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Panel Discussion: Bigger Carrots and Bigger Sticks: Issues and Developments in Corporate Sentencing

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PANEL DISCUSSION

FORDHAM UNIVERSITY SCHOOL OF LAW CENTER FOR CORPORATE, SECURITIES & FINANCIAL LAW

BIGGER CARROTS AND BIGGER STICKS: ISSUES AND DEVELOPMENTS IN CORPORATE SENTENCING[†]

WELCOME

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Fordham University Law School

MODERATOR

Hon. John S. Martin, Jr.
Debevoise & Plimpton LLP

PANELISTS

Richard C. Breeden
Richard C. Breeden & Co.

Timothy Coleman
Senior Counsel to Deputy Attorney General James Comey

[†] The panel discussion herein was held at Fordham University on April 20, 2005. It has been edited to remove the minor cadences of speech that appear awkward in writing and to identify significant sources when referred to by the speakers.

Stephen M. Cutler
Securities and Exchange Commission

Celeste Koeleveld
U.S. Attorney's Office, Southern District of New York

Richard H. Walker
Deutsche Bank AG

WELCOME

PROF. FISCH: Good evening. My name is Jill Fisch.[1] I am the Director of the Fordham Center for Corporate, Securities & Financial Law. On behalf of the Center and the entire Law School community, I want to welcome you to tonight's program.

For some of you, this is the first time that you are attending a Corporate Center program. Let me take just a couple of minutes to tell you about the Corporate Center.

John Feerick[2] established the Center four years ago to serve as a focal point for business-law issues at the Law School. Since that time, we have run a variety of programs, public events, policy roundtables, academic conferences, and student-oriented programs. The list of our events is too extensive to cover in full, but let me give you just a couple of highlights.

The Center hosts two annual public lectures, the A.A. Sommer, Jr., Lecture, which is sponsored by the firm of Morgan Lewis & Bockius, and the Albert A. DeStefano Lecture, sponsored by the firm of Becker Ross Stone DeStefano & Klein. Past Sommer lecturers have been an incredibly distinguished group. This past fall, Richard Ketchum, Chief Regulatory Officer of the New York Stock Exchange, delivered the Sommer Lecture.[3] The DeStefano Lecture has been a variety of

1. Jill E. Fisch is the Alpin J. Cameron Professor of Law at the Fordham University School of Law and is the Director of the Fordham Center for Corporate, Securities and Financial Law.

2. John D. Feerick is the Norris Professor of Law at the Fordham University School of Law.

3. CCH Incorporated, *NYSE Official Focuses on Independence of Exchange Regulatory Arm* (Dec. 7, 2004), *available at* http://business.cch.com/securitiesLaw/

different lectures, as well as some panel discussions, on market regulation and the future of the self-regulatory organizations. Just last week, this year's DeStefano Lecture was delivered by New York State Attorney General Eliot Spitzer.[4] I understand that Fordham made *The Wall Street Journal* as a result,[5] which isn't a bad thing.

The Center has hosted a number of other programs. In January, we held a roundtable on mutual and hedge-fund regulation, which followed prior programs on the evolving duty of good faith in corporate directors and the role of lawyers as gatekeepers. Next Fall we are scheduled to host an academic conference, the Eugene P. and Delia S. Murphy Conference on Corporate Law, which will be part of the Fordham Centennial Celebration.

We have introduced students to business-law issues through specialized business-law courses, many of which are taught by leaders in the field who, after hours, devote time to serving on our adjunct faculty. We also offer students informal career guidance and insight into practice issues through our Business Law Practitioner Series. The Center boasts one of the first clinical programs in securities arbitration in the country and a specialized business-law journal, the *Journal of Corporate and Financial Law*. You have met some of our student editors who are here tonight.

The Corporate Center is led by a distinguished Board of Advisors. Two of the advisors have gone above and beyond the call of duty in doing virtually all the work in putting together tonight's program. I want to publicly acknowledge and thank Pamela Chepiga[6] and Judge Loretta Preska[7] for all their hard work.

I also want to thank Professors Beth Young[8] and Caroline Gentile,[9] who have also worked tremendously hard on tonight's program.

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news/12-07-04.asp.

4. Gene Colter, *Deals & Deal Makers*, WALL ST. J., Apr. 15, 2005, at C4.

5. *Id.*

6. Pamela Rogers Chepiga is a partner at Allen & Overy LLP.

7. Judge Loretta A. Preska is a U.S. District Court judge for the Southern District of New York.

8. Beth Young is a former Associate Professor at the Fordham University School of Law and is the former Corporate Fellow at the Fordham Center for Corporate, Securities and Financial Law.

9. Caroline Gentile is an Associate Professor at the Fordham University School of Law.

Tonight's program is entitled "Bigger Carrots and Bigger Sticks: Issues and Developments in Corporate Sentencing."

The series of corporate scandals revealed over the past few years, coupled with a host of new regulations aimed at identifying, redressing, and preventing corporate misconduct,[10] have dramatically increased the level of enforcement attention directed to U.S. companies. Prosecutors have new powers, both in their investigatory tools and in the types of sanctions they can seek.[11] At the same time, corporations have become more proactive in instituting internal controls and initiating internal investigations of potential wrongdoing.

At times, the emphasis on enforcement can create tension. Today's corporations face substantial pressure to report potential problems to regulators at an early stage. Regulators are increasingly demanding access to corporate information. Sentencing rules impose substantial penalties for corporate failure to cooperate with regulators.[12] Yet concern about cooperation may impede corporate efforts to investigate and respond to potential wrongdoing, particularly if the price of cooperation is a compelled waiver of the attorney-client privilege.

