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# VICARIOUS SNITCHING: CRIME, COOPERATION, AND “GOOD CORPORATE CITIZENSHIP”

MICHAEL A. SIMONS<sup>†</sup>

## INTRODUCTION

Snitching—or, more euphemistically, “cooperation”—has a long history in our criminal justice system.<sup>1</sup> Judicial leniency for cooperators traces its roots back hundreds of years to the common law practice of approvement,<sup>2</sup> and American prosecutors have been striking deals with cooperators since at least the nineteenth century.<sup>3</sup> Over the past fifteen years, however, federal criminal prosecutions have undergone what can fairly be characterized as a cooperation revolution. Ever since the advent of the Federal Sentencing Guidelines in 1987,<sup>4</sup>

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<sup>1</sup> See, e.g., *United States v. Singleton*, 165 F.3d 1297, 1301 (10th Cir. 1999) (noting the “longstanding [common law] practice sanctioning the testimony of accomplices against their confederates in exchange for leniency”); *United States v. Cervantes-Pacheco*, 826 F.2d 310, 315 (5th Cir. 1987) (“No practice is more ingrained in our criminal justice system . . .”).

<sup>2</sup> See *Rex v. Rudd*, 98 Eng. Rep. 1114, 1116 (K.B. 1775) (describing an ancient practice then in disuse).

<sup>3</sup> See *The Whiskey Cases*, 99 U.S. 603 (1878) (approving the practice and describing it as commonplace). For discussions of the history of cooperation, see George Harris, *Testimony for Sale: The Law and Ethics of Snitches and Experts*, 28 PEPP. L. REV. 1, 13–16 (2000); Graham Hughes, *Agreements for Cooperation in Criminal Cases*, 45 VAND. L. REV. 1, 7–8 (1992).

<sup>4</sup> The United States Sentencing Guidelines were created in response to the Sentencing Reform Act of 1984, see Pub. L. No. 98-473, 98 Stat. 1987 (1984) (codified as amended at 18 U.S.C. §§ 3551–59, 3561–66, 3571–74, 3581–86, & 28 U.S.C. §§ 991–98), and apply to all federal crimes committed after November 1, 1987. See Kate Stith & Steve Y. Koh, *The Politics of Sentencing Reform: The Legislative History of the Federal Sentencing Guidelines*, 28 WAKE FOREST L. REV.

defendants have increasingly seen cooperation as their best chance to avoid a stiff prison sentence, and prosecutors have increasingly relied on cooperators to make cases.<sup>5</sup>

This cooperation revolution has not been limited to individual defendants. With increasing frequency, prosecutors are demanding that corporations act as “good corporate citizens”—which, to prosecutors, means cooperating fully in any investigation.<sup>6</sup> Prosecutors are well positioned to make such demands: corporations have broad responsibility for crimes committed by their employees, prosecutors have nearly unrestrained discretion to bring charges against corporations, and the Organizational Sentencing Guidelines specifically reward cooperation (and punish its absence).<sup>7</sup> Thus, it is not surprising that many corporations facing an investigation have acceded to prosecutors’ demands for cooperation.<sup>8</sup> Indeed, if a

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223, 228 (1993). Cooperation has also been spurred on by legislatively mandated minimum sentences, which, like the Sentencing Guidelines, restrict judicial discretion and increase sentence severity. See Stephen J. Schulhofer, *Rethinking Mandatory Minimums*, 28 WAKE FOREST L. REV. 199, 203 (1993).

<sup>5</sup> In 2001, approximately seventeen percent of federal defendants received a sentence reduction for cooperating. See UNITED STATES SENTENCING COMMISSION, 2001 SOURCEBOOK OF SENTENCING STATISTICS [hereinafter “2001 SOURCEBOOK”], at Tbl. 26. Many more defendants offer to cooperate, but are rebuffed by prosecutors. See Michael A. Simons, *Departing Ways: Uniformity, Disparity, and Cooperation in Federal Drug Sentences*, 47 VILL. L. REV. 921, 953 (2002). For a more detailed discussion of the incentives created by the Guidelines and how those incentives have affected cooperation rates in federal court over the past fifteen years, see *id.* at 931–38.

<sup>6</sup> See William S. Laufer, *Corporate Prosecution, Cooperation, and the Trading of Favors*, 87 IOWA L. REV. 643, 653 (2002) (“Every year following passage of the Sentencing Guidelines, there has been a noticeable escalation in prosecutorial expectations of organizational cooperation.”).

<sup>7</sup> See UNITED STATES SENTENCING COMMISSION, GUIDELINES MANUAL [hereinafter U.S.S.G.] § 8C2.5(g) (2000). The Organizational Sentencing Guidelines apply to all federal crimes committed by organizations after November 1, 1991. *Id.* at ch. 8. For an introduction to the Organizational Sentencing Guidelines, see Ilene H. Nagel & Winthrop M. Swenson, *The Federal Sentencing Guidelines for Corporations: Their Development, Theoretical Underpinnings, and Some Thoughts About Their Future*, 71 WASH. U. L.Q. 205 (1993).

<sup>8</sup> See, e.g., David M. Zornow & Keith D. Krakaur, *On The Brink of a Brave New World: The Death of Privilege in Corporate Criminal Investigations*, 37 AM. CRIM. L. REV. 147, 153–58 (2000) (describing increasing prosecutorial demands for corporate cooperation and corresponding corporate acquiescence); see also Elkan Abramowitz & Barry A. Bohrer, *Mary Jo White’s Legacy*, 227 N.Y.L.J. 5 (2002) (noting that “in recent years” it has become a “routine defense strategy for corporations to alert the government at the earliest hint of wrongdoing within the corporation to mitigate their own criminal exposure”).

corporation can prove its “good corporate citizenship” by cooperating, it may be able to avoid indictment altogether.

