdoing find themselves at great risk if they side with their employees, and the pressure to cooperate against will them can be overwhelming.

A final comment on this point: The vintage of the cases cited above is telling. The lack of recent cases on the issue of vicarious liability only proves the point that the corporation caught in this situation is cooperating, not litigating.

6. *Corporations in Certain Industries Have No Option But to Cooperate*

¹² See Audrey Strauss, *New Voices Question Corporate Criminal Liability*, N.Y.L.J. (July 5, 2007); see also Gregory L. Diskant, *Time to Rethink Corporate Criminal Liability*, N.Y.L.J. (Aug. 2, 2007).

For some companies, pressures exist that leave no room for debate about the decision to cooperate. These corporation *must* cooperate or go out of business. These include corporations that depend on licenses that will be at risk on conviction; those that rely on pristine public reputations, such as investment firms;¹³ those that could be excluded from government business or from participation in healthcare reimbursement programs;¹⁴ and those that need access to the short-term money market.

7. *A Corporation That Fights But Loses May Not Survive*

Arguably the most important factor of all is that corporations considering the cooperation decision inevitably ask themselves, “what if we fight, pre- or post-indictment or both, and lose?” The answer is generally two words – Arthur Andersen – the global accounting firm that rapidly deteriorated its indictment for the actions of a few employees discarding records relating to their Enron engagements. While there are corporations that have survived indictment in recent years – Reliant Energy Services Inc. (a subsidiary of Reliant Energy Inc.); TAP Pharmaceutical Products Inc.; America Online, Inc.; and Monsanto Company, to name a few – they are rare.

Although it dealt with penalties imposed on individuals, the recent survey of white collar criminal cases conducted by *The American Lawyer* and *Corporate Counsel* magazines is instructive for corporate entities as well:

The harshest sentences are reserved for defendants convicted at trial. In the cases we analyzed, only two defendants who pled guilty were sentenced to more than 15 years in prison. The vast majority of those who pled received sentences of fewer than five years – the beneficiaries of sentencing guidelines that reward cooperation. Defendants who went to trial and lost paid dearly for the gamble. In our analysis, the largest concentration of white-collar criminals convicted at trial received five-to-

¹³ Witness the swift handling by Alliance Capital (now known as AllianceBernstein), a global investment firm, of then-N.Y. Attorney General Elliott’s Spitzer’s “market timing” investigation. The investigation began in the Fall of 2003 but was settled by December, with an agreement requiring payment of \$250 million to investors allegedly harmed by the conduct (\$150 million being classified as disgorgement and \$100 million classified as a penalty).

¹⁴ TAP Pharmaceutical Products, Inc., a company partially owned by Abbott Laboratories, pled guilty in 2001 to conspiracy in connection with its sales force’s provision of free samples of the drug Lupron to physicians who, in turn, sought reimbursement from federal programs for the drugs. The company settled for \$875 million in criminal and civil penalties but could not buy peace for its employees. Interestingly, though 13 fought the charges, none were ultimately convicted – all but one were dismissed from the case pre-trial or acquitted, and the single employee who entered a guilty plea was allowed to withdraw it after her colleagues’ acquittals. As a local editorial pointedly observed, “[t]he obvious conclusion is that if TAP Pharmaceuticals had gone to trial, it too, would have been acquitted. But TAP could not take the chance of losing all federal reimbursement for Lupron, even though its president said the company ‘fundamentally disagreed’ with most of the prosecution’s allegations.” Grainger & Newhouse, *Misusing Courts Against Companies*, *The Boston Globe*, at A13 (May 10, 2005).

ten-year sentences. A quarter were sentenced to more than ten years in prison.

Litigation 2007, supra, at 40.

C. In the Exercise of Fiduciary Care, However, a Director Must Take Care to Consider the Negative Consequences of Cooperation, As Well as to Consider Whether Self-Reporting Can Be Avoided

To be sure, the pressures on a corporation confronted with allegations or evidence of wrongdoing to cooperate is substantial. But before resolving to commit a corporation to the path of cooperation, the directors and company management have a duty not just to take the most conservative approach and protect their own personal interests, but to consider all the alternatives after they “inform themselves . . . of all material information reasonably available to them.” *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984), *overruled in part by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000). This must include giving careful consideration to the negative consequences of cooperation and the possibility that the problem they face can sometimes be solved without self-reporting to the government and cooperating.

