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# Branch Office of the Prosecutor: The New Role of the Corporation in Business Crime Prosecutions

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# BRANCH OFFICE OF THE PROSECUTOR: THE NEW ROLE OF THE CORPORATION IN BUSINESS CRIME PROSECUTIONS

HARRY FIRST\*

*The Article describes the evolution of the public corporation's role in the criminal justice process—from potential defendant to “branch office of the prosecutor,” partnering with the government in investigating business crime—and assesses the impact of this evolution on criminal justice policy.*

*The first part of the Article describes the branch-office role, tracing its development back to the 1970s, and shows how it has come to be routine for public corporations to assist prosecutors in their investigations. The second part of the Article discusses the implications of this shift in institutional role. The Article first argues that the public corporation's branch-office role is likely to be a durable one because it benefits both corporations and prosecutors, effectively exploiting the misalignment of interests between the corporation and its employees and providing substantial efficiency gains to prosecutors. The Article next examines the effect of this new role on legal rules, arguing that the protections of the corporate attorney-client privilege should not be increased nor constitutional constraints imposed when the corporation is acting in its branch-office role. The Article then examines the potential effect of the new role on prosecutors' willingness to bring criminal charges against corporations and, ultimately, on deterrence in business crime cases. The Article argues that the danger of this new role lies primarily in these areas. The new branch-office role, with its tools of amnesty,*

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\*\* Charles L. Denison Professor of Law, New York University School of Law. I thank Jennifer Arlen, Rachel Barkow, Sara Sun Beale, Samuel Buell, Brandon Garrett, and Frank Tuerkheimer for their comments on an earlier draft of the Article. I also thank the participants at the Hoffinger Colloquium on Criminal Justice at New York University School of Law and at the Workshop on Ideas and Innovations in Legal Scholarship at the University of Wisconsin Law School. Erik Paulsen, Rebecca Jenkin, and Jesse Jensen provided extremely valuable research assistance. A research grant from the Filomen D'Agostino and Max E. Greenberg Research Fund at New York University School of Law provided financial assistance for the Article.

*agreements not to prosecute, and agreements to defer prosecution, provides a middle ground for prosecutors between declination and prosecution. This middle ground may prove overly attractive to prosecutors, increasing their ability to prosecute corporate executives, but cutting down on first-offense prosecutions against corporations, likely the most critical for deterring corporations from committing business crimes. Although pursuing criminal charges against executives and employees can certainly be an effective deterrent to business crime, it is not a sufficient one. A credible threat of corporate criminal liability is necessary to assure overall deterrence, as well as to assure that corporations continue to have an incentive to play this important branch-office role in investigating complex business crime cases.*

INTRODUCTION .....	25
I. EVOLUTION OF THE CORPORATION'S ROLE .....	32
A. <i>The Early Period</i> .....	32
B. <i>The Enron Era: 2001–2006</i> .....	39
1. The Scandals Emerge.....	39
2. Congressional Response .....	41
3. Executive Response .....	42
C. <i>Banking the Fires: 2006–2009</i> .....	50
D. <i>Conclusion</i> .....	58
II. IMPLICATIONS FOR CRIMINAL JUSTICE POLICY .....	59
A. <i>The Economics of the Branch-Office Role</i> .....	60
B. <i>Effect of the Branch-Office Role on Legal Rules</i> .....	65
1. Judicial Review of Agency Agreements.....	66
2. Attorney-Client Privilege .....	69
3. Constitutional Protections.....	73
C. <i>Corporations as Proper Targets of Criminal Prosecution</i> .....	81
D. <i>Deterrence</i> .....	88
E. <i>Conclusion</i> .....	96
CONCLUSION.....	97

## INTRODUCTION

*Our duty [in the Department of Justice] is to enforce the law—duties not all that different from the duties of a corporate officer or director . . . .*

*The faithful execution of these duties by corporate leadership serves the same values in promoting public trust and confidence that our criminal prosecutions are designed to serve . . . .*

*There must also be integrity in what the company does when investigating misconduct. In internal investigations of corporate wrongdoing, corporate counsels play a quasi-public role, not because they are an arm of the prosecutor, but because they are acting on behalf of their investors and must vindicate the good name of the company.*

—Deputy Attorney General Paul J. McNulty,  
December 12, 2006<sup>1</sup>

*These corporations do not care about your criminal statutes aimed at their servants. They could give up at once one or two or three of their servants to bear this penalty for them. But when you strike at their powers, at their franchises, at their corporate existence, when you deal with them directly, then they begin to feel the power of the Government.*

—Senator John Sherman, March 24, 1890<sup>2</sup>

For more than a century, legislators and prosecutors have been trying to determine the best way to control improper business behavior. One path chosen, starting with the enactment of the Sherman Antitrust Act of 1890 (“Sherman Act”),<sup>3</sup> has been to use the criminal law, penalizing both the individual actor who engages in illegal behavior and the entity on whose behalf the individual is acting.<sup>4</sup> Congress made this policy decision, however, with little appreciation for the problems it would create and with little thought

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1. Paul J. McNulty, Deputy Att’y Gen., Prepared Remarks at the Lawyers for Civil Justice Membership Conference Regarding the Department’s Charging Guidelines in Corporate Fraud Prosecutions (Dec. 12, 2006), [http://www.justice.gov/archive/dag/speeches/2006/dag\\_speech\\_061212.htm](http://www.justice.gov/archive/dag/speeches/2006/dag_speech_061212.htm).

2. 21 CONG. REC. 2569 (1890).

3. Ch. 647, 26 Stat. 209 (codified as amended at 15 U.S.C. §§ 1–7 (2006)).

4. See 15 U.S.C. § 7 (defining “person” in the Sherman Act to include “corporations and associations”).

as to why or when it might be useful to punish both the actor and the entity, or when it might be preferable to choose only one or the other. We continue to struggle with these basic questions today, and the very idea of making an entity a target of criminal prosecution and punishment remains controversial.<sup>5</sup>

For nearly three-quarters of a century after the passage of the Sherman Act, however, the issues of individual and entity liability in business crime cases were a low-level policy concern. After early business crime prosecutions sorted out the basic questions of entity liability and constitutional privileges,<sup>6</sup> the use of the criminal law to deal with economic behavior receded. Academics criticized this general prosecutorial neglect, but with little effect.<sup>7</sup>

Then in the late 1970s, things began to change, although the signs were hard to decipher at the time. In 1977, Congress passed the Foreign Corrupt Practices Act,<sup>8</sup> making foreign bribery illegal, but few corporate prosecutions followed.<sup>9</sup> In 1984, the Justice

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5. See, e.g., Jennifer Arlen & Reinier Kraakman, *Controlling Corporate Misconduct: An Analysis of Corporate Liability Regimes*, 72 N.Y.U. L. REV. 687, 692–93 (1997) (arguing that although individual liability produces optimal deterrence in some cases, corporate liability is generally needed because individual agents may be judgment-proof or it is too costly to sanction individual agents); Samuel W. Buell, *The Blaming Function of Entity Criminal Liability*, 81 IND. L.J. 473, 474, 506, 525 (2006) (noting that the criminal form of enterprise liability “remains of puzzling legitimacy,” and arguing that the criminal legal process adds a “unique and strong communicative force to any societal conclusion about institutional fault” and that managers seek to avoid criminal liability because the social stigma of criminal prosecution can harm a business firm’s reputation); Vikramaditya S. Khanna, *Corporate Criminal Liability: What Purpose Does It Serve?*, 109 HARV. L. REV. 1477, 1532–34 (1996) (arguing that noncriminal corporate liability regimes can achieve deterrence at a lower cost).

6. See *N.Y. Cent. & Hudson River R.R. Co. v. United States*, 212 U.S. 481, 494–96 (1909) (approving imposition of criminal liability on a corporate defendant); *Hale v. Henkel*, 201 U.S. 43, 69–70, 74–77 (1906) (deciding scope of Fourth and Fifth Amendment protections for corporations); see also Henry W. Taft, *The Tobacco Trust Decisions*, 6 COLUM. L. REV. 375, 375–76 (1906) (stating that *Hale* “set at rest” Fourth and Fifth Amendment issues relating to corporate conduct that had not previously been decided).

7. For the classic critique, see generally EDWIN H. SUTHERLAND, *WHITE COLLAR CRIME* (1949) (arguing that white collar crime was largely ignored by prosecutors in the early 20th century); see also, e.g., MARSHALL B. CLINARD & PETER C. YEAGER, *CORPORATE CRIME* (1980) (updating Sutherland’s research and arguing that corporate crime is still under-prosecuted).

8. Pub. L. No. 95-213, 91 Stat. 1494 (1977) (codified as amended in scattered sections of 15 U.S.C.).

9. There was only one corporate criminal prosecution in the Act’s first four years. See *United States v. Kenney Int’l Corp.*, 2 Foreign Corrupt Prac. Act Rep. (Bus. L., Inc.) 649, 651 (D.D.C. Aug. 2, 1979) (guilty plea for payment related to postage stamp distribution in the Cook Islands); Ruth Aurora Witherspoon, *Multinational Corporations Governmental Regulation of Business Ethics Under the Foreign Corrupt Practices Act of*

Department's Antitrust Division filed ninety-six criminal antitrust cases, mostly against local bid-riggers, a record; ninety-two corporations were fined that year and thirty-two individuals were sent to jail.<sup>10</sup> In 1985, E.F. Hutton, then the country's fifth-largest brokerage firm, pleaded guilty to 2,000 counts of mail and wire fraud involving a systematic practice of overdrafting its bank accounts, paying a fine of \$2.75 million.<sup>11</sup> Weakened by the case, and by revelations of broader management problems, it was taken over two years later by a rival brokerage company, Shearson Lehman Brothers.<sup>12</sup> Between 1980 and 1987, the U.S. Attorney's Office in the Southern District of New York filed sixty-three criminal insider-trading cases.<sup>13</sup> In 1988, Drexel Burnham Lambert, another major brokerage and investment firm, agreed to plead guilty to six felony counts of mail, wire, and securities fraud and to pay \$650 million in fines and restitution.<sup>14</sup> Michael Milken, the driving force behind Drexel, was charged in a ninety-eight count indictment; he eventually pleaded guilty and served twenty-two months in jail.<sup>15</sup> In 1990, Drexel declared bankruptcy and ceased doing business.<sup>16</sup>

This slow but steady increase in business crime prosecutions brought out a tension that had been present even in the early cases,

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1977: *An Analysis*, 87 DICK. L. REV. 531, 551 (1983) (reporting eighty-five Department of Justice investigations by 1981, resulting in one criminal prosecution and two civil cases).

10. See *Antitrust Division's Workload Statistics During the 1980s*, [Jan.-June] 58 Antitrust & Trade Reg. Rep. (BNA) No. 1449, at 109, 112, 115 (Jan. 18, 1990).

11. See Nathaniel C. Nash, *E.F. Hutton Guilty in Bank Fraud*, N.Y. TIMES, May 3, 1985, at A1.

12. See Robert J. Cole, *Hutton-Shearson Deal Announced*, N.Y. TIMES, Dec. 4, 1987, at D4; see also Scott McMurray & Andy Pasztor, *Growing Problems: Hutton Group Suffers a Series of Reverses in Wake of Overdrafts*, WALL ST. J., Apr. 9, 1986, at 1 (describing Hutton's managerial problems); James Sterngold, *E.F. Hutton, Losing Two-Year Struggle, is Looking for Buyer*, N.Y. TIMES, Nov. 24, 1987, at A1 (reporting that Hutton's value was affected by fallout from overdrafting case and recent stock market decline).

13. See 1 CORP. CRIME REP., Apr. 13, 1987.

14. James B. Stewart et al., *Drexel Agrees to Plead Guilty and Pay Out a Record \$650 Million*, WALL ST. J., Dec. 22, 1988, at A1.

15. See Laurie P. Cohen, *Milken's Stiff 10-Year Sentence is Filled with Incentives to Cooperate with U.S.*, WALL ST. J., Nov. 23, 1990, at A3 (reporting Milken's sentence); Laurie P. Cohen, *Public Confession: Milken Pleads Guilty to Six Felony Counts and Issues an Apology*, WALL ST. J., Apr. 25, 1990, at A1 (reporting the entry of Milken's plea); Laurie P. Cohen & Stephen J. Adler, *The Other Shoe: Indicting Milken, U.S. Demands \$1.2 Billion of Financier's Assets*, WALL ST. J., Mar. 30, 1989, at A1 (reporting Milken's indictment); Jonathan M. Moses & Amy Stevens, *Milken is Released to Halfway House in Los Angeles Area*, WALL ST. J., Jan. 5, 1993, at B6 (reporting completion of prison term).

16. See Michael Siconolfi et al., *Rise and Fall: Wall Street Era Ends as Drexel Burnham Decides to Liquidate*, WALL ST. J., Feb. 14, 1990, at A1.

but had never been quite so apparent: the interests of the organization and its employees are not necessarily aligned when it comes to a criminal prosecution. Organizations might prefer to blame the employee and not pay a penalty, while the employee might prefer to blame the organization and not go to jail. Given the fact that business crime legislation never specifies which “person” to charge criminally, prosecutors have the opportunity to exploit this divergence of interest to further their ability to investigate and prosecute business crimes. Although the early prosecutorial approach was to turn employees against their corporations,<sup>17</sup> the current trend is otherwise. Beginning with the investigations that triggered the enactment of the Foreign Corrupt Practices Act,<sup>18</sup> prosecutors have tended to enlist corporations more often than individuals, to the point that corporations have gradually become a critical institution in the investigation of business crime. In essence, the public corporation has now become a branch office of the prosecutor.

The importance of this branch-office role can be seen clearly in two recent business crime investigations. The first is the investigation into improper backdating of stock options for executives. Options backdating occurs when a company changes the date for the option’s exercise price from the original date to a date when the stock was selling below the current market price, making the option holder an instant winner when the stock is sold at the market price, “the Perfect Payday,” as the *Wall Street Journal* has called it.<sup>19</sup> A newspaper account of this practice sparked Securities and Exchange Commission (“SEC”) scrutiny in 2003.<sup>20</sup> After the publication of an important

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17. See, e.g., *Hale v. Henkel*, 201 U.S. 43, 66–70 (1906) (upholding constitutionality of grant of immunity to Secretary and Treasurer of potential corporate criminal defendant); *Brown v. Walker*, 161 U.S. 591, 609–10 (1896) (upholding constitutionality of grant of immunity to railroad’s auditor in an investigation of the railroad’s illegal rebating practices, where witness claimed the Fifth Amendment privilege for the purpose of shielding the railway or its officers from answering a charge of having violated the Interstate Commerce Act’s provisions).

18. Pub. L. No. 95-213, 91 Stat. 1494 (1977) (codified as amended in scattered sections of 15 U.S.C.).

19. See Charles Forelle & James Bandler, *The Perfect Payday*, WALL ST. J., Mar. 18, 2006, at A1 (describing stock option grants at a number of companies). For a concise description of stock options and the problems that backdating can raise, see Affidavit of Kevin Riordan in Support of Arrest Warrants at 6–9, *United States v. Alexander*, No. M-06-817 (E.D.N.Y. July 31, 2006) [hereinafter *Riordan Affidavit*], available at <http://online.wsj.com/public/resources/documents/20060809-ComverseSignedComplaintAlexander.pdf>.

20. See James Bandler & Kara Scannell, *In Options Probes, Private Law Firms Play Crucial Role*, WALL ST. J., Oct. 28–29, 2006, at A1.

scholarly article<sup>21</sup> and more detailed newspaper accounts,<sup>22</sup> the SEC and various U.S. attorneys' offices began investigating these grants, eventually looking into stock option granting practices at more than 130 companies.<sup>23</sup> An investigation of this scope requires massive resources, but the government did not rely solely on its own limited staffs. Instead, the government used the options-issuing companies themselves, relying on these firms' willingness to do their own internal investigations, some of which have required substantial effort.<sup>24</sup> The SEC even set up a computer tracking system to follow the efforts of the various law firms performing these internal investigations, as a way to check the independence of these firms and the credibility of their findings.<sup>25</sup>

The link between these internal investigations and the subsequent criminal prosecution can be seen in the backdating case involving Comverse Technology (a maker of telecommunications software) and three of its former officers, the Chief Executive Officer ("CEO"), Chief Financial Officer ("CFO"), and senior general counsel.<sup>26</sup> Comverse's inside lawyers investigated the backdating, as did an outside law firm that Comverse hired.<sup>27</sup> In the course of these investigations, the three officers made statements to the lawyers confessing their wrongdoing.<sup>28</sup> After the company turned these statements over to the U.S. attorney, the statements became key recitals in the affidavit supporting arrest warrants for the three individuals.<sup>29</sup> The CEO fled the country, but the other two officers pleaded guilty.<sup>30</sup> Comverse was never charged.

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21. Erik Lie, *On the Timing of CEO Stock Option Awards*, 51 MGMT. SCI. 802, 810 (2005) (concluding that abnormal stock returns both before and after options' award dates can best be explained by ex post facto award timing, unless "executives' ability to forecast future price patterns is uncanny," based on statistical study of stock option grants).

22. See Forelle & Bandler, *supra* note 19; Bandler & Scannell, *supra* note 20.

23. See generally *Options Scorecard*, WALL ST. J., <http://online.wsj.com/public/resources/documents/info-optionsscore06-full.html> (last updated Sept. 4, 2007) (listing companies that have been investigated for stock options grant practices) (on file with the North Carolina Law Review).

24. See Bandler & Scannell, *supra* note 20 (reporting that UnitedHealth's internal investigation examined nearly four million documents and interviewed eighty employees and other witnesses and that Mercury Interactive's investigation reportedly cost approximately \$70 million).

25. See *id.*

26. See *id.* (discussing the internal investigation).

27. See *id.*

28. See *id.*

29. See Riordan Affidavit, *supra* note 19 at 41-42, 45-50; see also *id.* at 46 n.49 (stating "CTI [Comverse] has provided the government with information about the defendants'

The second example involves the investigation that Hewlett-Packard (“H-P”) undertook to determine who had leaked information to the press about H-P Board meetings.<sup>31</sup> In the course of this investigation, H-P used “pretexting” (calling the telephone company and falsely claiming to be the telephone company’s customer) to get telephone records of suspected directors and newspaper reporters.<sup>32</sup> H-P subsequently conducted an investigation of the pretexting effort—as did Congress, the California State Attorney General, and the U.S. Attorney’s Office<sup>33</sup>—eventually giving the state attorney general more than 5,000 pages of internal records, including emails.<sup>34</sup> The Attorney General’s Office was also able to get copies of memoranda that H-P’s outside counsel had prepared during its investigation of the pretexting, memoranda that detailed interviews with the main players in the pretexting effort.<sup>35</sup> As in the Comverse investigation, information obtained from H-P formed a critical part of the declaration supporting the arrest warrants, in this case for H-P’s chairman, Patricia Dunn, and for an H-P lawyer. The declaration reported that H-P “admitted” that it had obtained telephone record information for twelve persons “without the subscribers [sic] consent.”<sup>36</sup> The declaration also quoted an email from Dunn to the lawyer that she “came away with a good sense of

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statements to the Special Committee” of CTT’s Board of Directors that had conducted the internal investigation).

30. See Paul Davies, *A Second Comverse Ex-Executive Pleads Guilty*, WALL ST. J., Nov. 3, 2006, at A3 (reporting on William Sorin, former general counsel); Paul Davies, *Comverse’s Former Finance Chief Pleads Guilty*, WALL ST. J., Oct. 25, 2006, at C3. Sorin was subsequently sentenced to one year and one day in jail, the first corporate executive to be sentenced in the options backdating investigations. See Chad Bray, *Former Comverse Official Receives Prison Term in Options Case*, WALL ST. J., May 11, 2007, at A6.

31. See Alan Murray, *Directors Cut: H-P Board Clash Over Leaks Triggers Angry Resignation*, WALL ST. J., Sept. 6, 2006, at A1.

32. For a more general description of the practice, see John R. Emshwiller, *Old Trick: Hewlett-Packard was Far from First to Try ‘Pretexting.’* WALL ST. J., Dec. 16–17, 2006, at A1.

33. See Jim Carlton & John R. Emshwiller, *H-P’s Leak Probe Comes Under Wider Scrutiny: Justice Department, FBI, House Panel to Examine ‘Pretexting’ Inquiry Tactics*, WALL ST. J., Sept. 12, 2006, at A3.

34. See Declaration of Robert Morgester in Support of Felony Complaint and Arrest Warrant at 3, *People v. Dunn*, No. CC644296 (Cal. Super. Ct. Oct. 4, 2006) [hereinafter Morgester Declaration].

35. See Peter Waldman & Don Clark, *California Charges Dunn, 4 Others in H-P Scandal*, WALL ST. J., Oct. 5, 2006, at A1 (reporting that although H-P resisted turning over the results of the internal investigation, the Attorney General’s office was able to obtain 700 pages of documents from congressional investigators to whom H-P had given them).

36. Morgester Declaration, *supra* note 34, at 5.

what you and the team are doing” and indicated that the lawyer informed Dunn of the pretexting effort through “conversations, emails, and weekly briefings.”<sup>37</sup> Dunn and the lawyer were charged in a four-count state felony complaint.<sup>38</sup> H-P was never charged.

Commentators have often taken a critical view of the public corporation’s new role in investigating its own crimes, colorfully describing companies like Comverse and H-P as “doing the equivalent of Maoist self-criticisms and turning the results over to the authorities.”<sup>39</sup> This Article argues otherwise. This new role offers substantial benefits both to corporations and prosecutors, effectively exploiting the misalignment of interests between the corporation and its employees and providing important efficiency gains to prosecutors. The danger of the new role lies not in some coercive effect on corporations; rather, the danger is that the branch-office role may affect prosecutors’ views of the merits of corporate criminal liability and adversely impact deterrence in business crime cases.

To set these policy arguments in context, Part I of the Article traces the evolution of the corporation’s branch-office role. This history is divided into three periods: (1) the “early period,” from the 1970s to the end of the 1990s, when the key roles were played by the SEC, the U.S. Sentencing Commission, and the Antitrust Division of the Department of Justice; (2) the “Enron Era,” from 2001 to 2006, when the Justice Department articulated guidelines for corporate criminal prosecutions and developed a new prosecutorial tool, the non-prosecution and deferred prosecution agreement; and (3) the current period, when prosecutorial enthusiasm for business crime prosecutions may have cooled, but the branch-office role remains undiminished.

Part II of the Article sets out the policy arguments. It examines four questions: (1) Does economic theory shed light on the durability of the institutional shift to the branch-office role? (2) What are the implications of this shift for the legal rules regarding the prosecution and investigation of business crime cases? (3) How might this shift

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37. *See id.* at 6–7.

38. *See* Complaint at 1, 5–6, *People v. Dunn*, No. 061027481 (Cal. Super. Ct. Oct. 4, 2006), available at [http://ag.ca.gov/newsalerts/cms06/06-087\\_0a.pdf](http://ag.ca.gov/newsalerts/cms06/06-087_0a.pdf). For later developments, see Peter Waldman & Christopher Lawton, *H-P Case Fizzles in State Court*, WALL ST. J., Mar. 15, 2007, at A3 (discussing the dismissal of charges against Dunn and the acceptance agreement from three other defendants not to contest a misdemeanor charge; state had previously dismissed charges against one defendant after he pleaded guilty to federal charges and the federal investigation was reported as continuing).

39. *See, e.g.*, Bandler & Scannell, *supra* note 20 (quoting Professor Joseph Grundfest, former SEC commissioner).

affect the willingness of prosecutors to bring criminal cases against corporations? (4) How might this shift affect deterrence in business crime cases? This Part will argue that the institutional shift is likely to be durable; that legal rules regarding review of agreements with prosecutors, the protections of the attorney-client privilege, and constitutional protections should not be adjusted to reflect this new role; that the new branch-office role might very well lead prosecutors to cut back on bringing criminal charges against corporations; and that over-use of the branch-office role could end up reducing deterrence in business crime cases. The Article concludes by stressing the importance of using the criminal sanction against corporations for business crime violations.

## I. EVOLUTION OF THE CORPORATION'S ROLE

### A. *The Early Period*

The role that corporations have come to play in the criminal process today can be traced back to the SEC's investigations in the early 1970s of "questionable payments."<sup>40</sup> At first, the payments being investigated were illegal corporate campaign contributions made during the 1972 presidential campaign, contributions whose existence was uncovered by the Watergate special prosecutor.<sup>41</sup> The SEC's investigations, however, soon revealed a broader problem of corporate commercial bribery taking place both in the United States and abroad. Just as with today's options backdating problem, the SEC quickly found that it lacked the resources to pursue careful investigations of all the cases that were being uncovered.<sup>42</sup> Drawing on its experience in negotiating consent decrees in fraud cases that required corporations to undertake internal reviews by court-appointed outside counsel, the SEC began to encourage companies to perform internal reviews before the SEC took action and to reveal

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40. Payments made at this time by U.S. companies to secure business abroad were often euphemistically called "questionable payments," rather than "bribes." See John C. Coffee, *Beyond the Shut-Eyed Sentry: Toward a Theoretical View of Corporate Misconduct and an Effective Legal Response*, 63 VA. L. REV. 1099, 1102 nn.2-4, 1103 n.7, 1105 nn.11-12 (1977) (citations omitted).

