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WHITE-COLLAR CRIME

Government likely to go after corporations

The Department of Justice has issued new guidelines detailing when it will prosecute a business entity for criminal acts.

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IN THE WAKE OF THE well-publicized corporate fraud scandals at Enron, WorldCom and other public companies, various branches of the federal government—from the president to Congress to the U.S. Sentencing Commission to the Securities and Exchange Commission (SEC)—have taken dramatic steps to address the problem.

The president formed the Corporate Fraud Task Force to oversee the federal government's law enforcement response. Congress passed the Sarbanes-Oxley Act of 2002, imposing a host of new duties on public companies and their executives, directors and outside professional advisors and increasing the penalties for a variety of white-collar crimes. The sentencing commission issued new guidelines that markedly increase the penalties for financial fraud. The SEC promulgated rules that obligate attorneys to report evidence of corporate wrongdoing to the highest levels of corporate governance. And last month, Deputy Attorney General Larry D. Thompson issued the Department of Justice's (DOJ) revised guidelines for when it will, and will not, seek the most drastic sanction for corporate wrongdoing: criminal prosecution of the organization. It is this last measure that is the subject of this article.

The new guidelines, which are available on the DOJ's Web site, have their genesis in a 1999 memorandum issued by Thompson's predecessor, Eric H. Holder Jr., entitled "Federal Prosecution of Corporations." That memorandum set forth the general policy that corporations "should not be treated leniently because of their artificial nature," and that the prosecution of corporations can result in "great benefits for law enforcement and the public, particularly in the area of white collar crime." The guidelines are available at www.usdoj.gov/usao/eousa/foia_reading_room/usam/title9/crm00162.htm and the memorandum is available at www.usdoj.gov/04foia/readingrooms/6161999a.htm.

In addition to the normal considerations that attend any decision whether to prosecute—the strength of the evidence, likely deterrent and rehabilitative consequences of a conviction and adequacy of noncriminal alternatives to prosecution—the memo specifies eight factors that the federal prosecutor is instructed to consider in deciding whether or not a corporation should be criminally charged. These include: the nature and seriousness of the offense, including the risk of harm to the public; the pervasiveness of corporate wrongdoing; the corporation's history of similar conduct and prior enforcement actions against it; the corporation's timely and voluntary disclosure of wrongdoing; the existence and adequacy of a corporate compliance program; the corporation's remedial actions; the collateral consequences of a conviction; and the adequacy of civil or regulatory remedies for the corporation's conduct.

Compliance program can't be just words on paper.

Thompson's revision of the Holder memorandum makes clear that a number of changes have been made in direct response to the recent spate of corporate fraud cases. While the memo purports to provide assurance that business organizations will be criminally charged in only a "minority of cases," it emphasizes that prosecutors will be closely scrutinizing the efficacy of a corporation's internal compliance programs to ensure that they are "truly effective" and not "mere paper programs." A corporation's efforts to cooperate with law enforcement will be more closely scrutinized as well, because, in Thompson's view, "[t]oo often business organizations, while purporting to cooperate with a Department investigation, in fact take steps to impede the quick and effective exposure of the complete scope of wrongdoing." These and other revisions are all described as measures that will "enhance our efforts against corporate fraud." A description of the principal revisions follows.

Nature of offense

Among the many factors that the prosecutor is directed to consider in making the charging decision is the nature of the offense. This was true under both the Holder memorandum and its more recent iteration. What is new, however, is the explicit statement that "[t]he nature and seriousness of the offense may be such as to warrant prosecution regardless of the other factors" set forth in the memo. Thus, in some cases, a corporation could face prosecution regardless of what measures it has taken to prevent or uncover wrongdoing, or the harm to innocent parties—employees, shareholders, pensioners and others—that will flow from a criminal prosecution.

Another factor under both memos is whether the corporation has an "effective" corporate compliance program to prevent and detect wrongdoing. Thompson's memo, however, adds a new dimension of scrutiny that places the DOJ squarely in the corporate boardroom. Prosecutors are now directed to pay particular attention to the role of directors in the conduct of the organization's affairs. Prosecutors are told to consider whether the directors are exercising independent judgment rather than "unquestioningly ratifying officers' recommendations," whether they are provided with information sufficient to enable them to exercise independent judgment and whether they have established information and reporting systems that enable them to reach informed decisions regarding the corporation's compliance with the law. Ultimately, the prosecutor is supposed to determine whether a corporation's compliance program is "merely a 'paper program' " or is designed and

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implemented in an effective manner.

In other words, even if a corporation has a compliance program, the corporation may nevertheless face prosecution if the prosecutor determines that the program is not sufficiently meaningful or effective in preventing corporate wrongdoing. This adds new risk and uncertainty for companies and their directors. From now on, the decision whether to charge a corporation may turn on a prosecutor's judgment about the quality of a corporation's internal governance mechanisms. Indeed, the fact that a crime was committed by an employee may be enough to lead a prosecutor to conclude that compliance program was flawed, no matter how individually motivated the employee's behavior. Let us hope, however, that prosecutors give greater weight to the overall efficacy of a compliance program and not automatically conclude that it was defective just because it failed to prevent the particular crime in question.