1. ***The Option of Not Self-Reporting and Instead Responsibly Addressing the Issue Internally Must Be Considered***

The government repeatedly asserts that it will treat companies that self-report more leniently than those that do not – although published settlements hardly suggest that self-reporting companies are treated “leniently” at all, and one wonders what the “non-lenient” penalties would have been if the cases went to trial. However, that begs the question of whether the companies should self-report in the first instance, especially in cases where the alleged wrongdoing has not and perhaps may not be disclosed absent self-reporting. This is not to suggest that companies should not truthfully disclose what they are legally required to disclose or that they engage in illegal activity in covering up criminal conduct.¹⁵ However, there are many situations where corporations are in a position where they can legally choose not to self-report and instead use legal counsel to remedy the situation internally, by doing such things as investigating the situation thoroughly to determine its full extent, terminating employees responsible for the wrongdoing, compensating third parties who are damaged by the conduct, implementing policies and procedures to ensure that the conduct will not be repeated, and installing compliance systems to that end.

¹⁵ There are, obviously, many legal requirements in a public company’s securities law filings, its certified financial statements, its tax returns and various other filings with federal, state and local governments (as well as foreign governments) that may require disclosure or partial disclosure of information relating to possible wrongdoing. Contractual dealings with third parties may also require disclosure. These requirements must be considered in the context of the particular corporation involved and its business dealings and may compel a decision to cooperate if disclosure is inevitable.

Many, if not most, of the significant corporate crime prosecutions recently brought by the government have been aided or even initiated as a result of the decisions by the boards to self-report and cooperate. They have spent millions to employ major law firms to conduct internal investigations, waive the corporation's attorney-client privilege, produce the work product of the investigation to the government, and seek to appease the prosecutors by terminating the employees involved and declining (if they can) to advance legal fees and expenses and engage in any joint defense activities. Some of these cases may never have come to the attention of the government. Others, even if they were likely to be discovered, may not have been investigated at all or investigated enough to be prosecuted. It should be plain to anyone with experience in this area that an internal investigation commissioned by a corporation with millions to spend on legal fees for a major law firm to devote its massive resources will produce better results than a government investigation conducted by even the most dedicated and experienced government prosecutors and agents.

2. Negative Consequences of Cooperation Are Also a Factor

The decision to cooperate should not be undertaken lightly. While there are several obvious reasons *to* cooperate, discussed above, there are real downsides as well. The corporation may be forced to (1) pay a sizeable amount of money, whether in the nature of a fine and/or restitution to victims; (2) waive its privileges; (3) submit to independent (and possibly intrusive and costly) monitoring; and (4) turn on valued and long-serving employees. There are also important collateral consequences, including the release of information that will incite the plaintiffs' bar to bring civil litigation, and the demoralization of the company's employees

a. Fines, Restitution and other Costs of Cooperation

The cooperation decision almost always carries a steep financial price tag. While that price tag might, concededly, pale in comparison to the financial repercussions of an indictment, it is rarely a good deal. Driven by Congressional legislation that has substantially increased prospective financial penalties in criminal cases, as well as by the Federal Sentencing Commission's Organizational Guidelines, penalties and/or restitution paid by *even a cooperating corporation* now routinely run, not into the tens of millions of dollars, but *hundreds* of millions of dollars.¹⁶ To cite but a few recent examples, Boeing agreed to pay \$615 million to resolve criminal and civil fraud allegations in connection with a 2006 deferred prosecution agreement; Prudential Equity Group LLC agreed to pay \$600 million in fines, restitution and penalties in connection with a 2006 deferred prosecution agreement; KPMG committed to pay \$456 million as part of its August 2005 deferred-prosecution agreement; Bristol-Myers Squibb Co. committed to pay \$300 million in restitution in connection with its 2005 non-prosecution agreement; and British Airways Plc and Korean Air Lines agreed last August to pay fines totaling \$600 million

¹⁶ 1 Kathleen F. Brickey, *Corporate Criminal Liability* § 1:07 (1992) (discussing the historical evolution of restitution and fines).