41. See *id.* at 1115-16.

42. See *In re Sealed Case*, 676 F.2d 793, 800-01 (D.C. Cir. 1982).

the results of those reviews, where necessary, to the Commission.<sup>43</sup> Thus was born the Commission's "Voluntary Disclosure Program."<sup>44</sup>

Pressing corporations to undertake *ex ante* reviews not only helped the Commission; corporations reaped the benefits of these reviews as well. As one of the key practitioners of the day put it, corporations saw that it might be "more prudent" to engage in private investigation without court supervision or SEC monitoring, undertaken by counsel of their own choice.<sup>45</sup> Further, by putting its "corporate house in order" on its own, a corporation might be able to negotiate a "milder settlement" with the SEC.<sup>46</sup>

The increase in these internal investigations then triggered a renewed attention to the question of the corporation's attorney-client and work-product privileges. Before the 1970s, the extent to which these privileges protected corporations had received only sporadic lower court attention<sup>47</sup>: the Supreme Court had not considered the corporate attorney-client privilege since 1915 and had never considered the application of the work-product doctrine in the corporate criminal context.<sup>48</sup>

In 1976, the outside accountants for the Upjohn Company, a pharmaceutical manufacturer, discovered that a foreign Upjohn subsidiary had made improper payments to foreign government officials.<sup>49</sup> Upjohn reported this discovery to its general counsel and the company undertook an internal investigation of the payments.<sup>50</sup>

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43. See Arthur F. Mathews, *Internal Corporate Investigations*, 45 OHIO ST. L.J. 655, 661-62 (1984).

44. See Coffee, *supra* note 40, at 1117.

45. See Mathews, *supra* note 43, at 666.

46. See *id.*

47. See, e.g., *Harper & Row Publishers, Inc. v. Decker*, 423 F.2d 487, 492-93 (7th Cir. 1970) (adopting "subject matter" test for coverage of communications under the corporate attorney-client privilege), *aff'd*, 400 U.S. 348 (1971) (equally divided court); *Radiant Burners, Inc. v. Am. Gas Ass'n*, 207 F. Supp. 771, 775 (N.D. Ill. 1962) (holding that a corporation was not entitled to assert attorney-client privilege), *rev'd*, 320 F.2d 314 (7th Cir. 1963); *City of Phila. v. Westinghouse Elec. Corp.*, 210 F. Supp. 483, 485 (E.D. Pa. 1962) (adopting the "control group" test).

48. See *United States v. Louisville & Nashville R.R. Co.*, 236 U.S. 318, 336-37 (1915) (noting that the Government "frankly admitted" that Congress did not intend the ICC's subpoena power to include confidential correspondence between the railroad and its counsel, the Court observed: "The desirability of protecting confidential communications between attorney and client as a matter of public policy is too well known and has been too often recognized by textbooks and courts to need extended comment now. If such communications were required to be made the subject of examination and publication, such enactment would be a practical prohibition upon professional advice and assistance.").

49. See *Upjohn Co. v. United States*, 449 U.S. 383, 386 (1981).

50. See *id.* at 386-87.

Upjohn subsequently made a report to the SEC disclosing the payments, after which the Internal Revenue Service sought all of Upjohn's documents relating to its investigation of the payments (the payments raised tax problems because they should not have been treated as deductible business expenses), including interviews with its employees.<sup>51</sup> Upjohn resisted. In *Upjohn Co. v. United States*,<sup>52</sup> the Supreme Court held that Upjohn could assert the attorney-client privilege and the work-product doctrine in an effort to shield these documents from government discovery, although the Court declined to set out any specific tests for the assertion of these privileges.<sup>53</sup>

*Upjohn* is a somewhat paradoxical marker in the development of the corporation's branch-office role. On the one hand, permitting the assertion of these privileges would seem to run counter to viewing the corporation as having public responsibilities because the privileges shield information from government scrutiny. Although it is true that the privileges shield only the specific communication of the information, not the underlying information itself,<sup>54</sup> keeping communications confidential deprives the government of material that could be quite useful in an investigation or prosecution, if only to cross-examine witnesses who might later change their stories. On the other hand, acknowledging a strong privilege gives some comfort to corporations when they engage in internal reviews, arguably providing an incentive for corporations to engage in thorough self-investigation and self-policing without fear that the investigation itself could create liability. Indeed, the Court specifically noted that an inhospitable approach to these privileges "threatens to limit the valuable efforts of corporate counsel to ensure their client's compliance with the law."<sup>55</sup> This self-regulatory message was the one that corporate counsel took from the case when it was decided.<sup>56</sup>

The next step toward developing the branch-office role of corporations was to institutionalize the private internal investigation. If there were potential benefits from engaging in such investigations when a government agency had focused on the widespread occurrence of a particular corporate practice, perhaps there would be

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51. *See id.* at 387-88.

52. 449 U.S. 383 (1981).

53. *See id.* at 396-97. For further discussion of the factual context of the case, see John E. Sexton, *A Post-Upjohn Consideration of the Corporate Attorney-Client Privilege*, 57 N.Y.U. L. REV. 443, 457-59 (1982).

54. *See Upjohn*, 449 U.S. at 395.

55. *Id.* at 392.

56. *See* Sexton, *supra* note 53, at 468-76.

greater benefits from putting into place programs that could more generally prevent criminal behavior in the first place, or at least more certainly detect it. Some major corporations had instituted such programs after the electrical equipment criminal antitrust prosecutions of the 1960s,<sup>57</sup> variously called “compliance programs” or “codes of ethics,” but corporate counsel now saw the possibility that criminal liability might extend beyond a few specific business crime statutes to a wider range of corporate behavior. The legal advice of the day thus stressed that “[t]he past decade has been marked with a dizzying expansion of potential corporate liability, particularly corporate criminal liability” and that “[e]ffective self-regulation could provide a measure of protection” in this hostile legal environment.<sup>58</sup> Indeed, compliance programs could “foster public goodwill,” allowing a public company “to be perceived as a law-abiding corporate citizen rather than as a company that does not care.”<sup>59</sup> Further, counsel also saw that there could be a connection between the adoption of compliance programs and the legal standard that courts might apply in determining corporate criminal liability. Compliance programs, if reviewed under a due diligence standard, might lead courts to “base criminal liability on some showing of corporate recalcitrance rather than upon one employee’s actions,” thereby limiting prosecutions to cases where the corporation had “fostered an atmosphere conducive to criminal activity.”<sup>60</sup> Thus, the programs carried a dual hope: (1) to reduce illegal behavior in the first place and (2) to reduce the likelihood of corporate criminal liability in the event that corporate employees did engage in illegal conduct.

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57. See Harvey L. Pitt & Karl A. Groskaufmanis, *Minimizing Corporate Civil and Criminal Liability: A Second Look at Corporate Codes of Conduct*, 78 GEO. L.J. 1559, 1578 (1990). This interest in corporate compliance programs came notwithstanding the fact that General Electric, one of the major defendants in the criminal prosecution, had a “formal company policy rule” to avoid discussions of pricing. See Myron W. Watkins, *Electrical Equipment Antitrust Cases: Their Implications for Government and for Business*, 29 U. CHI. L. REV. 97, 105 (1961).

58. See Pitt & Groskaufmanis, *supra* note 57, at 1561.

59. *Id.* at 1635–36.

60. *Id.* at 1652. The standard rule is that entities are criminally liable for the conduct of their employees, undertaken within the scope of their employment for the benefit of the entity. See *N.Y. Cent. & Hudson River R.R. Co. v. United States*, 212 U.S. 481, 494 (1909). In applying the rule, courts have resisted taking account of compliance programs. See, e.g., *United States v. Hilton Hotels Corp.*, 467 F.2d 1000, 1007 (9th Cir. 1972). For a review of the current approach to finding entity criminal liability, see Erik Paulsen, *Imposing Limits on Prosecutorial Discretion in Corporate Prosecution Agreements*, 82 N.Y.U. L. REV. 1434, 1445–48 (2007). For an argument that the “for the benefit” part of the *New York Central* test should be more strictly applied, see Buell, *supra* note 5, at 530–32.

The movement to institutionalize compliance programs received further support from the United States Sentencing Commission (“Commission”) in 1991. Under the Sentencing Reform Act of 1984,<sup>61</sup> the Commission was required to write sentencing guidelines applying both to individuals and to organizations.<sup>62</sup> The Commission began with guidelines for individuals, which it issued in 1987, and then turned its attention to organizational guidelines.<sup>63</sup> In 1988, the Commission proposed organizational guidelines based on a theory of optimal deterrence, with fines keyed to the loss caused by the illegal behavior and the difficulty of detecting and punishing particular offenses.<sup>64</sup> Those guidelines were not well-received, and the Commission subsequently changed its approach: the guidelines it finally adopted in 1991 were aimed more at culpability and remediation than at optimal deterrence.<sup>65</sup>

The guidelines’ focus on culpability and remediation led to several important provisions which drew on then-current trends and incrementally advanced the corporation’s branch-office role. As with the earlier draft guidelines, the 1991 guidelines began by assessing the harm caused by the illegal behavior.<sup>66</sup> The 1991 guidelines, however, then reduced the fine to reflect lesser culpability.<sup>67</sup> One significant way an organization could obtain such a reduction would be to have adopted an “effective program to prevent and detect violations of law” prior to the commission of the criminal offense.<sup>68</sup> Another

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61. Pub. L. No. 98-473, 98 Stat. 1837, 1987 (1984) (codified as amended in scattered sections of 18 U.S.C. and 28 U.S.C.).

62. See 18 U.S.C. § 3551 (2006).

63. See generally Stephen Breyer, *The Federal Sentencing Guidelines and the Key Compromises Upon Which They Rest*, 17 HOFSTRA L. REV. 1 (1988) (discussing the adoption of the first set of guidelines for individuals).

64. See U.S. SENTENCING COMM’N, DISCUSSION DRAFT OF SENTENCING GUIDELINES AND POLICY STATEMENTS FOR ORGANIZATIONS (July 1988), reprinted in 10 WHITTIER L. REV. 7, 58–61 (1988). For an explanation of optimal deterrence theory, see generally Gary Becker, *Crime and Punishment: An Economic Approach*, 76 J. POL. ECON. 169 (1968); William M. Landes, *Optimal Sanctions for Antitrust Violations*, 50 U. CHI. L. REV. 652 (1983).

65. See generally Ilene H. Nagel & Winthrop M. Swenson, *The Federal Sentencing Guidelines for Corporations: Their Development, Theoretical Underpinnings, and Some Thoughts about Their Future*, 71 WASH. U. L. Q. 205 (1993) (discussing criticisms of the draft guidelines’ optimal deterrence approach and the guidelines that the Commission subsequently adopted).

66. See U.S. SENTENCING GUIDELINES MANUAL § 8C2.4 (1991).

67. See *id.* § 8C2.5.

68. See *id.* § 8C2.5(f). The Commission revised the original guidelines provision in 2004, inter alia, changing “Effective Program to Prevent and Detect Violations of Law” to “Effective Compliance and Ethics Program.” *Id.* § 8C2.5(f) app. C.

significant source of reduction was for an organization to report violations promptly (and before they were known to the government) and/or to “fully cooperate[]” in the investigation and show “affirmative acceptance of responsibility” for its criminal conduct.<sup>69</sup> An organization that qualified for the maximum “discounts” could, in theory, obtain a ninety-five percent reduction in the fine that would otherwise be imposed.<sup>70</sup>

The 1991 guidelines also envisioned the possibility of placing organizations on court-supervised probation for up to five years, part of an effort to use the criminal sanction to remedy past harm.<sup>71</sup> One recommended condition of probation was to require the adoption of a compliance program approved by the court, along with periodic reporting to the court of compliance efforts and periodic visits by probation officers or other “experts.”<sup>72</sup> Conditions of probation could also include restitution to victims<sup>73</sup> and “community service.”<sup>74</sup>

The final critical step in this period came when the Antitrust Division of the Department of Justice (“Division”) changed its previously existing amnesty program for those involved in criminal bid-rigging or price fixing.<sup>75</sup> Although the Division historically had been willing to forgo criminal prosecutions in appropriate circumstances, defense counsel generally considered applying for amnesty to be a risky proposition, and the program was not often

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69. *Id.* § 8C2.5(g).

70. *See id.* § 8C2.6.

71. *See id.* § 8D1.1.

72. *See id.* § 8D1.4(b)(2).

73. *See id.* § 8B1.1.

74. *See id.* § 8B1.3.

75. *See generally* Donald C. Klawiter, *Corporate Leniency in the Age of International Cartels: The American Experience*, 14 ANTITRUST, no. 3, 2000 at 13 (discussing the Antitrust Division’s amnesty program, formally begun in 1978, and its application only to cases where the Division had not begun an investigation). Although section 1 of the Sherman Act, 15 U.S.C. § 1 (2006), does not specify which restraints of trade should be prosecuted criminally, price fixing and bid-rigging have generally been considered appropriate subjects for criminal prosecution under section 1. *See* U.S. DEP’T OF JUSTICE, ANTITRUST DIV. MANUAL III-20 (4th ed. 2008), available at <http://www.justice.gov/atr/public/divisionmanual/atrdvman.pdf>; *United States v. U.S. Gypsum Co.*, 438 U.S. 422, 439–40 (1978) (discussing earlier views). Other anticompetitive conduct has, on occasion, been criminally prosecuted as well. *See, e.g., Am. Tobacco Co. v. United States*, 328 U.S. 781, 783 (1946) (involving monopolization under section 2 of the Sherman Act); *United States v. Hilton Hotels Corp.*, 467 F.2d 1000, 1002 (9th Cir. 1972) (boycott under section 1). While the Department’s amnesty program does not specify the “illegal antitrust activity” to which it applies, *see* ANTITRUST DIV., U.S. DEP’T OF JUSTICE, CORPORATE LENIENCY POLICY 1 (1993), <http://www.justice.gov/atr/public/guidelines/0091.pdf>, there are no reports of its application outside of conduct involving price fixing or bid-rigging.

used.<sup>76</sup> In 1993, however, the Division instituted a more articulated program.<sup>77</sup> Critical was the provision for full amnesty for a company that was first to report illegal activity even if the investigation had already begun, so long as the Department did not yet have sufficient evidence for a conviction and the reporting company met a number of conditions, including reporting “with candor and completeness” and providing “full, continuing and complete cooperation that advances the Division in its investigation.”<sup>78</sup> The Division also provided that corporate officers, directors, and employees of the reporting corporation would get amnesty, if they admitted their wrongdoing and continued to assist the Division.<sup>79</sup> The new program was immediately successful, with twelve corporations coming forward to cooperate in the first year, in comparison to the one corporation per year, on average, that had come forward before the program was instituted.<sup>80</sup>

The Antitrust Division’s amnesty program provided clearer and more powerful incentives for corporate cooperation than other policy instruments then in use. For example, the sentencing guidelines’ penalty reductions applied only after a corporation had been convicted (with the attendant potential for collateral consequences), thereby reducing the value of corporate efforts to self-investigate and report illegal behavior. Likewise, the SEC’s earlier efforts to encourage corporate compliance did not guarantee that the SEC would take no action, although it held out the potential for reduced sanctions.<sup>81</sup> Perhaps more importantly, the SEC’s policy did not affect the conduct of U.S. attorneys around the country, who remained free to exercise prosecutorial discretion to bring criminal charges without regard to the SEC’s actions.<sup>82</sup> Nevertheless, by the end of the 1990s,

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76. See Klawiter, *supra* note 75, at 13.

77. See *id.* at 13–14; accord ANTITRUST DIV., *supra* note 75 (explaining the program requirements).

78. See ANTITRUST DIV., *supra* note 75, § B. Under the Division’s policy, amnesty is easier to get where the Department does not yet know about the illegal activity. See *id.* § A.

79. See *id.* § C. One year later, the Department announced an amnesty program for individuals who report illegal activity on their own, rather than in connection with a corporate proffer of cooperation. See U.S. DEP’T OF JUSTICE, INDIVIDUAL LENIENCY POLICY § A (1994), <http://www.usdoj.gov/atr/public/guidelines/0092.htm>.

80. See 67 Antitrust & Trade Reg. Rep. (BNA) No. 1676, at 183 (Aug. 11, 1994).

81. See *In re Sealed Case*, 676 F.2d 793, 801 (D.C. Cir. 1982) (describing the SEC program).

82. Cf. *Chiarella v. United States*, 445 U.S. 222, 224 (1980) (prosecution of an individual for insider trading after entering into a consent decree with the SEC disgorging profits from the illegal trading). For a description of how one corporation convinced the

the movement to reward corporations, in one way or another, for revealing their crimes and helping the prosecution was well underway.

*B. The Enron Era: 2001–2006*

1. The Scandals Emerge

The next steps in developing the branch-office role of corporations came in what can be called the Enron era, dated 2001 to 2006. Five years might not be sufficient time to qualify as an “era,” but this is roughly the time period when prosecutors, legislators, courts, and (often) juries reacted strongly to the unfolding stories of corporate wrongdoing. During this time, prosecutors used the earlier developments—compliance programs, reporting illegality to the government, full cooperation, and assistance—to deal with the emergence of a new wave of corporate accounting and other scandals. Enron was not the only corporation to be involved in this widespread fraud, but its name has come to symbolize the problems that were uncovered during this time.

The era began quietly. In August 2001, Jeffrey Skilling, the CEO of Enron, then the seventh largest U.S. corporation, resigned from his position after only six months on the job and with little explanation.<sup>83</sup> Two months later, Enron reported a third-quarter loss of \$618 million along with a reduction in shareholder equity of \$1.2 billion to reflect transactions with limited partnerships controlled by the company’s CFO, Andrew Fastow.<sup>84</sup> Despite pleas for government financial help that Enron’s new CEO, Kenneth Lay, made to the highest officials in the Bush Administration, no government rescue was forthcoming.<sup>85</sup> Enron’s admission in November 2001 that it had overstated profits for

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U.S. attorney not to indict it for insider trading, despite the fact that key executives had already been arrested on insider trading charges, see James B. Stewart & Janet Guyon, *Damage Control: How GE and Kidder Managed to Ward Off an Impending Disaster*, WALL ST. J., June 8, 1987, at 1 (describing General Electric internal investigation of its subsidiary, Kidder Peabody, and how its decision to “clean house” convinced U.S. Attorney Rudolph Giuliani not to indict the corporation).

83. See Kathleen F. Brickey, *From Enron to Worldcom and Beyond: Life and Crime After Sarbanes-Oxley*, 81 WASH. U. L. Q. 357, 360–61 (2003) (discussing Skilling’s resignation and reaction inside Enron).

84. See John R. Emshwiller & Rebecca Smith, *Enron Jolt: Investments, Assets Generate Big Loss*, WALL ST. J., Oct. 17, 2001, at C1.

85. See Jeanne Cummings & Michael Schroeder, *Enron’s Lay Sought Cabinet Officials’ Help*, WALL ST. J., Jan. 11, 2002, at A3 (reporting contacts in October and November 2001 between Enron Chairman Kenneth Lay, Alan Greenspan, Treasury Secretary Paul O’Neill, and Commerce Secretary Donald Evans).

the previous five years by \$586 million sealed its fate.<sup>86</sup> In December 2001, Enron declared bankruptcy, at that time the largest bankruptcy filing in U.S. history.<sup>87</sup>

The next critical event occurred on March 14, 2002, when Arthur Andersen LLP, Enron's auditing company, was indicted for obstruction of justice arising out of its massive destruction of Enron-related documents, allegedly done both before and after the SEC had begun its investigation of Enron's accounting practices.<sup>88</sup> David Duncan, the Arthur Andersen partner in charge of auditing Enron, pleaded guilty in April 2002 to obstruction of justice, thereby strengthening the government's case against the accounting firm.<sup>89</sup> On June 15, 2002, after ten days of deliberation, the jury found Arthur Andersen guilty.<sup>90</sup> The eventual result was the collapse and dissolution of the firm, even though three years later the Supreme Court vacated Arthur Andersen's criminal conviction, and the government chose not to retry the case.<sup>91</sup>

Enron and Arthur Andersen were not the only major corporations to be caught in major accounting and securities frauds during this era. The impressive group of major corporations involved in frauds at the same time includes—Adelphia Communications: questionable accounting practices, insider loans and guarantees of \$3.1 billion not approved by the board; Bristol-Myers: accounting fraud involving manipulation of reserves and valuation of sales to wholesalers; Cendant: accounting and securities fraud that inflated earnings by several hundred million dollars; Computer Associates: artificially inflating revenues and improperly rewarding top executives; Dynegy: accounting practices to make cash flow appear

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86. See John R. Emshwiller et al., *Enron Slashes Profits Since 1997 by 20%*, WALL ST. J., Nov. 9, 2001, at A3.

87. See Rebecca Smith, *Enron Files for Chapter 11 Bankruptcy, Sues Dynegy*, WALL ST. J., Dec. 3, 2001, at A3.

88. See Kathleen F. Brickey, *Andersen's Fall from Grace*, 81 WASH. U. L. Q. 917, 921 (2003).

89. See *id.* at 930.

90. See Kurt Eichenwald, *Andersen Guilty in Effort to Block Inquiry on Enron*, N.Y. TIMES, June 16, 2002, at 1.

91. See *Arthur Andersen LLP v. United States*, 544 U.S. 696, 706–08 (2005) (holding that the trial court's instructions did not correctly inform the jury of the mens rea required to prove a violation of 18 U.S.C. § 1512(b)). In addition to deciding not to retry the defunct firm, the government also did not object to a motion made by David Duncan, its star cooperating witness in the Andersen case, to withdraw his guilty plea. See John R. Emshwiller, *Andersen Figure Files to Withdraw His Guilty Plea*, WALL ST. J., Nov. 23, 2005, at C3; Carrie Johnson, *U.S. Ends Prosecution of Arthur Andersen*, WASH. POST, Nov. 23, 2005, at D1.

greater than it was; Halliburton: investigation into improper accounting for revenue from cost overruns on large projects; ImClone Systems: former CEO trading in advance of FDA negative report on major drug; Kmart: investigation into accounting practices; Lucent Technologies: \$679 million adjustment to revenues led to SEC investigation; Merrill Lynch: paid \$100 million in criminal fines to state prosecutors, led by New York, for providing investment advice through advisors whose incentives were to recommend Merrill Lynch stocks without regard to merit; Qwest Communications: possible inflation of revenues for 2000 and 2001 related to capacity swaps and equipment sales; Tyco International: improper accounting practices to boost profits and failure to report publicly excessive executive compensation; Rite Aid: accounting fraud tactics inflated income by more than \$250 million; WorldCom: improper accounting of capital expenses to inflate before-depreciation earnings, leading to overstatement of earnings in excess of \$7 billion; and Xerox: paid \$10 million civil penalty to SEC for inflating revenue and profits from 1997 to 2000.<sup>92</sup>

## 2. Congressional Response

With the stock markets tumbling and more scandals emerging following the Enron collapse, political pressure mounted for Congress to take action. Congress's response was to enact the Sarbanes-Oxley Act, passed by a near-unanimous vote in the House and Senate and quickly signed into law by President Bush on July 30, 2002.<sup>93</sup>

Sarbanes-Oxley was an amalgam of various proposals aimed at the specific abuses that had been uncovered. Among its more important features were: (1) the establishment of a "Public Company

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92. For the listed cases, see Brickey, *supra* note 83, at 382–401 app. A (listing corporate fraud trials from March 2002 to August 2003); Ann Davis, *Ex-Chairman of Cendant is Indicted*, WALL ST. J., Mar. 1, 2001, at A3 (describing criminal charges brought against former chairman and vice chairman of Cendant); Charles Gasparino, *Merrill Lynch to Pay Big Fine, Increase Oversight of Analysts*, WALL ST. J., May 22, 2002, at A1 (describing settlement of state charges against Merrill Lynch); Gardiner Harris, *Booster Shots: At Bristol-Myers, Ex-Executives Tell of Numbers Games*, WALL ST. J., Dec. 12, 2002, at A1 (describing Bristol-Myers' accounting practices under investigation by SEC and Justice Department); Scott Kilman, *Rite Aid Ex-Officials Charged in Accounting-Fraud Probe*, WALL ST. J., June 24, 2002, at A2 (describing criminal charges brought against three former Rite Aid executives); David Wessel, *Venal Sins: Why the Bad Guys of the Boardroom Emerged en Masse*, WALL ST. J., June 20, 2002, at A1 (listing investigations).

93. See Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified as amended in scattered sections of 15 U.S.C. and 18 U.S.C.). For the votes, see 148 CONG. REC. H5480 (daily ed. July 25, 2002); 148 CONG. REC. S7365 (daily ed. July 25, 2002).

Accounting Oversight Board,” with power to regulate auditing companies to assure the independence of the audit and the following of professional standards;<sup>94</sup> (2) a provision requiring an annual assessment of the effectiveness of a company’s “internal control structure and procedures” for financial reporting;<sup>95</sup> (3) two separate provisions requiring principal executive and financial officers to certify annual and quarterly reports, with criminal liability for certifying when “knowing” that the report does not “fairly present” the financial condition of the company;<sup>96</sup> (4) provisions for knowing alteration or destruction of documents with intent to obstruct federal investigation;<sup>97</sup> (5) a new crime of “securities fraud” that would be easier to prosecute;<sup>98</sup> (6) an increase in the penalties for violating the 1934 Securities Exchange Act and the mail and wire fraud statutes, including directives to the United States Sentencing Commission to increase penalties for serious frauds and obstruction of justice;<sup>99</sup> and (7) a requirement that the SEC issue rules for “minimum standards of professional conduct” for lawyers practicing before the SEC, including a requirement that lawyers report a client corporation’s securities law violations or breaches of fiduciary duty either to the company’s chief legal counsel or CEO, or, if they fail to act, to its Board of Directors.<sup>100</sup>

### 3. Executive Response

With the passage of Sarbanes-Oxley, there was the hope, as the Chairman of the SEC, William Donaldson, said, that “we’ve seen the worst of it.”<sup>101</sup> Still, there was need for a prosecutorial response to deal with the wrongdoing that had been disclosed, a response that would likely require use of the criminal law. Paul O’Neill, secretary of

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94. § 101, 116 Stat. at 750, *invalidated in part by* Free Enter. Fund v. Pub. Co. Accounting Oversight Bd., 130 S. Ct. 3138 (2010).