Increased remedial authority also raises issues about the most appropriate way to address corporate misconduct. Regulators are facing public demands that individual wrongdoers be held personally accountable. At the same time, money penalties are reaching unprecedented levels. Sometimes the penalties seem disproportionate to the public harm, and some have questioned whether corporate-level penalties, penalties that are typically borne by the issuer's current stockholders, are an appropriate response to misconduct by corporate officials.

I can't imagine a better-qualified group to address these issues than tonight's panel. Let me introduce you to the moderator of the panel – although he needs no introduction – the Honorable John S. Martin, Jr. Judge Martin is currently Of Counsel to the firm of Debevoise &

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10. *See Developments in the Law – Corporations and Society*, 117 HARV. L. REV. 2169, 2174 (2004).

11. *See* Marie Tracey & Paul Fiorelli, *Nothing Concentrates the Mind Like the Prospect of a Hanging: The Criminalization of the Sarbanes-Oxley Act*, 25 N. ILL. U. L. REV. 125, 135-37 (2004).

12. Kathleen F. Brickey, *Symposium: White Collar Criminal Law in Comparative Perspective: The Sarbanes-Oxley Act of 2002*, 8 BUFF. CRIM. L. REV. 221, 240-42 (2004).

Plimpton, and a member of the firm's Litigation Department. Prior to joining Debevoise in 2003, Judge Martin served for thirteen years as a United States District Judge for the Southern District of New York and for three years as the United States Attorney for the Southern District of New York. Judge Martin's past experience also includes service as Assistant to the Solicitor General of the United States and consultant to the National Commission on Law Enforcement and the Administration of Criminal Justice.

He graduated from Manhattan College in 1957 and received his law degree from Columbia Law School in 1961.

Judge Martin, welcome. The floor is yours.

INTRODUCTION

JUDGE MARTIN: Thank you.

Since we have a panel that needs no introduction, I will be very brief in identifying the people here.

Richard Breeden now has his own company, Richard Breeden & Co.[13] He is a former Chairman of the Securities and Exchange Commission, and has served as a monitor appointed by the court in the WorldCom case.[14] I saw his good work in a case called *United States v. Patrick Bennett*.[15] Bennett Funding was one of the biggest frauds of all time.[16] Mr. Breeden came in and tried to rescue the assets for the creditors and people who had been defrauded.

Sitting next to Mr. Breeden is Tim Coleman,[17] Senior Counsel to the – I understand, as of today, departing – Deputy Attorney General, Jim Comey.[18] Tim's major qualification is that he was once an Assistant

13. Richard C. Breeden currently serves on the board of directors of BBVA, one of Europe's largest banks. His firm, Richard C. Breeden & Co., offers turnaround advisory services and strategic consulting to companies experiencing financial or governance distress.

14. *See In re* Worldcom, Inc. Sec. Litig., 388 F. Supp. 2d 319 (S.D.N.Y. 2005).

15. United States v. Bennett, 97 CR 639, 2000 U.S. Dist. LEXIS 4928 (S.D.N.Y. Apr. 18, 2000).

16. *Id.*

17. Tom Coleman is a senior Justice Department lawyer and its representative on the Corporate Fraud Task Force.

18. Jim Comey served as Deputy Attorney General after being nominated by President George W. Bush. He was unanimously confirmed by the U.S. Senate on December 9, 2003.

United States Attorney in the Southern District of New York.

Sitting next to Tim is Steve Cutler,[19] who, as you know, is the Director of the Division of Enforcement at the SEC. He, too, has announced that he will soon be leaving that position and learning how unreasonable the SEC can be.

Sitting next to Steve is not David Kelley, who could not be here, but Celeste Koeleveld, who is the Chief of the Criminal Division. The most important position she has ever held is that of Chief Appellate Attorney in the United States Attorney's Office. I say that not only because I once held that position, but because it is a position that was held by a number of people, including Tony Sifton[20] of the Eastern District, John Sprizzo,[21] Pierre Leval,[22] Mary Jo White,[23] and Gerry Lynch,[24] among others. So we can expect even greater things for Celeste.

Finally, Richard Walker,[25] the Global General Counsel of Corporate and Investment Banking at Deutsche Bank, a former SEC General Counsel and head of the Division of Enforcement.

We are really honored to have this distinguished group of people.

PANEL DISCUSSION

JUDGE MARTIN: I thought I would get the ball rolling by allowing the panelists to comment on the following proposition. To paraphrase the National Rifle Association, corporations do not commit crimes; people do. Then why is it that we are sanctioning, through civil

19. Stephen M. Cutler left the SEC's Division of Enforcement in April 2005 and is currently co-chair of the Securities Department at the law firm of Wilmer Cutler Pickering Hale and Dorr LLP, where he is a partner.

20. Charles P. Sifton is a district judge in the U.S. District Court, Eastern District of New York.

21. Hon. John E. Sprizzo is a district judge in the U.S. District Court, Southern District of New York.

22. Hon. Pierre N. Leval is a circuit judge in the U.S. Court of Appeals for the Second Circuit.

23. Mary Jo White is Chair of the lawyer litigation group of Debevoise & Plimpton LLP.

24. Hon. Gerard E. Lynch is a district judge in the U.S. District Court, Southern District of New York.

25. Richard H. Walker served as SEC General Counsel from 1996-1998, and Director, Division of Enforcement of the SEC from 1998-2001.

proceedings by the SEC and criminal proceedings by the Department of Justice, corporations rather than the individuals who commit the crime?

