# A NEW WAY FORWARD IN INTERNAL INVESTIGATIONS

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## I. INTRODUCTION

The doctrine of *respondeat superior* and the difficulty that most companies would have in surviving a criminal indictment have given the government enormous leverage over companies whose employees are suspected of criminal activity. Over the last decade, the Department of Justice has consciously used this leverage as a force multiplier. By making clear that the extent of a company's "cooperation" will impact the government's decision whether to indict the company, Justice has ensured that companies under suspicion will undertake their own, internal investigations, the results of which will promptly be reported to the Department.

This strategy has some benefits, although they are largely overrated. It saves the taxpayers money, since the companies themselves pay for their internal investigations, and it increases the number of investigations that the Department can manage at one time, thereby ostensibly encouraging a culture of compliance with the law. But it has also paradoxically made it harder for internal investigators to find out the truth about what happened at a company. And, by outsourcing critical governmental functions, it has threatened the constitutional rights of individual employees of the companies being investigated and created moral hazards for prosecutors, companies and outside lawyers alike. Finally, it has precipitated a dynamic whereby the government can effectively micro-manage a company's reaction to a government investigation, and it has encouraged waiver of the attorney-client privilege.

It has also resulted in a backlash from the judicial and legislative branches, spurred on by an unusual coalition of business concerns and civil liberties groups. As a result of this pressure, and in particular the threat of impending Congressional action, the Department has attempted to backpedal twice in the last three years by issuing revised instructions to federal prosecutors, under the authority first of former Deputy Attorney General Paul McNulty (the "McNulty Memorandum") and then McNulty's successor, former Deputy Attorney General Mark Filip (the "Filip Memorandum"). Although these modifications, particularly the Filip Memo, have gone some way toward redressing certain of the more obnoxious aspects of the Department's approach to internal investigations, they have done little to address the fundamental problem: investigation of alleged criminal conduct by, or within, business organizations, is a core government function, and its outsourcing to private companies and their attorneys inevitably leads to violations of individual rights and distorted investigations of corporate crime. It is time for the government to do more – not less – and reclaim its role as the investigator of alleged wrongdoing in corporate America.

## II. BACKGROUND

### A. Corporate Criminal Liability

The widespread application of the criminal law to entities other than natural persons is a relatively recent phenomenon. It originated in the 19th century, when British and American judges began to impose criminal liability on corporations in certain "strict liability" crimes.[1] Because these crimes required no criminal intent, the defendant's state of mind was not at issue. With the development of antitrust laws in the United States, corporations increasingly became criminally liable, a development approved by the Supreme Court in *New York Central & Hudson River Railroad v. United States*, 212 U.S. 481 (1909). There, the Court endorsed the use of *respondeat superior* in the criminal context, borrowing the doctrine from tort law. *Id.*

Under *respondeat superior*, the government can meet its burden to prove a corporation's mens rea by proving that an employee or agent of the company had the requisite criminal intent. Thus, if the applicable *mens rea* is knowledge, the corporation can be found guilty if a single employee has knowledge, even if he has not shared it with his superiors.

### B. The Demand for Corporate "Cooperation"

In June 1999, the Department of Justice first formalized the policies for guiding the decision as to whether to indict business organizations in a document that became known as the "Holder Memorandum," after then Deputy Attorney General (and current Attorney General) Eric Holder. The Holder Memo, in an attempt to discourage counsel for business organizations from cooperating with counsel for individuals in the face of a government investigation, directed prosecutors who were considering indicting a company to take into account "whether the corporation appears to be protecting its culpable employees … through the advancing of attorneys fees, through retaining the employees without sanction for their misconduct, or through providing information to the employees about the government's investigation pursuant to a joint defense agreement." The Holder Memo also explicitly advised prosecutors to consider, when weighing a company's cooperation, whether the company had been willing to waive the attorney-client privilege and work product protection.