in resolution of an Antitrust Division investigation. These companies presumably incurred legal fees in the tens of millions in connection with these cases.¹⁷

b. Waiver of the Privilege

While the Department of Justice has gone to great lengths to assure the legal community that waiver of the attorney-client privilege and work product doctrine is supposedly not a mandatory condition of cooperation, it has declared that corporations which waive will get “extra credit” in the cooperation analysis. This is the distinction between the Department’s Thompson Memorandum and the McNulty Memorandum that replaced it. The Thompson Memorandum made waiver of the attorney-client privilege and work product doctrine an explicit consideration in a charging decision. Now the McNulty Memorandum provides: “Prosecutors may always favorably consider a corporation’s acquiescence to the government’s waiver request in determining whether a corporation has cooperated in the government’s investigation,” and further, a failure to comply with a so-called Category I request (seeking factual information such as chronologies and interview memorandum) “may be considered in determining whether a corporation has cooperated”¹⁸ But this is a distinction without a difference. Rewarding waivers instead of punishing refusals to waive will still ensure that most corporations will be driven to “cooperate” by waiving.

Of course, privilege waivers can have devastating repercussions for a corporation in related civil litigations or other investigations, potentially arming civil litigants, regulators and other governmental authorities with strong ammunition from reports on internal investigations and the work product that led to those reports. Should the cooperating corporation waive its privileges in negotiations with federal prosecutors, management must assume that that waiver will make otherwise privileged information disclosable in civil discovery or in a related state and/or regulatory investigation. Even producing documents to the government pursuant to a confidentiality agreement offers no real comfort since courts have been loathe to allow selective waivers and routinely reject efforts to enforce such agreements.¹⁹ While commendable and admittedly gaining ground, legislative efforts to address this “Catch 22” have not been effective so far.

¹⁷ The amounts of these fees are always disclosed in public filings, depending on materiality. One example, however, is provided in Tyco’s 2003 10-K, which states that the company paid \$39,000,000 in legal fees in connection with the internal investigation prompted by the troubles of its CEO Dennis Kozlowski.

¹⁸ McNulty Memorandum, at VII.B.2. Until December 2006, the Department of Justice’s internal guidance on prosecution of corporations was expressed in the so-called Thompson Memorandum. That was amended in December 2006 by the McNulty Memorandum, which asserts that “[w]aiver of attorney-client and work product protections is not a prerequisite to a finding that a company has cooperated in the government’s investigation.” See McNulty Memorandum at VII.B.2. The Memorandum purports to no longer make waiver a prerequisite to cooperation credit, restricts waiver requests to situations where there is a legitimate need for the privileged information and, where such a need exists, forces consultation with and, in certain circumstances, approval by the Department of Justice before a waiver request can be made.

¹⁹ The only apparent statutory exception to the general prohibition against selective waivers is in the banking world. Section 607 of the Financial Services Regulatory Relief Act of 2006, 12 U.S.C. § 1785(j)

c. Independent Monitoring

Virtually every non-prosecution and deferred prosecution agreement in recent years has mandated internal reforms and independent monitoring to confirm the adequacy and efficacy of such reforms. The corporation which has been charged and which is cooperating in hopes of securing a more lenient sentence also faces a sizeable risk of being sentenced to a term of organizational probation, running in the case of a felony conviction from one to five years.²⁰ Under the U.S. Sentencing Guidelines, the probation conditions can include periodic submissions to the court, unannounced examinations of books and records, the development of a comprehensive corporate program to prevent and detect violations of the law, including elaborate training programs for corporate employees, and extensive monitoring and auditing by independent firms, with the full cost of retaining such outside auditors, accountants and other experts borne by the organization.

When a corporation is sitting down at a negotiating table, acceptance of independent monitoring can seem tolerable enough and, indeed, as a practical matter, no corporation seeking a cooperation deal is in a position to reject this government condition. Nonetheless, corporations should be aware that such arrangements can be expensive over time, particularly in high profile matters, and potentially intrusive. Monitors, after all, report to the government, which selects them, and are understandably keen to prove both their worth and their independence to the government.

d. Turning on Employees

In the current climate, the government gives all appearances of considering loyalty to employees a negative strike against the cooperating corporation. The McNulty Memorandum explicitly cites as a factor in the corporate charging analysis whether “the corporation appears to be protecting its culpable employees and agents.”²¹

and 1828(x) (2006), provides that productions to specified banking regulators in the course of the supervisory or regulatory process cannot effect a privilege waiver as to any person or entity. As one commentator has observed, “[u]nless and until a more general selective waiver doctrine is adopted, Section 607 creates an anomalous rule eliminating waiver solely for privileged information disclosed to banking regulators – even though provision of the same documents to a different government agency would likely result in waiver.” Audrey Strauss, *Selective Privilege Waiver for the Banking Industry*, N.Y.L.J., at 8 (Mar. 1, 1007).