95. § 404(a)(2), 116 Stat. at 789 (pertaining to public issuers).

96. § 302(a), 116 Stat. at 777 (SEC regulation); § 906(a), 116 Stat. at 806 (criminal procedure).

97. *See* § 802, 116 Stat. at 800 (criminal penalties for altering or destroying documents); § 1101, 116 Stat. at 807 (criminal penalties for record tampering).

98. § 807, 116 Stat. at 804.

99. *See* § 805, 116 Stat. at 802 (reviewing sentencing guidelines); § 903, 116 Stat. at 805 (pertaining to mail and wire fraud); § 1106, 116 Stat. at 810 (addressing Securities Exchange Act of 1934).

100. § 307, 116 Stat. 784. For SEC regulations, see 17 C.F.R. §§ 205.1–205.7 (2010).

101. *See* Press Briefing by SEC Chairman William Donaldson and Deputy Att’y Gen. Larry Thompson (July 22, 2003), <http://www.usdoj.gov/dag/cftf/press/072203whitehouse/cftfbriefing.htm>.

the treasury and a former CEO himself, put it this way: the guilty executives deserved “to hang . . . from the very highest branches.”<sup>102</sup>

On July 2, 2002, shortly before signing Sarbanes-Oxley into law, President Bush signed an executive order establishing the Corporate Fraud Task Force in the Department of Justice to coordinate the investigation and prosecution of “financial crimes.”<sup>103</sup> The Task Force’s authority included the right to “allocat[e] and reallocat[e]” resources within the Justice Department in an effort to coordinate and centralize prosecution of these cases.<sup>104</sup> By the end of the Task Force’s first year, Justice Department prosecutors had obtained over 250 corporate fraud convictions (including guilty pleas) and had charged and/or convicted at least twenty-five former CEOs.<sup>105</sup> By the end of the Task Force’s second year, it reported approximately 250 additional convictions, with corporate fraud charges pending in 400 filed cases against more than 900 defendants, sixty of whom were corporate CEOs and presidents.<sup>106</sup>

The Task Force’s directive to investigate corporate fraud raised the obvious question of how prosecutors should deal with the potential for corporate criminal liability. The only official guidance available at the time was a 1999 memorandum entitled “Federal Prosecution of Corporations,” that Deputy Attorney General Eric Holder had issued during the Clinton administration.<sup>107</sup> The Holder Memorandum did nothing to require prosecutors to adhere to its guidance—even the use of its discretionary factors was not required.<sup>108</sup> The guidelines set out in the memorandum, however, did

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102. Wessel, *supra* note 92.

103. Exec. Order No. 13,271, 67 Fed. Reg. 46,091 (July 9, 2002).

104. *See id.* § 3b.

105. *See* CORPORATE FRAUD TASK FORCE, FIRST YEAR REPORT TO THE PRESIDENT 2.2 (2003).

106. *See* CORPORATE FRAUD TASK FORCE, SECOND YEAR REPORT TO THE PRESIDENT 3.2 (2004).

107. *See* Memorandum from Eric Holder, Deputy Att’y Gen., U.S. Dep’t of Justice, to All Component Heads and U.S. Att’y’s (June 16, 1999), <http://www.justice.gov/criminal/fraud/documents/reports/1999/charging-corps.PDF> [hereinafter Holder Memorandum]. For discussion of the Holder Memorandum, see Lawrence D. Finder & Ryan D. McConnell, *Devolution of Authority: The Department of Justice’s Corporate Charging Policies*, 51 ST. LOUIS U. L.J. 1, 7–12 (characterizing the Holder Memorandum as a “little-noticed memo”).

108. *See* Holder Memorandum, *supra* note 107, at 1 (“These factors are, however, not outcome-determinative and are only guidelines. Federal prosecutors are not required to reference these factors in a particular case, nor are they required to document the weight they accorded specific factors in reaching their decision . . . . [P]lease forward any comments about the guidelines, as well as instances in which the factors proved useful or not useful in specific cases . . . .”).

draw on three earlier developments in voluntary corporate cooperation: (1) a corporation's "timely and voluntary disclosure of wrongdoing and its willingness to cooperate with the government's investigation" could lead to the grant of "immunity or amnesty";<sup>109</sup> (2) the existence of a compliance program "designed and implemented in an effective manner" could result in a decision "to charge only the corporation's employees and agents";<sup>110</sup> and (3) a corporation's willingness to make restitution, accept responsibility, and discipline wrongdoers "may [be] consider[ed] . . . in determining whether to charge the corporation."<sup>111</sup>

In January 2003, less than six months after the establishment of the Corporate Fraud Task Force in the Justice Department, the deputy attorney general of the Justice Department and head of the Task Force, Larry Thompson, announced a revision of the Holder Memorandum.<sup>112</sup> Thompson's introductory letter stated that the "main focus of the revisions [was its] increased emphasis on and scrutiny of the authenticity of a corporation's cooperation."<sup>113</sup> Expressing concern that business organizations too often "purport[] to cooperate with a Department investigation" while actually "imped[ing] the quick and effective exposure of the complete scope of wrongdoing under investigation," Thompson stated that such obstructionist behavior would "weigh in favor of a corporate prosecution."<sup>114</sup>

Despite the introductory tone indicating important changes from the Holder Memorandum, the actual changes in the Thompson Memorandum were rather slight. With regard to the critical indicia of corporate cooperation that might merit prosecutorial discretion in the charging decision, the Thompson Memorandum changed almost nothing: a slight word change in the provision dealing with waivers of attorney-client and work-product protections and no changes in the provision expressing a negative view of corporations that protect "culpable employees" by advancing their attorneys' fees, not firing them, or sharing information with them through a joint defense

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109. *Id.* § VI.A–B.

110. *Id.* § VII.B.

111. *Id.* § VIII.A.

112. See Memorandum from Larry D. Thompson, Deputy Att'y Gen., U.S. Dep't of Justice, to Heads of Dep't Components, U.S. Att'ys (Jan. 20, 2003), [http://www.usdoj.gov/dag/cftf/corporate\\_guidelines.htm](http://www.usdoj.gov/dag/cftf/corporate_guidelines.htm). [hereinafter Thompson Memorandum].

113. *Id.*

114. *Id.*

agreement.<sup>115</sup> If anything, there was a nuanced shift of emphasis away from prosecuting corporations and toward prosecuting individuals. For example, to the Holder Memorandum's eight general factors to be considered in deciding whether to prosecute a corporation the Thompson Memorandum added a ninth: "the adequacy of the prosecution of individuals responsible for the corporation's malfeasance."<sup>116</sup> Instead of the statement in the Holder Memorandum that individual criminal liability "provides a strong deterrent against future corporate wrongdoing,"<sup>117</sup> the Thompson Memorandum states: "[b]ecause a corporation can act only through individuals, imposition of individual criminal liability may provide the strongest deterrent against future corporate wrongdoing."<sup>118</sup>

What changed more than the language between the two memoranda was the times. The Department had faced corporate wrongdoing before 2002, of course, but the pressure had never before been so great to demonstrate results. Issuing a new memorandum, even though it was almost unchanged from the one issued in the Clinton administration, underscored the new Bush administration's seriousness of purpose. Nor was the preference for individual liability over organizational liability surprising. Such a shift in emphasis had been seen in the 1980s, when a republican administration replaced a democratic one and corporate-centered questionable payment investigations gave way to individually-centered insider trading investigations.<sup>119</sup>

The Department's focus on individual culpability was genuine, however, and it was a natural step to make serious, if instrumental, use of corporate resources in an effort to deal with the wrongdoing that was making newspaper headlines. The tool that emerged to

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115. The only real difference between the sections in the two memoranda was the deletion of "only" in the Holder Memorandum. Compare Holder Memorandum, *supra* note 107, § VI.B ("The Department does not, however, consider waiver of a corporation's privileges an absolute requirement, and prosecutors should consider the willingness of a corporation to waive the privileges when necessary to provide timely and complete information as only one factor in evaluating the corporation's cooperation."), with Thompson Memorandum, *supra* note 112 § VI.B ("The Department does not, however, consider waiver of a corporation's privileges an absolute requirement, and prosecutors should consider the willingness of a corporation to waive the privileges when necessary to provide timely and complete information as one factor in evaluating the corporation's cooperation.").

116. Thompson Memorandum, *supra* note 112, § II.A.

117. Holder Memorandum, *supra* note 107, § I.B.

118. Thompson Memorandum, *supra* note 112, § I.B.

119. See Kenneth B. Noble, *The Dispute Over the S.E.C.: Critics Call Agency Less Aggressive*, N. Y. TIMES, Apr. 21, 1982, at D1 (discussing change in enforcement policies).

marshal this corporate effort was a formal agreement between a corporation under investigation and the government prosecutor, an agreement that has taken one of two basic forms. One form is the “deferred prosecution agreement,” in which the government files charges but defers a decision on prosecution pending the corporation’s performance of agreed upon conditions; the other form is the “non-prosecution agreement,” in which the government agrees not to prosecute the corporation at all in exchange for the corporation’s agreement to perform certain acts.<sup>120</sup>

At the core, these government/corporate agreements reflect a familiar trade-off between a prosecutor and defendant—some degree of immunity from prosecution (or reduction in sentence) in exchange for cooperation—which hardly seems innovative. Indeed, prosecutors had made sporadic use of these types of agreements prior to either the Holder or Thompson memoranda.<sup>121</sup> The Holder Memorandum included a discussion of the use of non-prosecution agreements;<sup>122</sup> the Thompson Memorandum simply added a reference to pretrial diversion,<sup>123</sup> a procedure developed in the context of juvenile and drug offenders where charges might be filed, but prosecution deferred in an effort to avoid stigmatization and to encourage rehabilitation.<sup>124</sup>

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120. See Leonard Orland, *The Transformation of Corporate Criminal Law*, 1 BROOK. J. CORP. FIN. & COM. L. 45, 56 (2006) (describing differences between the two types of agreements).

121. The earliest example of a fully framed deferred prosecution agreement in a fraud case appears to be the 1994 agreement with Prudential Securities, in which Prudential agreed to “cooperate fully” with government investigators, to add \$330 million to an SEC restitution fund, to appoint outside counsel to ensure that Prudential was complying with the compliance-related directives that the SEC had imposed, and to appoint a new outside director to act as compliance “ombudsman.” See Letter Agreement from Mary Jo White, U.S. Att’y, S. Dist. of N.Y., to Scott W. Muller, Esq., & Carrey R. Dunne, Esq. (Oct. 27, 1994), <http://www.corporatecrimereporter.com/documents/prudential.pdf>. Accompanying the letter agreement was a formal deferred prosecution agreement, filed in court with a six-page criminal complaint charging Prudential with securities fraud, the prosecution of which would be deferred for three years conditioned on “satisfactory compliance” with the cooperation agreement. See *id.* at 1. The complaint alleged violations of 15 U.S.C. §§ 78j(b) and 78ff, and Rule 10b-5. See *id.* Three cases predate the Prudential agreement, but one did not involve securities fraud and the other two did not include a formal non-prosecution agreement. See Finder & McConnell, *supra* note 107, at 36, 44 (agreements with Armour of America and Aetna); Orland, *supra* note 120, at 58–59 (Solomon Brothers’ settlement, involving securities and antitrust violations, did not include formal agreement).

122. See Holder Memorandum, *supra* note 107, § VI.B.

123. See Thompson Memorandum, *supra* note 112, § VI.B.

124. See Benjamin M. Greenblum, *What Happens to a Prosecution Deferred? Judicial Oversight of Corporate Deferred Prosecution Agreements*, 105 COLUM. L. REV. 1863, 1866 (2005) (discussing antecedents of these agreements); Paulsen, *supra* note 60, at 1444 n.46 (discussing antecedents of deferred prosecution agreements). The 1997 U.S. Attorneys’

The innovation in the use of these agreements has come through practice, as prosecutors began to use these agreements more frequently, in more major cases, to obtain more substantial relief. As the agreements have evolved, they generally function in two different ways: they create an agency relationship between the government and the corporation, under which the corporation assumes certain continuing efforts on behalf of the prosecution, and they structure remediation, under which the corporation agrees to defined undertakings to repair the harm caused and to prevent future violations. Although there is no standard agreement, the agreements generally impose some combination of the following conditions: (1) an internal investigation; (2) a code of conduct and/or an effective compliance program to “prevent or deter violations of the law”; (3) corporate acceptance of responsibility; (4) the provision of specified information to the government with “full candor and completeness”; (5) waivers of attorney-client and work-product protections; (6) dismissals of errant employees; (7) a continuing duty to cooperate; (8) payment of restitution and/or a fine; and (9) probation with the use of continuing monitors, whose duties depend on the extent of the remedial actions to which the corporation has agreed.<sup>125</sup>

The increased use of these agency/remedial agreements in high-profile cases began to draw considerable attention, and the very concept of these agreements, along with certain provisions, such as attorney-client privilege waivers and corporate monitoring, has proved deeply controversial.<sup>126</sup> Despite the increased attention and

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Manual included guidelines for pretrial diversion. See U.S. DEP’T OF JUSTICE, U.S. ATTORNEYS’ MANUAL 9-22.010 (1997) (listing three objectives of pretrial diversion: “prevent future criminal activity among certain offenders by diverting them from traditional processing into community supervision and services”; “save prosecutive and judicial resources for concentration on major cases”; and “provide, where appropriate, a vehicle for restitution to communities and victims of crime”).

125. Within this general framework there is great diversity in the specifics of these agreements. For fuller descriptions, see Finder & McConnell, *supra* note 107, at 17–24; Brandon L. Garrett, *Structural Reform Prosecution*, 93 VA. L. REV. 853, 893–901 (2007); Orland, *supra* note 120, at 71–75; Paulsen, *supra* note 60, at 1439–43.

126. See, e.g., Garrett, *supra* note 125, at 913–19 (discussing criticism for disparities in terms, abusive insistence on “privilege waivers,” unfairness to third parties such as employees, the imposition of obligations unrelated to the organization’s conduct, and “potential abuses [in] implementation”); Lisa Kern Griffin, *Compelled Cooperation and the New Corporate Criminal Procedure*, 82 N.Y.U. L. REV. 311, 324–26 (2007) (criticizing deferred prosecution agreements for imposing excessive and inappropriate managerial control on the involved corporations); Orland, *supra* note 120, at 78–81 (discussing arguments relating to abusive government tactics). *But see* James B. Jacobs & Ronald Goldstock, *Monitors & IPSIGS: Emergence of a New Criminal Justice Role*, 43 CRIM. L. Bull. 217, 230–35 (2007) (favorably evaluating the use of private sector monitors and

criticism, there have been relatively few of these agreements overall. Although commentators' counts vary, it appears that there were (at most) sixty such agreements in the fifteen-year period from 1992 through 2006, the bulk of which, approximately forty, were entered into between 2001 and 2006.<sup>127</sup>

Despite their relative infrequency, these agreements have further shifted the role of corporations in the criminal process from criminal target to prosecutorial agent. Nearly half of the agreements in the fifteen-year period were described as “non-prosecution” agreements,

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Independent Private Sector Inspectors General (“IPSIGs”) to supervise corporate reform of organizations targeted for criminal prosecution).

127. For totals, see *Crime Without Conviction: The Rise of Deferred and Non Prosecution Agreements*, CORP. CRIME REP. (Dec. 28, 2005), <http://www.corporatecrime reporter.com/report122805.htm> (totaling thirty-four cases); Finder & McConnell, *supra* note 107, at 36–52 app. (totaling forty-eight cases); Orland, *supra* note 120, at 71–72, 86–87 tbls.I & II (totaling forty-four cases to June 2006); Paulsen, *supra* note 60, at 1444 (totaling fifty-nine cases). Orland includes some cases that Finder & McConnell do not include and vice-versa; Paulsen includes some additional cases plus settlements that have been publicly reported but where there is no available public agreement. See Paulsen, *supra* note 60, at 1444 n.46. For a more updated list of agreements, see Brandon Garrett, *Federal Organizational Prosecution Agreements*, VA. L. LIBR., [http://lib.law.virginia.edu/Garrett/prosecution\\_agreements/home.suphp](http://lib.law.virginia.edu/Garrett/prosecution_agreements/home.suphp) (last visited Nov. 6, 2010) (listing the companies that have reached prosecution agreements with the government, including copies of those agreements).

Note that these counts include only agreements entered into with the Justice Department and do not include state agreements or similar agreements entered into with other government agencies, such as the “corporate integrity agreements” entered into with the U.S. Department of Health and Human Services (even though these agreements may be accompanied by corporate criminal prosecutions). See Lewis Morris & Gary W. Thompson, *Reflections on the Government’s Stick and Carrot Approach to Fighting Health Care Fraud*, 51 ALA. L. REV. 319, 341–43 (1999) (discussing use of corporate integrity agreements, which stress compliance programs and mandatory outside auditing); *Corporate Integrity Agreements*, U.S. DEP’T OF HEALTH & HUMAN SERVS., <http://oig.hhs.gov/fraud/cias.asp> (last visited Nov. 6, 2010) (describing typical provisions of corporate integrity agreements with link to a list of providers currently subject to such agreements). For examples of simultaneous filings of a criminal guilty plea and a corporate integrity agreement, see Press Release, U.S. Dep’t of Justice, *Eli Lilly and Company Agrees to Pay \$1.415 Billion to Resolve Allegations of Off-Label Promotion of Zyprexa* (Jan. 15, 2009), <http://www.justice.gov/opa/pr/2009/January/09-civ-038.html> (announcing guilty plea and \$515 million fine, the “[l]argest [i]ndividual [c]orporate [c]riminal [f]ine in [h]istory,” plus up to \$800 million in settlement of civil suits with federal and state governments and summarizing corporate integrity agreement); Press Release, U.S. Dep’t of Justice, *Tap Pharmaceutical Products Inc. and Seven Others Charged with Health Care Crimes* (Oct. 3, 2001), <http://www.usdoj.gov/opa/pr/2001/October/513civ.htm> (announcing guilty plea and \$290 million criminal fine, the largest criminal fine ever in a health care fraud prosecution). In the Eli Lilly case, the corporate integrity agreement was accepted in lieu of probation and included a non-prosecution agreement with regard to other conduct relating to Zyprexa. See Gov’t Memorandum For Entry of Plea and Sentencing at 6–7, *United States v. Eli Lilly & Co.*, No. 09-020 (E.D. Pa. Jan. 14, 2009), available at <http://www.usdoj.gov/usao/pae/News/Pr/2009/jan/lillygovtmementrypleasent.pdf>.

meaning that no criminal charging document was even filed against the corporation that entered into the agreement.<sup>128</sup> In the Enron era, there were fewer than twenty-five deferred prosecution agreements (in which a charging document was filed in court).<sup>129</sup> Of all the Enron era agreements, fewer than twenty required the payment of a fine or monetary penalty, although more agreements have required some form of civil penalty and/or restitution payment.<sup>130</sup> So far, there are no reports of any corporation having been found in breach of its agreement, which means that all of the corporations that have entered into these agreements have escaped the criminal process, albeit at some financial and organizational cost.

The experience of these corporations stands in some contrast to the individuals involved in these cases. According to the Justice Department's Corporate Fraud Task Force, in the five years from 2002–2007, it obtained 1,236 convictions of individuals, of whom 214 were chief executive officers and presidents, 53 were chief financial officers, 129 were vice presidents, and 23 were corporate counsel or attorneys.<sup>131</sup> In comparison, by the end of the Enron era, only one organization had been subject to criminal trial, Arthur Andersen LLP, Enron's outside auditor, and that was on a charge of obstructing justice during the government investigation of Enron rather than for any accounting fraud.<sup>132</sup> Enron, a corporation in bankruptcy, cooperated with prosecutors without entering into any formal agreement. It was never criminally charged.

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128. See Orland, *supra* note 120, at 57 (listing twenty of forty-four agreements as non-prosecutions). Commentators point out, however, that the Department has not been consistent in its characterization of the agreements, occasionally referring to agreements in which no charging documents are filed as being deferred prosecution agreements. See *id.* at 56 n.62 (discussing the difference in characterization of the Prudential agreement); Letter Agreement from Edwin J. Gale, Acting U.S. Att'y, Dist. of Conn., Peter A. Clark, Assistant U.S. Att'y, Dist. of Conn., & Thomas J. Murphy, Assistant U.S. Att'y, Dist. of Conn. to Eliot Lauer, Esq. & Shaun S. Sullivan, Esq., (Apr. 15, 1996), <http://www.corporate.crimereporter.com/documents/andersen.pdf>; *infra* notes 310–21 and accompanying text.

129. See Finder & McConnell, *supra* note 107, at 36–52 app. (listing twenty-three cases); Orland, *supra* note 120, at 57 (listing twenty-one cases).

130. Orland lists fourteen cases. See Orland, *supra* note 120, at 86–87 tbls.1 & 2. Finder & McConnell include four later-filed agreements, of which two require a monetary penalty. See Finder & McConnell, *supra* note 107, at 36–52 app.

131. Press Release, U.S. Dep't of Justice, Fact Sheet: President's Corporate Fraud Task Force Marks Five Years of Ensuring Corporate Integrity (July 17, 2007), [http://www.usdoj.gov/opa/pr/2007/July/07\\_odag\\_507.html](http://www.usdoj.gov/opa/pr/2007/July/07_odag_507.html).

132. Cf. *id.* (making no mention of any corporate defendants, not even Arthur Andersen LLP, even though the Justice Department's press release, covering five years of corporate fraud prosecutions, discusses "prosecuting corporate criminals").

C. *Banking the Fires: 2006–2009*

As the wave of corporate accounting scandals receded, some reassessment of the steps taken during the Enron era began to emerge, along with some resistance to those steps. This reassessment and resistance manifested itself in three important developments. The first was the district court's two decisions in *United States v. Stein*, one finding unconstitutional certain aspects of the Thompson Memorandum along with the conduct of the U.S. Attorney's Office in negotiating a deferred prosecution agreement with the accounting firm of KPMG ("*Stein I*"),<sup>133</sup> and the other suppressing certain statements that KPMG employees made to the government after KPMG threatened to withhold advancement of their attorneys' fees and to fire them if they failed to cooperate ("*Stein II*").<sup>134</sup> The second important development was the revision of the Thompson Memorandum to moderate the Justice Department's position regarding waiver of attorney-client and work-product protections. The third was proposed revisions for regulating securities markets and professionals, including modifications of the Sarbanes-Oxley Act and a proposal to change the standard that federal prosecutors use for determining when to prosecute entities criminally.

The *Stein* decisions, handed down in June and July of 2006, grew out of the federal government's investigation of aggressive tax shelter strategies that KPMG had promoted from the late 1990s through 2002.<sup>135</sup> After congressional hearings in 2003 and a Senate subcommittee report criticizing the tax shelter industry and KPMG, a federal grand jury was convened to investigate KPMG's conduct.<sup>136</sup> In May 2005, KPMG was informed that it faced criminal charges.<sup>137</sup> In June 2005, KPMG representatives met with Justice Department officials and admitted that KPMG had sold shelters illegally, after which KPMG made a public admission that former KPMG partners

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133. 435 F. Supp. 2d 330, 382 (S.D.N.Y. 2006), *aff'd*, 541 F.3d 130 (2d Cir. 2008) (dismissing indictments of thirteen of sixteen defendants).

134. 440 F. Supp. 2d 315, 338 (S.D.N.Y. 2006).

135. See Lynnley Browning & Jonathan D. Glater, *How an Accounting Firm Went from Resistance to Resignation*, N.Y. TIMES, Aug. 28, 2005, at 1; Letter From David N. Kelley, U.S. Att'y, S. Dist. of N.Y., to Robert S. Bennett, Esq. (Aug. 26, 2005) [hereinafter KPMG Deferred Prosecution Agreement] (accepting responsibility for conduct from 1996 through 2002).

136. See Browning & Glater, *supra* note 135. See generally *U.S. Tax Shelter Industry: The Role of Accountants, Lawyers, and Financial Professionals: Hearing Before the Subcomm. on Investigations of the S. Comm. on Gov't Affairs*, 108th Cong. (2003).

137. See David Reilly, *How a Chastened KPMG Got by Tax-Shelter Crisis*, WALL ST. J., Feb. 15, 2007, at A16.

had engaged in unlawful conduct.<sup>138</sup> In August, the government unsealed fraud indictments against nine individuals and announced a deferred prosecution agreement with KPMG.<sup>139</sup>

At the press conference announcing the agreement, Attorney General Gonzales emphasized that KPMG had “admitted to criminal wrongdoing” in the largest tax-shelter fraud ever prosecuted and would pay \$456 million in “fines, restitution, and penalties.”<sup>140</sup> Gonzales also explained that the decision to defer prosecution, rather than to require that KPMG go to trial on the criminal information that was part of the agreement, “reflects the reality that the conviction of an organization can affect innocent workers and others associated with the organization, and can even have an impact on the national economy.”<sup>141</sup> Although Gonzales described the collateral consequences rather broadly, the Department was particularly concerned that a criminal conviction of KPMG could have put the firm out of business, the fate that other financial services firms had suffered, particularly Arthur Andersen.<sup>142</sup>

The deferred prosecution agreement acknowledged that KPMG’s cooperation with the criminal investigation had been an “important and material factor” in the Justice Department’s willingness to enter into the agreement.<sup>143</sup> One aspect of that cooperation, although not mentioned directly in the deferred prosecution agreement, was KPMG’s decision to condition advancement of its partners’ and employees’ legal fees on their willingness to assist the government’s investigation.<sup>144</sup> KPMG took this action as part of an effort to demonstrate a cooperative attitude, consistently with the Thompson Memorandum.<sup>145</sup> Indeed,

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138. *See id.*

139. *See* Jonathan Weil, *Nine are Charged in KPMG Case on Tax Shelters*, WALL ST. J., Aug. 30, 2005, at C1.