I think we should start by giving the Justice Department the first whack at that one.

MR. COLEMAN: Is that me or Celeste?

JUDGE MARTIN: Jump ball.

MR. COLEMAN: If the question is whether there is a point to prosecuting corporations as opposed to individuals, I think the answer has to be a resounding, yes, there is a point. Corporations, especially large corporations, can do a lot more harm to the public than any individual. Prosecuting individual employees and officers of the corporation does not necessarily mean that a corporation will stop doing the bad things that it does.

What we have seen in a number of cases are corporations that, over time, develop a culture that fosters, and even requires, wrongdoing and criminal conduct. Sometimes – it is a rare case, but sometimes – it is necessary to prosecute the corporation to stop that corruption from continuing. The corporation can not only harm individual investors and other stakeholders in the corporation, but it can have dramatic impacts on the integrity of the capital markets and the economy as a whole. We saw this a couple of years ago with the whole constellation of scandals involving Enron and WorldCom and Adelphia and a number of other major corporations.

Prosecuting the corporation criminally does a number of things. One thing it does is, it gives an opportunity to send a very powerful message of deterrence that can be much stronger than the deterrent message that you get from prosecuting an individual. It is a message that can resound throughout an industry and cause other participants in the industry to change their behavior, and can even have effects across the entire economy.

So with all respect to the National Rifle Association, I will have to take issue on the paraphrase and say that the answer is yes.

JUDGE MARTIN: Steve, what is the SEC's perception of that issue?

MR. CUTLER: Maybe I should start by saying that my views are only my own, and not those of the SEC or the staff. That has probably never been as true as it is today, at least in the last several years.

I do not disagree with anything Tim said. Maybe it is useful to actually think of the prosecution, both civilly and criminally, of

companies in two distinct ways. One is prosecutions where the victims are third parties, and the other is prosecutions where the victims – and Jill mentioned this in her opening – are the company's own security holders. Certainly, the issue of whether it is fair and appropriate and sensible to proceed against a company, I think, takes on more – the criticisms of company prosecutions, I think, resonate more – when you are, by virtue of the prosecution, visiting harm against the very people who suffered from the wrongful conduct in the first place.

So let me put a marker there, because I think it is important that we talk about each of those separate situations. I think it is a lot easier for people to come to grips with the notion of penalizing an entity that was trying to do something to put more money in its coffers or to save it from expenses that it otherwise would have incurred.

You can think of examples from many walks of life. You can think of, say, an investment firm that visits fraud upon its customers. The customers are not owners of the firm, but they are third parties. If an investment firm commits a lot of fraud and gets more people to buy a product, that puts more money in the company's coffers. How do you deter that? How do you get rid of it?

To me, it seems an almost unassailable proposition that you go after the entity because the conduct has benefited the entity. Examples in other industries come to mind – in the environmental area, a company that dumps a bunch of pollutants into a lake, instead of doing what it needs to do to remediate, which would cost it a lot of money.

I am not sure that a lot of people in this debate have been arguing about those types of cases. What they have really been taking issue with is whether it makes sense to punish companies – something that has become much more common over the last three to five years, which is prosecutions of companies that have committed financial reporting misconduct – where, by virtue of that misconduct, they have hurt their own owners.

I think it is very tricky. Invariably, you do have to face several questions: Who are we visiting the penalty upon? Who is paying for it? Have they already suffered? Haven't they suffered enough?

I still think you go back to questions of deterrence. Tim talked about specific deterrence and stopping the misconduct at the company you are punishing. I guess the way I think of penalties against corporate entities – and this applies to both sorts of situations I alluded to – is that what you are after is the fundamentally honest CEO or CFO, when she

wakes up in the morning and looks at herself in the mirror and says to herself, "What am I going to spend my day doing?" That CEO or CFO is not, if she is fundamentally honest – which is my proposition – going to go steal, lie, or cheat. The question is whether she is going to make sure that other people do not.

The prosecutions of Bernie Ebbers and Ken Lay and Andy Fastow, and on and on and on, in some way, do not affect that fundamentally honest CEO or CFO, because she is never going to find herself on the wrong side of the law. She is not going to lie, cheat, or steal. But we want more from that CEO or CFO. We want to make sure that she has created – and Tim mentioned this – a culture of compliance, a good corporate culture, so that it does not happen around her. How can we give her the incentive to do that? How can we use law enforcement as a tool to create that kind of inducement?

I think one of the ways you do it is through the prospect of a penalty. There will never be a prosecution against that honest CEO or CFO, but if at the end of the day her company fails to comply with the law, if her company commits fraud, she and her company will pay for it. Those are terms that every executive in America can understand.

So when I think about penalties against companies, it is that CEO or CFO that I am thinking about.

Let me spend just one minute – I have probably gone on too long, and I will pass the baton – talking about penalties visiting harm on those who have already suffered. When Congress actually gave the SEC the power to impose penalties against non-broker dealers, non-investment advisors – the unregulated part of our capital markets – it said, we want you to be very careful about visiting harm upon those who have already suffered.[26] If you look at what the Commission did in the years preceding the adoption of Sarbanes-Oxley,[27] it was to avoid penalties in almost every case against corporate entities where the misconduct being charged was a fraud upon the company's own security holders.

Dick will tell you, in his regime as director, I think we had maybe two or three cases where we imposed penalties against corporate entities

26. *See* Zack Christensen, *The Fair Funds For Investors Provision of Sarbanes-Oxley: Is It Unfair to the Creditors of a Bankrupt Debtor?*, 2005 U. ILL. L. REV. 339, 359-60.