²⁰ U.S. Sentencing Guidelines Manual, § 8D1.2(a)(1).

²¹ McNulty Memorandum, at § VII.B.3; *see also* § VII.A (“In gauging the extent of the corporation’s cooperation, the prosecutor may consider . . . the corporation’s willingness . . . to identify the culprits within the corporation, including senior executives.”), § IX.B (“Among the factors prosecutors should consider and weigh are whether the corporation appropriately disciplined the wrongdoers and disclosed information concerning their illegal conduct to the government. . . . [P]rosecutors may evaluate the willingness of the corporation to discipline culpable employees of all ranks and the adequacy of the discipline imposed.”).

The considerable difficulty with this factor is that while, on the one hand, the government pressures and expects corporations to report evidence of wrongdoing on a timely basis in order to gain cooperation credit, on the other hand, it effectively demands that the corporation identify which employees are “culpable” almost at the outset of negotiations, before the cooperation can realistically have conducted a thorough investigation. The government often will then insist that the corporation turn against the supposedly culpable employees, terminating them if they dare assert their Fifth Amendment rights and decline to speak to the authorities. It may strongly suggest that the corporation avoid a joint defense relationship through which the employees might be able to obtain information necessary to prepare his or response to the investigation, e.g., his or her own e-mails.²² As for financial support in the way of advancing legal fees so that a presumptively innocent employee can have the benefit of competent and experienced counsel, the McNulty Memorandum suggests that only contractually required support to employees is to be tolerated.²³ Presumably, a voluntary agreement to advance fees, say for those mid- and low-level employees least able to shoulder the burden of paying for counsel and least likely to be covered by by-laws’ indemnification language, would be disfavored.

Given these pressures, it is possible that a corporation eager to prove to the government its willingness to cooperate might mistakenly turn on involved employees, including those with lengthy, distinguished and unblemished careers, who might be actually be found innocent after a thorough investigation is completed. This facet of cooperation is particularly pernicious. As two colleagues at the bar have observed, “the government is, in effect, turning corporations and their counsel against possibly accusable employees, often forcing companies to mete out punishment before there is even an indictment, lawsuit or other significant determination of wrongdoing. . . . The government’s aggressive enforcement tactics diminish employee loyalty and cooperation, particularly in times of crisis, and breed insecurity and suspicion among employees of companies under government investigation.”²⁴

D. The Westar Case – When a Corporation Resorted to the Orthodox Strategy of Conducting a Massive Internal Investigation, Waived the Privilege and Paid Dearly for its Cooperation

While some may think that corporate cooperation is always “doing the right thing,” they have to consider the costs that frequently occur not only in dealing with

²² Id. at § VII.B.3 (“a corporation’s promise of support to culpable employees and agents, e.g., 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 prosecution in weighing the extent and value of a corporation’s cooperation.”).

²³ Id. at § VII.B.3 (“a corporation’s compliance with governing state law and its contractual obligations cannot be considered a failure to cooperate.”).

²⁴ Stanley S. Arkin & Howard J. Kaplan, *Coerced Cooperation Policy Threatens Employee Rights*, N.Y.L.J., May 11, 2005, at 3.

the immediate problem but in handling the inevitable collateral litigation that self-reporting may provoke. They may well consider the *Westar* case, dubbed the *Enron* of Kansas, a prosecution brought against the two senior executives of the electric power company that serves most of Kansas.