140. *See* Press Conference, Prepared Remarks, Alberto R. Gonzales, Att’y Gen., U.S. Dep’t of Justice (Aug. 29, 2005), <http://www.justice.gov/archive/ag/speeches/2005/082905agkpgmcorpfraud.htm> [hereinafter Press Conference]. Of the \$456 million, only \$128 million was denominated as a fine, an amount that reflected a disgorgement of the fees that KPMG had received for its illegal activities. *See* KPMG Deferred Prosecution Agreement, *supra* note 135, at 2.

141. Press Conference, *supra* note 140, at 1–2.

142. *See* Weil, *supra* note 139.

143. *See* KPMG Deferred Prosecution Agreement, *supra* note 135, at 9.

144. *See* United States v. Stein (*Stein I*), 435 F. Supp. 2d 330, 349 (S.D.N.Y. 2006) (quoting law firm memorandum).

145. *See* Thompson Memorandum, *supra* note 112, § VI.B (advancing attorneys’ fees “may be considered by the prosecutor in weighing the extent and value of a corporation’s cooperation”).

government prosecutors had placed great stress on the issue in the course of their discussions with KPMG.<sup>146</sup> The second aspect of KPMG's cooperation was its willingness to make its employees available for interviewing by the government. This type of cooperation was not only specifically mentioned in the Thompson Memorandum as relevant to the decision on whether to charge the corporation;<sup>147</sup> it was subsequently required in the deferred prosecution agreement as part of KPMG's continuing duty to cooperate with the government.<sup>148</sup>

In the *Stein* litigation, the defendants filed two sets of motions: one to exclude statements they made to government attorneys, as being coerced by KPMG's threats to cut off their legal fees and fire them, in violation of their Fifth Amendment privilege against self-incrimination; the other to dismiss their indictments because the government's conduct relating to advancement of legal fees violated their Fifth Amendment due process right and Sixth Amendment right to counsel. The district court held that some of the defendants' statements were, in fact, coerced and that the coercive pressure on these defendants "was a product of intentional government action."<sup>149</sup> Accordingly, the district court suppressed the use of these statements.<sup>150</sup> Although the motions to dismiss the indictments were not initially granted (instead, the court sought a way to require KPMG to advance the fees<sup>151</sup>), the district court did find that the Thompson Memorandum, coupled with the conduct of the U.S. Attorney's Office, deprived defendants of their Fifth and Sixth Amendment rights.<sup>152</sup> In so holding, the court emphasized the enormous complexity of the case—"the largest tax case in United States history," at that point being litigated jointly against eighteen

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146. See *Stein I*, 435 F. Supp. 2d at 341–49 (describing focus on KPMG's payments of partners' counsel fees).

147. See Thompson Memorandum, *supra* note 112, § 6A.

148. See KPMG Deferred Prosecution Agreement, *supra* note 135, at 11 ("Using its reasonable best efforts to make available its present and former partners and employees to provide information and/or testimony as requested by the [U.S. Attorney's] Office and the IRS, including sworn testimony before a grand jury or in court proceedings, as well as interviews with law enforcement authorities . . .").

149. See *United States v. Stein (Stein II)*, 440 F. Supp. 2d 315, 337 (S.D.N.Y. 2006).

150. *Id.* at 338.

151. See *Stein I*, 435 F. Supp. 2d at 377–80 (exercising ancillary jurisdiction to allow civil suit against KPMG for state law claim for advancement of counsel fees).

152. See *id.* at 382.

defendants—and pointed out that a “minimal defense” for a defendant would likely be \$500,000 to \$1 million.<sup>153</sup> The court wrote:

Justice is not done when the government uses the threat of indictment—a matter of life and death to many companies and therefore a matter that threatens the jobs and security of blameless employees—to coerce companies into depriving their . . . employees of the means of defending themselves against criminal charges in a court of law . . . . [T]he determination of guilt or innocence must be made fairly—not in a proceeding in which the government has obtained an unfair advantage long before the trial even has begun.<sup>154</sup>

The district court’s highly critical opinions in *Stein* came in the midst of substantial criticism of the Thompson Memorandum on another ground: its discussion of a corporation’s willingness to waive the attorney-client and work-product protections. As with the non-advancement of counsel fees and making employees available for questioning, the Thompson Memorandum considered such waiver an indicium of cooperation with the government’s investigation.<sup>155</sup> Indeed, many lawyers believed that government prosecutors in the Enron era had come routinely to demand such waivers, leading to a “culture of waiver” among prosecutors.<sup>156</sup> As with non-advancement of employee legal fees, privilege waiver involved a concern about the adequacy of legal representation, but, here, for corporations rather than individuals.

In December of 2006, with legislation on these issues pending in Congress,<sup>157</sup> the deputy attorney general of the Justice Department,

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153. See *id.* at 362 n.163. For the district court’s further elaboration on the case’s complexity, see *United States v. Stein*, No. S1-05CR-0888, 2007 U.S. Dist. LEXIS 1825, at \*11–12 (S.D.N.Y. Jan. 8, 2007) (responding to court of appeals’ invitation to comment on issues raised by defendants’ mandamus petition).

154. *Stein I*, 435 F. Supp. 2d at 381–82.

155. See Thompson Memorandum, *supra* note 112, § VI.A.

156. See, e.g., ASS’N OF CORPORATE COUNSEL, *THE DECLINE OF THE ATTORNEY-CLIENT PRIVILEGE IN THE CORPORATE CONTEXT* 3–4 (2006) (discussing survey results relating to whether there is a “government culture of waiver”: “Almost 75% of both inside and outside counsel who responded to this question expressed agreement [almost 40% agreeing strongly] with a statement that a ‘culture of waiver’ has evolved in which governmental agencies believe it is reasonable and appropriate for them to expect a company under investigation to broadly waive attorney-client privilege or work-product protections”).

157. See Attorney-Client Privilege Protection Act of 2006, S. 30, 109th Cong. § 3 (2006) (applying to attorney-client privilege and work-product protection waivers, and to advancement of counsel fees). The bill did not pass, but Senator Specter, responsible for introducing the bill, continued to introduce similar legislation. See Attorney-Client

Paul McNulty, announced a revision of the Thompson Memorandum, replacing it with the “McNulty Memorandum.”<sup>158</sup> The primary changes in the Memorandum were in the provisions dealing with waivers and advancement of attorneys’ fees. For the former, the new guidelines established a more formal procedure for assessing the need for waivers and described the types of privileged information that can be sought;<sup>159</sup> for the latter, the new guidelines elaborated on the brief discussion of advancement of fees in the Thompson Memorandum, now stating that “[p]rosecutors generally should not take into account whether a corporation is advancing attorneys’ fees to employees or agents under investigation and indictment.”<sup>160</sup>

The day after McNulty announced the changes in the Thompson Memorandum, the SEC announced several changes in guidance it provides for compliance with the requirements of section 404 of the Sarbanes-Oxley Act,<sup>161</sup> the most criticized section of the Act.<sup>162</sup> Section 404 gives the Commission authority to prescribe rules for management reporting of its internal control structure and procedures for financial reporting.<sup>163</sup> The new guidance the Commission proposed was intended to ease the burdens of that reporting, particularly for smaller public companies.<sup>164</sup> Like the McNulty Memorandum, the SEC’s actions reflected an effort to respond to calls for congressional cut-back of government

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Privilege Protection Act of 2009, S. 445, 111th Cong. § 3 (2009); *see also* 154 CONG. REC. 2331–32 (2009) (remarks of Senator Arlen Specter).

158. *See* Memorandum from Paul J. McNulty, Deputy Att’y Gen., U.S. Dep’t of Justice, to Heads of Dep’t Components, U.S. Att’y’s, [http://www.usdoj.gov/dag/speeches/2006/mcnulty\\_memo.pdf](http://www.usdoj.gov/dag/speeches/2006/mcnulty_memo.pdf) [hereinafter McNulty Memorandum].

159. *See id.* § VII.B.2.

160. *Id.* § VII.B.3.

161. 15 U.S.C. § 7262 (2006).

162. *See* INTERIM REPORT OF THE COMMITTEE ON CAPITAL MARKETS REGULATION 115 (2006), *available at* [http://www.capmktreg.org/pdfs/11.30Committee\\_Interim\\_Report\\_REV2.pdf](http://www.capmktreg.org/pdfs/11.30Committee_Interim_Report_REV2.pdf) (“The main policy debate over SOX, however, is focused on the implementation of a single provision, Section 404 . . . .”); Stephen Labaton, *S.E.C. Eases Regulation on Business*, N.Y. TIMES, Dec. 14, 2006, at C1.

163. *See* 15 U.S.C. § 7262(a).

164. *See* Press Release, U.S. Sec. & Exch. Comm’n, SEC Votes to Propose Interpretive Guidance for Management to Improve Sarbanes-Oxley 404 Implementation (Dec. 13, 2006), <http://www.sec.gov/news/press/2007/2007-101.htm> (“While the guidance is intended to help public companies of all sizes, smaller companies . . . should benefit from its scalability and flexibility.”). For the full text of the proposed guidance release, *see* MANAGEMENT’S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND CERTIFICATION OF DISCLOSURE IN EXCHANGE ACT PERIODIC REPORTS OF COMPANIES THAT ARE NOT ACCELERATED FILERS 17 (2006), *available at* <http://www.sec.gov/rules/final/33-8618.pdf>.

enforcement. Like the McNulty Memorandum, the SEC still did not go as far as it could have.<sup>165</sup>

The post-Enron era reassessment is perhaps best encapsulated in a report by the Committee on Capital Markets Regulation (“Committee”), a private group made up of experts from finance, business, academia, and law. Issued on November 30, 2006, shortly before the McNulty Memorandum and the SEC’s Rule 404 guidance, the Committee’s report suggested a wide range of regulatory and enforcement changes “to prevent a further erosion of the competitive position of U.S. capital markets.”<sup>166</sup> Among its recommendations was a change in Justice Department prosecutorial policy “to *prohibit* federal prosecutors from seeking waivers of the attorney-client privilege or the denial of attorneys’ fees to employees, officers, or directors.”<sup>167</sup>

The Committee’s report also considered the wisdom of corporate criminal liability. The Committee asserted that, “[e]xcept in truly exceptional cases, there is no independent benefit to be gained from indicting what is in fact an artificial entity” and emphasized the cost of a corporate criminal prosecution to “innocent employees and shareholders” and, sometimes, “the entire economy”—an echo of the concerns expressed by Attorney General Gonzales in announcing the deferred prosecution agreement with KPMG.<sup>168</sup> The Committee accordingly recommended a change in the Justice Department’s prosecutorial policies so that “firms are only prosecuted in exceptional circumstances of pervasive culpability throughout all offices and ranks.”<sup>169</sup>

There is no indication that the Committee’s recommendation to limit corporate criminal liability, a sweeping recommendation not restricted to securities or accounting fraud prosecutions, is about to be adopted as a formal matter. Nevertheless, the recommendation may very well have reflected Justice Department policy at that time, at least regarding fraud prosecutions, where actual corporate prosecutions have been quite rare.

The McNulty Memorandum, however, did not turn out to mark the Justice Department’s final retreat from its Enron era

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165. See Labaton, *supra* note 162.

166. INTERIM REPORT OF THE COMMITTEE ON CAPITAL MARKETS REGULATION, *supra* note 162, at xii.

167. *Id.* at 86. The Committee recommended no changes in section 404 of Sarbanes-Oxley, but did recommend changes in SEC guidance. See *id.* at 131–34.

168. See *id.* at 85.

169. *Id.* at 84.

prosecutorial stance. Critics of the new guidelines, including the American Bar Association, believed that the changes fell “far short of what [wa]s needed to prevent further erosion” of the privilege because they still left open the possibility that the Department would insist on waiver as an indicium of cooperation and because the guidelines failed to protect employees from corporate discipline during an investigation.<sup>170</sup> On August 28, 2008, the Justice Department finally responded to this continuing criticism with new Corporate Charging Guidelines, now incorporated in the United States Attorneys’ Manual.<sup>171</sup> The new guidelines went considerably further toward removing privilege waiver as an important aspect in deciding whether to prosecute and made more categorical the prohibition on taking account of whether a corporation was advancing or reimbursing attorneys’ fees to its employees.<sup>172</sup> Perhaps more importantly, the Corporate Charging Guidelines try to position non-prosecution and deferred prosecution agreements as related to the problem of the “significant” collateral consequences that criminal prosecution can cause.<sup>173</sup> Such agreements are now formally viewed as a “third option” between indictment and declination that can promote compliance and prevent recidivism.<sup>174</sup> It is, of course, true that these agreements can advance these two goals, but the agreements are also a way to secure assistance with the prosecution. Moreover, they do not necessarily eliminate the potential for collateral effects, particularly for deferred prosecution agreements,

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170. See Karen J. Mathis, President, Am. Bar Ass’n, Statement Regarding Revisions to the Justice Department’s Thompson Memorandum (Dec. 12, 2006), <http://www.abanet.org/abanet/media/statement/statement.cfm?releaseid=59>.

171. See U.S. ATTORNEYS’ MANUAL § 9-28.000 (2008), [http://www.usdoj.gov/usao/eousa/foia\\_reading\\_room/usam/title9/28mcrm.htm](http://www.usdoj.gov/usao/eousa/foia_reading_room/usam/title9/28mcrm.htm) [hereinafter Corporate Charging Guidelines]. For explanation of the Department’s goals in issuing these guidelines, see Press Release, Mark R. Filip, Deputy Att’y Gen., Remarks Prepared for Delivery at Press Conference Announcing Revisions to Corporate Charging Guidelines (Aug. 28, 2008), <http://www.justice.gov/archive/dag/speeches/2008/dag-speech-0808286.html> [hereinafter Filip Press Release].

172. Compare Corporate Charging Guidelines, *supra* note 171, § 9–28.730 (“In evaluating cooperation, however, prosecutors should not take into account whether corporation is advancing or reimbursing attorneys’ fees . . .”), with McNulty Memorandum, *supra* note 158, § VII.B.3 (“Prosecutors generally should not take into account whether a corporation is advancing attorneys’ fees to employees . . .”). Curiously, although Deputy Attorney General Mark Filip indicated that the McNulty Memorandum had “allowed prosecutors to consider whether a corporation disciplined or terminated employees for the purpose of evaluating cooperation,” and that this was “now disallowed,” there does not appear to be any change in the language of the Corporate Charging Guidelines to reflect this change. See Filip Press Release, *supra* note 171.

173. See Corporate Charging Guidelines, *supra* note 171, § 9-28.1000.

174. See *id.*

which include some charging document that can be pursued in the event that the corporation breaches its agreement.

Coincidentally, on the same day that the Justice Department issued its new guidelines, the United States Court of Appeals for the Second Circuit decided the government's appeal in *Stein*, in which it affirmed the district court's decision that the Justice Department's conduct in pressuring KPMG to deny advancement of counsel fees to non-cooperating employees had violated the defendants' Sixth Amendment right to counsel.<sup>175</sup> The court rejected the government's argument that KPMG's action was private action, not state action, and held that the defendants' Sixth Amendment rights to counsel were violated when some of them could not retain counsel of their choosing and others had to restrict the efforts of the lawyers they retained.<sup>176</sup> The court was quite clear in its condemnation of the Department: "[I]f it is in the government's interest that every defendant receive the best possible representation, it cannot also be in the government's interest to leave defendants naked to their enemies."<sup>177</sup>

Just at the moment that the Justice Department, rebuked by the Second Circuit and with Congress still threatening legislative restrictions, was retreating from the prosecutorial zeal of the Enron era, events were set in motion that signaled the end of "banking the fires" and the likely beginning of the next era in financial fraud prosecutions. These events began with the subprime mortgage crisis in 2007, which led to a broad melt-down of financial institutions worldwide. With this melt-down came renewed attention to criminal prosecution. This time, however, the attorney general did not organize a prosecutorial task force similar to the Corporate Fraud Task of 2002, likely reflecting White House and Treasury Department criticism that earlier prosecutions demonstrated an "antibusiness attitude that could chill corporate risk taking."<sup>178</sup>

Nevertheless, the attorney general's decision did not mean that the Justice Department turned a blind eye to current problems.

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175. See *United States v. Stein*, 541 F.3d 130, 136 (2d Cir. 2008). The court did not reach the district court's decision that the government had also violated the defendants' Fifth Amendment due process rights. See *id.* at 136.

176. See *id.* at 147–48, 157.

177. *Id.* at 157.

178. See Eric Lichtblau et al., *F.B.I. Struggling to Handle Wave of Finance Cases*, N.Y. TIMES, Oct. 19, 2008, at 1 (reporting Attorney General Mukasey's rejection of "repeated calls" for forming such a task force and reporting that former law enforcement officials had said in interviews that "senior administration officials" in the White House and Treasury had conveyed their concerns to them about the cases they were bringing).

Instead, the prosecutorial effort was pushed out to other parts of the Justice Department, particularly U.S. attorneys offices in Manhattan, Brooklyn, and New Jersey, which, along with the New York state attorney general, began a relatively coordinated effort to investigate the collapses of Bear Stearns, Lehman Brothers, AIG, and Fannie Mae and Freddie Mac.<sup>179</sup> Whether those investigations would ripen into actual prosecutions (and of what sort), however, was left to the next administration at the Department of Justice.<sup>180</sup>

#### D. Conclusion

The development of the branch-office role has shown a continual honing of the prosecutors' tools in business crime cases. When prosecutors have been criticized for the way in which they have used these tools, particularly with regard to deferred and non-prosecution agreements, they have chosen to modify their practices, but not to abandon them. Political changes in the administration of the Justice Department can affect prosecutorial policies, of course, but the early returns from the Obama administration indicate a continuing exploitation of the branch-office role<sup>181</sup> and a continuing acceptance of the fundamental policy view expressed in the Bush administration's Corporate Charging Guidelines, guidelines which remain in effect:

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179. See Benjamin Weiser & Ben White, *In Crisis, Prosecutors Put Aside Turf Wars*, N.Y. TIMES, Oct. 31, 2008, at B1 (reporting agreement between U.S. attorney for the Southern District and New York Attorney General Cuomo to engage in joint investigation and stating that the Lehman investigation was split up "because there were too many avenues of inquiry for any one office to handle").

180. See Amir Efrati & Susan Pulliam, *Prosecutors are Poised to Impanel AIG Grand Jury*, WALL ST. J., Sept. 11, 2009, at C1 (describing efforts in major cases).

181. See, e.g., Deferred Prosecution Agreement at 1–3, *United States v. Barclays Bank*, No. 10-CR-00218 (D.D.C. Aug. 16, 2010), available at [http://lib.law.virginia.edu/Garrett/prosecution\\_agreements/pdf/barclays.pdf](http://lib.law.virginia.edu/Garrett/prosecution_agreements/pdf/barclays.pdf) (agreement to split a "Forfeiture Amount" of \$298 million 50-50 with the Manhattan D.A.'s Office) (violations of the Trading With The Enemy Act and the International Emergency Economic Powers Act); Deferred Prosecution Agreement at 6–7, *United States v. Daimler AG*, No. 10-CR-00063 (D.D.C. Mar. 24, 2010), available at <http://www.justice.gov/criminal/fraud/fcpa/cases/docs/daimlerag-def-agree.pdf> (agreement to pay \$93.6 million fine; fine amount reduced because of Daimler's cooperation, "including sharing information with the Department regarding evidence obtained as a result of Daimler's extensive investigation of corrupt payments made by Daimler in various countries around the world"); Deferred Prosecution Agreement at 3, *United States v. UBS AG*, No. 09-CR-60033 (S.D. Fla. Feb. 18, 2009), available at <http://wsj.com/public/resources/documents/UBSDeferredProsecutionAgreement20090219.pdf> (agreement to pay \$380,000 in disgorgement of profits and \$400,000 in federal backup withholding tax and interest and penalties; prosecution foregoes additional penalties because of the financial crisis).

The prosecution of corporate crime is a high priority for the Department of Justice . . . . In this regard, federal prosecutors and corporate leaders typically share common goals. For example, directors and officers owe a fiduciary duty to a corporation's shareholders, the corporation's true owners, and they owe duties of honest dealing to the investing public in connection with the corporation's regulatory filings and public statements. The faithful execution of these duties by corporate leadership serves the same values in promoting public trust and confidence that our criminal cases are designed to serve.<sup>182</sup>

## II. IMPLICATIONS FOR CRIMINAL JUSTICE POLICY

The continuing evolution of the public corporation's role in the criminal justice process, more as partner than as defendant, raises four important questions for criminal justice policy: (1) Will this institutional shift be short-lived or long-lasting? (2) What legal rules might be affected by the branch-office role? (3) Will the new branch-office role affect the willingness of prosecutors to bring criminal cases against corporations? (4) How might this new role affect deterrence in business crime cases?

This Part proceeds as follows. Part II.A argues that the institutional shift to the branch-office role will be long-lasting because the amnesty, non-prosecution, and deferred prosecution agreements (collectively referred to as "agency agreements") have important efficiency properties, effectively exploiting the misalignment of interests between the corporation and its employees. Part II.B deals with three important legal issues: judicial review of agency agreements, the application of the attorney-client privilege to corporate investigations, and the imposition of constitutional constraints on corporations involved in internal investigations. This subpart argues that judicial review should be confined to issues of breach and not examine the agreement's terms; that courts have already come close to aligning the attorney-client privilege with the branch-office role; and that any further effort to impose constitutional restrictions on corporate conduct could have a deleterious impact on business crime prosecutions. Part II.C discusses why the new branch-office role might lessen prosecutorial willingness to invoke the criminal law against corporations, arguing that it would be wrong to reason from current experience that it is safe to cut back on such prosecutions. Part II.D argues that over-reliance on the branch-office

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182. Corporate Charging Guidelines, *supra* note 171, § 9-28.100.

role, coupled with a reluctance to bring criminal charges against corporations, has the potential to undercut the deterrent function of the criminal law in business crime cases. This is the most serious adverse potential effect that the new branch-office role holds for criminal justice policy.

A. *The Economics of the Branch-Office Role*

The evolution of the public corporation's role may not have been inevitable, but its new role now reflects certain institutional realities that are unlikely to change in the near future. These realities relate to the efficiency properties of agency agreements and the incentives they reflect.

The history of entity criminal liability, from Senator Sherman's remarks in debate on the antitrust laws<sup>183</sup> to KPMG's recent actions,<sup>184</sup> demonstrate the potential misalignment of the interests of organizations and their members. Business organizations (or, more precisely, those who control them) may be perfectly willing to sacrifice the interests of particular employees if this sacrifice will avoid damage to the profitability of the enterprise.

A key insight of economics is that actors, whether individuals or organizations, will respond to incentives. To the extent that there are incentives to cooperate with government investigators in business crime cases, those making decisions for the organization will cooperate, even if it means that some constituents (employees or, perhaps, current shareholders) suffer.

The modern development of tools for rewarding corporate cooperation has increased the incentives for cooperation. Prosecutors have often made these incentives explicit, particularly when it comes to privilege waivers and non-support of investigational targets, but in the future, prosecutors can be less explicit and still gain corporate cooperation. Once corporate decision-makers are aware of the incentives calculus, cooperation will be forthcoming and explicit demands will actually be less necessary. Lawyers know this. As one practitioner put it, after noting the "tremendous pressure" that corporations feel to share the results of investigations with law enforcement personnel: "There may be a day when defense lawyers do defense work again,' . . . but 'we live in a world where the

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183. See *supra* note 2 and accompanying text.

184. See *supra* notes 133–39 and accompanying text.

expectation is, if you are conducting that investigation, you are doing it to help the Department of Justice.’ ”<sup>185</sup>

Developments outside of prosecutors’ control have also increased the conflicting incentives faced by the organization, its employees, and its management. As corporate boards, corporate employees, outside directors, and independent auditors face an increasing chance of incurring civil or criminal liability for participation in potentially unlawful corporate conduct, the ability of the corporation to maintain an adversarial stance with the government has decreased while the incentives to cooperate have increased.<sup>186</sup>

An example of the dynamic caused by conflicting interests and incentives to cooperate can be seen in the case of Stolt-Nielsen, a European conglomerate, allegedly involved in fixing the prices of ocean shipments of liquid chemicals.<sup>187</sup> In January 2002, a Stolt executive apparently announced to the Stolt transportation group’s management board that Stolt and a competitor had agreed to divide certain markets.<sup>188</sup> Shortly thereafter, the general counsel of the transportation group asked the chairman of the group to suspend the executive and conduct an internal investigation.<sup>189</sup> The chairman refused and the general counsel resigned.<sup>190</sup> There is some dispute about whether Stolt then terminated its participation in the

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185. *Compliance Pros Get Tips on Keeping Firms Out of Court*, 91 *Antitrust & Trade Reg. Rep. (BNA)* No. 2261, at 14, 16 (July 7, 2006) (quoting a lawyer from Covington & Burling).

