CORPORATE DEFERRED PROSECUTION AGREEMENTS

THE BREWING DEBATE

By Eugene Illovsky

All of the punishment, none of the guilt. What’s not to like about deferred prosecution agreements for corporations? Prosecutors get another choice for disposing of a corporate case other than declining or indicting. And they can still make sure wayward companies will be fined, chastised, restructured, and reformed—without unduly harming innocent constituencies. From the company side, deferred prosecution helps it avoid the distraction, risk, and often devastating consequences of indictment, trial, and conviction. The board of directors cleans house, pays money, and the company stays in business; though not without (sometimes a good bit of) pain.

A corporate deferred prosecution agreement is basically a way of imposing a term of probation before a conviction. The government files charges but then agrees to hold them in abeyance pending the company’s successful completion of certain terms in the agreement for a period of time. Sometimes companies get a “nonprosecution” agreement, the effect of which is often eventually the same. I do not distinguish between them here.

If the conditions set forth in the agreement are met to the government’s satisfaction—and to its satisfaction alone because there is no judicial supervision—the charges get dismissed. Typical terms come more or less right out of the U.S. Sentencing Guidelines and include an admission of wrongful conduct supported by a detailed factual basis (admissible in a later trial); payment of a fine (which can be quite large—KPMG paid $456 million); cooperation with the government’s ongoing investigation (which often obligates the company to make its employees available and includes privilege waivers); the adoption of compliance programs and other reform measures such as changes in corporate governance; personnel actions (e.g., firings, demotions, reassignments); and waivers of speedy trial rights and statutes of limitations defenses.

Other provisions that may appear in these deferred agreements include limits on public statements, restrictions on a company’s ongoing business practices, and the appointment of a government-selected monitor to oversee the company’s compliance with the agreement’s terms. The period of time in which compliance with the terms is required before the charges are dismissed varies from agreement to agreement and can be 12 months (e.g., Banco Popular), 15 months (e.g., Williams Power), 24 months (e.g., America Online); 36 months (e.g., Monsanto), or even longer.

Background and impact

In any event, the business in corporate deferred prosecution agreements has certainly been brisk, particularly since 2003. The dozens of deferred prosecution agreements since then have involved organizations large and small, public and private, for-profit and not-for-profit. Two things happened around that time that fueled the upsurge. (See, e.g., John C. Coffee, Deferred Prosecution: Has It Gone Too Far? Nat’l L.J., July 25, 2005, at 13.) One was the postindictment collapse of Arthur Andersen, which was reportedly offered a deferred prosecution agreement but refused the conditions, and the other was a memorandum from the deputy attorney general describing the nine factors the U.S. Department of Justice (DOJ) considers in corporate charging decisions. (Memorandum from Larry D. Thompson to Heads of Department Components and U.S. Attorneys Re: Principles of Federal Prosecution of Business Corporations (Jan. 20, 2003), http://www.usdoj.gov/usao/eousa/foia_reading_room/usam/title9/crm00161.htm.) That Thompson Memorandum signaled there would be situations in which a corporation’s cooperation might make “pretrial diversion” an option. Pretrial diversion—deferred prosecution—began in the early 1990s as a way to handle juveniles without stigmatizing them for life as criminals. It was mostly associated with individuals and not applied to companies until the early 1990s. (See Benjamin M. Greenblum, What Happens to a Prosecution Deferred? Judicial Oversight of Corporate Deferred Prosecution Agreements, 105 COLUM. L. REV. 1863 (2005).) The DOJ, therefore, did not have much in the way of standards Thompson could point to when he issued his memo. Not much help can be gleaned from other DOJ policies or the United States Attorneys’ Manual on corporate pretrial diversion, and some have proposed that DOJ fill this void in its policies. (See, e.g., F. Joseph Warin & Peter E. Jaffe, The Deferred Prosecution Jigsaw Puzzle: A Modest Proposal for Reform, 19 ANDREWS LITIG. REP., Sept. 2005, at 1.)

It is no surprise, then, that the combination of powerful prosecutors, risk-averse companies, and few standards would produce an upsurge in deferred prosecution agreements for organizations. Not to mention an interesting variety of provisions: requiring a hospital to give the public millions of dollars of free health care, obligating a

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company to endow a chair in business ethics at the U.S. attorney’s alma mater, or requiring a company to create 1,600 new jobs in the state over 10 years.