In the wake of Enron and other corporate scandals, in 2003 the Department issued the Thompson Memorandum. Distributed under the name of then Deputy Attorney General Larry Thompson, this policy underscored the Department's willingness to pressure companies to waive applicable privileges and discipline individual employees suspected of wrongdoing. Unlike the

Holder Memorandum, the Thompson Memo was binding on federal prosecutors. The Thompson Memorandum also ratcheted up the pressure on companies under investigation to fully "cooperate" with government investigators and explicitly equated corporate cooperation with the cooperation that the government expects from individual criminals who, in exchange for leniency at sentencing, help the government in the prosecution of others. Cooperation agreements between the government and these individuals are invariably conditioned on the defendant's admission of wrongdoing and his full and truthful disclosure of any knowledge of criminal conduct by others. Under this analogy, companies which "know" (often by virtue of an internal investigation conducted in the wake of receiving grand jury subpoenas) of criminal conduct by their employees have the same obligation to fully disclose these facts in order to obtain credit for cooperating as individual cooperators would have. (see section, V-C, *infra* for explanation of why this analogy is inapposite).

Predictably, the Thompson Memorandum emboldened federal prosecutors to make full use of their leverage over companies under investigation. The Southern District of New York's investigation of KPMG for promoting allegedly illegal tax shelters represented the apogee of this tactic.[2] There, government threats to indict KPMG, a move which would have almost certainly killed the accounting giant, forced it to throw a number of current and former partners "under the bus." As the price of a non-prosecution agreement, the company refused to enter into JDAs with individual subjects of the grand jury investigation, fired employees who refused to submit to interviews with the government and ultimately signed onto a statement accusing its (now former) employees with knowing violations of federal law. Additionally, the company, under pressure from the government, refused to pay legal fees for its indicted former employees.

Judge Kaplan's opinion in *United States v. Stein*, 435 F.Supp.2d 330 (S.D.N.Y. 2006), the constitutional portion of which was subsequently affirmed by the Second Circuit in *United States v. Stein*, 541 F.3d 130 (2008), concluded that the government's involvement in KPMG's decision to cut off legal fees violated the individuals' rights to due process and representation of counsel and dismissed the indictment against these individuals.

The long shadow that the Department of Justice casts over internal investigations also implicates the right against compelled self-incrimination, particularly when the government's influence encourages a company to force individuals to talk to internal investigators on pain of being terminated. Normally, one's right against self-incrimination is not implicated in an interaction between private parties, like a company and its employees. However, the lawyers conducting internal investigations often act as junior prosecutors, making regular reports of the results of their investigation to the government. By firing or otherwise punishing employees who refuse to be interviewed in an internal investigation, the company curries favor with the government, which has long considered the company's treatment of presumed wrongdoers when deciding whether to charge the company itself. Thus the government accomplishes indirectly what it cannot do directly – it forces people to choose between their constitutional right against forced self-incrimination and their jobs. As the Supreme Court held more than forty years ago in *Garrity v. New Jersey*, 385 U.S. 493 (1967), this is really no choice at all.

Eventually, the government's tactics created a backlash, which was helped by the KPMG debacle and stoked by an unlikely coalition of business interests and civil liberty groups. Certain senators, most prominently Arlen Specter, the ranking Republican on the Senate Judiciary Committee, began exerting pressure on the Department of Justice. In 2006, Senator Specter introduced legislation that would have prohibited the Department of Justice from considering various factors, including a company's willingness to cut off legal fees to its employees and waive the attorney-client privilege, when deciding whether or not to charge the company. In an effort to forestall such legislation, the Department began to backtrack, at first slowly. In 2006 it issued the "McNulty Memorandum," which modified the internal guidelines regarding the indictment of business organizations by, among other things, making it harder for prosecutors to ask for certain types of privilege waivers.

The McNulty Memo, however, did not really change the fundamental equation, and when Senator Specter pressed ahead with his plan for legislation, DOJ responded by retreating further. On July 9, 2008, then Deputy Attorney General Mark Filip sent Senators Leahy and Specter a letter (the "Filip Letter") pleading against the enactment of legislation and pledging that the Department would evaluate companies' "cooperation" without considering whether or not these companies did the following: waived applicable privileges; entered into JDAs with individuals suspected of wrongdoing; sanctioned these individuals; and advanced their defense costs. Instead, "the government's key measure of cooperation" will be "to what extent has the corporation timely disclosed the relevant facts about the misconduct. That will be the operative question – *not* whether the corporation waived attorney-client privilege or work product protection in making its disclosures." (emphasis in original).