That is not to say that the decision about whether to cooperate is an easy one, for prosecutorial demands for cooperation can place a corporation (or, more accurately, its officers and directors) in an extraordinarily difficult position. On the one hand, the cost of cooperating can be significant: the cooperating corporation may be required to terminate employees, disclose confidential documents, and waive privileges—all of which may expose the corporation to substantial civil liability. On the other hand, the cost of not cooperating can be even more devastating. While Arthur Andersen may have been doomed from the moment it began shredding documents, the accounting firm’s fate was largely sealed when, after not fully cooperating, it was indicted for obstruction of justice.<sup>9</sup>

This Article will examine corporate cooperation and the difficulties it can create for corporate decision-makers.<sup>10</sup> Part I describes the principles of vicarious guilt that give prosecutors the power to demand corporate cooperation. Part II examines how prosecutors exercise their discretion in deciding whether to charge corporations with crimes. In Part III, the Article examines the cooperators. Just as a corporation’s guilt is only vicarious, so too its cooperation can be only vicarious. In the end, it is not the corporation that cooperates, but its officers and

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<sup>9</sup> See Lynn Cowan & Cheryl Winokur Munk, *Andersen: Called to Account: Criminal Charges Threaten Auditor’s Survival*, WALL ST. J., Mar. 18, 2002, at C15 (“If you are a bettor, the odds [do not] look good for Arthur Andersen LLP’s survival: In the past two decades, no financial-services firm has remained in business after facing criminal charges.”). In plea negotiations with prosecutors on the eve of its indictment, Arthur Andersen’s lawyer argued that criminal charges meant “[d]eath, death, death” for the firm. See Flynn McRoberts et al., *Repeat Offender Gets Stiff Justice*, CHI. TRIB., Sept. 4, 2002, at 1.

<sup>10</sup> In discussing these issues, I focus on federal prosecutions for several reasons: (1) federal law provides for much broader corporate criminal liability than the law of many states; (2) most prosecutions of large corporations take place in federal court; and (3) the recent spate of corporate scandals—from Enron and Andersen to Adelphia and WorldCom—have resulted in federal prosecutions (or calls for federal prosecutions). That is not to say that some state prosecutors—most notably New York County District Attorney Robert Morgenthau—do not also target corporations. See, e.g., Gary Silverman, *Man in the News—Wall Street’s Scourge—Man in the News Robert Morgenthau*, FIN. TIMES, June 8, 2002, at 13; see also Sharon Walsh, *Robert Morgenthau: The Bulldog on BCCI’s Trail*, WASH. POST, Mar. 14, 1993, at H1.

directors—the men and women who make decisions for the corporation. For these vicarious snitches, the process can be a minefield, filled with conflicting loyalties and inevitable self-interest.

### I. VICARIOUS GUILT

Corporations don't commit crimes; people do. But when the people committing crimes are corporate employees, the corporation will often be just as guilty as the employee.<sup>11</sup>

It was not always so. Until the twentieth century, American courts followed the common law rule that a corporation could not be guilty of a crime, because it was an artificial entity that could not act with mens rea.<sup>12</sup> As one nineteenth century Chancellor of England put it, "How can you ever expect a corporation to have a conscience, when it has no soul to be damned and no body to be kicked?"<sup>13</sup> By the dawn of the twentieth century, however, American courts had begun chipping away at the common law rule, holding corporations

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<sup>11</sup> See *Developments in the Law—Corporate Crime: Regulating Corporate Behavior Through Criminal Sanctions*, 92 HARV. L. REV. 1227, 1247 (1979) [hereinafter *Developments*] (defining scope of corporate criminal liability); see also Pamela H. Bucy, *Corporate Ethos: A Standard for Imposing Corporate Criminal Liability*, 75 MINN. L. REV. 1095, 1102–05 (1991) (describing current standards of corporate criminal liability). Organizational liability is not, of course, limited to corporations. Partnerships, associations, and other organizational entities can also be criminally responsible for the actions of their agents. See RICHARD S. GRUNER, *CORPORATE CRIMES AND SENTENCING* (2d ed. 1997).

<sup>12</sup> Blackstone, writing in 1765, saw little need to elaborate on the well-settled common law rule: "A corporation cannot commit treason, or felony, or other crime, in its corporate capacity." 1 WILLIAM BLACKSTONE, *COMMENTARIES ON THE LAWS OF ENGLAND* 464; see also Daniel R. Fischel & Alan O. Sykes, *Corporate Crime*, 25 THE J. OF LEGAL STUD. 319, 333 (1996) ("Blackstone treated the point as so obvious it needed no elaboration. How could anybody think differently?"). For a general historical examination of vicarious corporate guilt, see Kathleen F. Brickey, *Corporate Criminal Accountability: A Brief History and an Observation*, 60 WASH. U. L.Q. 393 (1982).

<sup>13</sup> John C. Coffee, Jr., *Making the Punishment Fit the Corporation: The Problems of Finding an Optimal Corporation Criminal Sanction*, 1 N. ILL. U. L. REV. 3, 4 (1980) (quoting Edward, First Baron of Thurlow, Land Chancellor of England). As Kathleen Brickey explains:

The corporation was recognized in law not as a natural person, but as an artificial entity. As an abstraction, it lacked physical, mental, and moral capacity to engage in wrongful conduct, or to suffer punishment. It could neither commit criminal acts, entertain criminal intent, nor suffer imprisonment. It had no soul, and so could not be blamed.

Brickey, *supra* note 12, at 396.

responsible for strict liability offenses involving failure to perform statutory duties.<sup>14</sup> Then, in 1909, in *New York Central & Hudson River Railroad Co. v. United States*,<sup>15</sup> the Supreme Court inaugurated the modern era of corporate criminal responsibility.

In *New York Central*, a railroad employee—the assistant freight traffic manager—had been charged with violating the Elkins Act by giving a customer “rebates” on government-fixed shipping rates. The railroad had also been charged because the statute provided that the act of an employee “‘within the scope of his employment’” was “‘deemed to be the act’” of the employer.<sup>16</sup> The railroad argued that it could not be convicted of a crime, if not because it could not form the necessary intent, then at least because the criminal intent of a mid-level employee could not be imputed to the individuals who ran the company (its board of directors) or to the individuals who owned the company (its stockholders).<sup>17</sup> The Court, however, rejected the common law view of corporate intent in favor of a respondeat superior theory borrowed from tort law.<sup>18</sup>

The tort principles adopted in *New York Central* have governed corporate criminal liability ever since. A corporation is criminally responsible for “the acts of any of its agents if an agent (1) commits a crime (2) within the scope of employment (3) with the intent to benefit the corporation.”<sup>19</sup> This vicarious

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<sup>14</sup> See Fischel & Sykes, *supra* note 12, at 333 & n.22 (citing *Commonwealth v. Proprietors of New Bedford Bridge*, 68 Mass. 339 (1854)); see also Shaun P. Martin, *Intracorporate Conspiracies*, 50 STAN. L. REV. 399, 406 & n.48 (1998) (citing *State v. Morris & Essex R.R. Co.*, 23 N.J.L. 360, 364 (1852)).