That not everyone is completely delighted by the development is also no surprise. The reasons for the displeasure vary, of course, depending on whom you are hearing from among practitioners, professors, and bloggers. Some commentators criticize the practice precisely because it allows “corporate criminals” to opt out of the criminal justice system and avoid conviction. Defense lawyers are happy to have another tool to help corporate clients—for whom often the only real question is how soon to cooperate—avoid conviction. At the same time, there is concern that there may be a negative effect on criminal justice. For instance, some provisions may hinder a person’s ability to defend himself or herself, and privilege waivers may contribute to the perception that the government is imposing a “culture of waiver” and eroding the privilege. These concerns are not calmed by the fact that prosecutors retain the sole discretion to determine whether a company has materially breached an agreement.

Indeed, the concessions that companies make in these agreements and the invasive nature that federal “cooperation” often entails have raised the question of whether the practice has “gone too far.” (See John C. Coffee, supra.) Not only have some proposed that DOJ provide more policy guidance, there have also been proposals that some level of judicial involvement is necessary to check prosecutorial power. (See, e.g., Benjamin M. Greenblum, supra.) Because of concerns on a number of fronts, a working group of the American Bar Association Section of Criminal Justice’s Corrections and Sentencing Committee is analyzing some 40 deferred and nonprosecution agreements and preparing a report for the committee. The members include David Axelrod, Barry Boss, Kirby Behre, Peter Jaffee, Samuel Buffone, and Eric Jaso, and many look forward to the fruits of their efforts.

A sampling of provisions sparking debate

Listed below are a few types of provisions in corporate deferred prosecutions that have engendered argument. Briefly discussing some of these terms raises just some of the myriad challenges and questions for companies and their defense counsel, not the least of which is whether the price the company pays for peace may be too high. Such a discussion also highlights some of the challenges and questions for the justice system more broadly.

Waiver provisions. The American Bar Association, among others, has spoken out about DOJ practices and policies embodied, for instance, in the Thompson Memorandum of making waiver of the attorney-client and work product privileges a sign of a company’s good faith cooperation in an investigation. Practitioners’ widespread concern, based on experience, that there is a corrosive culture of waiver among prosecutors that is eroding the privilege is reflected, among other places, in a recent survey done by a coalition of organizations and presented to the Congress and the U.S. Sentencing Commission. (See The Decline of the Attorney-Client Privilege in the Corporate Context, http://www.acca.com/Surveys/attyclient2.pdf.)

Waiver provisions are fairly common in deferred prosecution agreements. As part of the promise to cooperate with the government in exchange for a prosecution deferral, companies often must agree to waive attorney-client and work product privileges regarding the company’s investigation and the conduct at issue. Naturally, the government often insists that waiver is critical to its efforts to get fully at what wrongdoing occurred. And perhaps the waiver issue is different when a company waives as part of getting the benefit of deferred prosecution after it has admitted to wrongful conduct.

Of course, when a company is negotiating an agreement to avoid prosecution, its leverage to resist a waiver provision is not at its highest. And, to the extent that deferred prosecution agreements are getting more prevalent—some question whether the government is getting deferred prosecution agreements in cases it would otherwise decline; companies certainly would be hard pressed to see if the government were bluffing in any particular case—waiver becomes more and more simply business as usual.

Even if waivers have been negotiated rather than simply demanded as a condition of cooperation, it hardly requires comment that their impact is the same. Certainly, the effect on the company’s pending or future civil litigation is obvious. Some have also noted that waiver can actually harm corporate governance by discouraging consultation with lawyers and making it more difficult to detect and fix wrongdoing early. (Elkan Abramowitz & Barry A. Bohrer, Waiver of Corporate Attorney-Client and Work Product Protection, 234 N.Y. L.J. ___ (Nov. 1, 2005.) So the erosion of the privilege could be at odds with the very reforms the government has achieved through these agreements.

Noncontradiction provisions. An organization getting a deferred prosecution must accept responsibility for the wrongful conduct. This is done, in part, by the company’s admitting to a factual basis for the offense. This basis is usually set forth in a sometimes quite extensive statement of facts, which may be attached as an exhibit to the agreement. For instance, the statement of facts for the FirstEnergy Nuclear Operating Company agreement is at least as long as the agreement itself. It contains a detailed version of events pertaining to problems at the Davis-Besse Nuclear Power Station in Ohio along with several false statements FirstEnergy says its employees made to the Nuclear Regulatory Commission.