Subsequently set forth in a formal memorandum (the "Filip Memorandum") and incorporated into a revised set of corporate charging guidelines in the United States Attorneys Manual, these changes appeared to go a long way toward addressing some of the flaws in the Department's policy. But they are less meaningful than they seem at first glance.

## III. Flaws in the New Guidelines

### A. Tolerance of Company Participation in Joint Defense Agreements

One of the much-touted reforms instituted by the Filip Memo and memorialized in the Principles of Federal Prosecution of Business Organizations ("Corporate Charging Guidelines") is the Department's commitment to refrain from pressuring companies under investigation to refuse to enter JDAs with potentially culpable employees. It is also one of the most cosmetic and least substantive changes.

According to revised Section 9-28:730 of the United States Attorneys' Manual, the "mere participation by a corporation in a joint defense agreement does not render the corporation ineligible to receive cooperation credit, and prosecutors may not request that a corporation refrain from entering into such agreements." However, this section makes clear that the government will continue to exact a significant price from any company that actually chooses to enter into a JDA worthy of the name, as the section continues:

> Of course, the corporation may wish to avoid putting itself in the position of being disabled, by virtue of a particular joint defense or similar agreement, from providing some relevant facts to the government and thereby limiting its ability to seek such cooperation credit. Such might be the case if the corporation gathers facts from employees who have entered into a joint defense agreement with the corporation, and who may later seek to prevent the corporation from disclosing the facts it has acquired. Corporations may wish to address this situation by crafting or participating in joint defense agreements, to the extent they choose to enter them, that provide such flexibility as they deem appropriate.

This language actually represents a *retreat* from the language of the Filip Letter, which contained the broad promise that the government "would not consider" a company's participation in a JDA when evaluating the company's cooperation. But the government, in both the Filip Memo and the revisions to the Corporate Charging Guidelines, has made clear that, while companies can participate in JDAs with employees, if the companies want cooperation credit, these agreements had better not prevent the companies from sharing information about the "relevant facts" with the government.

But if counsel for individual subjects cannot be assured that information that they share with company counsel pursuant to a JDA will not be relayed to the government, what possible motivation do they have for entering into such an arrangement? After all, the point of JDA and other common interest agreements is to encourage the free flow of information in a protected context. The Filip Memo, however, appears to approve companies entering only those JDAs which allow them to provide any information they receive to the government. Under such circumstances, companies are not likely to find a lot of takers from counsel for individuals.

### B. Punishing Allegedly Culpable Employees

The Department's pledge not to consider whether the corporation has retained or sanctioned employees in evaluating a company's cooperation is also less meaningful than it first seems. Although not mentioned in the Filip Letter, the old rules directed prosecutors to consider in two separate ways whether the company has sanctioned purportedly culpable employees: an evaluation of the company's cooperation, and a consideration of its "remediation." The Filip Memo addresses the consideration of sanctions under the first but not the second category, and the modified Guidelines confirm that the company's treatment of individual "wrongdoers" will remain an important consideration for prosecutors weighing indictment of the company. Section 9-28:900 explicitly permits prosecutors to consider whether the company has disciplined "wrongdoers," and the Comment to this section stresses that "[a]mong the factors prosecutors should consider and weigh are whether the corporation appropriately disciplined wrongdoers, once those employees are identified by the corporation as culpable for the misconduct."

Of course, there's nothing wrong with a company firing or otherwise disciplining employees who have been found to violate the company's code of conduct, much less federal law, if it is truly the company's judgment that these employees committed misconduct. And to be fair, the Comment to Section 9-28:900 is phrased in terms of punishment only for those who have been found culpable by the company. But where the company's conclusion that certain employees are guilty of wrongdoing is motivated by a desire to please the government, one begins to slip back into KPMG-land. There, the company initially vigorously defended its employees' actions and only later, under the threat of imminent indictment, was persuaded to "conclude" that its (by then terminated) employees were actually guilty of serious crimes. If the government believes that the company, and certain employees, committed crimes, it is likely to regard any exoneration by the company of its employees as "circling the wagons" or protecting culpable employees. For this reason, internal investigations done in the shadow of a grand jury investigation are not likely to reach conclusions that are radically different from those favored by the government. And if refusal to be interviewed by internal investigators who are likely to relay the substance of these interviews to the government is a violation of company policy, individual employees who exercise their Fifth Amendment right not to be interviewed will continue to be labeled “wrongdoers.”