<sup>15</sup> 212 U.S. 481 (1909).

<sup>16</sup> *Id.* at 491–92 (quoting the Elkins Act, 32 Stat. 847, Pub. L. No. 107-223, ch. 708 (1903)).

<sup>17</sup> *Id.* at 492.

<sup>18</sup> *Id.* at 494 (“Applying the principles governing civil liability, we go only a step farther in holding that the act of the agent, while exercising the authority delegated to him to make rates for transportation, may be controlled, in the interest of public policy, by imputing his act to his employer and imposing penalties upon the corporation for which he is acting . . .”).

<sup>19</sup> See Developments, *supra* note 11, at 1247; see also *N.Y. Central*, 212 U.S. at 493 (noting that “the liability is not imputed because the principal actually participates in the malice or fraud, but because the act is done for the benefit of the principal, while the agent is acting within the scope of his employment in the business of the principal.”). The American rule of vicarious corporate guilt is “considerably broader than in most other countries.” See V.S. Khanna, *Corporate Liability Standards: When Should Corporations Be Held Criminally Liable?*, 37 AM. CRIM. L. REV. 1239, 1243 (2000); see also Jeffrey S. Parker, *Doctrine for*

corporate guilt is extraordinarily broad. Indeed, as one commentator has noted, courts so rarely find an employee's conduct to be outside the scope of employment or without an intent to benefit the corporation that a corporation will be vicariously guilty whenever an agent "commits a crime related in almost any way to the agent's employment."<sup>20</sup> Thus, corporations have been found guilty when criminal acts are performed by low-level employees,<sup>21</sup> when the specific criminal acts are unauthorized,<sup>22</sup> when the criminal acts are against the corporation's specific instructions,<sup>23</sup> when the corporation actively sought to prevent the crime,<sup>24</sup> when the corporation did not actually benefit from the crime,<sup>25</sup> and when no one in the

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*Destruction: The Case of Corporate Criminal Liability*, 17 *MANAGERIAL & DECISION ECON.* 381, 382 (1996) (noting "[t]hat the United States virtually stands alone in the world on its approach to" corporate criminal liability).

<sup>20</sup> Bucy, *supra* note 11, at 1148-49 (noting also that a corporation will be guilty of an employee's crime so long as the employee was "carrying out a job related activity" and the corporation was not "the intended victim of the illegality" (internal quotations omitted)); *see also* Developments, *supra* note 11, at 1250 (noting that the "scope of employment" requirement means "little more than that the act occurred while the offending employee was carrying out a job-related activity"). *See generally* H. Lowell Brown, *The Corporate Director's Compliance Oversight Responsibility in the Post Caremark Era*, 26 *DEL. J. CORP. L.* 1, 73-77 (2001) (summarizing the breadth of corporate criminal liability).

<sup>21</sup> *See* Brown, *supra* note 20, at 74 & n.332 (citing *United States v. Bank of New England*, 821 F.2d 844 (1st Cir. 1987)) (bank teller); *Texas-Oklahoma Express, Inc. v. United States*, 429 F.2d 100 (10th Cir. 1970) (truck stop workers); *Boise Dodge, Inc. v. United States*, 406 F.2d 71 (9th Cir. 1969) (automobile dealership employees)).

<sup>22</sup> *See* *N.Y. Cent. & Hudson River R.R. Co. v. United States*, 212 U.S. 481, 493-94 (1909) ("A corporation is held responsible for acts not within the agent's corporate powers strictly construed, but which the agent has assumed to perform for the corporation when employing the corporate powers actually authorized, and in such cases there need be no written authority under seal or vote of the corporation in order to constitute the agency or to authorize the act."); *see also* Brown, *supra* note 20, at 75 & n.335.

<sup>23</sup> *See, e.g.*, *United States v. Automated Med. Labs.*, 770 F.2d 399, 407 (4th Cir. 1985) (stating that although employees' conduct was "contrary to corporate policy" this does not "absolve [a corporation] of legal responsibility for their acts"); *United States v. Hilton Hotels Corp.*, 467 F.2d 1000, 1004 (9th Cir. 1972) (holding corporation guilty even though offending employee's conduct was contrary to corporate policy and against the express instructions of employee's supervisors); *see also* Brown, *supra* note 20, at 74 & n.335; Bucy, *supra* note 11, at 1102 & n.21.

<sup>24</sup> *See* Brown, *supra* note 20, at 74-75 & n.335 (citing numerous cases holding that "corporate policies of compliance provide no shelter from vicarious criminal liability"); *see also* KATHLEEN BRICKEY, *CORPORATE CRIMINAL LIABILITY* § 3.02 (1984); Bucy, *supra* note 11, at 1102 & n.21.

<sup>25</sup> *See, e.g.*, *Automated Med. Labs.*, 770 F.2d at 407 ("[I]t is not necessary for

corporation (other than the perpetrator) knew about the crime at the time of its commission.<sup>26</sup>

The breadth of this vicarious organizational guilt has been roundly criticized. Some have criticized as misguided any effort to anthropomorphize artificial entities, particularly because they cannot act with a *mens rea*.<sup>27</sup> Others have argued that criminal liability is an inefficient alternative to civil regulation and civil liability.<sup>28</sup> Still others have argued that corporate criminal liability undercuts respect for the criminal law by divorcing criminal liability from individual moral responsibility.<sup>29</sup>

Notwithstanding these criticisms, vicarious organizational guilt has survived nearly unchanged since 1909—at least in

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an agent's actions to have actually benefited the corporate entity.”); see also BRICKEY, *supra* note 24, § 4.02 (1984); Bucy, *supra* note 11, at 1102–03 & n.22.

<sup>26</sup> See BRICKEY, *supra* note 24, § 4.02 (1984); Bucy, *supra* note 11, at 1102 & n.22. For a good example of the breadth of corporate vicarious guilt, see *United States v. Basic Constr. Co.*, 711 F.2d 570, 572 (1983) (upholding corporation's conviction for bid rigging even though bid rigging was done by “two relatively minor officials . . . without the knowledge of high level corporate officers[,]” and in violation of the corporation's “longstanding, well known, and strictly enforced policy against bid rigging”); see also Pamela H. Bucy, *Organizational Sentencing Guidelines: The Cart Before the Horse*, 71 WASH. U. L.Q. 329, 335 (1992).