In the fall of 2002, the Board of Directors of Westar Corporation (“Westar”) learned of a subpoena from a local prosecutor seeking records relating to the executives’ personal use of the corporate aircraft. This subpoena was followed by others for information relating to the executives’ employment agreements and benefits, suggesting an investigation into “excessive, unauthorized compensation” of the sort charged against Dennis Kozlowski, the former CEO in the *Tyco* case. The company at that time was led by David Wittig, the Chairman of the Board and CEO, and Douglas Lake,²⁵ the Executive Vice President of Corporate Development, both of whom had been New York investment bankers brought in-house by Westar’s prior management. The two had implemented a corporate expansion and diversification program that had a remarkable initial success (an \$867 million profit on the acquisition of a home protection company) followed by several years of growing losses in the main business and the diversified subsidiaries. By 2002, the two were vilified in the local press for their compensation packages in light of the company’s deteriorating performance, and the Board of Directors had lost confidence in them. Upon advice from a prestigious national firm, the Board decided to conduct an internal investigation into all aspects of the two executives’ compensation, and counsel ultimately produced an exhaustive 367 page report that, while it was critical of some of the internal controls at the company and recommended tighter corporate governance, did not conclude that the two had committed any prosecutable crimes.²⁶

At the time of the initial investigation, the only apparent charge that could have been threatened against the corporation itself was a minor tax charge for its failure not to account properly for the expense of the corporate aircraft and put a number for the value of the personal flights on Wittig’s and Lake’s W-2 forms.²⁷ Nonetheless, the decision was made to waive the corporate privilege and produce the report and work product to the local federal prosecutor. Shortly thereafter, he obtained an indictment against the individuals with numerous counts tracking all the compensation issues laid out in the report of the internal investigation but alleging them all as part of a massive “conspiracy to defraud” the company. The company was predictably not charged.

The *Westar* case did not work out well for the government and even worse for the company. The prosecutors failed to convict the two executives after the first three-month trial, which ended in a hung jury favoring acquittal, and a second three-

²⁵ It should be noted, in the interests of disclosure, that Mr. Little and Ms. Cahill represented Mr. Lake in the investigation and the two trials that followed.

²⁶ The lawyers at the law firm who conducted the investigation included a prominent former United States Attorney and a number of former Assistant United States Attorneys.

²⁷ Significantly, the Tax Division of the Department of Justice declined to authorize a tax case even against the two individuals.

month trial, which resulted in convictions that were later completely overturned by the Tenth Circuit Court of Appeals, which dismissed most of the charges and left only a few for a third trial. As for the company, after it waived its attorney-client privilege and gave its internal investigation report to the government, it suffered the following: It was investigated by the SEC in connection with its public filings. It was investigated by the Federal Election Commission (“FEC”) for its executives’ activities in coordinating their political contributions. It was sued in a shareholder class action for securities fraud. Its directors were sued in a shareholder derivative action for violation of fiduciary duty. It was sued by employees in ERISA litigation relating to the alleged conduct of the defendant executives. And it was sued by the defendants themselves in arbitration for violation of their employment agreements.

The company’s legal fees for the internal investigation and representation in the criminal and SEC investigations were over \$9,500,000. Its legal fees for the FEC investigation were over \$600,000. It settled the class action for \$30,000,000 and paid plaintiffs’ attorneys’ fees of \$9,000,000. It settled the derivative action for \$12,500,000. Its legal fees for both actions exceeded \$17,500,000. It settled the ERISA action for about \$9,300,000, and it spent over \$1,200,000 in legal fees on that case. Legal fees for the arbitration with its former executives exceeded \$2,300,000 (since the company must pay the executives’ fees as well as its own) and continue (as it has not been settled or tried). And, since the executives were entitled to advancement of their legal fees defending the criminal case,²⁸ it has paid over \$13,900,000 and must continue to pay for the retrial the government has announced. To date, Westar has paid over \$105,800,000 for a case that began with a complaint about personal use by the executives of corporate aircraft.²⁹

While the company has survived and this was not quite “assisted suicide,” one might well wonder if there would have been a significant criminal case and, more importantly, any of the collateral civil and regulatory litigation, if the company had defended itself the good, old-fashioned way.

E. The Reliant Energy Case – When a Corporation Weighed its Options in a Defensible Case, Refused to Succumb to Government Pressure, Fought and Won

In stark contrast, there is the case of Reliant Energy Services (and its parent, publicly held Reliant Energy Inc.) (“Reliant”), a company that made the tough

²⁸ Westar’s Articles of Incorporation had made mandatory the permissive provision in Kansas General Corporation Law (modeled on the Delaware code) for advancement of legal fees prior to the resolution of a case.