27. *See* William R. McLucas et al., *An Overview of SEC Enforcement, Remedial and Settlement Powers Before and After the Sarbanes-Oxley Act*, 1396 P.L.I. CORP 1111, 1113-17 (2003).

in those sorts of situations, because they involved very unique circumstances. I should probably leave it at that.

The reason why we have taken a different tack more recently is because Sarbanes-Oxley has allowed the Commission to take the money that it would otherwise obtain in the form of a penalty and put it back in the hands of those investors who suffered, by virtue of the Sarbanes-Oxley Fair Funds provision.[28] At least in that way, you mitigate the harm that would otherwise be suffered by those who have already suffered as a result of the misconduct.

That is why I think we are in a much different place today than the Commission was five or ten years ago.

JUDGE MARTIN: Dick Walker, is what the Commission has done good or ill?

MR. WALKER: I want to challenge a couple of the things that Steve said, but let me, to get to that point, start at the beginning and –

MR. CUTLER: And, by the way, Dick trained me, and everything I have done he is responsible for.

MR. WALKER: It is a very dangerous thing for me. I have two former bosses sitting here, Richard Breeden and Steve Cutler, who, though my deputy, I always looked to for real advice.

JUDGE MARTIN: I see, arguably, three purposes that can be served by penalizing corporations, either in the enforcement or the criminal context. One is to take away the fruits of ill-gotten activity. That, to me, is a very legitimate goal and a very legitimate objective. It is something the Commission does all the time in the form of disgorgement. It basically tells the wrongdoer, "You have got to give back the profits that you made." To me, that is sort of a no-brainer, and no harm comes from that. From a criminal prosecution, I do not think that that is a customary feature of criminal prosecution, but it is certainly covered on the civil side.

The second objective which is articulated is punishment. Again, the law allows entities and individuals to be punished, to have some stigma attached to their conduct, to make some hurt to what people have done.

The third is, of course, the argument about deterrence, whether it specifically deters some and whether it acts as general deterrence to others. That argument I have a harder time understanding.

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28. 15 U.S.C. 7246(a) (2002).

Steve, in your example, you talked about the honest CEO who wakes up in the morning, who, because she knows that there has been a $750 million penalty imposed against WorldCom, says, "Of course, I am not personally threatened by that, because I am an honest, hardworking CEO, and I am not about to stray from the straight and narrow. But I am going to work extra hard to prevent others in my company from engaging in wrongdoing."

I think there is some truth to that. But when you balance that against the effects to innocent parties of imposing a large fine and a penalty, it seems to me a bit disproportionate. Are there other ways that you can achieve deterrence without imposing a monetary fine that is going to harm people that had no responsibility or culpability for the wrongdoing?

In the case of WorldCom, shareholders come and go – well, WorldCom is a bad case, because, frankly, WorldCom was bankrupt by the time this was imposed. Let us take another company as to which a fine has been imposed. In that case, the fine is borne by the shareholders of the company. The company pays, and the current shareholders are the ones that lose. They very well may be a different group of people than the people who were shareholders and perhaps had some opportunity to influence management at the time of wrongdoing.

I just worry that there is a disproportionate harm to the monetary sanction – though I can see that there is some deterrence that is achieved by having the honest CEO worry about doing more, and even the dishonest CEO or CFO, which I think we have seen, really, the largest number of in the large prosecutions of the last two or three years. I think there is deterrence as to those people. But is there deterrence because you are suing their company, or is there deterrence because they know that they are going to be criminally prosecuted, like Bernie Ebbers?[29] That, to me, achieves great deterrence, when a white-collar executive of a company says, "Wow, if I break the law, there is a chance that I could go to jail." And jail, for white-collar defendants, I think, is a much worse proposition than perhaps other defendants –

JUDGE MARTIN: And it is getting worse.

MR. WALKER: And it is getting worse.

So I do challenge the notion of achieving deterrence in the best and

29. *See* Ken Belson, *A Guilty Verdict: The Overview; Ex-Chief of WorldCom is Found Guilty in $11 Billion Fraud*, N.Y. TIMES, Mar. 16, 2005, at A1.

most desirable way.

I also challenge the Sarbanes-Oxley notion that it is okay, and it is better now, because money does go back to the injured people. Obviously, there is some truth to that, too. Sarbanes-Oxley allows the penalties to be redirected to people who suffered harm.[30] But it still does not solve the problem of who is paying those penalties. It is still the current shareholders that are stuck picking up the bill for that.

That is my take on this. There are some legitimate goals, but I think some of them can be achieved by better means.

JUDGE MARTIN: Mr. Breeden, you have tried to help shareholders in these types of companies. What is your perception?

MR. BREEDEN: There is some merit to the argument and the concern about not wanting to penalize shareholders by imposing a fine on the victims, the people who have already been victimized by the fraud. I understand that argument. I think it is something that has to be considered. All of these cases are really different. You need to not look at them and think about them as all identical. The facts and circumstances of each one really are important: Who was involved? How high up were they? How persistent was the conduct? How many warning signs were there? How egregious is this?

With all due respect to Steve and Commissioners Atkins and Glassman and some of the people who have been raising these questions, I guess I would subscribe myself to Tim's comments at the outset and the importance in both the criminal and the SEC enforcement arena of deterrence, and deterrence on a large scale. I think it is a critical thing that a message be sent to boards of directors that it is essential for them to oversee their management team, and that there could be very substantial consequences, which will affect them as directors, if they allow it to happen by failing to supervise and failing to oversee discipline and create the right incentives for the management team.