<sup>27</sup> The classic statement of this view came from Gerhard O.W. Mueller almost fifty years ago:

Many weeds have grown on the acre of jurisprudence which has been allotted to the criminal law. Among these weeds is a hybrid of vicarious liability, absolute liability, an inkling of *mens rea*—though a rather degenerated *mens rea*—, a few genes from tort law and a few from the law of business associations. This weed is called *corporate criminal liability*....

Nobody bred it, nobody cultivated it, nobody planted it. It just grew.

Gerhard O.W. Mueller, *Mens Rea and the Corporation: A Study of the Model Penal Code Position on Corporate Criminal Liability*, 19 U. PITT. L. REV. 21, 21 (1957–1958) (arguing also that the law of corporate criminal liability “has proceeded without any rationale whatsoever”).

<sup>28</sup> See Fischel & Sykes, *supra* note 12, at 334; V.S. Khanna, *Corporate Criminal Liability: What Purpose Does It Serve?*, 109 HARV. L. REV. 1477 (1996).

<sup>29</sup> See Parker, *supra* note 19, at 381 (“The very idea of ‘corporate crime’ is a corruption of the core meaning of crime and a dilution of the underlying ethic of individual moral responsibility and autonomy.”); see also Bucy, *supra* note 11, at 1099–1100 (arguing that allowing criminal convictions “without proof of the corporation's intent” encourages “the blurring of criminal and civil liability,” which “dilutes the impact of a criminal conviction, and, ultimately, erodes the power of the criminal law”). Corporate criminal liability, however, does have its defenders. See, e.g., Lawrence Friedman, *In Defense of Corporate Criminal Liability*, 23 HARV. J.L. & PUB. POL'Y 833, 856 (2000) (arguing that the moral condemnation accompanying a corporate criminal conviction sends an important retributive message about corporate misconduct).



theory. In practice, though, vicarious organizational guilt is not nearly so broad. It has been limited not by statute or by case law, but rather by the exercise of prosecutorial discretion.<sup>30</sup> There is little doubt that corporate crime abounds and that prosecutors do not lack for corporate targets.<sup>31</sup> Of the thousands of individuals prosecuted each year for white-collar crimes, it is safe to assume that many were corporate employees and were motivated at least in part by an intent to benefit the corporation.<sup>32</sup> Yet corporations—particularly large public corporations—are prosecuted quite infrequently.<sup>33</sup> Armed with

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<sup>30</sup> As William Laufer has observed, since 1909, corporations have resorted to numerous strategies to minimize the risks of criminal prosecution, including fidelity insurance, derivative suits, and, more recently, compliance programs. See William S. Laufer, *Corporate Liability, Risk Shifting, and the Paradox of Compliance*, 52 VAND. L. REV. 1343, 1356–57 (1999). None of these strategies, however, immunize corporations from prosecution, they simply made some corporations less attractive targets for prosecutors. As Laufer recognizes, the rule of vicarious guilt has remained unchanged. See *id.* at 1357 (“For nearly a century, during many shifts of liability risk, courts and legislatures have embraced enforcement strategies, both implicit and explicit, but only one liability rule: vicarious liability.”). Like these corporate risk-shifting strategies, the Organization Sentencing Guidelines have also indirectly limited corporate prosecutions by making some corporations less attractive targets. See *infra* note 65 and accompanying text. Since the underlying vicarious liability rule has not changed, it is the prosecutors who decide which corporations should be prosecuted. See Laufer, *supra* note 6, at 647 (“In theory, the substantive corporate criminal law is ruled by principles of vicarious liability that stretch back to rules articulated in *New York Central & Hudson River Railroad Co. v. United States*. In practice, cases of corporate crime are adjudicated by a brand of negotiated compliance.”).

<sup>31</sup> In 2001, over 12,500 defendants were sentenced for what the Sentencing Commission considers to be “white-collar” offenses. See 2001 SOURCEBOOK, *supra* note 5, at Fig. A, Tbl. 3. The Commission does not provide data on how many of these offenses were related to the offender’s employment.

<sup>32</sup> For example, in just the last few months, former executives of Rite Aid, WorldCom, and Enron have pleaded guilty to fraudulently inflating their company’s income, yet none of the corporations has been charged. See *Rite Aid’s Former President Pleads Guilty*, WALL ST. J., July, 11, 2002, at B4; Deborah Solomon, *WorldCom’s Ex-Controller Pleads Guilty to Fraud*, WALL ST. J., Sept. 27, 2002, at A3; Jonathan Weileta, *Guilty Plea by Enron’s Kopper Increases Scrutiny of Ex-CFO*, WALL ST. J., Aug. 22, 2002, at A1.

<sup>33</sup> Organizational prosecutions have gradually increased—from 111 in 1995 to 238 in 2001. See UNITED STATES SENTENCING COMMISSION, 1995 ANNUAL REPORT, at Tbl. 47; 2001 SOURCEBOOK, *supra* note 5, at Tbl. 51. Those prosecutions, however, are only a tiny fraction of all federal cases. In 2001, the 238 organizational prosecutions were only one-half of one percent of all federal prosecutions. See 2001 SOURCEBOOK, *supra* note 5, at Tbls. 3, 51. Moreover, the vast majority of organizational defendants are small, privately held corporations. One study indicated that over a five-year period in the 1990s, ninety-six percent of all organizations sentenced in federal court had fewer than fifty employees and

a broad liability rule and facing no shortage of targets, why is it that prosecutors so rarely indict corporations? Put another way, if vicarious organizational guilt is limited only by prosecutorial discretion, what principles, if any, guide the exercise of that discretion?

## II. PROSECUTORIAL DISCRETION AND GOOD CORPORATE CITIZENSHIP

On one level, prosecutors decide whether to charge a corporation in the same way they decide whether to charge an individual: they weigh the seriousness of the harm and the culpability of the offender against the resources required for the prosecution.<sup>34</sup> But on another level, a corporation's artificial nature makes the prosecution decision very different.