²⁹ These numbers have been taken from the company’s 10-K and 10-Q filings in 2006 and 2007, as well as the “Victim Impact Statement” it filed with the District Court for the District of Kansas after the second trial. These are conservative, as they do not include legal fees of other counsel representing Westar, or the presumably large internal costs to the company in dealing with the various criminal, civil and regulatory cases.

decision to limit its “cooperation” and defend itself and its employees against a federal indictment charging conspiracy, wire fraud, and commodities manipulation, all relating to the energy crisis in California during 2000 and 2001.³⁰ The government asserted that the company manipulated the California electricity market by creating the false appearance of electricity shortages for the purpose of artificially increasing the price. Then-Attorney General John Ashcroft announced the indictment with the usual rhetoric expected in DOJ press releases: “When evidence shows that a company’s corporate culture breeds corruption and disrespect for the law, the Department of Justice will not hesitate to bring criminal charges against the company itself.”

Reliant forcefully reacted, issuing a press release the same day stating that “any suggestion that Reliant did not fully cooperate with the Department of Justice investigation is inaccurate and unfair. The company voluntarily disclosed the conduct, agreed to a [\$13.8 million] settlement with the [Federal Energy Regulatory Commission], assisted in making evidence available to the [Commodity Futures Trading Commission] and Department of Justice, and made a series of presentations to the Department of Justice concerning the facts and the law. What Reliant did not do was agree that the conduct constitutes a criminal offense.”

There were four considerations that apparently led Reliant to do what so few corporations have done in recent years, namely, to defend itself and not buckle under the pressures the government can apply in these situations: (1) it had a good legal defense, namely that the government was applying a 68-year-old statute (never used before in a criminal case) to conduct that was arguably within the bounds of market rules approved by the Federal Energy Regulatory Commission; (2) it felt that its stock price could withstand announcement of an indictment because its involvement in California’s energy crisis was old news that the market had already factored in;³¹ (3) the company could afford to pay the maximum statutory fine to which it was exposed and still survive; and (4) management sincerely believed neither the company nor its employees had committed a crime. Also helpful to the company, although it could not have foreseen it at the time, was that the prosecution team, ran out of the Northern District of California, would see multiple personnel changes over the case’s lifetime.

Notably, Reliant stood by its employees. As reported in a Corporate Fraud supplement from *The American Lawyer and Corporate Counsel*, “Nanci Clarence of Clarence & Dyer, who represented Reliance trader [Lisa] Flowers, calls Reliant’s defiance ‘the anti-KPMG defense.’ ‘There was no pressure [for my client] to plead guilty,’ says Clarence. . . . I don’t think there was ever any sense that this was a case where the company was going to pull the plug.” *Id.* at 78.

Reliant’s courageous stance was vindicated. Although not a total win, on March 6, 2007, days before trial was to commence, it signed a deferred prosecution

³⁰ This case is discussed at length in one of the authors’ previous articles. See Lisa A. Cahill, *Trends at Third Anniversary of Bush’s Corporate Fraud Task Force*, N.Y.L.J. (Aug. 17, 2005).

³¹ Andrew Longstreth, *Resisting Arrest*, *Litigation* 2007, Fall 2007, at 74.

agreement calling for payment of a \$22.2 million fine. “[T]hat result debunks the idea that jousting with the government is inevitably corporate suicide.” *Id.* at 76. And, for those lawyers concerned about the fate of corporate employees, the agreement covered the individual defendants as well – none would have to plead guilty – a result that is not common in most “corporate cooperation cases,” where the company settles out on condition that it assist the government in bringing cases against its former employees. Reliant’s lawyer was quoted as crediting the merits of the defense and the company’s unique resolve for the successful outcome; “ ‘I think there are a lot of instances where companies go way too far in cooperating. The key is to make a decision early on and stick with it.’” *Id.* at 79.

F. Conclusion

There are no easy answers. When a corporation learns of possible wrongdoing, it is obviously under a legal and a practical obligation to investigate it thoroughly and make an informed decision about how to deal with the situation. It is no panacea to summon a large and prestigious law firm to conduct an exhaustive and expensive investigation, to self-report to the government, to waive the attorney-client privilege, to hand over the file to prosecutors and to cut off the employees involved. On the other hand, there may be situations where, painfully, just that course of action or a modified version of it is necessary to save the company or mitigate the consequences. As the trial courts are wont to say, “it all depends on the facts and circumstances of each individual case.”