We talk about how essential tone at the top is and the culture of ethics. Does a given entity have a culture in which people give a wink and a nod and lip-service to – "yeah, yeah, we need to do all this compliance stuff" – but they do not really get it, and they are not really

30. Douglas A. Henry, *Subordinating Subordination: Worldcom and the Effect of Sarbanes-Oxley's Fair Funds Provision on Distributions in Bankruptcy*, 21 EMORY BANKR. DEV. J. 269 (2004).

focused on dealing with those problems? There are other corporations where you may have a more isolated situation. It is essential to reach the boards and have boards of directors understand that one of their most important responsibilities is overseeing the compliance and ethical practices of the corporation, that it is a core competency for every major company, that its ethical track record is as important as its financial track record, and that they, the corporation, will be held accountable, and, down the line, the board and the management.

I am troubled by this argument that you are penalizing the shareholders. When you have a corporate fraud, in the SEC context only – I am not speaking to the criminal side, but I will stick to my area of expertise – there have been shareholders who benefited, as well as shareholders who were hurt by the fraud. In the early stage of a fraud, if a company is reporting earnings that it did not really generate, the shareholders are benefiting in a real way. The stock is at a higher level than it ought to be. They are able to access capital in larger amounts and at lower cost than they would otherwise be able to do. That company has a tremendous advantage compared to its competitors and may use that advantage to distort the entire marketplace. So the shareholders have benefited directly and substantially in many of these cases.

Now, that is shareholders at a moment in time when the fraud is ongoing and has not yet been discovered. Then, when it is discovered, the company, if it goes all the way into a WorldCom-type situation or Enron – yes, there may be shareholders who are wiped out or severely damaged. Those may not be the same ones who were benefiting. I do not know whether we would ever be successful enough to track and say whether the precise people were being hit with that consequence.

I think the message to the overall marketplace, though, to all shareholders investing, to all people investing in bonds of troubled corporations, is, look, there is an exposure for violations of the law. If you have a serious financial fraud that involves conduct at high levels of the corporation that is material in magnitude, persistent in time, knowing in its dimensions, a serious financial exposure exists. Be on notice of that when you are deciding what corporation to invest in. It should matter to you what kind of a board of directors they have and what priorities they place on the overall issue of ethics and integrity and compliance in running the company. You may well have financial loss if it turns out that you are an investor in a corporation that does not invest what they need to do in obeying the law.

I do not find that unfair. I think it is actually quite critical in the broader deterrence structure to have as an element, in the right cases, the ability to impose a substantial fine.

In the end, the obligations under the securities laws and the financial reporting area are not the individual obligations of Mrs. CEO or Mr. CFO; they are corporate obligations. The corporation has the obligation to report, fully, fairly, completely, in a timely manner, its financial results. They are doing so, knowing in advance that failure to comply with the law is going to damage a wide spectrum of people – employees, customers, shareholders, creditors of other kinds.

With that knowledge in advance, to me, having the exposure of monetary sanctions against the corporation, which has the obligation under the law, is not unfair, and I think it is, in general, good policy.

JUDGE MARTIN: Celeste, let me ask you this. We talk about how these balances get struck when you are actually deciding whether or not you are going to indict a particular corporation. I looked recently at the Thompson factors,[31] and they seem not to give much weight to the harm to shareholders. Am I misreading them?

MS. KOELEVELD: One of the factors is whether going after the individuals is adequate to address the harms that have occurred. So the very issues that we have been discussing so far here are really incorporated in the Thompson factors. I think, under that rubric, you could consider whether it would do more harm than good to go after the corporation at some point, than not.

But I can say that, whether it is explicitly one of the Thompson factors or not, I think it is something that goes into our calculus in the U.S. Attorney's Office in deciding whether or not to prosecute a corporation. One thing we do look at is exactly the nature of the misconduct and how the corporation is responsible.

I disagree with the premise of the quotation that you began with, that individuals commit the crimes and not corporations. Individuals are not acting alone. They are acting through the corporation, and the corporation should generally be held responsible for what it did.

I think, in terms of deterrence, I second – and third and fourth – the comments that to create a culture of compliance and a culture of social responsibility, it is important to, in appropriate cases, hold corporations

31. Memorandum from Larry D. Thompson, Deputy Attorney General, to Heads of Department Components, United States Attorneys (Jan. 20, 2003) (on file with author).

responsible.

JUDGE MARTIN: Tim, the Justice Department has recently had a number of cases in which there are deferred prosecutions. What are the factors that go into determining whether or not you should prosecute or have a deferred prosecution?

I should say on this, I like the idea of deferred prosecution with monitors, and Mr. Breeden and I strongly encourage it.

MR. COLEMAN: I am glad you asked, Judge.

The concept of a deferred prosecution is something that is not new, but it has gotten a lot of attention recently. In the last couple of years, the Justice Department has entered, often with the participation of the SEC, into about a dozen of these agreements with major corporations. We can go back to the 1980s. There was a case with Prudential Securities here in the Southern District that resulted in a deferred-prosecution agreement.[32] But there were not many others until the last couple of years, after the 2003 revisions to the Thompson Memo, which specifically encouraged consideration of deferred prosecutions as an alternative.[33]

To step back for a minute, the decision about whether to indict a corporation is one of the most difficult decisions that a prosecutor has to make. You have to look at all the fundamental factors of principles of federal prosecution and decide whether a crime has been committed, whether somebody has committed it, whether there is really a federal interest here, and so on. But there is an overlay on top of that of these Thompson factors, of which there are nine, that make it an incredibly complicated decision.