Obstruction of justice

Similarly, even a corporation that cooperates with the government faces a risk of prosecution. Under both versions of the guidelines, a prosecutor is told to consider a variety of factors in deciding whether to charge a corporation that has expressed a willingness to cooperate with the government.

Is the corporation willing to implicate culpable employees or even managers? Will it make witnesses available to the government? Will it disclose the results of an internal investigation? And—perhaps the most controversial factor to date—will the corporation waive its attorney-client and work-product privileges? See Tamara Loomis, *Justice Encourages Waiving Attorney-Client Privilege*, N.Y.L.J., Feb. 20, 2003, at 1; G. Wallance, *Holder Memorandum Revisited: DOJ Offers Clarification of Corporate Waiver*, Bus. Crimes Bull., Vol. 9, No. 12 (January 2003).

The revised version of the Holder Memorandum goes further, however, and explicitly directs prosecutors to examine whether a corporation has engaged in conduct inconsistent with its effort to cooperate. This is reflected in a completely new "factor" that prosecutors are obliged to consider: whether the corporation, while endeavoring to cooperate, engaged in "conduct that impedes the investigation."

The memo's explication of this factor should give criminal practitioners pause. According to the memo, conduct that "impedes the investigation" includes "overly broad assertions of corporate representation of employees or former employees"; and "directions not to cooperate openly and fully with the investigation," including directing employees not to consent to interviews. It also includes conduct that could more readily be viewed as obstructionist, such as "making misleading presentations or submissions that contain misleading assertions or omissions," making "incomplete or delayed production of records" and failing to "promptly disclose illegal conduct known to the corporation."

All told, these factors reflect an increased focus not merely on the conduct of corporate officers and employees during the course of a criminal investigation, but on the conduct of corporate counsel in representing the corporation in its dealings with prosecutors. This, in turn, places added responsibilities on both parties to a criminal investigation.

Individuals won't be saved by company's guilty plea.

Corporate counsel must take care not to allow their vigorous representation of corporate clients to be interpreted by prosecutors as an effort to impede investigations rather than to resolve them favorably for their clients. At the same time, prosecutors should avoid using this provision as an excuse to undermine a company's right to be represented responsibly and even zealously by counsel.

Pretrial diversion

One modification that is favorable to corporate targets is the explicit recognition that pretrial diversion, rather than prosecution, may be an acceptable means of resolving a criminal investigation of a corporation. While obviously not as favorable as a grant of immunity or a declination, it does provide another means by which a corporation that has engaged in criminal wrongdoing can ultimately avoid the stigma and collateral consequences of a conviction. It also puts corporations on equal footing with individual targets, for whom prosecution is deferred on occasion for relatively low-level white-collar crimes.

A recent illustration of this policy is the *Banco Popular de Puerto Rico* case, which grew out of the bank's failure to file Suspicious Activity Reports (or to file accurate reports) over a five-year period. In January, the bank agreed to forfeit $21.6 million in satisfaction of all federal claims, including an extant $20 million civil penalty from the Treasury Department's Financial Crimes Enforcement Network. In exchange, the government agreed to dismiss the criminal charge against the bank with prejudice if the bank complies with its reporting and financial obligations for the next 12 months. See www.usdoj.gov/opa/pr/2003/January/03_crm_024.htm.

The revised memo adds a new, ninth factor in the analysis of whether to prosecute a corporation criminally: the adequacy of the prosecution of individuals responsible for the corporation's malfeasance. The significance of this addition is unclear, since this factor is the only one of the nine that is not described further in the memo. At first blush, this would seem to be a beneficial addition for corporations, for it suggests that a prosecutor might conclude that corporate prosecution was unnecessary if the individual wrongdoers were held accountable.

However, it certainly is not a welcome development for corporate officers and employees. Indeed, if anything, the memo emphasizes the importance of holding individuals responsible for corporate malfeasance. The memo cautions that the prosecution of a corporation should not be viewed as a "substitute for the prosecution of criminally culpable individuals within or without the corporation." It then states, in new language, that "[o]nly rarely should provable individual culpability not be pursued, even in the face of offers of corporate guilty pleas."

This pronouncement suggests that the joint-defense strategy of offering up the corporation as a means of forestalling the prosecution of individuals will meet new resistance.

Unlike some of the drastic regulatory and legislative measures that have been promulgated in the post-Enron world, DOJ has maintained a relatively consistent approach in its guidelines for corporate prosecution. Indeed, much of the lengthy Holder memorandum remains unchanged. However, the recent modifications to these guidelines make clear that a corporation seeking to avoid federal prosecution through cooperation may have a tougher row to hoe. A corporation must not only cooperate with the government, but also convince the government that its efforts to cooperate are complete and genuine and that everyone involved—from management to outside directors to corporate counsel—is fully committed to the effort. If a company is not confident that it can satisfy these standards, it should seriously question whether cooperation is the best strategy after all.

Defending the case aggressively, or convincing the government that either deferring prosecution or civil remedies will accomplish its objectives without the collateral consequences of a criminal conviction, may be better options—or the only options—under those circumstances.