### C. Waiver of the Attorney-Client Privilege

Of course, the Department’s most controversial practice under previous versions of the Guidelines was to link a company’s willingness to waive applicable privileges to prosecutors’ evaluation of its cooperation. And while the Filip Memo contains language eliminating the explicit linkage between the two, the fact is that the new policies do not eliminate waiver as a factor in evaluating a company’s cooperation. In contrast, it reaffirms the legitimacy of consideration of waiver in deciding whether to bring charges against a company.

As set forth above, the Filip Memo reassured Congressional critics that “the government’s key measure of cooperation” will be “to what extent has the corporation timely disclosed the relevant facts about the misconduct. That will be the operative question – *not* whether the corporation waived attorney-client privilege or work product protection in making its disclosures.” (emphasis in original). But this is far less meaningful than it seems at first glance, as the “timely disclosure” of “relevant fact about the misconduct” that will be the government’s “key measure” of a company’s cooperation will often still require companies to waive attorney-client privilege. After all, internal investigators will doubtless learn some of these facts through privileged conversations with employees of the company. *Upjohn v. United States*, 449 U.S. 383, 390 (1981). So when the government considers whether a company is entitled to credit for cooperating with the investigation by timely disclosure of these key facts, it will *still* be punishing companies who don’t waive the privilege and rewarding those companies who do waive. It just won’t explicitly be tied to a formal waiver any more.

The modifications to the Charging Guidelines do make explicit that the government may not request the company to waive privilege over communications that go to the “core” of the attorney-client privilege or work product protection. However, the Guidelines define this core overly narrowly, limiting it to consultations “separate from (and usually preceding)” fact gathering, as well as legal opinions provided to the company. This attempt to separate communications containing facts and those that do not is artificial, particularly since the attorney-client privilege, at its “core,” is intended to protect facts provided by a client to a lawyer for the purpose of obtaining legal advice, more so even than the actual advice provided by the attorney to the client.[3]

Moreover, the evidence suggests that, even before the Filip Memo, prosecutors weren't explicitly asking for waivers of the type of information that they're now prohibited from asking for. According to the Filip Letter, in the eighteen months between the issuance of the McNulty Memo and the Filip letter, prosecutors made zero requests for this type of "core" privileged information.

In fact, the changes wrought by the Filip Memo are in some ways, a step backwards for waiver. The McNulty Memo at least required prosecutors to obtain high-level approval within the Department for any request for waiver. Under the current system, line prosecutors can ask for factual information unearthed in the internal investigation without obtaining approval from anyone. The current Guidelines make clear that companies deny these "requests" at their own peril, and that companies shouldn't even wait for the request, noting that companies which do not disclose factual information should not typically receive any credit for cooperating. In other words, provide the factual results of your internal investigation or risk indictment. Of course, much of this information will be privileged.

## IV. A NEW WAY FORWARD

The government should stop outsourcing criminal investigation to internal investigators hired by companies under investigation. This system, whereby company counsel are essentially deputized as junior AUSAs for an investigation that, while funded by the company, is more or less directed from the Department of Justice, is bad for American business, bad for individual rights and, ultimately, bad for justice. In addition to the abuses and inefficiencies detailed above, it doesn't even make for good law enforcement.

Investigation and enforcement of the criminal laws are core government functions, and internal investigations are simply not a substitute for government doing the work itself. Lawyers, like all professionals, answer to those paying their bills. This is not to say that the role of attorneys (or other professional advisors) as corporate "gatekeepers" is a complete fiction, but internal investigators hired by the company (or some collection of ostensibly independent members of the Board of Directors) have different agendas than federal prosecutors. This dynamic can be discerned in the conclusions of various internal investigations which somehow find a way to exonerate powerful constituencies like the largest shareholder, company founder, Chairman of the Board or current CEO. Too often, these investigations sacrifice subordinate employees or executives by dubiously concluding that these individuals were "rogue" underlings, when the independent record strongly suggests that they were merely enacting a flawed company policy. This is not to impugn the integrity of the attorneys conducting the internal investigation, most of whom are no doubt honorable people. But there are credibility determinations and judgment calls to be made in every internal investigation, and when lawyers (or investigators) paid by the company make those decisions, they do so with a perspective different than that of a career prosecutor who answers to no one except his or her supervisor.