186. See Peter Lattman, *Settlement in Just for Feet Case May Fan Board Fears: Directors’ Payment of \$441.5 Million Shows the Risk of Liability*, *WALL ST. J.*, Apr. 23, 2007, at B6 (reporting agreement of outside directors of Just for Feet to pay \$41.5 million settlement in securities fraud litigation, a larger settlement than outside directors of WorldCom or Enron had paid); Jonathan Weil, *WorldCom’s Ex-Directors Pony Up: Agreement in Principle to Pay Out Personal Funds Creates Liability Precedent*, *WALL ST. J.*, Jan. 6, 2005, at A3 (agreement by ten WorldCom outside directors to pay \$18 million above amount covered by directors’ liability insurance). *But cf.* Bernard Black, Brian Cheffins, & Michael Klausner, *Outside Director Liability*, 58 *STAN. L. REV.* 1055, 1063–64 (2006) (finding only thirteen cases between 1980 through 2005 in which directors made out-of-pocket payments in private securities actions and assessing the risk of such liability as very low).

187. See James Bandler, *Ship Mates: How Seagoing Chemical Haulers May Have Tried to Divide Market*, *WALL ST. J.*, Feb. 20, 2003, at A1.

188. See *id.*

189. See *id.*

190. See *id.*

conspiracy, but there is no dispute that Stolt did not inform the Justice Department at the time about the illegal behavior.<sup>191</sup>

In June 2002, however, the former general counsel filed suit in Connecticut state court against Stolt for money damages, claiming that he was forced to leave Stolt because he could not “ethically and legally” remain in Stolt’s management when it was engaged in illegal behavior.<sup>192</sup> Stolt resisted the suit, but five months later the *Wall Street Journal* published an article relating the details of Stolt’s former general counsel’s suit.<sup>193</sup> With the publication of the article, Stolt’s calculus of what was in its corporate interests changed. Its rational choice now was to join with the government, not fight it. Stolt hired outside antitrust counsel and briefed him on the day the *Wall Street Journal* article appeared.<sup>194</sup> He immediately contacted the Justice Department and applied for amnesty for Stolt, thereby committing the company to its branch-office role of assisting the government in investigating the illegal conduct.<sup>195</sup>

Making corporations into agents of the prosecutor also offers substantial efficiency benefits to prosecutors. Obviously, prosecutorial resources are scarce, so enlisting corporations and their lawyers extends those resources with no direct financial cost to taxpayers, enabling investigations to be done more cheaply and more quickly. This was the lesson that the SEC learned early on in its investigation of corporate questionable payments.

The efficiencies go beyond the simple question of finite resources, however. Prosecutors’ offices face an issue of institutional competence that is familiar to the business world. Just as corporations often face the question of “build or buy,” that is, the question of whether it is more efficient to bring into the firm the necessary resources for accomplishing a particular task or to buy the resources through an external contract, so, too, do prosecutors’ offices.

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191. See Government’s Memorandum of Law in Opposition to Defendants’ Motions to Dismiss the Indictment at 5–12, *United States v. Stolt-Nielsen S.A.*, 524 F. Supp. 2d 586 (E.D. Pa. 2007) (No. 06-CR-466) [hereinafter Memorandum in Opposition], available at <http://www.usdoj.gov/atr/cases/f220800/220771.pdf>. (setting out Justice Department’s view of Stolt’s conduct after its general counsel’s resignation).

192. See *O’Brien v. Stolt-Nielsen Transp. Grp. Ltd.*, 838 A.2d 1086, 1079 (Conn. Super. Ct. 2003) (describing litigation).

193. See James Bandler & John McKinnon, *Stolt-Nielsen Unit is Probed for Traffic with Iran*, WALL ST. J., Nov. 22, 2002, at A3. Although the *Journal* reported the date of the complaint as November 1, this was apparently the date of the amended complaint; the original complaint was filed on June 18, 2002. See Memorandum in Opposition, *supra* note 191, at 8.

194. See Memorandum in Opposition, *supra* note 191, at 11.

195. See *id.* at 12–13.

Although prosecutors might be able to acquire internal expertise about particular industries or practices, the challenge of understanding complex industries and their practices is particularly acute in business crime cases where much of the information about the crime is embedded in the business entity itself.<sup>196</sup> For these cases to be prosecuted successfully, prosecutors need to “contract out” by forming some type of public-private partnering with the business entities themselves. This is why prosecutors have been willing to make use of the private sector in many areas of business crime enforcement, not just in accounting fraud cases.<sup>197</sup>

Although it might be efficient for prosecutors to partner with private firms in investigating business crime, such partnerships involve the familiar problem of agency cost.<sup>198</sup> Particularly where an agent is outside the firm, the risk that an agent will act in its own interest requires the principal to undertake potentially costly monitoring of the agent’s behavior to ensure consistency with the principal’s desires. Today’s amnesty, non-prosecution, and deferred prosecution agreements can be seen as a way to deal with this agency problem. These agreements are tools to ensure that the agent’s conduct is aligned with the principal’s interests by memorializing the various obligations of the corporation-agent and the prosecutor-principal and providing enforcement mechanisms for the agent’s breach. These contractual obligations are then strengthened through social norms of cooperation (hence the introduction to the McNulty

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196. See Yane Svetiev, *Antitrust Governance: The New Wave of Antitrust*, 38 LOY. U. CHI. L.J. 593, 632–33 (2007) (discussing benefits to the firm of accessing external sources of knowledge).

197. See, e.g., Statement from John Brownlee, U.S. Att’y, W.D. Va., On the Guilty Plea of ITT Corporation 7 (Mar. 27, 2007), [http://www.justice.gov/nsd/pdf/itt\\_statement\\_by\\_usattorney.pdf](http://www.justice.gov/nsd/pdf/itt_statement_by_usattorney.pdf) (noting that the government was able to develop only a “limited criminal case” against ITT until a change in corporate management led ITT to cooperate with the government and produce evidence that led to guilty pleas and a deferred prosecution agreement requiring extensive monitoring and reporting to government agencies). For the information and plea agreement, see *United States v. ITT Corp.* (W.D. Va. Mar. 26, 2007), available at [http://www.justice.gov/nsd/pdf/it\\_information\\_plea\\_agreement.pdf](http://www.justice.gov/nsd/pdf/it_information_plea_agreement.pdf). For an earlier example of the private industry training government investigators and assisting in identifying criminal conduct, see Harry First, *Protecting Soft Property Through the Criminal Law: The Emerging View from the United States*, 2 NIHON U. COMP. L. 1, 2–3 (1985) (describing IBM’s assistance to the FBI in “Operation Pengem” to prevent the illegal sale of technological information).

198. “Agency costs” are the costs incurred in dealing with the divergence of interest between a principal and its agent. See Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure*, 3 J. FIN. ECON. 305, 308 (1976). These costs include the principal’s monitoring expenditures, the agent’s bonding expenditures, and any “residual” loss arising from the remaining divergence between the agent’s decisions and the principal’s welfare. See *id.*

Memorandum, reminding corporate leaders of their duties<sup>199</sup>) and trust (hence the importance of the reputation of legal intermediaries who carry out the internal investigations or make cooperation proffers to prosecutors<sup>200</sup>).

Adding to the usual problem of agency risk is the possibility that these agreements may be prone to breakdowns or failures because some of the agents making these agreements were lawbreakers in the first place, who cooperate only because they were caught or were about to be caught. This concern for ensuring against bad faith behavior from lawbreakers may explain the much-criticized provisions in the deferred prosecution agreements that give the Department the unilateral right to revoke the agreement in the event of a breach.<sup>201</sup> Indeed, declared breaches appear to have been rare so far, perhaps indicating that the unilateral revocation clause has deterred corporations from renegeing on their agreements.<sup>202</sup>

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199. See *supra* note 1 and accompanying text.

200. See Bandler & Scannell, *supra* note 20 and accompanying text (describing SEC's efforts to track the thoroughness of law firms in doing internal investigations); Klawiter, *supra* note 75, at 17 (describing the role of lawyers in seeking leniency on behalf of a client and concluding that "[u]ltimately, it is a question of commitment, trust and good faith that both parties have a solemn obligation to uphold").

201. See, e.g., KPMG Deferred Prosecution Agreement, *supra* note 135, at 14 ("It is further understood that should the Office in its sole discretion determine that KPMG has, after the date of the execution of this Agreement: (a) given false, incomplete or misleading information, (b) committed any crime other than a minor state violation, or (c) otherwise violated any provision of this Agreement, KPMG shall, in this Office's sole discretion, thereafter be subject to prosecution for any federal criminal violation of which the Office has knowledge, including but not limited to a prosecution based on the Information and the conduct described therein."). *But see* Greenblum, *supra* note 124, at 1892–93 (arguing for judicial involvement in the event of a breach); Paulsen, *supra* note 60, at 164–65.

202. A rare example of a revocation is the Antitrust Division's decision to revoke Stolt-Nielsen's amnesty agreement. The agreement was conditioned on continuing cooperation with the Division, but the Division uncovered evidence that it believed demonstrated that Stolt had not stopped its illegal price fixing conduct when its general counsel brought the conduct to the attention of upper management, even though it had told prosecutors otherwise. See Memorandum in Opposition, *supra* note 191, at 12–13. Stolt vigorously resisted the revocation. See *Stolt-Nielsen, S.A. v. United States*, 442 F.3d 177, 186 (3d Cir. 2006) (reversing district court decision enjoining the Division from indicting Stolt and a Stolt executive; putative defendant's ability to challenge a government decision to pursue a prosecution is "narrow[]"; proper place to raise the issue is on a motion to dismiss an indictment, should one be returned). The Division subsequently indicted Stolt and the executive, but the district court dismissed the indictment. See *United States v. Stolt-Nielsen S.A.*, 524 F. Supp. 2d 586, 609 (E.D. Pa. 2007) ("The Division has no reasonable basis upon which to void or revoke the Agreement because it has not demonstrated any breach by Stolt-Nielsen or the individual defendants."). The Division chose not to appeal. See Press Release, Dep't of Justice, Justice Department Will Not Appeal *Stolt-Nielsen* Decision (Dec. 21, 2007), [http://www.justice.gov/atr/public/press\\_releases/2007/228788.pdf](http://www.justice.gov/atr/public/press_releases/2007/228788.pdf).

*B. Effect of the Branch-Office Role on Legal Rules*

Putting prosecutorial agreements into a principal/agent framework may help describe the problems that these agreements are trying to address, but this contractual framework is not a perfect institutional fit for analyzing these agreements or assessing the effect of the branch-office role on the institutions of criminal law enforcement. After all, law enforcement agencies have some specific institutional goals that corporations do not have: prosecutors are supposed to seek justice and to operate in the public interest; private corporations have no such obligation.<sup>203</sup> Prosecutors also have a different constraint imposed on them than corporations have: prosecutors are bound by constitutional limitations; private corporations are not. The branch-office role, however, shifts private corporations closer to the public agency. Does that mean that the legal rules affecting this partnership should be altered to take greater account of the public duties and constraints that we normally place only on government agencies?

There are three areas in which this institutional shift might affect legal rules. One is the scrutiny with which courts review prosecutorial agency agreements. The other two involve the legal rules that courts apply to private corporations engaged in investigations in their branch-office roles, specifically, the attorney-client privilege and the scope of constitutional protections.<sup>204</sup>

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203. See *Young v. United States*, 481 U.S. 787, 814 (1987) (“Between the private life of the citizen and the public glare of criminal accusation stands the prosecutor . . . For this reason, we must have assurance that those who would wield this power will be guided solely by their sense of public responsibility for the attainment of justice.”) (holding that a court cannot appoint an interested party to prosecute a contempt of the court’s order); *Berger v. United States*, 295 U.S. 78, 88 (1935) (“The United States Attorney is the representative not of an ordinary party to a controversy, but of a sovereignty whose obligation to govern impartially is as compelling as its obligation to govern at all; and whose interest, therefore, in a criminal prosecution is not that it shall win a case, but that justice shall be done.”) (granting new trial where prosecutor’s misconduct during the trial was “pronounced and persistent”); Rachel E. Barkow, *Separation of Powers and the Criminal Law*, 58 *STAN. L. REV.* 989, 1044 (2006) (discussing the need for constitutional separation of powers analysis to check the prosecutorial administration of the criminal law).

204. Obstruction of justice is another important area affected by the branch-office role. Although federal obstruction statutes apply to government investigations, some courts have been willing to apply these statutes to misstatements made to private counsel in the course of an internal investigation or audit when the results would likely be shared with governmental investigators. See, e.g., *United States v. Singleton*, No. H-06-080, 2006 U.S. Dist. LEXIS 47961, at \*17–21 (S.D. Tex. July 14, 2006) (denying motion to dismiss indictment charging obstruction of justice for impeding a governmental investigation by providing false information to corporate employer’s outside lawyers which the lawyers

### 1. Judicial Review of Agency Agreements

It is arguable that when courts review prosecutorial agency agreements they should recognize the public nature of these agreements by providing greater supervision of their terms than they provide for the terms of purely private agreements. This increased scrutiny would not only acknowledge the prosecutor's public interest obligation, but it would also take account of the fact that a prosecutor wields the coercive power of the state, power which may lead the prosecutor to over-reach in situations where defendants can resist prosecutorial demands only at great peril.

Concern for the misuse of the state's coercive power was the underlying message of the district court in *Stein*, when it pointed out that KPMG faced enormous risks to its continued existence if it decided to go to trial, leading KPMG to accede to prosecutors' demands that it cut off attorneys fees to its partners and employees despite its past history of advancing such fees.<sup>205</sup> Indeed, much of the criticism of the current use of agency agreements is bottomed on the perception that corporate defendants are at such an enormous bargaining disadvantage that prosecutors are able to obtain excessively stringent terms that may have adverse public effects.<sup>206</sup>

Despite the arguments for greater judicial oversight of these agreements, it is not clear that such oversight is either likely or

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reported to government investigating agencies); *United States v. Abrams*, 543 F. Supp. 1184, 1188 (S.D.N.Y. 1982) (denying motion to dismiss indictment charging obstruction of justice arising out of internal corporate investigation where defendants allegedly lied to outside lawyers and defendants could reasonably have believed that the information would be communicated to government criminal investigators); see also Julie Rose O'Sullivan, *The Challenge of Cooperation: The DOJ Risks Killing the Golden Goose Through Computer Associates/Singleton Theories of Obstruction*, 44 AM. CRIM. L. REV. 1447, 1450 (2007) (discussing *Singleton*, *supra*, and an indictment against three executives of Computer Associates for lying to outside counsel investigating corporate practices in cooperation with a government investigation and criticizing Justice Department policy to bring indictments in such situations). *But cf.* *United States v. Kirkland*, 985 F.2d 535, 537–38 (11th Cir. 1993) (reversing sentencing guidelines enhancement for obstruction of “official investigation” arising from defendant bank employee's lie to bank auditors with regard to embezzled funds, where no law enforcement officer or governmental entity was involved).

205. See *Stein I*, 435 F. Supp. 2d 330, 381–82 n.243 (S.D.N.Y. 2006) (pointing out that an indictment can be “a matter of life and death to many companies” and referring specifically to the experience of Arthur Andersen LLP).

206. See *supra* note 126. For a defense of one agreement that has been criticized as overly-intrusive (the agreement with Bristol-Myers Squibb), see generally Christopher J. Christie & Robert M. Hanna, *A Push Down the Road of Good Corporate Citizenship: The Deferred Prosecution Agreement Between the U.S. Attorney for the District of New Jersey and Bristol-Myers Squibb Co.*, 43 AM. CRIM. L. REV. 1043 (2006).

warranted. As a general matter, courts have consistently been reluctant to interfere with the exercise of prosecutorial discretion in a wide variety of situations, at least absent legislative guidance or intentionally unconstitutional behavior. Declinations of prosecution are unreviewable in U.S. courts, for example, although actual (and threatened) prosecutions can be subject to some constitutional constraints.<sup>207</sup> The decision to grant a witness immunity,<sup>208</sup> the terms of plea bargains,<sup>209</sup> even government settlements of cases<sup>210</sup> are only loosely controlled, even when there are federal statutes and court rules that apply to these actions.

Courts can certainly be involved in deciding whether the government or the defendant breached an agreement,<sup>211</sup> but it is

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207. See *Stolt-Nielsen*, 442 F.3d at 183 (citing cases where the threat of prosecution could chill the exercise of constitutional rights); cf. *Yick Wo v. Hopkins*, 118 U.S. 356, 373–74 (1886) (“Though the law itself be fair on its face and impartial in appearance, yet, if it is applied and administered by public authority with an evil eye and an unequal hand, so as practically to make unjust and illegal discriminations between persons in similar circumstances, material to their rights, the denial of equal justice is still within the prohibition of the Constitution.”) (local ordinance making laundries operated in wooden buildings illegal, unless approved by board of supervisors; enforced only against Chinese-operated laundries).

208. See, e.g., *United States v. Skilling*, No. H-04-025, 2006 U.S. Dist. LEXIS 42664, at \*7 (S.D. Tex. June 23, 2006) (rejecting defense effort to attack government’s use of immunity grants, including government’s unwillingness to immunize witnesses for the defense: “The exclusive nature of Congress’s delegation [under the statute establishing the immunity process] and the fact that the balancing process is wholly within the expertise of the executive branch foreclose federal courts from taking more than a ministerial role in prosecutorial immunity decisions that are properly made under 18 U.S.C. § 6003”).

209. Courts must review a plea agreement prior to entry to be certain that it is voluntary and has a factual basis, but the court cannot participate in the negotiations or modify the plea’s terms. See FED. R. CRIM. P. 11; *United States v. C.R. Bard, Inc.*, 848 F. Supp. 287, 288 (D. Mass. 1994) (accepting corporate plea agreement, stating that “[w]hen, as here, the joint sentencing recommendation is the result of arms’ length negotiations between capable counsel, this court believes the agreement should be accepted if it is reasonable”).

210. See, e.g., *United States v. SBC Commc’ns, Inc.*, 489 F. Supp. 2d 1, 15–16 (D.D.C. 2007) (holding that a statute providing for court review of settlements of government antitrust cases only requires district court to be certain that settlement is “within the reaches of the public interest” and requires deference to the government’s view); cf. *Maryland v. United States*, 460 U.S. 1001, 1105 (1983) (Rehnquist, J., dissenting) (“The question assigned to the district courts by the Act [that permits court review of government antitrust settlements] is a classic example of a question committed to the Executive . . . . The question whether to prosecute a lawsuit is a question of the execution of the laws, which is committed to the Executive by Art. II.”).

211. See *Santobello v. New York*, 404 U.S. 257 (1971) (vacating conviction based on guilty plea, where prosecutor failed to keep its bargain regarding sentence recommendation); *Stolt-Nielsen*, 442 F.3d at 186 (stating in dictum that defendants may assert government’s breach of amnesty agreement as a defense to subsequent criminal prosecution).

doubtful whether this intervention should go beyond enforcing the terms to which the parties have agreed. For one, the corporations that have entered into these agreements have generally been powerful public companies, well-counseled, and with a clear informational advantage over the prosecution in terms of the offenses being investigated. Part of these agreements include assistance in prosecuting others, whether their own employees or co-conspirators. It is hard to believe that these corporations would enter into such agreements if they had no criminal exposure or that they would accept agreements regardless of cost. “Baring one’s breast” isn’t free: civil litigation for damages will inevitably follow, and it is not organizationally costless to turn over culpable employees to the government for prosecution.<sup>212</sup> For another, the criminal process, for whatever its vagaries, provides important procedural advantages to corporate defendants in business crime cases, not the least of which is the requirement that the prosecution prove what can be a very complicated case beyond a reasonable doubt. Corporate defendants have been successful in obtaining acquittals even in highly publicized cases.<sup>213</sup> It is also worth remembering that even relatively

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212. These employees have included high-level management, as well as lower-level employees. *See, e.g.*, *United States v. Stein*, 495 F. Supp. 2d 390, 394 (S.D.N.Y. 2007) (investigating and indicting KPMG partners and employees). Sacrificing such employees may cause managerial crises and may trigger later litigation if the employee is subsequently exonerated. *See, e.g.*, Carrick Mollenkamp & Evan Perez, *HealthSouth May Alter Board*, WALL ST. J., June 22, 2004, at A10 (detailing changes in management in wake of accounting scandal); Dan Morse, *Scrushy Wants His Job Back*, WALL ST. J., July 1, 2005, at A3 (threatening a “long and very public battle” with new HealthSouth management in wake of acquittal in criminal case); Dan Morse et al., *HealthSouth’s Scrushy is Acquitted*, WALL ST. J., June 29, 2005, at A1 (detailing Scrushy acquittal after five former HealthSouth chief financial officers testified against him). HealthSouth’s management had cooperated with the government and had entered into a non-prosecution agreement, which acknowledged the extent of HealthSouth’s monetary settlements with the SEC and defrauded investors, as well as HealthSouth’s extensive management changes. *See* Letter from Alice H. Martin, U.S. Att’y, to Robert S. Bennett, Esq. 1–4, <http://www.corporatecrimereporter.com/documents/healthsouth.pdf>.

213. *See, e.g.*, *State v. Ford Motor Co.*, No. 5324 (Ind. Super. Ct. 1980), dealing with prosecution of the Ford Motor Co. for reckless homicide arising out of the design of the Pinto, acquittal reported, N.Y. TIMES, Mar. 14, 1980, at 1. *See generally* FRANCIS T. CULLEN ET AL., CORPORATE CRIME UNDER ATTACK: THE FORD PINTO CASE AND BEYOND (1987) 145–89 (providing a historical overview of corporate criminal liability and discussing the Ford Pinto case as an in-depth example). Reports of corporate acquittals, however, are rare, perhaps because corporations prefer to plead rather than take the risk of trial. *See* Sheri Qualters, *Company Wins Rare Acquittal Against Price-Fixing Charges*, NAT’L L. J. (July 27, 2007), available at <http://www.law.com/jsp/article.jsp?id=900005487306> (reporting acquittal of corporate defendant tried on price fixing charges and defense counsel’s statement that “[c]orporations charged with criminal price fixing rarely go to trial, much less win”).

uncomplicated cases can be difficult for the government to win once they are placed within the corporate context. The Arthur Andersen document destruction case demonstrates this point well. What was supposed to be a “lay-down” case took the jurors ten days to decide, with jurors at one point split on which of four Arthur Andersen employees actually was the “corrupt persuader” for purposes of the obstruction charge, and this despite the fact that the lead partner on the Enron account had pleaded guilty and testified to his illegal activities.<sup>214</sup>

It is thus more likely that corporations enter into deferred prosecution agreements not because they are coerced to agree to them despite excessively onerous terms, but because the terms are more attractive than the present value of trial and punishment.<sup>215</sup> In this setting, courts should be very cautious about rewriting the agreement to give corporations a better deal than they originally bargained for. Perhaps there will be cases where smaller, less well-resourced companies are overborne by prosecutors’ demands, but those cases have yet to be seen.

## 2. Attorney-Client Privilege

An important area in which the private corporation and a public agency might be treated the same is the application and scope of the attorney-client privilege. At first glance, of course, similar treatment would seem unlikely because the privilege rules for private corporations and the government are quite different. Under *Upjohn*, private corporations can assert a corporate attorney-client privilege to protect confidential communications. On the government side, courts have consistently rejected the application of the attorney-client privilege to communications between government attorneys and government employees who reveal criminal misconduct,<sup>216</sup> taking the

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214. See Kurt Eichenwald, *Andersen Guilty in Effort to Block Inquiry on Enron*, N.Y. TIMES, June 16, 2002, at 1 (reporting trial evidence of massive document destruction, as well as evidence relating to the alteration of one key document); Kurt Eichenwald, *One Victory, and a Signal*, N.Y. TIMES, June 16, 2002, at 1 (reporting the “far from muscular” jury verdict in an “easy case”); Jonathan D. Glater, *Jurors Say File Shredding Didn’t Factor Into Verdict*, N.Y. TIMES, June 16, 2002, at 22 (reporting juror split over identity of corrupt persuader and juror focus on alteration of one document, rather than document shredding, and apparent disregard of testimony of David Duncan, the Andersen partner who had pleaded guilty before trial).

215. Cf. Brandon L. Garrett, *Corporate Confessions*, 30 CARDOZO L. REV. 917, 924 (2008) (arguing that non-prosecution and deferred prosecution agreements are entered into “at arms length during a bargaining process”).

216. See, e.g., *In re A Witness Before the Special Grand Jury*, 288 F.3d 289, 293 (7th Cir. 2001) (“It would be both unseemly and a misuse of public assets to permit a public

view that “the general duty of public service calls upon government employees and agencies to favor disclosure over concealment.”<sup>217</sup> Nevertheless, in practice, the courts’ treatment of the two privileges may not be so dissimilar, for the private attorney-client privilege has not proved as strong a barrier to disclosure of internal corporate investigations as the Court might have envisioned in *Upjohn*.

For one, although *Upjohn*’s holding is unquestioned, courts have narrowly construed the privilege in the context of corporate compliance efforts. For example, courts have refused to apply the privilege to compliance audits done by non-lawyers, despite arguments that a self-evaluative privilege would further *Upjohn*’s policies.<sup>218</sup> Even when the attorney-client privilege applies as an initial matter, corporations often find it difficult to maintain the privilege when they disclose the results of internal investigations to

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official to use a taxpayer-provided attorney to conceal from the taxpayers themselves otherwise admissible evidence of financial wrongdoing, official misconduct, or abuse of power.”) (rejecting assertion by former Illinois Secretary of State of privilege for communications with his chief legal counsel; federalism does not require a different result for state government); *In re Bruce R. Lindsey*, 158 F.3d 1263, 1278 (D.C. Cir. 1998) (“When government attorneys learn, through communications with their clients, of information related to criminal misconduct, they may not rely on the government attorney-client privilege to shield such information from disclosure to a grand jury.”) (rejecting assertion of attorney-client privilege by an attorney in the Office of the President for legal advice given to the president); *In re Grand Jury Subpoena Duces Tecum*, 112 F.3d 910, 925–26 (8th Cir. 1997) (holding that the White House has no attorney-client privilege or work-product protection to withhold potentially relevant information from federal grand jury). *Contra In re Grand Jury Investigation*, 399 F.3d 527, 528–29, 535 (2d Cir. 2005) (allowing former chief legal counsel in the office of the governor of Connecticut to assert attorney-client privilege, in response to federal grand jury subpoena, with regard to conversations with the governor and his staff, where communications would have been protected from state subpoena under specific state statute and recognizing conflict with other circuits).