In prosecuting a large corporation – and the problem of the bankrupt company is particularly difficult – you have to look at the other stakeholders. Whatever benefit you might achieve by indicting the company and likely putting it out of business is only going to come at a great cost to other stakeholders.

One of the factors that we take very seriously – it is a factor in every case, but particularly in a case against a corporation – is the collateral consequences. What will the consequences be to individuals or entities other than the defendant? We look at that in drug cases. Will

32. *In re* Prudential Securities Inc., No. 1005 M-21-67, 1995 WL 798907, at *8 (S.D.N.Y. Nov. 20, 1995).

33. *See* Thompson, *supra* note 31, at (vi)(b).

prosecuting a husband-and-wife team who are smuggling cocaine from their native country make their children orphans? It is the same concept, but we are talking about a lot more people when we are talking about a large corporation.

So we take that very seriously. One of the ways that we have tried to deal with that very difficult issue is by encouraging prosecutors to be more creative and innovative in coming up with resolutions that do not necessarily involve a death sentence for the corporation. These deferred prosecutions are not a panacea. It is not a good solution in every case, but it is a good option in a range of cases.

What it allows us to do is to send a deterrent message by charging a corporation criminally. It allows us to remediate the harm through a fine, restitution, forfeiture, or some other payment of compensation by the company. It allows us to work with the regulators – and we try to work very closely with the SEC, the CFTC,[34] FERC,[35] whoever it is, depending on the case – to try to come up with a fix for the corporation that will allow it to reform itself so that the risk of a culture of corruption will be minimized.

It also allows us to ensure continued employment for some very good lawyers and other professionals that we know very well.

JUDGE MARTIN: We are happy for that great benefit.

Let us move on. We are talking about carrots and sticks. I think we have seen some of the sticks. What are the carrots? What do you extract by way of cooperation from the supplicants who come before you in these enforcement proceedings in order to get the best deal possible? Who makes those decisions?

Let us start with the attorney-client privilege. It seems to me that the sentiment in the private bar is that there is no attorney-client privilege anymore because if you are in an investigation with the Justice Department or the SEC, you are simply going to be forced to waive it, unless you want to be pinned to the wall. Is that a fair comment, Steve?

MR. CUTLER: Not about the SEC.

We actually issued a report about three years ago outlining the elements that the Commission considers in determining how to reward, or not, cooperation. The Commission expressly said that the touchstone of cooperation was not waiver.

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34. Commodity Futures Trading Commission.

35. Federal Energy Regulatory Commission.

But now let me talk practically. What we do want is an ability to understand what happened, and to understand that quickly. Sometimes that means, as a practical matter, that corporations are going to waive the privilege.

I guess the other thing that needs to be said in this area is that cooperation is not like a light switch. We do not say to ourselves, okay, they were cooperative, or they were not cooperative. There are going to be gradations of cooperation. We have had plenty of corporations – I assume we are talking about the corporate context – that have been cooperative and rewarded for their cooperation without having waived the privilege. We may try to find ways around waiver issues. We might get a report orally, for example, from counsel about what it is that they have seen during the course of an internal investigation.

But we do not, at the end of the day, make the waiver itself the touchstone of whether an entity gets rewarded for cooperation.

JUDGE MARTIN: Tim?

MR. COLEMAN: To paraphrase Mark Twain, reports of the demise of the attorney-client privilege have been greatly exaggerated.

There really are not that many cases where corporations are waiving the privilege, contrary to what you hear in many panels like this one. Usually, what we are looking for is not what one would typically think of as information covered by the attorney-client privilege, but we are looking for information that would be covered by the work-product doctrine. Typically, that is notes of interviews with employees that were prepared in the course of an internal investigation of the company. That is sort of the –

JUDGE MARTIN: May I just interrupt to ask, why is that not calling for privileged information? The whole idea of the privilege for the corporation is that your employees can talk to you. I understand the need for those notes, but that certainly requires the waiver of the privilege, does it not?

MR. COLEMAN: Sure. I do not want to split hairs about whether it is work product or privilege. But if it is factual information about what happened, as opposed to a request for legal advice or the rendition of a legal opinion, arguably, it is work product, and different rules apply.

MR. CUTLER: Even if it is not, and even if it is a classic attorney-client communication, I guess the way I have always thought about this is that – and tell me if I am wrong – we ought to be less sensitive about claims of privilege with respect to after-the-fact internal investigations,

if you will, than we should be about invading the privilege when it comes to contemporaneous advice rendered on the scene. We certainly want to encourage people to seek out legal advice for hard problems as they arise.

In my own mind, I have drawn a special circle around that sort of attorney-client communication. I think it would be bad policy for the government to chill that sort of communication and that kind of advice seeking.

I really think differently, or not as sensitively, about the post-hoc investigation, once everything has gone wrong. Now you have called in Judge Martin to do an internal investigation. That is a different exercise. Yes, there are sensitivities there, but not in the same sort of way.

JUDGE MARTIN: But doesn't that make it almost impossible for me to do a really thorough investigation? I am called in. I have to tell everybody, "Look, there is a thing called attorney-client privilege that would normally protect this conversation. But you should know that in this type of case, the SEC is going to insist we waive it."

You are effectively saying there is no privilege. If we view the privilege as having a benefit in getting out the information, it has restricted my ability, certainly, to get out that information.