This hurts law enforcement. The most obvious, and most frightening, impact of a flawed internal investigation is that it can send the government down the wrong track and even lead to the prosecution of the wrong people. Although no prosecutor will admit that he or she makes a practice of simply adopting the conclusions reached by an internal investigation and inserting them into an indictment after a perfunctory and credulous "independent" process of verification or confirmation, a tidy little basket of case is bound to tempt a busy prosecutor who is supervising more investigations than he or she could ever prosecute.

Even if the government is able to detect, and address, the erroneous conclusions of the internal investigation, an outcome which would itself come at the cost of a rigorous and time-consuming reinvestigation that would moot most, if not all, of the supposed efficiencies of the internal investigation, mistakes made by company counsel can irrevocably damage the government's ability to successfully prosecute a case. Consider the internal investigation which, in its pursuit of facts consistent with a preferred conclusion, results in a number of likely witnesses going on the record with an unlikely version of events.

If the government takes custody of these statements and later brings a case, it will have to turn over the prior statements of anyone it decides to call as a witness. The government can choose not to take custody of such statements and thereby try to deny the defense a potent line of impeachment. But company claims of privilege are dubious in this context, since the content of the interviews is often contemporaneously disclosed to the government. Moreover, the unseemly two-step of "selective waiver," whereby companies waive privilege with respect to the government but purport to maintain it with respect to third parties, has been decisively rejected in the newly enacted Rule 502 of the Federal Rules of Evidence. The Advisory Committee refused to codify selective waiver, and Congress agreed. Furthermore, even if the government were successful in denying defendants access to prior inconsistent statements of its witnesses, would we want them to be?

Having company counsel act as an appendage to the government also hurts companies under investigation. This is not because these companies don't have an interest in ferreting out lawbreaking and other types of misconduct; they do. However, by impairing (if not destroying) the company's ability to provide its employees with assurances that their privileged statements will not be shared with the authorities, the current system makes it harder for internal investigators to get at the truth. If companies could enter into JDAs which actually offered safety and protection for its employees, attorneys for these individuals would not feel compelled to counsel their clients to refuse to talk to company counsel. And if the results of these interviews were protected from the government, there would be nothing wrong (constitutionally or otherwise) with companies making such cooperation mandatory.

The current system also has created an unnecessary moral hazard for all parties involved. Companies are incentivized, or even forced, to throw their own employees "under the bus" as soon as the government launches an investigation. This reality cannot help but undermine employees' loyalty to the company, and to each other. It is true, of course, that our system of justice consciously aims to undermine certain types of loyalty. We don't complain when the government encourages lifelong friends to betray each other in its efforts against organized crime or violent gangs. And we certainly don't want blind loyalty to The Company to create a culture of circling the wagons against government probes. Still, the current system makes a company's willingness to abandon its employees a *sine qua non* of cooperation, even if the company does not share the government's belief that these employees committed wrongdoing.

The government's insistence on a company's "recognition" of its own sins as a price of survival also makes it much harder for the company to successfully resist even unmeritorious related civil litigation. Once a company has confessed to a crime to avoid indictment, it becomes almost impossible to resist opportunistic civil litigation.

As mentioned above, much of the current debate in this area revolves around the question of whether the changes wrought by the Filip Memo go "far enough" or whether legislation is required to dissipate the culture of waiver. Those who favor Congressional action point to the four different DAG-monikered memos within the last 10 years, and argue that the problem clearly cannot be resolved by further tweaking by the Department.

However, the fundamental issue cannot be addressed by just any legislation. The draft law advanced by Senator Specter would essentially codify, and slightly firm up, the Filip changes. The Report on the House side also endorses Justice's demand for disclosure of the relevant facts discovered by the internal investigation, as long as DOJ doesn't consider whether or not these facts are privileged when deciding whether to charge the company.

We need a more radical break from the practice of the last decade, one that will bring the function of a criminal investigation back inside the government. A "wall" between the government and any internal investigation conducted by the company is one potential solution, although "walls" that prevent facts being shared with other investigators have a bad name after 9/11.