A company then also typically agrees that it, as well as its lawyers, employees, or agents, will make no statement “contradicting” anything in the statement of facts. A typi-
cial example is the Roger Williams Medical Center’s agreement prohibiting any contradictory statement by “present or future attorneys, agents, officers, directors, trustees, or employees.” And, as in the KPMG agreement, it is in the sole discretion of the government whether that contradictory statement should be imputed to the organization. The government, also in its sole discretion, will decide whether any such contradictory statement is a material breach of the agreement. To avoid being in breach, the organization must—usually within 48 hours—repudiate the statement to the DOJ as well as to the recipient of the statement, and agree to the DOJ’s public release of the repudiation.

Of course, it could be difficult for a large organization to keep tabs on every statement generated by its agents and employees. (The KPMG agreement requires the DOJ to notify KPMG of the supposedly contradictory statement.) Not to mention that this provision, like the waiver provision, raises the cost of any parallel civil cases.

Aside from the impact on the company of such a provision, it affects employees’ ability to defend themselves in any ongoing government investigation. Not only are they told they must cooperate with the government (indeed, their jobs may depend on it), but they may feel pressure to testify consistently with the agreed-upon version of facts. If an executive strays from the detailed factual statement the company has agreed to, the company’s repudiation of his or her statement or testimony may be the least of his or her problems.

Neither will the job of those defending former employees who have been charged be made any easier. It creates one more obstacle to access to current employee witnesses and raises the question of whether their testimony has already been signed and sealed in any event. Further, this assumes counsel is getting paid; some organizations may feel pressured to refuse to indemnify an employee for the costs of a defense on the ground that the government will view organizations making such payments as being less than cooperative.

**Business limitation and governance reform provisions.** All deferred prosecution agreements require a company to commit to future compliance. Some have provisions that restrict the organization’s ongoing business activities. For instance, in the government’s tax shelter investigation, KPMG agreed, among other things, to permanently cease its private client and compensation and benefits tax practice. It also agreed to certain detailed thresholds it would apply in providing clients with “covered opinions” under the agreement. Bayerische Hypo-and Vereinsbank AG, in the agreement arising from its tax shelter problems, agreed to similar restrictions on its involvement in tax advice and transactions.

The agreements also can provide for various types of corporate governance reforms. Usually, the company at a minimum must agree to institute a new, or beef up an existing, compliance and ethics program, appoint a compliance officer, and ensure all employees have access to a hotline of some type to allow anonymous reporting of any noncompliance. The government may very well require changes in board of directors composition or the creation of board committees. Some of these more creative provisions have caused commentators such as Professor Coffee to express concern that shareholders’ rights to choose directors might be sacrificed to a prosecutor’s experiment in corporate governance. (See John C. Coffee, *supra.* )

Finally, the agreement may require the appointment of an independent, government-selected monitor for some period to oversee compliance with its terms—at the company’s expense. The deferred prosecution agreement for the University of Medicine and Dentistry of New Jersey offers an interesting example. As is typical, the monitor is responsible for tracking compliance with the terms of the deferral agreement, as well as with all other laws and regulations. The monitor is to be promptly notified by the university of any “allegations of unlawful conduct or other wrongdoing” and kept abreast of any investigation. The agreement charges the monitor with reviewing and evaluating corporate structure, effectiveness of legal and audit functions, health program billing, training, security programs, and management compensation, among other things. It also gives the monitor unfettered access to all information, documents, and employees as he or she deems necessary. Aside from the business issues of coping with an independent monitor, complicated legal issues may arise—from insurance coverage for the acts of the monitor (sometimes the agreement mentions indemnification, as in Roger Williams Medical Center) to the privileged status of information to which the monitor has access (which is effectively everything).

While some question the impact of prosecutor-imposed corporate reforms—for which there may be no empirical support of their effectiveness—on the country’s system of business, others view these reform provisions as a good thing, an innovative form of “responsive regulation” of corporate activities.

These are just a few of the interesting issues for debate that appear to be arising from deferred prosecution agreements. There are likely to be more calls for some change: fuller DOJ standards, judicial involvement, or something else triggered by a court challenge. Given the importance of these agreements to the prosecution and defense of corporate white-collar cases, we can be assured of an interesting debate.

Editor’s note: For more on this topic, see Ethics, Page 42.