217. *In re Grand Jury Subpoena Duces Tecum*, 112 F.3d at 920.

218. See, e.g., *In re Kaiser Alum. & Chem. Co.*, 214 F.3d 586, 593 (5th Cir. 2000) (rejecting privilege for pre-accident documents and enforcing Mine Safety and Health Administration subpoena); *In re Grand Jury Proceedings*, 861 F. Supp. 386, 391 (D. Md. 1994) (rejecting privilege for drug company’s audits done by an outside consultant). Compare Jennifer Arlen, *The Potentially Perverse Effects of Corporate Criminal Liability*, 23 J. LEGAL STUD. 833, 848, 865–66 (1994) (suggesting that some internal audits may not be undertaken for fear of increasing the risk of corporate criminal and civil liability, and arguing for a “modified ‘evidentiary privilege’ rule . . . which prohibits prosecutors from using voluntarily prepared corporate records against the corporation, while allowing such records to be used against wrongful agents”), with Jodi L. Short & Michael W. Toffel, *Coerced Confessions: Self-Policing in the Shadow of the Regulator*, 24 J. L. ECON. & ORG. 45, 64 (2007) (empirical study concluding that state law audit privilege shields have little effect on compliance and that such laws “provide cover for corporate wrongdoing without providing countervailing benefits in the form of increased self-policing or self-reporting”).

government agencies<sup>219</sup> or outside auditors,<sup>220</sup> or use internal investigations as part of an effort to sway public perceptions about the company.<sup>221</sup>

Faced with pressures of their branch-office role, which requires disclosure of the results of internal investigations to the government, corporations have attempted to argue for a doctrine of “partial waiver” so that they do not lose the privilege entirely where they disclose information only to government investigators. Although courts have acknowledged that permitting partial waivers might increase the likelihood that corporations would engage in the self-policing that government agencies have been encouraging,<sup>222</sup> nevertheless, courts have been unwilling to recognize that government involvement should affect the waiver standard: “The investigatory agencies of the Government should act to bring to light illegal activities, not to assist wrongdoers in concealing the information from the public domain.”<sup>223</sup>

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219. See, e.g., *In re Columbia/HCA Healthcare Corp. Billing Practices Litig.*, 293 F.3d 289, 291 (6th Cir. 2002) (finding waiver of privilege with regard to documents produced to the Department of Justice and other governmental agencies).

220. See *In re John Doe Corp.*, 675 F.2d 482, 486, 488 (2d Cir. 1982) (upholding subpoena for memorandum and ethics review disclosed to outside auditor); *In re Willkie, Farr & Gallagher*, No. M8-85(JSM), 1997 U.S. Dist. LEXIS 2927, at \*7, \*10 (S.D.N.Y. Mar. 14, 1997) (finding that documents related to an internal investigation by a law firm are protected by attorney-client privilege, but this privilege is waived when they are turned over to accountants for the purpose of obtaining an audit opinion); cf. *United States v. Ruehle*, 583 F.3d 600, 609 (9th Cir. 2009) (holding that statements made to counsel for disclosure to outside auditors are not protected) (“That he might regret those statements after later learning of the subsequent corporate disclosure to law enforcement officials is not material to the privilege determination . . .”); *Cavallaro v. United States*, 284 F.3d 236, 249 (1st Cir. 2002) (holding that accountants for targets of tax fraud investigation were properly subpoenaed for documents because those documents were not provided to accountants for the purpose of assisting with legal advice).

221. See *In re Kidder Peabody Sec. Litig.*, 168 F.R.D. 459, 469–70 (S.D.N.Y. 1996) (ordering disclosure of documents relating to preparation of internal investigation report that corporation made public).

222. See *In re Columbia/HCA Healthcare Corp. Billing Practices Litig.*, 293 F.3d at 303; see also Katie M. True, *Restricting Prosecutors’ Powers: Increasing Oversight to Reinstate Corporate Interests*, 92 IOWA L. REV. 1523, 1542–47 (2007) (discussing federal court approaches to waiver in the context of cooperation).

223. *In re Columbia/HCA Healthcare Corp. Billing Practices Litig.*, 293 F.3d at 303; see also *United States v. Reyes*, 239 F.R.D. 591, 602–03 (N.D. Cal. 2006) (noting that “federal courts of appeals have overwhelmingly disapproved of” selective waiver; allowing selective waiver may not be necessary because a publicly traded company “remains under a fiduciary duty to shareholders to investigate and eradicate fraudulent activity” and the SEC has sufficient power to obtain information without the encouragement of a selective waiver of the attorney-client privilege), *aff’d in part and vacated in part*, 577 F.3d 1069 (9th Cir. 2009). The Advisory Committee of the Judicial Conference of the United States considered a rule to allow selective waiver, but did not recommend it to Congress. See

Finally, the corporate privilege has never protected the individuals who have made disclosures to corporate counsel from having the corporation disclose these communications. Courts have long held that the privilege belongs to the corporation, not the individual, and so the corporation has always been free to waive the privilege and disclose the communications.<sup>224</sup> Presumably, this rule could inhibit the free flow of information to the corporation, at least if an employee fully understands the rule when being questioned by corporate counsel, but that has not led courts to restrict a corporation's ability to play its branch-office role free of any control by the errant employee.<sup>225</sup>

The courts' approach to treating *Upjohn* narrowly may thus reflect a convergence in the treatment of government and private corporations in the area of attorney-client privilege. Recall the Justice Department's approach to attorney-client waivers in the context of non-prosecution or deferred prosecution agreements: in the words of Deputy Attorney General McNulty, the corporation has a "quasi-public role" to promote "public trust and confidence."<sup>226</sup> The government's expectation that a corporation engaged in a good faith internal investigation will waive its attorney-client and work-product

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Letter from Lee H. Rosenthal, Chair, Comm'n on Rules of Practice and Procedure, Judicial Conference of the U.S., to Senators Patrick J. Leahy and Arlen Specter 6 (Sept. 26, 2007) ("[P]rovision proved to be very controversial.") (on file with the North Carolina Law Review). When Congress subsequently approved the new Rule 502 of the Federal Rules of Evidence, an explanatory note was agreed to expressing congressional intent that the new Rule 502(d) "does not provide a basis for a court to enable parties to agree to a selective waiver of the privilege, such as to a federal agency conducting an investigation, while preserving the privilege as against other parties seeking the information." See 154 CONG. REC. 7818-19 (2008).

224. See, e.g., *Commodity Futures Trading Comm'n v. Weintraub*, 471 U.S. 343, 348 (1985) (holding that the power to waive the privilege rests with corporate management); *United States v. Int'l Brotherhood of Teamsters*, 119 F.3d 210, 215 (2d Cir. 1997) (citing several supporting cases).

225. Griffin argues the Thompson Memorandum's emphasis on waiver of the attorney-client privilege put corporate counsel in an "untenable position" because counsel would find it difficult to conduct an "honest investigation" knowing that this material "will likely be ceded to the government." See Griffin, *supra* note 126, at 347. Corporate counsel have always been in this position, however, because the privilege always belonged to the corporation; the Thompson Memorandum just made it clearer to corporations that they could benefit from waiving the privilege by playing the branch-office role. Cf. *In re Grand Jury Subpoena*, 415 F.3d 333, 336, 340 (4th Cir. 2005) (upholding corporate waiver of privilege with regard to employee interviews in context of a pre-Thompson Memorandum corporate investigation, despite attorneys' statement that they could represent employees as well as the corporation as long as no conflict appeared; court warns counsel against giving such "watered-down 'Upjohn warnings,'" noting the "potential legal and ethical mine field" such warnings present during the investigation).

226. See *supra* note 1 and accompanying text.

protections reflects the view that the corporation operates in this public role and should have no interest in shielding information. Just like the government, corporations should not use lawyers to keep corporate activity out of public view.<sup>227</sup>

### 3. Constitutional Protections

The greatest legal difference between the public prosecutor and the private corporation in the legal rules governing investigation of business crime lies in the area of constitutional protections. The Fourth Amendment places important restraints on the ability of prosecutors to search for and seize evidence, even when that search occurs in the workplace;<sup>228</sup> the Fifth Amendment restricts the methods used in questioning suspects.<sup>229</sup> By contrast, corporations remain constitutionally unconstrained in their ability to search offices, seize documents, review and monitor emails and voicemails, question employees, and fire employees for failure to cooperate.<sup>230</sup>

As corporations have increasingly come to play the new branch-office role in business crime investigations, commentators and courts have begun to focus on the question of whether corporate conduct should be subject to constitutional constraints.<sup>231</sup> Although

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227. The concern that corporations might route communications through lawyers as a way to keep them from government investigators is not an imaginary one. *See* Morgester Declaration, *supra* note 34, at 4–5 n.6 (“In a January 20, 2006 e-mail, Hunsaker [H-P attorney and chief ethics officer] ask [sic] Baskins [H-P general counsel] ‘[i]n order to ensure that we can rely on privlidge [sic] if anything ever comes of this, would you like me to oversee the investigation . . . ?’ In a January 23, 2006 e-mail, Hunsaker further states ‘Ann Baskins has asked me to oversee the investigation into this in order to protect the attorney-client privilege in the event there is litigation or a governmental inquiry of some sort.’”).

228. *See, e.g.,* O’Connor v. Ortega, 480 U.S. 709, 715 (1987) (holding that the Fourth Amendment applies to searches by government employers of workplace areas where government employees have a reasonable expectation of privacy); Mancusi v. DeForte, 392 U.S. 364, 372 (1968) (holding the warrantless police seizure of employer’s documents in employee’s office and in employee’s custody violated employee’s Fourth Amendment rights); United States v. Jones, 286 F.3d 1146, 1148–49 (9th Cir. 2002) (holding warrantless FBI search of office of city governmental agency violated the Fourth Amendment).

229. *See, e.g.,* Miranda v. Arizona, 384 U.S. 436, 444 (1966).

230. *See, e.g.,* Skinner v. Ry. Labor Execs. Ass’n, 489 U.S. 602, 614 (1989) (“[T]he Fourth Amendment does not apply to a search or seizure, even an arbitrary one, effected by a private party on his own initiative.”); *cf.* Borse v. Piece Goods Shop, Inc., 963 F.2d 611, 619–20 (3d Cir. 1992) (stating that constitutional protections may be relevant in determining whether termination of an at-will employee violates state public policy).

231. *Compare* Griffin, *supra* note 126, at 352–53 (arguing corporate conduct should be subject to constitutional constraints), *with* Samuel W. Buell, *Criminal Procedure Within the Firm*, 59 STAN. L. REV. 1613, 1634–46 (2007) (arguing against providing Fifth Amendment protection to employees subject to workplace investigations).

corporations engage in a variety of investigative practices, current concern has focused on whether statements produced under threat of firing should be considered coerced, in violation of the Fifth Amendment, and therefore inadmissible at trial, and whether corporate refusal to advance attorneys' fees, done to obtain prosecutorial leniency, should be found to violate an employee's Sixth Amendment right to counsel. The institutional shift to the branch-office role does provide some factual support for applying the Constitution to these corporate actions (and to other corporate investigative conduct). On the other hand, a decision to constitutionalize corporate investigations faces substantial doctrinal objections and might not only undermine the ability of government prosecutors to draw on the investigative efforts of private corporations, but also reduce the ability of private companies to undertake internal investigations.

The most obvious doctrinal issue is whether corporate conduct, undertaken in its branch-office role, can be considered "government action," for the constitutional protections available to parties involved in the criminal process apply only to government action. Although there are cases where courts have been willing to find that private parties have been used as "instruments" of the prosecutor, those cases involve clear and direct orders for specific private action, often embodied in government regulations.<sup>232</sup> Even in cases where government interaction with private conduct is pervasive—public utility regulation and self-regulation by the National Association of Securities Dealers ("NASD") under the federal securities laws, to give two examples—courts have been unwilling to put the mantle of government action on private actors.<sup>233</sup>

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232. For example, in *Skinner*, 489 U.S. at 615–16, the Court held that a private railroad company's testing of blood and urine of certain of its employees, pursuant to regulations of the Federal Railroad Administration that authorized, but did not compel, such tests, implicated the Fourth Amendment because there were sufficient "indices of the Government's encouragement, endorsement, and participation" in the testing. *See also* *United States v. Montayne*, 500 F.2d 411, 415 (2d Cir. 1974) (finding that statements made in the course of a lie detector test administered by employer at police request were subject to the Fifth Amendment and that the private employer "was admittedly acting as an agent for the police"); *cf.* *United States v. Welch*, 455 F.2d 211, 213 (2d Cir. 1972) (court need not consider whether the Fifth Amendment might apply to foreign police officers' interrogation of the suspect where U.S. police officers "simply used foreign police officials as instruments" because foreign police officers had "an interest of their own" in interrogating the suspect).

233. *See* *Jackson v. Metro. Edison*, 419 U.S. 345, 358–59 (1974) (holding that private electric utility's termination of customer was not "state action," even though the utility was extensively regulated by the state, enjoyed some state protection from competition,

Despite the courts' general unwillingness to expand constitutional protection where private and public efforts are mixed, the court of appeals in *Stein* was willing to find that the constant interaction between government prosecutors and counsel for KPMG over the payment of attorneys' fees and getting KPMG employees to submit to government questioning gave rise to constitutional protection.<sup>234</sup> The court pointed out that the government conveyed to KPMG that "its survival depended on its role in a joint project with the government to advance government prosecutions," which made the government "legally responsible" for KPMG's conduct.<sup>235</sup> The government argued that there could not have been state action because an adversary of the government cannot be its partner.<sup>236</sup> Although the court agreed that "[a]n adversarial relationship does not normally bespeak partnership," it concluded that the existential "threat of indictment was easily sufficient to convert the government's adversary into its agent."<sup>237</sup>

Whether this approach becomes a slippery slope to finding government action when the government uses less obvious, but equally effective, pressure remains to be seen.<sup>238</sup> Unless future courts confine *Stein* closely to its facts, however, a decision to expose to constitutional constraint the broad range of governmentally encouraged internal corporate compliance efforts would open up for consideration a number of other difficult issues. It is perhaps not a Pandora's box of problems, but at least a "*Stein's* box."

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and had included the termination provision in its tariffs, which were subject to review by state public utilities commission); *D.L. Cromwell Inv., Inc. v. NASD Regulation, Inc.*, 279 F.3d 155, 163 (2d Cir. 2002) (holding actions by the Division of Enforcement of the NASD, Inc., to compel member-firm employees to submit to interviews were not state action for Fifth Amendment purposes; even though the Division had a "Criminal Prosecution Assistance Unit" that assisted the FBI and U.S. Attorney's Office in the investigation in question, the unit is generally walled off from the NASD's regulatory efforts and the particular interview request came directly from the Division of Enforcement as a result of its private investigation, not from "governmental persuasion or collusion"). For further discussion of the NASD cases, see Griffin, *supra* note 126, at 368–69 (acknowledging that these cases "present the most significant obstacle to finding state action in this arena"). The NASD cases are a particular obstacle to a finding of state action in the case of private corporations in light of the legal position of the NASD, a self-regulatory agency established by federal law with the responsibility to investigate its members' conduct and discipline them. See 15 U.S.C. § 78o-3(b)(7), (h) (2006).

234. See *United States v. Stein*, 541 F.3d 130, 147–51 (2d Cir. 2008).

235. *Id.* at 147 (internal quotation marks omitted).

236. See *id.* at 151.

237. *Id.*

238. See Buell, *supra* note 231, at 1641.

The problems would likely begin with statements that employees make to corporate counsel (whether inside or outside counsel) in the course of an internal investigation or compliance program. *Stein* involved statements made to government investigators, but the critical point was not the questioner but the compulsion to speak being exerted on the employee. The compulsion was the threat of discipline for failure to cooperate, discipline which could include firing.<sup>239</sup> The Supreme Court held in *Garrity v. New Jersey*<sup>240</sup> that such threats (which were made by the State) constitute a form of compulsion that violates the Self-Incrimination Clause and makes the resulting statements inadmissible at trial.<sup>241</sup> Such threats, however, are likely part of any compliance program.<sup>242</sup> Indeed, the sentencing guidelines require appropriate penalties if a compliance program is to be considered “effective”<sup>243</sup> and corporations would certainly be remiss in not disciplining employees who fail to cooperate in such efforts or who fail to reveal wrongdoing.

What problems might arise in placing such statements within constitutional constraints? Recall the statements that executives from Comverse made to corporate counsel investigating their options backdating, discussed earlier.<sup>244</sup> Presumably under *Garrity* these statements would be inadmissible at their criminal trial, but could they be used in the affidavit supporting their arrest warrants (which they were)? If these statements led corporate counsel to find particular documents, would those documents then be inadmissible at trial as a fruit of the illegal activity (*Garrity* held that the immunity provided is for use and derivative use<sup>245</sup>)? Could the executives be fired? Presumably they could be fired for what they told corporate counsel (the Self-Incrimination Clause protects only against use in the

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239. See *Stein II*, 440 F. Supp. 2d 315, 321–22 (S.D.N.Y. 2006) (describing KPMG’s pressure on two employees, one of whom was fired for failing to cooperate).

240. 385 U.S. 493 (1966).

241. See *id.* at 497–98. The court in *Stein II* relied on *Garrity* and its progeny for the proposition that KPMG’s conduct in conditioning the payment of legal fees on talking with government agents could result in coerced statements that violate the Fifth Amendment privilege against self-incrimination. See *Stein II*, 440 F. Supp. 2d at 327–28, 330–31 (applying test and suppressing statements).

242. See Garrett, *supra* note 215, at 939 (discussing how the failure to cooperate in an internal investigation “would be proper grounds for termination”).

243. U.S. SENTENCING GUIDELINES MANUAL § 8B2.1(b)(6)(B) (2009).

244. See *supra* notes 26–29 and accompanying text.

245. *Garrity*, 385 U.S. at 498–500; see *United States v. Patane*, 542 U.S. 630, 644 (2004) (stating that the Constitution “requires the exclusion of the physical fruit of actually coerced statements”).

criminal process, not collateral effects<sup>246</sup>), but suppose they had refused to cooperate? Although in *Gardner v. Broderick* the Court pointed out that there is no constitutional violation if the government fires or disciplines its employees for refusing to cooperate,<sup>247</sup> courts disagree on whether government employees must be told that although statements made under threat of firing may not be used in a criminal proceeding, the employee's refusal to answer questions may be a basis for disciplinary action.<sup>248</sup> This raises the possibility that corporate counsel's lack of clear explanation of an employee's constitutional rights would prevent the corporation from taking appropriate disciplinary action.<sup>249</sup>

*Stein's* box also opened Sixth Amendment issues. Normally, the Sixth Amendment's right to counsel does not attach until the initiation of adversary judicial proceedings.<sup>250</sup> Despite the fact that KPMG's pressure to deny advancement of fees, with its attendant impact on the KPMG employees' ability to choose counsel, came during investigation and before any charges were filed, the court of appeals found a Sixth Amendment violation: "[w]hen the government acts prior to indictment so as to impair the suspect's relationship with counsel post-indictment, the pre-indictment actions ripen into cognizable Sixth Amendment deprivations upon indictment."<sup>251</sup> This

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246. See, e.g., *Ullman v. United States*, 350 U.S. 422, 430–31 (1956) (rejecting claim that the Fifth Amendment self-incrimination privilege should be extended to cover the infamy that might be incurred from being forced to testify).

247. *Gardner v. Broderick*, 392 U.S. 273, 278 (1968) (holding an employee's dismissal solely for his refusal to waive his constitutional privilege against self-incrimination is unconstitutional, but stating that "[i]f appellant, a policeman, had refused to answer questions specifically, directly, and narrowly relating to the performance of his official duties, without being required to waive his immunity with respect to the use of his answers or the fruits thereof in a criminal prosecution of himself, the privilege against self-incrimination would not have been a bar to his dismissal") (internal citations omitted).

248. For a review of the split in the circuits on the content of the warnings to employees, see *Sher v. United States Veteran's Admin.*, 488 F.3d 489, 502–05 (1st Cir. 2007).

249. Constitutionalizing the internal investigation process would not likely require corporate counsel to provide *Miranda* warnings for an employee's statements to be constitutionally admissible in a criminal case because internal investigations would not likely be considered custodial interrogation, the required setting for *Miranda* warnings. See *United States v. Montayne*, 500 F.2d 411, 416 (2d Cir. 1974) (finding that warnings not required before employer-administered lie detector test because employee was not in custody).

250. *Kirby v. Illinois*, 406 U.S. 682, 689–90 (1972).

251. *United States v. Stein*, 541 F.3d 130, 153 (2d Cir. 2008). The Sixth Amendment right to counsel includes the right to counsel of one's choice, at least if the defendant can pay for such counsel. See *United States v. Gonzalez-Lopez*, 548 U.S. 140, 144–45 (2006); *Wheat v. United States*, 486 U.S. 153, 159 (1988); cf. *Caplin & Drysdale v. United States*,

is a potentially broad approach, however. Pre-charge investigative proceedings in business crime proceedings may be the most critical in terms of the ultimate outcome. If the constitutional harm is “interfer[ing] with defendants’ relationship with counsel and their ability to mount a defense,”<sup>252</sup> must corporations then permit their employees to retain counsel in an investigation, particularly those employees who are likely to be indicted and whose rights will consequently “ripen?” Will they be able to discipline those who do? Will they be able to suggest counsel? Will there be any obligation to make resources available for counsel (this is what *Stein* requires, at least in the factual context presented in the KPMG investigation<sup>253</sup>)?

Not discussed in *Stein*, but potentially part of *Stein*’s box, is the impact on document production. Corporate counsel might very well demand that an employee produce records of appointments or expenses in the course of an internal investigation, documents which will be turned over to prosecutors in the event that illegal conduct is found. If these investigations are equated to government action, then the compelled production of documents, like the compelled production of testimony, may give rise to Fifth Amendment issues, leading to complex problems of immunity and derivative use.<sup>254</sup> Corporate counsel might also “seize” documents under an employee’s control (recall the emails in the Hewlett-Packard pretexting case, discussed earlier<sup>255</sup>). This could raise the question of whether the seizure infringes on an employee’s Fourth Amendment rights, that is, whether the employee’s justifiable expectations of privacy were infringed and whether the search and seizure was done “unreasonably.”<sup>256</sup>

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491 U.S. 617, 626 (1989) (finding that the defendant has no constitutional right to use funds for counsel that would otherwise be forfeited to the United States: “A defendant has no Sixth Amendment right to spend another person’s money for services rendered by an attorney . . .”).

252. *Stein*, 541 F.3d at 136.

253. *See id.* at 155–57.

254. *See United States v. Hubbell*, 530 U.S. 27, 40–42, 46 (2000) (dismissing indictment as result of derivative use of immunized act of production).

255. *See supra* note 34 and accompanying text.

256. For an example of the types of issues that can arise in such cases, see *United States v. Ziegler*, 474 F.3d 1184, 1190 (9th Cir. 2007) (finding that, although the defendant had a reasonable expectation of privacy in relation to his computer located in a private office, and that his employer’s IT officers acted as “de facto government agents” in making a hard copy of his computer’s hard drive, the search was not unreasonable because the employer possessed common authority over the office and the workplace computer such that it could validly consent to a search).

It is possible, of course, to overdraw the parade of horrors that might occur if the branch-office role leads to placing constitutional constraints on corporate investigations. Courts have dealt with many of these issues in the government context. *Kastigar v. United States*<sup>257</sup> sets out the methods for avoiding derivative use of unconstitutionally obtained evidence.<sup>258</sup> The government has still been able to discipline its employees who do not cooperate in internal investigations, and so would corporations; whatever warnings the courts end up requiring for the government can simply be followed by corporate counsel.<sup>259</sup> Courts have most often given wide berth to the government when it compels production of documents;<sup>260</sup> presumably, corporations would have similar latitude. Employee expectations of privacy would be no different depending on who is doing the searching and courts have been creative in crafting standards of reasonableness for searches in which warrants and “neutral magistrates” are unavailable.<sup>261</sup>

It may be that the critical arguments over expanding constitutional protections to corporate investigations do not relate as much to worries about opening *Stein’s* box as they do to institutional concerns. The argument for this constitutional expansion rests, ultimately, on the realization that corporations are being required to take on a different institutional role, one with certain public duties. The public quality of this new institutional role might then lead courts to provide employees with the protections that the Constitution provides for the exercise of public power. But not only is the textual

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257. 406 U.S. 441 (1972).

258. *See id.* at 460 (stating that the government’s burden of proof “is not limited to a negation of taint; rather, it imposes on the prosecution the affirmative duty to prove that the evidence it proposes to use is derived from a legitimate source wholly independent of the compelled testimony”). For an argument that *Kastigar’s* procedures can readily be used in the corporate context, see Griffin, *supra* note 126, at 375–76. *But see* Buell, *supra* note 231, at 1644–45 (“The appearance of *Kastigar* in the firm context would abundantly complicate matters.”).