MR. CUTLER: Although in a limited sort of way.

One, by the way, we are not going to insist that you waive the privilege. Tim might. Celeste might. We will not insist on it.

But beyond that, when you start those interviews, Judge, you are going to have to say, "You are talking to in-house counsel" – or someone employed by the board of directors or whatever capacity you are – "and you ought to know that if there is a privilege here, it belongs not to you, but it belongs to the company." Now, at the end of the day, maybe some individual will think, "Boy, I can't imagine this will ever get turned over to the government." But that would be foolish thinking, and the privilege does not even belong to that individual in the first place.

JUDGE MARTIN: I think there is an argument to be made that we should not even think that there is such a thing as the attorney-client privilege in a corporate context. I remember back in the SEC-Vesco case,[36] Vesco was running this corporation for years. He was ultimately thrown out by the SEC. Of course, the first thing the board did was

36. SEC v. Vesco, 358 F. Supp 1186 (S.D.N.Y. 1973).

waive the privilege, so everything he did was exposed. I am not sure that people really should be relying on the privilege, in any event.

MR. BREEDEN: I just wanted to jump in on these investigations, having participated in quite a few of them and having been very involved in WorldCom. We were very upfront with people that what they had to say was absolutely going to be, most likely, turned over to the government. The company had pledged complete and full cooperation, and we were determined to get to the bottom of things. The employees had a choice. They were either going to give what we considered to be full and credible testimony and tell us everything they knew about what had gone on, or they were going to be fired right there, on the spot, and we were going to refer their names to every law-enforcement authority who would take our call. That is their choice.

MR. CUTLER: Now you know why we like Richard doing these internal investigations.

MR. BREEDEN: We did not have a lot of people who were not already talking to the Southern District who refused to talk to us. So we did not need to promise people, "Look, if you tell us that you have been a serial murderer of the accounting rules, we will not tell anyone else," in order to get the truth. "This is your Judgment Day, right here and right now, and you have to decide which side of the law you are going to be on. Are you going to cooperate fully and unburden your conscience or are you not?"

So I think, in the big Enron, WorldCom, those kinds of frauds, the availability of the promise of confidentiality through the privilege is overblown as something that is necessary in order for the investigators to get at it.

JUDGE MARTIN: Let us see what Dick Walker, as a general counsel, thinks about the privilege.

MR. WALKER: I agree. I think the practice is, when something goes wrong in a corporation and you bring in an employee, you give him a pretty tough talk right up front and you basically tell him that it is part of his responsibility as an employee – the code of conduct requires that he either cooperate or not.

We always tell attorneys that they have to give them a very blunt warning: "When we are talking to you, we are representing the corporation. We are not looking out for your best interests. Now sit down and please answer our questions."

So I think that is the practice that has developed.

I do think, though, Tim, on something that you said, if the reports of the demise of the attorney-client privilege are greatly exaggerated, just as exaggerated are, frankly, some of the assurances that we get sometimes that this is not an automatic, knee-jerk thing. This is something that the government does seem to require. Though in SEC parlance it is true that there is a mix of factors, if the SEC asks you to waive the privilege and you are not willing to do that, I think most people would conclude that they are not going to get the benefits of the holy grail of cooperation that they seek.

There are some reasons why I think it is important for the SEC – for instance, if an internal investigation has been done and submitted by a company, I think it is appropriate and the SEC needs to be able to kick the tires. They need to be able to look at interview notes to determine whether the lawyer that has done the internal investigation has done a credible and faithful job in reaching conclusions. I do not know too many ways around that, other than showing the government the interview notes and the kinds of materials that are prepared.

Similarly, when people say, "Do not sue me. I relied on the advice of counsel," if you cannot somehow penetrate and find out what the advice of counsel was and probe that, then it is very difficult to determine whether that is really a credible and rational defense or not.

So there are certainly reasons why it can be done. But I think that real practice is that it is done almost reflexively. In many instances, I think there are better ways and there are alternate ways of getting the same kinds of assurances that the government needs, without triggering the kinds of consequences that you trigger once you waive the privilege. This information is out for anybody and for everybody. You cannot protect it at all. I think sometimes there are more limited ways of serving the same goals.

JUDGE MARTIN: I notice that it is 7:07. We were scheduled to stop at 7:00. The panel is now in the very dangerous position of standing between an Irishman and the bar. But I think we should continue for a few more minutes.

Because we have so many distinguished practitioners here, can we see if any of them have any questions?

QUESTION: I would like to ask Richard, Tim, and Steve about penalties for entities, how the answers they gave would be affected if they knew that it was virtually certain that the results of that decision would be the destruction of the corporation and the unavoidable loss of

all jobs.

MR. BREEDEN: We certainly had that issue in WorldCom. I was trying to distinguish in my remarks between financial penalties and criminal indictment. Personally, my own observation is that criminal remedy against a corporate entity, which is in most circumstances going to be an immediate death sentence, should be reserved for the most egregious of all egregious circumstances, and typically a company that is not cooperating, that is resisting and, in some way, continuing ongoing violations of the law.

I prefer to avoid the criminal sanction for a corporation entity and use financial penalties wherever possible, because I think they do not lead to that unavoidable loss of jobs and so on.

There were many people who argued that WorldCom was such a corrupt enterprise that it should be put out of business. At that point we had 75,000 employees who had not done anything wrong. We had conducted what we believed to be the most thorough housecleaning any company had ever undergone. It was really in the hands of some pretty unimpeachable people, including a former Attorney General of the United States, leading the special committee, Nick Katzenbach.[37] So I strongly was of the view then, and remain so today, that an indictment and putting the corporation out of business and throwing 75,000 people into the street would have been very much the wrong course of action.