The most obvious difference is in the available sanctions. With "no body to be kicked," a corporation cannot be imprisoned. Prosecutors are accustomed to gauging the seriousness of a crime (and, thus, the importance of their work) by the amount of imprisonment that results.<sup>35</sup> Prosecutors are also keenly aware of the unique expressive power of

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were privately held. See William S. Laufer, *A Study of Small Business Compliance Practices*, in PROCEEDINGS OF THE SECOND SYMPOSIUM OF CRIME AND PUNISHMENT IN THE UNITED STATES, CORPORATE CRIME IN AMERICA: STRENGTHENING THE "GOOD CITIZEN" CORPORATION 135, 135 (Sept. 7-8, 1995) [hereinafter PROCEEDINGS]. Sentencing Commission data confirm the paucity of public companies who are actually prosecuted. For example, in 1997, of the 220 organizations prosecuted in federal court, only four were publicly traded. See UNITED STATES SENTENCING COMMISSION, 1997 ANNUAL REPORT 40.

<sup>34</sup> Department of Justice guidelines list seven factors that prosecutors should consider in deciding whether or not to bring charges against individuals:

1. Federal law enforcement priorities;
2. The nature and seriousness of the offense;
3. The deterrent effect of prosecution;
4. The person's culpability in connection with the offense;
5. The person's history with respect to criminal activity;
6. The person's willingness to cooperate in the investigation or prosecution of others; and
7. The probable sentence or other consequences if the person is convicted.

*Principles of Federal Prosecution*, in THE DEPT OF JUSTICE MANUAL, U.S. ATTORNEY'S MANUAL § 9-27.230 (2d ed. 2000).

<sup>35</sup> See *id.* § 9-27.230(B)(8) ("In assessing the strength of the Federal interest in prosecution . . . [federal prosecutors should consider] the sentence, or other consequence, that is likely to be imposed if prosecution is successful, and whether such a sentence or other consequence would justify the time and effort of prosecution.").

imprisonment—it conveys moral condemnation far more effectively than any fine.<sup>36</sup> Thus, it is not surprising that prosecutors prefer individuals as targets. Moreover, because corporate guilt is only vicarious, prosecutors who are considering charging a corporation usually have already identified the individual wrongdoers who actually committed the crimes. Thus, the relevant question for prosecutors is not simply whether the corporation should be charged, but rather whether it is necessary to charge the corporation *in addition to* the individual wrongdoers.<sup>37</sup>

For this reason, a prosecutor's focus is less likely to be on the seriousness of the harm (which can be accounted for in prosecuting the individuals) and more likely to be on the corporation's culpability—in particular, the extent to which the corporation is culpable separate and apart from the individual offenders. With “no soul to be damned,” however, a corporation itself is hard to blame. As a proxy, prosecutors typically look for

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<sup>36</sup> See Dan M. Kahan, *What Do Alternative Sanctions Mean?*, 63 U. CHI. L. REV. 591, 621, 650, 652–53 (1996) (arguing that fines are not as effective as imprisonment because fines do not express moral condemnation). Legislators are also keenly aware of the expressive power of imprisonment. For example, when debating and passing the Sarbanes-Oxley Act of 2002, Congress (and the media) focused on those provisions that increased maximum prison sentences for corporate executives, not those provisions that increased maximum fines for organizations. See Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, §§ 802, 807, 116 Stat. 745, 800, 804 (to be codified at 18 U.S.C. §§ 1519, 1348(2)); Michael A. Perino, *Enron's Legislative Aftermath: Some Reflections on the Deterrence Aspects of the Sarbanes-Oxley Act of 2002*, 76 ST. JOHN'S L. REV. 671 (2002) (describing the Act). The recently staged “perp walks” of some corporate defendants, including the executives of Adelphia and WorldCom, are an obvious—if somewhat coarse—example of the politics behind white-collar prosecutions. See Howard Fineman & Michael Isikoff, *Laying Down the Law*, NEWSWEEK, Aug. 5, 2002, at 20 (describing White House involvement in arranging the very public arrest of top executives of Adelphia Communications); Anne Gearon, *Arrest Spectacle, A Bone for the Public*, PITT. POST-GAZETTE, Aug. 2, 2002, at C12 (discussing the “perp walk[s]” of Adelphia and WorldCom executives and quoting one white-collar defense lawyer as stating, “[y]ou get a better headline by dragging somebody into custody in handcuffs than by indicting a faceless corporation”).

<sup>37</sup> It is possible, under the doctrine of collective knowledge, for a corporation to be guilty of a crime even though no one individual possessed all the knowledge necessary to satisfy the requisite criminal mental state. See *United States v. Bank of New England*, 821 F.2d 844, 856 (1st Cir. 1987) (“[A] corporation cannot plead innocence by asserting that the information obtained by several employees was not acquired by any one individual who then would have comprehended its full import. Rather the corporation is considered to have acquired the collective knowledge of its employees and is held responsible for their failure to act accordingly.” (quoting *United States v. T.I.M.E.-D.C., Inc.*, 381 F. Supp. 730, 738 (W.D. Va. 1974))).

a corporation's soul in the conduct of its top managers. But until relatively recently, the factors that prosecutors use to gauge a corporation's culpability revealed themselves only through the various (and sometimes inconsistent) ways in which prosecutors exercised their discretion. Two events in the 1990s, however, brought these factors into the limelight: the promulgation in 1991 of the Organizational Sentencing Guidelines,<sup>38</sup> and the publication in 1999 of Department of Justice guidelines for charging organizations.<sup>39</sup>

#### A. *The Organizational Sentencing Guidelines*

After a decade-long effort to reform federal sentencing, Congress passed the Sentencing Reform Act of 1984, which abolished parole, established the United States Sentencing Commission, and charged the Commission with creating binding rules to govern criminal sentences in federal court.<sup>40</sup> The resulting Sentencing Guidelines, which first took effect in 1987, have revolutionized federal sentencing. For white-collar offenders, the changes are particularly striking: sentences have become more severe (often involving imprisonment)<sup>41</sup> and judges are generally prohibited from considering a host of personal factors (such as age, education, employment, family background, family responsibilities, charitable works, and public service) that typically benefited white-collar offenders.<sup>42</sup>

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<sup>38</sup> See U.S.S.G., ch 8.

<sup>39</sup> U.S. Dep't of Justice, *Federal Prosecution of Corporations* (June 16, 1999) available at <http://www.usdoj.gov/criminal/fraud/Chargingcorps.html>.