259. *See United States v. Ruehle*, 583 F.3d 600, 604 n.3 (9th Cir. 2009) (discussing the content of *Upjohn* or “corporate *Miranda*” warnings).

260. *See, e.g., Fisher v. United States*, 425 U.S. 391, 401–02 (1976) (holding that the Fifth Amendment self-incrimination privilege protects only the act of production, not the documents themselves, even if the documents contain incriminating information).

261. *See, e.g., Nat’l Treasury Emps. Union v. Von Raab*, 489 U.S. 656, 677 (1989) (upholding, as “reasonable,” drug testing by urinalysis, without warrant or suspicion, for those applying for certain positions with the U.S. Customs Service); *New York v. Burger*, 482 U.S. 691, 710–12 (1987) (permitting warrantless inspection, without probable cause, of automobile junkyard pursuant to state statute permitting such inspections); *Donovan v. Dewey*, 452 U.S. 594, 602–03 (1981) (permitting warrantless administrative search, without probable cause, of mine pursuant to Federal Mine Safety and Health Act, which set out procedures for regular inspections).

base in the Constitution for equating private corporations and public government less than clear. Courts also need to be concerned with the ways in which private corporations are institutionally different than public prosecutors, such that the imposition of constitutional duties would come at high cost.

The immediate cost to the criminal justice system from imposing these duties on private companies is the substantial likelihood that important evidence of criminal conduct may be lost to prosecutors through corporate constitutional error, making the enforcement of the criminal law in business crime cases far more difficult. The problem of constitutional mistake exists on the prosecutor's side, of course, but statutory and administrative controls exist for directing the efforts of government prosecutors and minimizing mistakes. A federal statute regulates the process for granting immunity, for example;<sup>262</sup> the Justice Department uses a variety of tools, including the U.S. Attorneys' Manual, to exert administrative control over the ninety-three U.S. Attorneys Offices and its more specialized prosecutorial divisions.<sup>263</sup> There are no such administrative controls on the numerous corporations operating in the United States today, no central agency to review their conduct in undertaking corporate investigations. Perhaps more importantly, private corporations still have different incentives than public prosecutors, particularly if corporate agents have been involved in illegal behavior. Giving private corporations the power, in effect, to create immunized testimony sets up the possibility that those directing the corporation will provide "immunity baths" that make it impossible for the government to prosecute corporate executives.<sup>264</sup> Indeed, it is for fear of this result that courts have historically resisted arguments either that private corporations have the power under federal law to create immunized testimony<sup>265</sup> or that defendants should be able to immunize defense witnesses who would otherwise refuse to testify for fear of criminal prosecution.<sup>266</sup>

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262. See 18 U.S.C. §§ 6001–6005 (2006).

263. See U.S. DEP'T OF JUSTICE, *supra* note 124, at 1-1.100, 3-2.100.

264. See Buell, *supra* note 231, at 1645 (discussing the possibility of immunity baths).

265. See *United States v. Standard Sanitary Mfg. Co.*, 187 F. 232, 236–37 (E.D. Pa. 1911) (“[E]ach defendant could call the other, until they brought about an immunity of all the defendants in the indictment . . . Such a construction of the [statute] would result in practically wiping out the criminal provisions of the Sherman Act.”).

266. See *United States v. Skilling*, No. H-04-025, 2006 U.S. Dist. LEXIS 42664, at \*9–14 (S.D. Tex. June 23, 2006) (discussing cases in which courts have refused to grant witness immunity to defense witnesses). Defense witness immunity has been granted in only one

Institutionally, then, the power to prosecute, and the responsibility for poor execution of that power, still reside in the hands of public prosecutors who are ultimately politically accountable for their successes and failures. Attempting to control corporate behavior by requiring private corporations to follow constitutional rules undercuts both prosecutorial power and prosecutorial responsibility, for it gives private corporations power to direct the development of public prosecutions and penalizes public prosecutors for misconduct done by “agents” over whom they lack adequate control.

Whatever direction the courts take in regard to constitutionalizing corporate involvement in business crime investigations will likely affect the development of prosecutorial agency agreements. To the extent that corporations can investigate unencumbered by constitutional restriction, prosecutors will have incentives to enter into these agreements and make use of corporate efforts. This will allow prosecutors to continue to take advantage of the substantial efficiency benefits that these agreements offer. On the other hand, the imposition of constitutional duties when prosecutors get too involved with corporate investigations, as in *Stein*, might lead prosecutors to become less explicit in revealing the reasons for why they might decide to prosecute, a dubious result. Should courts move to a position where the implicit incentives to undertake compliance programs or internal investigations are considered sufficient to impose constitutional duties on corporate efforts, there would then be a substantial possibility that the government will abandon the use of these important tools for detecting and preventing business crimes.

### *C. Corporations as Proper Targets of Criminal Prosecution*

The change in role for corporations in business crime cases not only reflects the incentives that corporations and prosecutors face in prosecuting these cases. It also reflects an increasing prosecutorial unwillingness to see corporations as proper targets of criminal prosecution, at least in cases involving major accounting fraud. Corporations have come to be seen more as instruments than targets, which helps validate prosecutors’ decisions to provide greater incentives for corporations to cooperate and assist in the

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circuit. See *Gov’t of V.I. v. Smith*, 615 F.2d 964, 972 (3d Cir. 1980) (holding that a court can immunize a witness on behalf of a defendant in certain circumstances).

prosecution.<sup>267</sup> Although acknowledging that corporate criminal prosecutions might still be necessary, this choice is held out for rare cases. James Comey, the former head of the Corporate Fraud Task Force, put it this way:

There are some corporations that have a profoundly screwed-up culture . . . . At some point we have to say, “Look, we need to put you out of business. We need to hit you. We need to kill you, because you’re bad in your own right, and it also serves the broader purpose of general deterrence.”<sup>268</sup>

The unspoken implication of this view may be that corporate criminal liability is inappropriate outside of this small range of cases.

A more general unwillingness to prosecute corporations can be traced to a lingering uncertainty as to the wisdom of entity criminal liability. Although entity criminal liability has long been accepted by legislators and courts,<sup>269</sup> commentators have frequently questioned its utility, arguing that civil remedies are more efficient in controlling corporate misconduct.<sup>270</sup> Practical outcomes increase the attractiveness of academic theory. The current panoply of available criminal remedies involve imposing some sort of financial penalty on the organization, most obviously, a fine, but also, under the sentencing guidelines, restitution, probation, and/or community service.<sup>271</sup> If the same outcomes can be obtained through either a deferral or a non-prosecution agreement, without a full criminal prosecution, what more is to be gained from bringing an actual criminal prosecution?

Compounding the uncertainty about the wisdom of entity liability is the problem of collateral damage. A criminal charge may carry additional collateral sanctions that end up causing harm to shareholders and employees, parties whom prosecutors view as innocent. As we have seen, the poster-child for this undesirable spillover is Arthur Andersen LLP, the only organization tried and

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267. See Buell, *supra* note 231, at 1625–27 (discussing instrumentalist arguments for entity liability).

268. Benjamin Weiser, *Empathy Shapes a Prosecutor, a Past Victim of Violence and Greed*, N.Y. TIMES, Dec. 21, 2002, at B1.

269. See *N.Y. Cent. R.R. Co. v. United States*, 212 U.S. 481, 492–94 (1909) (upholding constitutionality of criminal liability for corporations under the Elkins Act); Harry First, *General Principles Governing Criminal Liability of Corporations, Their Employees and Officers*, in *WHITE COLLAR CRIME: BUSINESS AND REGULATORY OFFENSES* § 5.02 (Otto Obermaier & Robert Morvillo eds., 1990) (reviewing history of criminal liability for entities).

270. See *supra* note 5 and accompanying text.

271. See U.S. SENTENCING GUIDELINES MANUAL §§ 8B 1.1–1.3, 8D 1.1–1.4 (2009).

convicted in the Enron era. Prosecutors are acutely aware that Arthur Andersen subsequently went out of business and have come to fear the possibility that a future corporate defendant might suffer a similar fate.<sup>272</sup>

The final note of uncertainty in prosecuting entities involves deterrence. Many prosecutors believe that the best deterrent is to prosecute the responsible individuals and put them in jail, a point somewhat subtly made by the shifts in language from the Holder Memorandum to the Thompson Memorandum.<sup>273</sup> Corporate decisions, after all, are made by individuals, and these individuals are thought to be more sensitive to spending time in jail than to any other possible sanction. As one prosecutor put it, many individual defendants have offered to pay higher fines to avoid jail or get a shorter jail sentence, but “defendants never offer to spend more time in jail in order to lower their fines.”<sup>274</sup>

Each of these arguments has some force, but there is some danger in evaluating these arguments just in the context of the major Enron era accounting fraud cases. Extrapolating from those cases to a general view of whether organizations are appropriate subjects of

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272. See Weiser, *supra* note 268 (describing interview with U.S. Attorney James Comey discussing the loss of jobs after the Arthur Andersen prosecution, where he stated, “[w]e do not want to swing at the wrongdoer and knock down 50,000 innocent people”); see also *supra* notes 140–42 and accompanying text (discussing Attorney General’s press conference relating to KPMG deferred prosecution agreement). There are times, however, when even a non-prosecution agreement cannot stave off the demise of a firm whose business has been adversely affected by its prior conduct. See Letter From Michael J. Garcia, U.S. Att’y, S. Dist. of N.Y., to Robert B. Fiske & James P. Rouhandeh, Davis Polk & Wardwell 2 (Mar. 26, 2007), [http://lib.law.virginia.edu/Garrett/prosecution\\_agreements/pdf/jenkinsgilchrist.pdf](http://lib.law.virginia.edu/Garrett/prosecution_agreements/pdf/jenkinsgilchrist.pdf) (memorializing non-prosecution agreement in which the investigated law firm represented that “as a result of its financial difficulties,” the firm’s offices had all been closed or would soon be closed); Nathan Koppel, *How a Bid to Boost Profits Led to a Law Firm’s Demise*, WALL ST. J., May 17, 2007, at A1 (reporting history of the investigation of Jenkins & Gilchrist that led to the dissolution and non-prosecution agreement).

273. See *supra* notes 116–18 and accompanying text; see also *Has the Government Gone Too Far in Its War on Corporate Crime?*, WALL ST. J., Nov. 1, 2006, <http://online.wsj.com/article/SB116224475563608109.html> (quoting David Pitofsky, a former federal prosecutor who had been responsible for the prosecution of Computer Associates International, Inc., for securities fraud related to its accounting practices, as saying, “[t]he simple truth is that prosecutors don’t actually want or need to prosecute corporations; they want to prosecute responsible individuals”).

274. Scott D. Hammond, Assistant Att’y Gen., U.S. Dep’t of Justice, Address at the Twentieth Annual Institute on White Collar Crime, Charting New Waters in International Cartel Prosecutions 13 (Mar. 2, 2006), <http://www.usdoj.gov/atr/public/speeches/214861.pdf>.

criminal liability can miss some important aspects of corporate criminal prosecutions.

For one, corporate criminal defendants are a varied lot, both by type of offense involved and size of the organization. As data from the U.S. Sentencing Commission indicate, federally prosecuted organizations run the gamut of offenses. In 2007, for example, organizational defendants were found in nearly twenty different categories of criminal conduct, from fraud, to antitrust, to money laundering, to environment, to drugs, to passport and immigration violations.<sup>275</sup> Further, based on the culpability factors assessed in the case of convicted organizations, they range in size from a few very large organizations to many smaller ones.<sup>276</sup> Cutting back on entity liability based on the experience with any one group of corporations may end up having quite disparate effects.

A second reason for caution in extrapolating from the Enron era cases is that these cases have generally focused on the involvement of very high-level management, including CEOs, CFOs, and corporate presidents, with prosecutors “trading up” to convict these defendants by making deals with lower level employees in return for testimony regarding their superiors.<sup>277</sup> But this is not necessarily the only pattern for business crime cases. Other business crimes may very well involve line operations in large, complex organizations where responsibility for illegal activity can be far removed from high-level management. Price fixing, for example, can be done by sales people in one division of a multi-product firm;<sup>278</sup> illegal foreign payments can be made by

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275. See *Organizations Receiving Fines or Restitution by Primary Offense Category and Applicability of Chapter Eight Fine Guidelines*, U.S. SENTENCING COMM’N (2007), <http://www.ussc.gov/ANNRPT/2007/Table51.pdf>.

276. *Organizations Sentenced Under Chapter Eight: Culpability Factors*, U.S. SENTENCING COMM’N (2007), <http://www.ussc.gov/ANNRPT/2007/Table54.pdf> (stating that sixty-four percent of reporting sentenced corporations with involvement of management in criminal conduct had fifty or fewer employees; nine percent had 1,000 or more employees).

277. See, e.g., John R. Emshwiller & Thaddeus Herrick, *Fastow Plea Deal May Boost Cases Against Enron’s Ex-CEOs*, WALL ST. J., Jan. 15, 2004, at A3 (describing agreement with Andrew Fastow, former CFO of Enron, to plead guilty and testify against former Enron CEOs Kenneth Lay and Jeffrey Skilling; Fastow described as the government’s “biggest catch” so far); Allan Murray, *Executives in Trouble Now Know to Sing*, WALL ST. J., Aug. 17, 2005, at A2 (discussing testimony of cooperating witness Scott Sullivan, former CFO of WorldCom, which allowed the government to land its “biggest fish,” Bernie Ebbers, former CEO of WorldCom).

278. For example, the DRAM price fixing prosecution has involved corporate executives in various sales and marketing positions in various subsidiaries of larger firms. See Press Release, U.S. Dep’t of Justice, *Three Executives Indicted for Their Roles in the DRAM Price-Fixing & Bid-Rigging Conspiracy*, 1–3 (Oct. 18, 2006), <http://www.justice>

foreign subsidiaries.<sup>279</sup> Proposals that would limit organizational liability only to cases of “pervasive culpability throughout all offices and ranks” (as the Committee on Capital Markets Regulation urged<sup>280</sup>) may very well cut too broadly and miss a large range of cases for which organizational criminal liability is appropriate.

A third reason for caution is that reliance on individual prosecutions for deterrence has its own limitations. The preference for individual liability over organizational liability carries with it two assumptions: (1) guilty individuals will be convicted and (2) convicted individuals will be adequately sanctioned for their crimes. Both assumptions may be problematic.

There are a variety of obstacles to convicting individuals in business crime cases. Some business crimes involve conduct that occurs abroad (international cartels, for example), and it is often easier to obtain jurisdiction over U.S. subsidiaries than foreign executives.<sup>281</sup> Business crimes are often the product of organizational effort. A low-level employee may engage in the actual act of pollution, or fail to keep rodents from infesting food stocks, or accept a large cash deposit from a customer without filing the required report, or threaten a customer with a boycott.<sup>282</sup> Prosecution of these

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.gov/atr/public/press\_releases/2006/219102.pdf (discussing charges against executives of Samsung, Hynix America, Infineon Technologies, and Micron Technology).

279. *See, e.g.*, Press Release, U.S. Dep’t of Justice, Akzo Nobel Acknowledges Improper Payments Made by its Subsidiaries to Iraqi Government Under the U.N. Oil for Food Program, Enters Agreement with Department of Justice (Dec. 20, 2007), [http://www.usdoj.gov/opa/pr/2007/December/07\\_crm\\_1024.html](http://www.usdoj.gov/opa/pr/2007/December/07_crm_1024.html) (describing improper payments made by foreign subsidiaries to Iraqi government in connection with U.N. “Oil for Food” program); Press Release, U.S. Dep’t of Justice, Schnitzer Steel Industries Inc.’s Subsidiary Pleads Guilty to Foreign Bribes and Agrees to Pay a \$7.5 Million Criminal Fine (Oct. 16, 2007), <http://skaddenpractices.skadden.com/fcpa/attach.php?uploadFileID=16> (discussing illegal payments by Korean subsidiary to government customers in China).

280. *See supra* note 169 and accompanying text.

281. *See, e.g.*, *United States v. General Elec. Co.*, 869 F. Supp. 1285, 1300 (S.D. Ohio 1994) (entering judgment of acquittal against corporate co-conspirator and stating that the government’s proof problems were made “more difficult because three of the four named defendants, and many potential witnesses, are foreign nationals beyond the jurisdiction of this Court”).

282. *See, e.g.*, *United States v. Park*, 421 U.S. 658, 660–64 (1975) (dealing with rodent infestation in food warehouses); *United States v. Hong*, 242 F.3d 528, 529–30 (4th Cir. 2001) (company employees discharged untreated wastewater directly into the municipal sewer system in violation of Avion’s discharge permit); *United States v. Bank of New England, N.A.*, 821 F.2d 844, 846–49 (1st Cir. 1987) (acceptance of reportable bank transactions by bank teller who mistakenly thought the transactions were not reportable); *United States v. Hilton Hotels Corp.*, 467 F.2d 1000, 1006 (9th Cir. 1972) (“Complex business structures . . . make it difficult to identify the particular corporate agents responsible for Sherman Act violations.”).

individuals, although legally possible, may be misplaced in light of the fact that the individual's conduct is only a small part of a greater organizational effort that produced the crime. On the other hand, high-level managers can be difficult to convict if they maintain sufficient distance from the illegal behavior to plead lack of knowledge, and if witnesses who can testify otherwise have made their own deals with prosecutors, making their testimony suspect in jurors' eyes. A particularly egregious example of this latter phenomenon is the acquittal of Richard Scrushy, former CEO of HealthSouth, on accounting fraud charges, despite the testimony of five former HealthSouth CFOs as to his involvement in the fraud.<sup>283</sup> Jurors apparently found the testimony of Scrushy's involvement "ambiguous" and questioned the credibility of the ex-CFOs.<sup>284</sup>

Even when individuals are convicted, sanctions may turn out to be lower than optimal. As a historical matter, sanctions for individuals in business crime cases have been viewed as too lenient, particularly in terms of jail time, a trend that Congress and the Sentencing Commission have tried to reverse, and with some success.<sup>285</sup> The Supreme Court's decision in *United States v. Booker*,<sup>286</sup> holding that judges are not required to follow the guidelines, however, has increased the discretion of district court judges to impose lighter sentences than the guidelines would have permitted.<sup>287</sup>

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283. See Dan Morse et al., *HealthSouth's Scrushy is Acquitted*, WALL ST. J., June 29, 2005, at A1.

284. See *id.* (quoting one juror as saying "[o]f course it was proven that it was fraud at the company," but finding insufficient evidence of Scrushy's involvement).

285. See U.S. SENTENCING GUIDELINES MANUAL ch. 1 § 4(d), 52 Fed. Reg. 18,046 (May 13, 1987) ("Under present sentencing practice, courts sentence to probation an inappropriately high percentage of offenders guilty of certain economic crimes, such as theft, tax evasion, antitrust offenses, insider trading, fraud, and embezzlement, that in the Commission's view are 'serious.' If the guidelines were to permit courts to impose probation instead of prison in many or all such cases, the present sentences would continue to be ineffective."). For congressional increases in criminal penalties, see for example, Antitrust Criminal Penalty Enhancement and Reform Act of 2004, Pub. L. No. 108-237, § 215, 118 Stat. 661 (2004) (codified as amended in scattered sections of 15 U.S.C.) (increasing imprisonment from three-year maximum to ten-year maximum); Sarbanes-Oxley Act of 2002 § 1106, 15 U.S.C. § 78ff(a) (2006) (increasing imprisonment for securities fraud from a ten-year maximum to a twenty-year maximum). For a review of some substantial sentences in Enron era high-profile fraud trials, see Cindy Perman, *White-Collar Sentences*, WALL ST. J., Nov. 3, 2006, at 1, available at <http://online.wsj.com/article/SB116249356296511625.html> (ranging from five years for Scott Sullivan to twenty-five years to life for Bernard Ebbers, both for WorldCom fraud).

286. 543 U.S. 220 (2005).

287. *Id.* at 245-46; see also *Rita v. United States*, 551 U.S. 338, 341 (2007) (holding that sentence within the guidelines range is presumptively reasonable on appeal, although the presumption may be overcome). For an example of the impact of *Booker* on sentencing in

Although appellate courts have attempted to check excessively light sentences,<sup>288</sup> the Supreme Court has upheld a district court decision disagreeing with basic Sentencing Commission policy decisions<sup>289</sup> and a district court decision imposing probation where the guidelines would have required substantial jail time, reminding appellate courts that they are to review sentencing decisions under a deferential abuse of discretion standard.<sup>290</sup> The difficulty of calibrating sanctions to societal harm may also make it hard to impose economically optimal sanctions. Efforts to fine guilty individuals, based on economic harm multiplied by the chance of detection and conviction, may very well lead to a fine that exceeds any particular individual's resources.<sup>291</sup> In such cases, only the organization's resources will be adequate.

Finally, abandoning entity liability in favor of individual liability may perversely make it more difficult to convict individuals in business crime cases because it would likely undermine the branch-office role that corporations are now playing. Prosecutors need a credible threat of criminal prosecution to induce corporations to enter into these agency agreements. The weaker that threat, the less likely it is that corporations will agree to such arrangements and the

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business crime cases, see *United States v. Ollis*, No. H-03-217-01, 2006 U.S. Dist. LEXIS 68281, at \*44–45 (S.D. Tex. Sept. 22, 2006) (sentencing defendant to a seventy-two-month non-guidelines sentence after pre-*Booker* 292-month sentence was reversed by court of appeals for post-*Booker* reconsideration).

288. A notable example is the tussle between the Eleventh Circuit and the trial judge in the HealthSouth fraud prosecution, in which the trial judge continued to sentence defendants to non-jail terms despite appellate court reversals, ultimately leading the district court judge to recuse himself from further proceedings in the case. See *United States v. Livesay*, 484 F.3d 1324, 1326–29 n.12 (11th Cir. 2007) (detailing prior history of reversals and resentencings, including recusal); *United States v. Martin*, 455 F.3d 1227, 1230 (11th Cir. 2006) (reversing re-imposition of seven-day sentence of imprisonment); *United States v. McVay*, 447 F.3d 1348, 1349 (11th Cir. 2006) (noting other “dramatic” and “extraordinary” departures by trial judge).

289. See *Kimbrough v. United States*, 552 U.S. 585, 591 (2007) (holding that because the distinction in the guidelines between crack and powder cocaine is advisory only, a non-guidelines sentence based on disagreement with the distinction could be reasonable).

290. See *Gall v. United States*, 552 U.S. 538, 541 (2007) (holding that courts of appeals must review sentences “under a deferential abuse-of-discretion standard” and upholding, as reasonable, a sentence of probation in a case where the guidelines would have required thirty months imprisonment).

291. For a list of corporate antitrust fines in excess of \$100 million, whose amount is based on the harm caused, see Scott D. Hammond, Deputy Assistant Att’y Gen., U.S. Dep’t of Justice, Presentation at the 56th Annual Spring Meeting of the ABA Section of Antitrust Law: Recent Developments, Trends, and Milestones in the Antitrust Division’s Criminal Enforcement Program 12 (Mar. 26, 2008), <http://www.usdoj.gov/atr/public/speeches/232716.pdf>. For discussion of the fines imposed against participants in the vitamins cartel, see Harry First, *The Vitamins Case: Cartel Prosecutions and the Coming of International Competition Law*, 68 ANTITRUST L.J. 711, 715–18 (2001).

weaker such arrangements are likely to be with respect to the corporation's obligations. To the extent that one views this new branch-office role as critical to the successful investigation and prosecution of business crime, one should be cautious about cutting back on organizational criminal liability.

*D. Deterrence*

A major goal of the criminal sanction, even if not the only goal, is deterrence.<sup>292</sup> Assuming that both individual and organizational criminal liability are necessary for adequate deterrence, an important question is how the corporation's new branch-office role might affect the willingness of individuals or entities to engage in business crime.

Any effort to assess the effect on deterrence of placing corporations in an agency role must begin with an acknowledgment of our limited understanding of how deterrence actually works in the area of business crime.<sup>293</sup> As an initial matter, economic theory, which has paid some attention to the theory of optimal deterrence, should be well-suited to making predictions about the effect of various sanctions on the deterrence of business crimes.<sup>294</sup> Economic theory is premised on rational profit-seeking and the effect of incentives on behavior; crimes committed by people operating in a business setting would seem to be the exact type of behavior amenable to this approach. Nevertheless, economic theory has tended to ignore behavioral complications, such as persistent underestimation of the risk of being caught for illegal behavior,<sup>295</sup> as well as the effect of social norms and social interactions on the willingness of people to

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292. For discussion of the deterrence function and the blaming function of corporate criminal liability, see Buell, *supra* note 5, at 491–526.

293. See, e.g., Geraldine Szott Moohr, *On the Prospects of Detering Corporate Crime*, 2 J. BUS. & TECH. L. 25, 27–28 (2007).

294. See, e.g., Gary Becker, *Crime and Punishment: An Economic Approach*, 76 J. POL. ECON. 169, 172–205 (1968) (discussing application of optimal deterrence theory to crime generally); William M. Landes, *Optimal Sanctions for Antitrust Violations*, 50 U. CHI. L. REV. 652, 661–72 (1983) (dealing with the application of optimal deterrence theory to antitrust).