In addition, companies must be able to continue to voluntarily report fraud or other crime to the government. One alternative is to compel the DOJ to change the Corporate Charging Guidelines so that the decision on whether or not to indict a company is based solely on its past actions. This would include many of the same criteria that the Department currently evaluates in its corporate charging decisions, including the level of the culpable individuals, the pervasiveness of the misconduct within the company, and whether the company was a recidivist.

However, the prospect of Congress legislating the criteria to be used in charging decisions, an area traditionally reserved for prosecutorial discretion, is discomforting. Such legislation, by appearing to confer substantive rights on potential defendants, also begs the question of how it would be enforced, and whether this would allow defendants to obtain discovery about the process used by prosecutors in making specific charging decisions.

An even more radical solution, although one that is more suited for Congressional action, would be to redefine entity criminal liability or even abolish it altogether. Under current law, a company can be held responsible for the criminal conduct of a single employee, even if his actions are proscribed by company policy, as long as the conduct was within the scope of that employees duties and done at least partially to benefit the company. The doctrine of *respondeat superior* could be narrowed in the criminal context, so that an entire company could no longer be threatened with indictment for an isolated incident by a lower-level manager and could only be indicted for something that was truly (even if informally) company policy.

Section 2.07 of the Model Penal Code provides an example of such an approach. Unlike federal law, under which corporations can be criminally liable unless Congress clearly indicated it did not intend to subject business organizations to the statute, § 2.07 requires that "a legislative purpose to impose liability on corporations plainly appears." § 2.07(1)(a). Additionally, while *respondeat superior* holds corporations criminally responsible for the acts of the lowliest employee, as long as done within the scope of his or her authority and at least partly for the benefit of the entity, the Model Penal Code requires the government to show that the criminal conduct was ordered, approved or "recklessly tolerated" by the board or a high-ranking member of management. § 2.07(1)(c). Finally, the Model Penal Code provides for a due diligence defense, where the company can demonstrate that it used due diligence to attempt to prevent the criminal act in question.

The complete abolition of criminal liability for entities is also an option, and not as outlandish an option as it might first appear. The true deterrent value of corporate criminal liability is debatable. Individuals are unquestionably deterred from committing crimes because they don't want to go to prison. Would-be criminals, particularly white-collar criminals, also may be deterred by the potential stigma of a felony conviction. Companies do not serve time in prison. Nor do they feel shame, although they may be sensitive to reputational damage. Companies do pay criminal fines, but even without potential criminal liability, they would still be financially liable for any regulatory and civil violations.

One of the ironies of the current situation, where companies are often forced to sacrifice individuals in order to preserve themselves, is that historically entity prosecutions have been subject to abuse from the opposite direction. In those cases where a company **could** sustain a conviction and continue to operate, a guilty plea from the company was often offered as a substitute for the punishment of the culpable individuals. This type of outcome is discouraged by the Corporate Charging Guidelines, but it is still a tempting solution for busy prosecutors and culpable corporate executives. The harm done to the deterrent power of the criminal law in these circumstances is manifest.

## V. COUNTERARGUMENTS

### A. The Difficulty of Investigating Corporate Crime

Defenders of the role of internal investigations in supplying information to the government argue that, if companies aren't rewarded for this type of cooperation, they will naturally fall back into a mentality of "circling the wagons" and enforced silence in the face of a government investigation. But the specter of corporate *olmerta* is overstated. Even without the added incentive of avoiding criminal indictment, companies will still have a host of reasons not to impede government investigations, not the least of which is the possibility that the corporation or culpable individuals could be prosecuted for obstruction of justice.

Business entities will also continue to have incentives to police themselves, particularly as a way of minimizing civil liability. Where an employee is defrauding the company, the corporation will have another powerful incentive to aid the government's investigation. And where the alleged misconduct benefited the company, the government, when considering whether to indict a company, would still be permitted to take into account the company's compliance programs and remediation (except where doing so would encroach upon the attorney-client privilege or individuals' constitutional rights), even without linkage between an internal investigation and a parallel grand jury investigation,

Companies can also cooperate without breaching the privilege by granting the government access to (willing) employees, interpretation of responsive documents and other assistance. And, of course, the government will still have the same carrots and sticks that have enabled it to successfully crack open organizations (like the mafia and violent gangs) that presumably have more effective ways of enforcing silence than corporate America.