Our friends at Verizon, actually, disagreed strongly at the time, although they have come around and recognize the benefits of rehabilitation, I am proud to say.

So I do think that that is a very important consideration. In most of these corporations, if the will is there – if a board will act, or a receiver or a court imposing a monitor, or in any other form – if the will is there to force a complete and total cleanup, these corporations can be turned around, cleaned up, and rehabilitated. That is the course we ought to follow. Indictment ought to come, in my personal opinion, when the corporation refuses to go down that path, when there is no board or somebody available to do that. Then you may have to go to another remedy.

MR. COLEMAN: In any case where we are considering indicting a corporation, we will get written submissions from the corporation analyzing the Thompson factors. Invariably, there is a long section

37. Nicholas Katzenbach was the sixty-fifth Attorney General of the United States.

about how the collateral consequences will be that everybody will lose all their investments, the corporation will be liquidated, and the world will end.

Sometimes those arguments are more persuasive than others. But we generally give them the benefit of the doubt. That is probably the factor that we take the most seriously in looking at the costs of indicting the corporation.

So I do not think my answer would change very much, because I think we are already painfully aware of that consequence.

MR. CUTLER: I cannot disagree with anything that either Richard or Tim has said. Richard's comments made me think about one of the other factors, or at least considerations, that have weighed on my mind over the last several years, and that is the notion of having a sufficiently large spectrum of sanctions that you can differentiate the capital markets' equivalent of ax murderer from the driver who exceeds the speed limit.

That is one of the problems that may be unique to the SEC. We have had injunctions and cease-and-desist orders and could try to distinguish between those, or maybe between a fraud charge and a books-and-records charge. But, boy, at the end of the day, that is a fairly narrow band with which to either reward cooperation or, if you will, penalize non-cooperation and to differentiate between very bad conduct that may, as Richard said, even in extreme circumstance, warrant the death sentence for the corporation and conduct that is a 10b violation,[38] a fraud on shareholders, but does not warrant the same sort of treatment.

That is one of the reasons that I think moving to a world in which penalties are part of the SEC regime makes sense.

MR. BREEDEN: Just a footnote that I want to also toss in, playing off Steve's comment. There is another really important dynamic here. The availability of the $500 million fine or the criminal indictment helps swing, in a practical world – often in these cases, there is a faction in the board who is in favor of a complete and total cleanup – get rid of the CEO, hire the toughest person you can find to come in and do a complete and thorough cleanup, really make a clean breast of it, and recognize there have been some bad practices. There may be other people who are in a damage-control mode – "we will go through the motions, we will offer up whatever we can, but we want to do as little to

38. 17 C.F.R. § 240.10b-5 (2003).

change" – and, frankly, they are often people who have a personal exposure for what they have done.

If the government stopped using these remedies as tools, you would swing the balance inside the boardroom and inside the advice companies are getting about how they need to respond to these situations – you would swing it in favor of it being safer to try to go through the motions without really cleaning it up. That would be a bad effect.

So the mere existence of these remedies, even if you do not use them, has a really positive effect in many of these cases.

QUESTION: Is there any likelihood we will seek legislation to [inaudible], which could go a long way towards solving this problem, because it would allow people to give material to regulators and the Justice Department [inaudible]? Does anybody know whether there is any likelihood of that?

MR. WALKER: I do not think so. It has been circulated. It has been part of bills. It has been discussed for years, but I do not think there is much likelihood that that will happen.

QUESTIONER: Just to make a comment. The whole theory of Sarbanes-Oxley was to encourage corporations to come forward. It is perfectly logical for Congress to then reward that by legitimizing [inaudible].

JUDGE MARTIN: What makes you think that Congress would ever be perfectly logical?

Are there any other questions from the audience?

[No response]

Let me just talk about one more, and that is the question of indemnification of employees and officers. Steve, there is a lot of concern in the bar on the Lucent settlement. Would you like to expand on that a little bit?

MR. CUTLER: Sure. I actually think Lucent has been misunderstood. That was not about indemnifying employees for the expense of mounting a defense. It was not about paying for lawyers. We like there to be good lawyers representing all interested parties. A good defense actually ends up, usually, producing a better, more just result. It is part of the adversarial process that I think makes the system work.

Where the SEC gets concerned is if a corporation voluntarily – particularly voluntarily, not pursuant to state law – indemnifies individual employees for penalties or disgorgement remedies that they

would otherwise suffer in an SEC or Justice Department action. And I think that should be a concern. If an individual can look to his or her employer to pay the freight and bear the cost of a penalty, I am not sure we achieve all the deterrence that Dick was talking about at the outset. In fact, it is the most important part of deterrence, making sure that individuals know that if they do wrong, they are going to go to jail or they are going to pay heavy fines. But if they can rely on someone else to pay those fines, what good have we done? What deterrence have we really achieved?

So I think it is critical that people be made to pay the fines that have been imposed on them.

JUDGE MARTIN: We are about out of time. Perhaps I would ask each of the panelists if there is anything they want to add on the topics that we have had for discussion. Dick?

MR. WALKER: I think we have said it all.

JUDGE MARTIN: Actually, I was going to ask one more question. We do not have time to get the answer. The question would have been, do you think it appropriate for a government official to say that he would not negotiate with a company unless they discharged their chairman?

Thank you all very much.