295. See Paolo Buccrossi & Giancarlo Spagnolo, *Optimal Fines in the Era of Whistleblowers: Should Price Fixers Still Go to Prison?*, in THE POLITICAL ECONOMY OF ANTITRUST 81, 95 (Vivek Goshal & John Stennek eds., 2007); Christine Jolls, *On Law Enforcement with Boundedly Rational Actors*, in THE LAW AND ECONOMICS OF IRRATIONAL BEHAVIOR 268, 273–78 (Francesco Parisi & Vernon L. Smith eds., 2005) (discussing optimism bias and availability bias as leading to underestimation of risk of being caught).

engage in illegal business behavior.<sup>296</sup> Although economic theory is a powerful tool, and can provide particular help in predicting the effect of incremental changes in criminal justice policy, it should be used with an appreciation that factors beyond rational self-interest can have an important role in ensuring lawful behavior.<sup>297</sup>

Compounding the difficulty of understanding how deterrence works is the fact that there are two different types of actors to be deterred from committing business crimes: individuals and organizations. Neo-classical economic theory treats the firm as equivalent to the individual, that is, as just another rational actor. As rational actor, with the proper external incentives (specifically, fines set at an “optimal” level) organizations will behave efficiently, adopting whatever internal measures are necessary to monitor and control their agents’ behavior, perhaps more efficiently than the government can with the threat of imprisonment and without the need for government to dictate how the organization should achieve its ends.<sup>298</sup>

Organization theory, on the other hand, addresses itself to the organizational quality of corporate conduct, looking to organizational process as an explanation for how organizations behave and react.<sup>299</sup>

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296. See PAUL OMEROD, *CRIME: ECONOMIC INCENTIVES AND SOCIAL NETWORKS* 44–48 (2005). A good example is the widespread backdating of stock options among high-technology firms in Silicon Valley, where the practice was described as “routine” and where the companies and the law firms and accounting firms that advised them seem to have “duped themselves into thinking they were doing this for the benefit of the stockholders” and considered backdating a “victimless crime.” See Gary Rivlin & Eric Dash, *Haunted by a Heady Past*, N.Y. TIMES, July 22, 2006, at C1 (quoting executive compensation specialist who has worked with “scores” of Silicon Valley firms; includes map showing location of involved firms).

297. Cf. Nuno Garoupa & Frank H. Stephen, *Law and Economics of Plea-Bargaining* 14–20 (July 2006) (unpublished manuscript), [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=917922#PaperDownload](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=917922#PaperDownload) (expressing skepticism at a law and economics view of plea bargaining which does not take account of the institutional setting in which bargains are made and which might undercut the efficiency hypothesis).

298. See Buccirosi & Spagnolo, *supra* note 295, at 114–15. Although some argue that corporate criminal liability under a respondeat superior rule is likely to result in over-deterrence and other perverse effects, given that monitoring alone can never eliminate all violations, see Arlen & Kraakman, *supra* note 5, at 707–09, other constraints on prosecution may moderate this effect, assuming that it, in fact, exists, see Richard A. Bierschbach & Alex Stein, *Overenforcement*, 93 GEO. L.J. 1743, 1776–77 (2005).

299. See GRAHAM ALLISON & PHILLIP ZELIKOW, *ESSENCE OF DECISION: EXPLAINING THE CUBAN MISSILE CRISIS* 143–96 (Longman 1999) (1971) (explaining different theoretical approaches to organizational behavior); Buccirosi & Spagnolo, *supra* note 295, at 85 (explaining how “team properties of cartels,” including agency problems within limited liability organizations, affect design of optimal sanctions); Barry D. Baysinger, *Organization Theory and the Criminal Liability of Organizations*, 71 B.U. L.

Organization theory suggests that organizations may be slow to change internal processes and that outside intervention may be necessary to change organizational process.<sup>300</sup> The proper policy prescription, then, should be directed at changing internal operating procedures and mandating procedures that lead to lawful organizational behavior.

There is little empirical support to favor one approach over the other. Prosecutions and penalties for cartel price fixing, for example, have increased steadily in the past decade, but how much (or even whether) these sanctions have deterred price fixing is unclear.<sup>301</sup> On the other hand, since 1991 the Sentencing Guidelines for Organizations have provided clear incentives for adopting compliance programs, but there is no evidence as to the effectiveness of these programs in deterring corporate crime.<sup>302</sup> United States Sentencing Commission data indicate that convicted corporations almost never have compliance programs,<sup>303</sup> but no one can say whether this means that corporations with effective programs are less likely to commit crimes in the first place, whether the data reflect the fact that most convicted organizations are small (formal compliance programs are

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REV. 341, 346–74 (1991) (discussing organizational structures and difficulties in controlling and incentivizing agents).

300. See ALLISON & ZELIKOW, *supra* note 299, at 280 (stating that actions at “Time 2” are likely to resemble actions at “Time 1”).

301. See JOHN M. CONNOR, *GLOBAL PRICE FIXING* (2d ed. 2007) (reviewing international cartel prosecutions and arguing that profits from collusion have exceeded fines imposed); John M. Connor & Robert H. Lande, *How High do Cartels Raise Prices? Implications for Optimal Cartel Fines*, 80 TUL. L. REV. 513, 533–64 (2005) (based on survey of social science literature describing serious cartels, arguing that sentencing guidelines’ estimate of cartel overcharges is too low).

302. See Short & Toffel, *supra* note 218, at 47 (literature on compliance programs and self-reporting “is largely theoretical; little empirical evidence exists to suggest what mix most effectively encourages self-policing”); Frank O. Bowman, III, *Drifting Down the Dnieper with Prince Potemkin: Some Skeptical Reflections About the Place of Compliance Programs in Federal Criminal Sentencing*, 39 WAKE FOREST L. REV. 671, 684 (2004) (arguing there are “no useful data” about whether compliance programs prevent crime or reduce the chance of prosecution if crime is detected).

303. In Fiscal Year 2007, for example, only one of the eighty-nine sentenced organizations for which the Commission had information reported that it had an effective compliance program. See U.S. SENTENCING COMM’N, SOURCEBOOK OF FEDERAL SENTENCING STATISTICS tbl.54 (2007), available at <http://www.ussc.gov/ANNRPT/2007/Table54.pdf>; cf. U.S. SENTENCING COMM’N, SOURCEBOOK OF FEDERAL SENTENCING STATISTICS tbl.54 (2006) [hereinafter FEDERAL SENTENCING STATISTICS 2006], available at <http://www.ussc.gov/ANNRPT/2006/Table54.pdf> (reporting none of 108 sentenced organizations had a compliance program).

ill-adapted to small organizations<sup>304</sup>), or whether corporate managers do not believe in their utility (judges, for example, do not routinely impose compliance programs on convicted corporations<sup>305</sup>).

Recognizing the limits of theory to predict outcomes should make us cautious in attempting to assess the overall effect on deterrence of the branch-office role. Nevertheless, within those limits, even if it is not possible to determine what sanctions, or combination of sanctions, are optimal, it is possible to make arguments about the likely incremental effects that this new role might have on organizational and individual incentive structures.

On the one hand, the branch-office role does lead to an increase in information about illegal behavior, information that is shared with prosecutors. This clearly has been the result, for example, in antitrust amnesty programs.<sup>306</sup> This increase in information makes detection and successful prosecution of business crimes more likely. To the extent that actors (individual or organizational) take any account of the risks in undertaking illegal behavior, whether accurately or not, increasing the risk of detection and successful prosecution should raise the expected cost of illegal behavior and consequently lower its incidence on the margin. Further, the increase in information may increase the chances of bringing successful civil suits against the corporation; this, too, may increase deterrence by making illegal behavior more costly.

On the other hand, this increased deterrent effect might be offset by two other aspects of the branch-office role: (1) the reduction in penalty for the reporting corporation and (2) a potential institutional change on the part of prosecutors.

A key aspect of today's branch-office role is that it takes a "fix-it-after" approach. That is, organizations are allowed to violate the law one time, so long as they promise to assist in investigating individual wrongdoers and then fix the problem by undertaking a variety of internal reforms, paying restitution, and, often, but not always, paying

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304. See U.S. SENTENCING GUIDELINES MANUAL § 8B2.1(a)(2) (2009) (discussing how "small organizations" can meet guidelines' requirements with less formality and fewer resources).

305. In 2007, judges ordered the institution of compliance programs for fewer than twenty-five percent of sentenced organizations. See U.S. SENTENCING COMM'N, SOURCEBOOK OF FEDERAL SENTENCING STATISTICS tbl.53 (2007), available at <http://sentencing.nj.gov/downloads/pdf/articles/2007/Apr2007/document03.pdf>.

306. See Hammond, *supra* note 274, at 13–15 (discussing benefits of amnesty program in major cartel prosecutions).

a fine.<sup>307</sup> Criminal charges are not pursued, an outcome that organizations obviously prefer, which is why they enter into these agreements in the first place. This means that corporations have determined that the cost of these agreements is lower than the expected cost of a criminal conviction. Reducing the cost of illegal behavior, however, makes the behavior more profitable and makes it more likely that the organization will engage in it in the first place.<sup>308</sup>

It may be, however, that it is the first offense with which we need to be most concerned in organizational crime. United States Sentencing Commission data indicate that organizations are rarely repeat offenders, or, at least, they are rarely prosecuted more than once.<sup>309</sup> This would indicate that, for whatever reason, deterrence (more precisely, specific deterrence) may work well for organizational offenders after the first offense. But lowering the cost of a first offense might very well increase the incidence of first offenses, indeed, may lead organizations to be lax in their internal controls in ways that will be difficult for prosecutors to detect *ex post*. Although it is not possible to know whether the negative effects swamp the positive effects, the first-offense concern serves as a caution in structuring a system that too readily rewards corporations for undertaking the branch-office role.

A second aspect of the branch-office role, particularly in the corporate fraud area, is its institutional effect on prosecutors. As discussed above, prosecutors may be moving toward a view that corporations are not generally a proper target for criminal prosecution. Indeed, the use of agency agreements provides prosecutors with an attractive middle option between declination and litigation, offering the possibility of an easier (that is, less costly) way for prosecutors to resolve high-profile cases. This increases prosecutors' incentives to employ these agreements, with the

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307. See Letter from Leslie R. Caldwell, Director, Enron Task Force, U.S. Dep't of Justice, to Robert Morvillo & Charles Stillman (Sept. 17, 2003), <http://www.corporatecrimereporter.com/documents/merill2003.pdf> (setting out terms of non-prosecution agreement but not imposing any corporate fine).

308. The possibility that a fix-it-after approach will reduce deterrence may be lessened for crimes such as price fixing, where a co-conspirator might defect from the agreement and disclose its behavior to the prosecutor, thereby depriving the other conspirators of amnesty for their fines. See, e.g., Buccrossi & Spagnolo, *supra* note 295, at 107–08 (discussing various deterrence effects); Christopher R. Leslie, *Trust, Distrust, and Antitrust*, 82 TEX. L. REV. 515, 520–680 (2004) (providing an in-depth exploration of the defection problem in price fixing cartels).

309. See FEDERAL SENTENCING STATISTICS 2006, *supra* note 303 (stating that 99.1% of convicted organizations had no prior record of committing similar acts within the previous ten years).

increased risk that the effectiveness of these agreements will diminish as defense lawyers and corporations discount the risk of an actual prosecution occurring. This, in turn, may further diminish the ex ante deterrent effects that these agreements now present.<sup>310</sup>

The possibility that deterrence can be lost if prosecutors too easily enter into agency agreements, and are too reluctant to bring criminal prosecutions, can be seen in the case of Arthur Andersen. The Andersen case, of course, is commonly seen now as the Justice Department's great mistake, an innocent company wrecked by an unproved criminal charge, with great losses to innocent employees and partners plus collateral damage to the economy through the loss of competition in the auditing market.<sup>311</sup> This case now hangs over Justice Department decision-making, as shown in the attorney general's reasons for entering into an agency agreement with KPMG.

Another Arthur Andersen case, however, tells a different story. Between 1989 and 1990 Arthur Andersen was involved in the sale of partnership interests in a multi-building development in downtown Hartford, Connecticut, known as Constitution Plaza.<sup>312</sup> The project was being developed by Colonial Realty, a large real estate developer for whom Andersen had worked for many years.<sup>313</sup> After the projected profits in the project failed to materialize, the Andersen accountant and auditor involved in promoting the investments made false statements to numerous potential investors about the project's profitability.<sup>314</sup> Colonial subsequently failed.<sup>315</sup> The Justice Department brought a criminal prosecution against the accountant involved in the deceptive promotion. He was convicted on ten counts of mail fraud and six counts of wire fraud.<sup>316</sup>

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310. The deterrence calculus is further complicated by the possibility that agency agreements free up resources for other investigations, with an increased effect on overall deterrence. See Buccirossi & Spagnolo, *supra* note 295, at 108.

311. See, e.g., INTERIM REPORT OF THE COMMITTEE ON CAPITAL MARKETS REGULATION, *supra* note 162, at 73 (discussing "substantial losses to society" from Arthur Andersen prosecution); Howard H. Chang & David S. Evans, The Optimal Prosecution of Corporate Fraud: An Error Cost Analysis 5 (Nov. 1, 2006) (unpublished manuscript), [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=943035#PaperDownload](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=943035#PaperDownload) ("Arthur Andersen's fate emphasized the well-known fact that prosecutors can make mistakes with tremendous and irreversible costs.").

312. See George Gombossy & Patricia Weiss, *Behind the Money: Accounting for Colonial's Fortunes*, HARTFORD COURANT, June 1, 1992, at A1 (describing the project).

313. See *id.*

314. See *United States v. Autuori*, No. 3:96-CR-161, 1998 U.S. Dist. LEXIS 22782, at \*6-42 (D. Conn. Aug. 27, 1998).

315. See Gombossy & Weiss, *supra* note 312.

316. See *United States v. Autuori*, 212 F.3d 105, 108 (2d Cir. 2000) (affirming convictions).

Arthur Andersen was not criminally prosecuted for its role in Colonial's collapse. In April 1996 (prior to the accountant's indictment) the U.S. attorney for Connecticut announced a settlement in which Andersen agreed to pay \$10.3 million to investors in the Constitution Plaza syndication.<sup>317</sup> Andersen agreed to provide "full cooperation" in the investigation, including encouraging Andersen employees to cooperate and providing all nonprivileged documents relevant to the investigation.<sup>318</sup> Andersen did not admit liability,<sup>319</sup> and the government did not file any charging document.<sup>320</sup> The U.S. attorney's reasons for entering into this agreement should sound familiar: 1) the allegations were not firm-wide; 2) the indictment would cause "significant collateral consequences to many innocent Andersen employees"; 3) Andersen agreed to cooperate in the investigation; and 4) Andersen agreed to make restitution.<sup>321</sup>

The Colonial Realty problems were not the last ones that Arthur Andersen had, of course. Rather, Colonial Realty was the first in a series of ever-larger frauds involving Andersen's accounting practices. Next came Waste Management, McKesson, Sunbeam, the Baptist Foundation, and eventually, Enron, leading to Andersen's

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317. See Press Release, U.S. Att'ys Office, Dist. of Conn. 1 (Apr. 23, 1996), <http://www.corporatecrimereporter.com/documents/andersen.pdf>.

318. See *id.* at 1.

319. See Letter Agreement from Edwin J. Gale, Acting U.S. Att'y, Dist. of Conn., *supra* note 128, at 2.

320. Commentators have classified this agreement as a deferred prosecution agreement, see Finder & McConnell, *supra* note 107, at 36 app., but it is not. By its terms, the government agreed to defer investigation, not prosecution. See Letter Agreement from Edwin J. Gale, Acting U.S. Att'y, Dist. of Conn., *supra* note 128, at 2. No charging document was filed with the agreement and the government agreed to terminate its investigation by formal letter in ninety days, so long as Andersen was cooperating. See *id.* at 3.

321. See Press Release, U.S. Att'ys Office, Dist. of Conn., *supra* note 317, at 3. There were other agreements as well. In 1993, Andersen also agreed to pay \$3.5 million to the state of Connecticut; of this amount, \$2.5 million was for fees and interest that it earned for work on eighteen Colonial Realty investment partnerships (this money was refunded to investors), \$100,000 was a civil penalty, and \$900,000 was to cover the costs of Connecticut's investigation and administration of the settlement. Andersen denied that it violated any laws, but agreed to a one-year ban on new contracts with the state and promised to adopt more stringent rules on gifts that its accountants could receive (Arthur Andersen accountant, Edmond Autuori, had apparently received various gifts from Colonial). See *Accounting Concern to Pay \$3.5 Million to Settle Realty Case*, N.Y. TIMES, May 5, 1993, at B6. In 1999 Andersen agreed to a \$90 million settlement of federal and state private civil litigation involving 6,800 investors who claimed that they were defrauded by Andersen's accounting practices involving Colonial. Andersen "denied wrongdoing" and said that it agreed to the settlement "to keep the case from dragging on another decade." See *Sued Accountants to Pay \$90 Million*, N.Y. TIMES, June 29, 1999, at B7.

prosecution for obstruction of justice and to the dissolution of the firm.<sup>322</sup>

The fuller Arthur Andersen story is at least a cautionary tale about how easy it can be for prosecutors to accept an agency agreement in place of a prosecution. But it also helps to illustrate the point that deterrence can be lessened if prosecutors are too willing to accept fix-it-after remedies that do not impose sufficiently strong requirements to force the organization to take steps to avoid future acts of wrongdoing. Andersen's willingness to sacrifice one of its employees—"throwing the accountant under the bus," in current lingo—did not convince either Arthur Andersen or its partners to stop engaging in illegal behavior. Eventually, its persistently improper behavior contributed to the prosecutorial decision to charge the firm with obstruction in the Enron case.<sup>323</sup> At that point one would be hard-pressed to argue that the firm should get yet another fix-it-after deal.

Arthur Andersen offers one last point relevant to the deterrence issue and that relates to the question of collateral impact of a criminal prosecution. No doubt the ultimate failure of Andersen was costly to Andersen's partners and employees, but the full social cost, and the impact on deterrence, is more complicated. The major asset of a service firm is human capital, and Andersen's bankruptcy did not affect its human capital or its value. Indeed, Andersen employees were much sought after by other accounting and auditing firms when Andersen was in the process of dissolving.<sup>324</sup> True, there is one fewer major accounting and auditing firm, reducing the market from five major firms to four.<sup>325</sup> Antitrust policy, however, is as much to blame for the concentration in this market (assuming that the market concentration adversely affects competition), for the federal antitrust agencies did not object to the mergers that formed these major firms in the first place.<sup>326</sup> Indeed, federal antitrust enforcement agencies today are unlikely to challenge a merger that reduces concentration in

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322. See Jonathan D. Glater, *Lone Ranger of Auditors Fell Slowly Out of Saddle*, N.Y. TIMES, Apr. 20, 2002, at C5 (reviewing cases).

323. See Brickey, *supra* note 88, at 922–28.

324. See David Reilly, *How a Chastened KPMG Got by Tax-Shelter Crisis*, WALL ST. J., Feb. 15, 2007, at A16 (describing competition among accounting firms, including KPMG, to convince Arthur Andersen partners to join these firms).

325. See U.S. GEN. ACCOUNTING OFFICE, PUBLIC ACCOUNTING FIRMS: MANDATED STUDY ON CONSOLIDATION AND COMPETITION 11 fig.2 (2003), available at <http://www.gao.gov/new.items/d03864.pdf>.

326. See *id.* at 10–19 (reviewing mergers since 1980 that have resulted in the “Big 8” becoming the “Big 4” and have led to increased concentration in the industry).

a market from five major firms to four, believing that most of these mergers are unlikely to result in a lessening of competition.<sup>327</sup> We should not assume, then, that competition necessarily suffered from Andersen's demise.

To generalize from the Arthur Andersen experience, closer attention to collateral consequences indicates that there may be less to fear from bankruptcy (as assets are redistributed to existing or new firms, hopefully to be used in more productive ways<sup>328</sup>) and more to be gained in deterrence if firms know that firm failure will not enter into a prosecutor's calculus in determining whether to bring a criminal case. The benefits of such increased deterrence could swamp the private costs to the owners of a corporation that engages in illegal behavior. Certainly this would have been true had a stronger prosecutorial effort in the Colonial Realty case changed Arthur Andersen's behavior before it went on to commit ever-larger frauds.

#### *E. Conclusion*

The movement to impose the branch-office role on public corporations is not likely to be rolled back. The agency relationship forged in recent years has too many benefits both for the prosecution and the corporation. These private benefits translate into benefits for the public interest, increasing the chances of successful prosecutions

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327. See William J. Kolasky, Deputy Assistant Att'y Gen., Antitrust Div., Dep't of Justice, Address Before the ABA Section of Antitrust Law Spring Meeting: From Dead Frenchmen to Beautiful Minds and Mavericks figs.7 & 8 (Apr. 24, 2002), <http://www.justice.gov/atr/public/speeches/fig7.pdf> and <http://www.justice.gov/atr/public/speeches/fig8.pdf> (showing that most merger challenges are for 3-2 mergers, that is, where the merger involves two of the three largest firms in the market). Technically, merger enforcement focuses on concentration in a market, as measured by the Herfindahl-Hirschman Index ("HHI"), rather than on market rank. See DEP'T OF JUSTICE & FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES § 5.3 (2010), available at <http://www.justice.gov/atr/public/guidelines/hmg-2010.pdf>. Enforcement agency statistics indicate that most recent merger challenges involve markets with a post-merger HHI above 2400, with most challenges exceeding 3000. See FED. TRADE COMM'N & DEP'T OF JUSTICE, MERGER CHALLENGES DATA, FISCAL YEARS 1999-2003 tbl.1 (Dec. 18, 2003), available at <http://www.usdoj.gov/atr/public/201898.htm>. The enforcement agencies did not challenge the 1998 merger of Price Waterhouse and Coopers & Lybrand, which reduced the number of major audit firms from six to five and increased the HHI to approximately 2200. See U.S. GEN. ACCOUNTING OFFICE, *supra* note 325, at 12, 21 fig.5. The HHI for the audit market in 2002, after the dissolution of Arthur Andersen, was 2566. *Id.* at 18-19.

328. One study did indicate that in the immediate aftermath of Arthur Andersen's conviction audit fees increased as the industry became more concentrated, but the study was unable to determine the effects of increased concentration after 2002 when Sarbanes-Oxley imposed new auditing requirements. See Emilie R. Feldman, *A Basic Quantification of the Competitive Implications of the Demise of Arthur Andersen*, 29 REV. INDUST. ORG. 193, 196-97 (2006).

in business crime cases. The existence of such public benefits counsels strongly in favor of not altering certain legal rules implicated in this agency relationship. Thus, as this Part has argued, courts should not review the fairness of the terms of these agency agreements, not provide stronger attorney-client protections for corporate communications, and not impose constitutional restrictions on corporate investigations.

The adoption of a partnering role for the public corporation, however, should not obscure the importance of corporate criminal liability in deterring business crime. As this Part has pointed out, the prosecution of culpable individuals is not sufficient deterrence for complex organizational crime. It may prove hard to prosecute and convict culpable individuals; sanctions might not be effective to deter them; and sanctions against particular individuals may be suboptimal when their conduct produces large economic gains that inure to the benefit of their organization. Corporate criminal prosecutions have been used in many different types of business crimes, even where criminal conduct has not been pervasive in the organization and even in the absence of involvement by high-management officials. Although prosecutors might worry about the collateral consequences of corporate prosecutions, prosecutors also need to be worried about not bringing such cases. As Arthur Andersen's conduct shows, the consequence to the public of lost deterrence from not bringing a case can be far greater than the consequence to the stakeholders from going forward with a criminal prosecution against the enterprise. Corporations might make good branch offices, but prosecutors need to choose the agency relationship with careful attention to the danger of undermining overall deterrence.

#### CONCLUSION

The Article has described an important, if gradual, change in the role of the public corporation in the criminal process, from potential criminal target to branch office of the prosecutor whose role it is to partner with prosecutors in investigating and prosecuting business crimes. Beginning with the SEC's efforts in the early 1970s through the Justice Department's prosecutions in the Enron era, the Article has shown how prosecutors' use of agency agreements (amnesty, non-prosecution agreements, and deferred prosecution agreements), along with the Sentencing Guidelines for Organizations, have created incentives for corporations to carry out this role. This change in role is not yet complete and not without controversy. Corporations are still prosecuted criminally; and courts, Congress, and commentators

have sometimes been critical of the government's efforts to get corporations to play the branch-office role. Even with the Justice Department's now more cautious view of what it expects corporations to do, however, there has been no change in the basic incentives that corporations have to cooperate in business crime investigations.

The Article has also explored the implications of this role for criminal justice policy. The major concern over the branch-office role is how it will affect deterrence in business crime cases. Reliance on the branch-office role and agency agreements could reduce deterrence if prosecutors too willingly substitute partnering in place of criminal prosecution. For one, the fix-it-after quality of agency agreements reduces the cost of the first violation, which might be the most important business crime violation to deter. For another, too easy willingness to enter into these agreements may end up reducing their effectiveness. A corporation's desire to accept onerous agency obligations hinges on the credibility of the threat to bring a criminal prosecution. There must be more than a bluff to call.

The criminal sanction against corporations is an important one in business crime cases. We should not lessen its use on the assumption that agency agreements can achieve the same goals as a criminal prosecution, or on the assumption that the collateral consequences of corporate prosecutions are so high that we should generally avoid bringing criminal charges against corporations. Entity criminal liability is now used in a wide variety of crimes and is particularly important in cases where individual sanctions are unlikely to achieve optimal deterrence. If the end result of the new branch-office role is that criminal prosecutions of corporations become rare, we may find ourselves back in the position that concerned Senator Sherman in 1890, where public corporations "do not care about your criminal statutes aimed at their servants" and do not "feel the power of Government."<sup>329</sup> Use of the power of government, in the form of corporate criminal prosecutions, should continue to be an important tool for deterring business crime violations.

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329. *See supra* note 2.