Finally, for those rare companies in which corruption is so endemic that the entity itself deserves to be put down, the government has the same tools which have enabled it to tackle other criminal enterprises. This includes the civil and criminal RICO statutes and the laws against participating in a Continuing Criminal Enterprise.

## B. Conserving Scarce Government Resources

The Department of Justice regards its ability to piggyback on internal investigations as a force multiplier. Prosecution is not unlike triage, where there are always more targets than they are resources to deploy, and having private companies fund internal investigations saves the government time and money, which is critically important in an era of massive governmental budget deficits. According to Steven Tyrell, Chief of the Fraud Section in the Department of Justice's Criminal Division, as of March 5, 2009, the Department was conducting active criminal investigations of more than 100 companies.[4] Investigations by local U.S. Attorney's Offices doubtless add to the that total, and it's safe to assume that the vast majorities of companies under investigation have conducted, or are currently conducting, internal investigations, the results of which were, or will be, shared with the DOJ. Without this dynamic, the Department will presumably be able to investigate and prosecute fewer companies.

The solution, however, is not to subcontract grand jury investigations to company counsel. As set forth above, even the most honest internal investigators understand that they have a client to serve, and particularly with companies where there is a dominant shareholder or executive, the results of the internal investigation can be badly skewed. In such cases, the government must either redo the investigation from the beginning (after being convinced of the necessity to do so), which eliminates any cost savings, or essentially accept the conclusions of the internal investigation. If the government adopts a hybrid approach, where it accepts the report with its own relatively abbreviated review of the credibility of the witnesses or the logic of the report, it still leaves the government vulnerable to flaws in the internal investigation.

Also, the triage aspect of prosecution is actually a good thing. The Department **should** have to choose its targets with care. The routine outsourcing of the initial investigation to lawyers working on the company's dime has eroded the connection between the prospects for a successful outcome and the cost of an investigation. It costs the government very little to initiate an investigation, but the mere act of sending out a grand jury subpoena can force a company to launch an incredibly expensive, massive investigation. Even where there is wrongdoing within the company, it is sometimes so minor (and old) as to not merit that investment, but companies facing a criminal investigation have no choice but to devote whatever resources are required to avoid indictment. In effect, every investigation becomes a "bet the company case."

This dynamic also undermines the ability that most clients have to control their purchase of legal services. In-house counsel might disagree with the scope and cost of an internal investigation, but they are often unable to rein it in because they don't want to be seen as interfering with or constraining the investigation. Meanwhile, the law firm conducting the internal investigation has no economic incentive to attempt to limit expenditures. All this is a recipe for internal investigations run amok, and a huge cost for American businesses. This effect can be seen most prominently in the raft of FCPA investigations initiated over the last five years.[5]

### C. Denying Companies "Special Treatment"

The Department of Justice insists that its Corporate Charging Guidelines are fair and notes that they are consistent in many ways with the policies governing charging decisions for individuals. Like individuals who seek to cooperate with the government, companies can only earn cooperation credit if they fully disclose facts in their possession. This approach, however, stretches the analogy between individual and corporate "minds" far beyond the useful point.

First, individuals who choose to cooperate with the government generally do so because the government has very strong evidence against them. This is true whether the person decides to cooperate before or after indictment. If the government does not have sufficient evidence to prove guilt beyond a reasonable doubt, the individual can force the government to try the case. For most companies, this is not an option. Once the company has been indicted, it has lost, and vindication at trial (or, as in the case of Arthur Andersen, post-trial) will have no practical relevance. This allows the government to extort "cooperation" from virtually any company, since the government can almost always obtain an indictment if it wants one.

Second, although DOJ policy requires both individual cooperators and corporate cooperators to fully disclose relevant "facts in their possession," this means very different things in the corporate context. Not being natural individuals, companies generally have no "facts in their possession" when they first receive a grand jury subpoena. They must gather these facts from an internal investigation, from the individuals who actually know these facts. The process of doing so, of course, usually involves lawyers, and privileged communications.