<sup>40</sup> See Pub. L. No. 98-473, 98 Stat. 1987 (codified as amended at 18 U.S.C. §§ 3551-59, 3561-66, 3571-74, 3581-86 & 28 U.S.C. §§ 991-98. The reform effort that resulted in the Sentencing Reform Act usually traces its roots to Judge Marvin Frankel's influential 1973 book *Criminal Sentences: Law Without Order*. For a detailed discussion of the legislative history of the Sentencing Reform Act, see Stith & Koh, *supra* note 4.

<sup>41</sup> Although the Guidelines were not generally designed to increase sentence severity, the Sentencing Commission did make a conscious choice to increase sentence severity for white-collar offenses. See U.S.S.G., ch.1, pt.A(3) (2001) (noting the Commission's conclusion that economic crime in the pre-Guidelines era had been punished "less severely than other apparently equivalent behavior"); Stephen Breyer, *The Federal Sentencing Guidelines and the Key Compromises upon Which They Rest*, 17 HOFSTRA L. REV. 1, 20-21 (1988) (discussing "the Commission's decision to increase the severity of punishment for white-collar crime" by requiring imprisonment "for many white-collar offenders, including tax, insider trading, and antitrust offenders, who previously would have likely received only probation").

<sup>42</sup> In pre-Guidelines sentencing, judges routinely considered such factors in sentencing white-collar offenders. See STANTON WHEELER ET AL, SITTING IN

This sentencing revolution did not reach corporations until 1991, when the Commission adopted the Organizational Sentencing Guidelines.<sup>43</sup> Like the Sentencing Guidelines for individuals, the Organizational Sentencing Guidelines were designed to restrict judicial discretion in the sentencing of organizations and, for the most part, to make corporate sentences more severe.<sup>44</sup>

Under the Organizational Sentencing Guidelines, a corporation's sentence—like an individual's sentence—is “based on the seriousness of the offense and the culpability of the organization.”<sup>45</sup> The seriousness of the offense is typically determined either by the economic impact of the crime (i.e., the loss to the victim or the gain to the offender) or by reference to the “offense levels” in the individual sentencing guidelines.<sup>46</sup>

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JUDGMENT: THE SENTENCING OF WHITE-COLLAR CRIMINALS 88–92, 102–05 (1988). Under the Sentencing Guidelines, such “factors are not ordinarily relevant to the determination of whether a sentence should be outside the applicable guideline range.” U.S.S.G., ch. 5, pt. H (2001). Judges may still consider those factors in deciding what sentence to impose within the relatively narrow Guidelines sentencing range. In addition, sentencing judges may rely on those factors to depart from the Guidelines sentencing range when such factors are present “to an exceptional degree.” See *Koon v. United States*, 518 U.S. 81, 96 (1996).

<sup>43</sup> For descriptions of the development of the Organizational Sentencing Guidelines, see Nagel & Swenson, *supra* note 7; Richard S. Gruner, *Towards an Organizational Jurisprudence: Transforming Corporate Criminal Law Through Federal Sentencing Reform*, 36 ARIZ. L. REV. 407, 411–14 (1994).

<sup>44</sup> See Jeffrey S. Parker, *Rules Without . . . Some Critical Reflections on the Federal Corporate Sentencing Guidelines*, 71 WASH. U. L.Q. 397, 424 (1993) (noting that the Organizational Sentencing Guidelines represent a “ten to twenty-fold increase in the general level” of corporate criminal penalties).

<sup>45</sup> U.S.S.G., ch. 8, *Introductory Commentary* (2001). The Commission initially proposed Guidelines based on an “optimal penalty” approach that eschewed any attempt to account for corporate culpability. Under this explicitly economic deterrence-based approach:

organizational fines were to be set by measuring the losses flowing from an offense, adding to that amount the incremental cost of detecting the violation, multiplying this sum by a factor reflecting the difficulty of detecting and prosecuting that type of offense, and adding a further amount equal to the cost of prosecuting and sentencing the defendant.

Gruner, *supra* note 43, at 412; see also Michael K. Block, *Optimal Penalties, Criminal Law and the Control of Corporate Behavior*, 71 B.U. L. REV. 395, 397–410 (1991) (defending the optimal penalties approach). Under the significant influence of the Department of Justice, this proposal was eventually replaced by one that followed the same basic approach as the guidelines for individuals. See Jeffrey S. Parker, *The Current Corporate Sentencing Proposals: History and Critique*, 3 FED. SENT. REP. 133, 134 (1990).

<sup>46</sup> See U.S.S.G. §§ 8A1.2(b)(2), 8C2.4(a). Other provisions govern the fine when the corporation cannot pay any fine. See U.S.S.G. § 8C2.2(b), and when the

This calculation will yield the corporation's "base fine,"<sup>47</sup> which is then adjusted up or down based upon the corporation's "culpability score."<sup>48</sup> The culpability score is determined by a mathematical calculation based on the following factors: (1) whether the organization's top management "participated in, condoned, or was willfully ignorant of the offense";<sup>49</sup> (2) whether "tolerance" of the offense by middle management was "pervasive throughout the organization";<sup>50</sup> (3) whether the organization has a history of criminal convictions or regulatory violations;<sup>51</sup> (4) whether the organization obstructed justice or violated specific court orders;<sup>52</sup> (5) whether the organization had in place "an effective program to prevent and detect violations of law";<sup>53</sup> (6) whether the organization reported the offense prior to any imminent threat of disclosure or government investigation;<sup>54</sup> (7) whether the organization "fully cooperated in the investigation";<sup>55</sup> and (8) whether the organization "demonstrated recognition and affirmative acceptance of responsibility for its criminal conduct."<sup>56</sup> A corporation with a

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corporation is "operated primarily for a criminal purpose" or "primarily by criminal means." U.S.S.G. § 8C1.1.

<sup>47</sup> The guidelines provide base fines ranging from a low of \$5,000 (for an offense level of 6 or less) to a high of \$72,500,000 (for an offense level of 38 or more). See U.S.S.G. § 8C2.4(d). If the loss or gain from the offense is greater than the fine resulting from the offense level, the loss or gain will then be the base fine. See U.S.S.G. § 8C2.4(a).

<sup>48</sup> See U.S.S.G. § 8C2.5.

<sup>49</sup> See U.S.S.G. § 8C2.5(b). This provision applies to "[h]igh-level personnel," which the Guidelines define as "individuals who have substantial control over the organization or who have a substantial role in the making of policy within the organization," including "a director; an executive officer; an individual in charge of a major business or functional unit of the organization, such as sales, administration, or finance; and an individual with a substantial ownership interest." U.S.S.G. § 8A1.2, cmt. n.3(b). The larger the organization, the more significant will be the involvement of top management. See U.S.S.G. § 8C2.5(b).

<sup>50</sup> See U.S.S.G. § 8C2.5(b). This provision includes tolerance by "[s]ubstantial authority personnel," which is defined to include "individuals who within the scope of their authority exercise a substantial measure of discretion in acting on behalf of an organization." U.S.S.G. § 8A1.2, cmt. n.3(c). Examples include plant managers, sales managers, and individuals with the authority to set prices or negotiate significant contracts. See *id.*

<sup>51</sup> See U.S.S.G. § 8C2.5(c).

<sup>52</sup> See U.S.S.G. § 8C2.5(d)–(e).

<sup>53</sup> U.S.S.G. § 8C2.5(f).

<sup>54</sup> See U.S.S.G. § 8C2.5(g)(1).

<sup>55</sup> See U.S.S.G. § 8C2.5(g)(2).

<sup>56</sup> See U.S.S.G. § 8C2.5(g)(3).

high culpability score could see its fine increased by up to 400%, while a corporation with a low culpability score could see its fine cut by up to 95%.<sup>57</sup>

While the Organizational Sentencing Guidelines are directed at judges' sentencing decisions—not prosecutors' charging decisions—they inevitably affect how prosecutors view potential targets.<sup>58</sup> Moreover, and more to the point, the factors that enter into the Guidelines' culpability score are largely consistent with those factors that prosecutors use to evaluate corporate culpability.

### B. DOJ's "Federal Prosecution of Corporations"

In 1980, the Department of Justice promulgated the *Principles of Federal Prosecution*, a comprehensive, if somewhat vague, set of guidelines for federal prosecutors' charging decisions.<sup>59</sup> The *Principles*, however, are silent about the prosecution of organizations.<sup>60</sup> It was not until 1999 that the Department formulated separate principles to guide prosecutors in deciding whether to charge a corporation.<sup>61</sup>

The policy statement—entitled *Federal Prosecutions of Corporations*—codifies in a non-binding way a set of principles and practices that prosecutors around the country had been

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<sup>57</sup> See U.S.S.G. § 8C2.6.

<sup>58</sup> While the liability rule may determine whether an offender *can* be charged, it is the sentencing rule that often determines whether an offender *will* be charged. See *supra* note 35; see also Laufer, *supra* note 6, at 646 (describing the Organizational Sentencing Guidelines as a "decision template for prosecutors . . . in cases of corporate crime").

<sup>59</sup> See *Principles of Federal Prosecution*, *supra* note 34. For a more detailed discussion of the *Principles of Federal Prosecution*, see Michael A. Simons, *Prosecutorial Discretion and Prosecution Guidelines: A Case Study in Controlling Federalization*, 75 N.Y.U. L. REV. 893, 934 (2000).

<sup>60</sup> See Audrey Strauss, *Exercise of Discretion in Prosecuting Corporations*, N.Y.L.J. 5, 5 (1998) (noting that most of the *Principles of Federal Prosecution* do not support the prosecution of corporations and arguing that the DOJ should promulgate separate guidelines for corporate prosecutions).

<sup>61</sup> See *Federal Prosecution of Corporations*, *supra* note 39. There has been some dispute over whether the corporate prosecution guidelines were meant to be public. See Mark F. Pomerantz, *Prosecuting Corporations: Applying the New Department of Justice Guidelines*, 224 N.Y.L.J. 9, 9 (2000) (reporting Assistant Attorney General's denials that policy statement was not intended to be released); Audrey Strauss, *New Justice Department Factors on Corporate Prosecution*, 223 N.Y.L.J. 5, 5 (2000) (noting that the policy statement was issued on June 16, 1999, but was not made public until December 1999 "following a leak to BNA").

developing ad hoc through the 1990s.<sup>62</sup> With respect to charging decisions, the policy statement first notes that prosecutors contemplating charging corporations should “weigh all of the factors normally considered in the sound exercise of prosecutorial judgment: the sufficiency of the evidence, the likelihood of success at trial, the probable deterrent, rehabilitative and other consequences of conviction, and the adequacy of non-criminal approaches.”<sup>63</sup> The policy statement then lists eight specific factors prosecutors should consider in deciding whether to charge corporations:

1. The nature and seriousness of the offense, including the risk of harm to the public, and applicable policies and priorities, if any, governing the prosecution of corporations for particular categories of crime;
2. The pervasiveness of wrongdoing within the corporation, including the complicity in, or condonation of, the wrongdoing by corporate management;
3. The corporation’s history of similar conduct, including prior criminal, civil, and regulatory enforcement actions against it;
4. The corporation’s timely and voluntary disclosure of wrongdoing and its willingness to cooperate in the investigation of its agents, including, if necessary, the waiver of the corporate attorney-client and work product privileges;
5. The existence and adequacy of the corporation’s compliance program;
6. The corporation’s remedial actions, including any efforts to implement an effective corporate compliance program or to improve an existing one, to replace responsible management,

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<sup>62</sup> Although the policy statement was created by a working group of federal prosecutors from around the country, it appears as if the Southern District of New York played a leading role in the formulation of the document. For one, the cover memo that accompanied the document when it was distributed to all United States Attorneys indicated that comments about the guidelines should be sent to the Deputy United States Attorney for the Southern District of New York. Moreover, the guidelines substantially reflect corporate prosecution policies that had been adopted and applied by the U.S. Attorney’s Office in the Southern District of New York throughout the 1990s. See Strauss, *supra* note 61, at 5 (observing that although the policy statement’s authors are not identified, “it is apparent that the U.S. Attorney’s Office for the Southern District of New York had a leadership role in the creation of the policy” because “many of the practices of that district are included in the policy”).