Finally, cooperating corporations and cooperating individuals are different in another important respect: the government cannot use individual cooperators to accomplish what it cannot do itself. For this reason, the government cannot use a cooperating co-defendant to elicit incriminating statements from an individual whose Sixth Amendment right to counsel has attached.[6] The use of a surrogate does not change the fact that it is government action. Yet that is precisely what the government does with corporate cooperators when it insists that, as a measure of the company's cooperation, the **company** must elicit incriminating statements from its own employees (often on pain of termination) and provide these statements to prosecutors.

### D. The Law of Unintended Consequences

Another concern is that any attempt to fix the problem described above could make matters worse. With regard to specific legislation, such as the law proposed by Senator Specter, there are a number of questions still unanswered, such as: will the law confer substantive rights on companies? Individuals? What will the remedy for violations of the statute be? Will the government, or individual prosecutors, be subject to suit for violations? This could overdeter aggressive investigation of business entities at a time when public confidence in American business is already at a historic low.

Some commentators also insist that companies would rather conduct the investigation themselves than be subject to the intrusiveness of a grand jury investigation. However, it is difficult to imagine a more intrusive and disruptive practice than many internal investigations, where outside counsel will essentially set up shop within a company and conduct adversarial "ambush" interviews with multiple employees. This approach is not only intrusive and distracting, it undermines corporate cohesion and can fray the bonds between coworkers.

The government has argued that any legislative action would be precipitous. In his letter to Senators Specter and Leahy, former Deputy Attorney General Filip noted that he had concluded that a change to internal DOJ policy was "preferable to any legislation, however well intentioned and diligently drafted, that would seek to address the same core set of issues." Filip also pleaded for Congress to adopt a "wait and see" approach: "I respectfully ask that you give us an opportunity to implement these changes and then review their operation after a reasonable amount of time before pursuing legislation in this area."

There is also some evidence that the government has modified its approach to corporate charging decisions in the last couple years. According to a new study, the number of deferred and nonprosecution agreements between companies and the government dropped 60% from 2007 to 2008.[7] Since these agreements are generally offered to companies as an alternative to indictment where the company's internal investigation met the government's approval, the reduction could reflect a less aggressive approach by the Department. Of course, it could be explained by other factors entirely.

In addition, the effective deputization of company counsel as junior prosecutors is likely to become even more tempting in the coming years. This is particularly true as the government's influence over private businesses, particularly in the financial industry, continues to increase in the face of the growing dependence of many American companies on governmental support. This danger could be compounded by the level of public anger and frustration at the meltdown of Wall Street. With demands increasing that the government find and punish those "responsible" for our financial predicament, some degree of prosecutorial overreach is probably inevitable. Government-directed internal investigations just magnifies the danger.

# ENDNOTES

1. J. Kelly Strader, Understanding White-Collar Crime, (2006) § 2.02.

2. I formerly represented one of the defendants at one stage of that case.

3. Paul R. Rice, Attorney-Client Privilege in the United States, § 5:2 (Privilege provides a direct protection for confidential communications from the client to the attorney and a derivative protection for communications from the attorney to the client.") (emphasis in original). See, also, Upjohn, 449 U.S. at 390-91.

4. Comments at 2009 ABA White Collar Institute in San Francisco.

5. Ironically, one of the costliest internal investigations in recent memory may have actually been a good use of corporate money. Siemens AG reportedly spent upwards of $200 million on a two-year internal investigation into allegations of widespread bribe-paying across the globe. The case settled in December 2008, with Siemens pleading guilty to books and records charges and making a total of $800 million in payments to DOJ and SEC, along with additional payments to resolve a parallel investigation by German authorities. However, the misconduct uncovered in that case amounted to even larger sums in damages (including bribes paid and contracts obtained), and the company ultimately was able to obtain a plea agreement that required it to pay less than half of the fine it could have been forced to pay. However, the Siemens investigation seems to be an outlier in many respects, as a number of companies have been forced to undertake enormously costly internal investigations to look for evidence of relatively minor wrongdoing.

6. Massiah v. United States, 377 U.S. 201, 205-06 (1964).

7. "Betting the Corporation: Compliance or Defiance," Corporate Counsel Review of South Texas College of Law, May 2009. According to the survey, over 43% of 2008 agreements involved FCPA violations.

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