<sup>63</sup> *Federal Prosecution of Corporations*, *supra* note 39, at II.A.



to discipline or terminate wrongdoers, to pay restitution, and to cooperate with the relevant government agencies

7. Collateral consequences, including disproportionate harm to shareholders and employees not proven personally culpable; and

8. The adequacy of non-criminal remedies, such as civil or regulatory enforcement actions.<sup>64</sup>

Among these factors, perhaps the most important are those that involve the corporation's conduct *after* the wrongdoing is discovered. While the "nature and seriousness of the offense" is no doubt important, it tells the prosecutor little about whether the corporation—as opposed to the individual wrongdoers—should be punished. Instead, prosecutors will often put great weight on the corporate response to the wrongdoing, in particular whether the corporation fully cooperates with the government's investigation and prosecution of the individual wrongdoers.<sup>65</sup>

From the prosecutors' perspective, a corporation's cooperation (or lack of cooperation) becomes a proxy for the corporation's character—a window, if you will, into the corporation's soul. Few prosecutors view an individual defendant's cooperation as an indication that the defendant has changed his ways.<sup>66</sup> Corporations, however, can change their

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<sup>64</sup> *Id.* (internal cross-references omitted). Several of these factors are not unique to corporations. In deciding whether to prosecute individuals, prosecutors certainly look to the nature and seriousness of the offense, the individual's criminal history, collateral consequences of a conviction, and the adequacy of non-criminal remedies. See *Principles of Federal Prosecution*, *supra* note 34, §§ 9–27.230, 9–27.250.

<sup>65</sup> The DOJ policy statement is explicit in this respect:

In determining whether to charge a corporation, that corporation's timely and voluntary disclosure of wrongdoing and its willingness to cooperate with the government's investigation may be relevant factors. In gauging the extent of the corporation's cooperation, the prosecutor may consider the corporation's willingness to identify the culprits within the corporation, including senior executives, to make witnesses available, to disclose the complete results of its internal investigation, and to waive the attorney-client and work product privileges.

*Federal Prosecution of Corporations*, *supra* note 39, at VI.A.

<sup>66</sup> See, e.g., Daniel C. Richman, *Cooperating Clients*, 56 OHIO ST. L.J. 69, 82 (1995) ("The assumption that defendants' reasons for cooperating are exclusively selfish seems reasonable enough . . ."); Ian Weinstein, *Regulating the Market for Snitches*, 47 BUFF. L. REV. 563, 624 (1999) (noting that the cooperator "is motivated by a desire for a personal benefit, not some greater good"). For an argument that this view of cooperation is too narrow, see Michael A. Simons,

“character” far more easily. For example, a corporation that changes its top management after discovering wrongdoing may seem to the prosecutor like a “new person.”<sup>67</sup> Similarly, if a corporation’s top management terminates and readily cooperates against the wrongdoers within the company, the prosecutor may view the wrongdoing as not reflective of the corporation’s character. By contrast, if a corporation defends the wrongdoers and resists prosecutorial demands to cooperate,<sup>68</sup> the prosecutor is likely to view the corporation as having a “bad” character (i.e., one that tolerates, or even condones, wrongdoing).<sup>69</sup>

Indeed, prosecutors put such great weight on cooperation that it can often save a corporation from indictment even if the corporation lacked a meaningful compliance program, even if top management knew about the criminal activity, and even if top management was involved in the criminal activity.<sup>70</sup> To do this, however, the corporation must cooperate so fully that it convinces prosecutors that it is a “good corporate citizen.”<sup>71</sup>

### C. *How to Be (or Not to Be) a “Good Corporate Citizen”*

Almost every corporation under investigation promptly announces that it is “cooperating” with the investigation.<sup>72</sup> But

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*Retribution for Rats: Cooperation, Punishment and Atonement*, 56 VAND. L. REV. (forthcoming 2003).

<sup>67</sup> See *infra* notes 89–132 and accompanying text (discussing the different fates of corporations that cooperated with criminal investigations and corporations that did not).

<sup>68</sup> The corporation, of course, may feel that its employees have done nothing wrong. That the corporation disagrees with the prosecutor on this score, however, is unlikely to help convince the prosecutor of the corporation’s virtuous character.

<sup>69</sup> As one-time corporate defense attorney and current federal judge Jed Rakoff has noted: “[P]rosecutors are reluctant to bring the criminal law to bear against organizations that appear more rueful than recalcitrant. Simply put, prosecutors tend to view themselves as avenging angels in simple morality plays where evil is banished and social order restored.” Jed S. Rakoff, *Four Postulates of White-Collar Practice*, 210 N.Y.L.J. 3, 3 (1993).

<sup>70</sup> See *infra* notes 72–73. While the involvement of top management in the criminal activity may be a reflection of deep corporate culpability, there is often little reason to prosecute the corporation once the top managers have been prosecuted.

<sup>71</sup> See generally Symposium, *Corporate Crime In America: Strengthening the “Good Citizen” Corporation*, UNITED STATES SENTENCING COMMISSION (1995) (collection of materials from a two-day conference devoted to the “good corporate citizenship” movement).

<sup>72</sup> For example, in early November 2001, in the midst of the massive shredding

cooperation comes in many forms, and prosecutors are increasingly demanding that corporations do far more than simply hand over documents and make witnesses available.<sup>73</sup>

Traditionally, a corporation faced with apparent wrongdoing within its ranks would conduct an internal investigation—interviewing witnesses and gathering documents to determine exactly what happened and who was responsible.<sup>74</sup> The corporation's investigators (usually outside counsel) could act quickly and thoroughly because employees could be threatened with termination if they did not cooperate.<sup>75</sup> The corporation would then evaluate the results of the internal investigation to determine the extent of the corporation's civil and criminal exposure and what remedial action, if any, should be taken.<sup>76</sup>

Now, prosecutors take a far more aggressive approach.<sup>77</sup> If a corporation hopes to avoid indictment, it may have to disclose the factual findings of the internal investigation,<sup>78</sup> to disclose all

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that eventually led to its indictment, Andersen announced that "the firm 'will continue to cooperate with [Enron's] special committee, lawyers and accounting advisers' and 'will also cooperate with other official investigations as requested.'" Jonathan Weil, *What Enron's Financial Reports Did—and Didn't—Reveal*, WALL ST. J., Nov. 5, 2001, at C1 (quoting Andersen spokesman David Tabolt); see also Richard A. Opiel, Jr. & Kurt Eichenwald, *Arthur Andersen Fires an Executive for Enron Orders*, N.Y. TIMES, Jan. 16, 2002, at A1 (quoting Andersen as admitting that its "expedited effort to destroy documents" began on Oct. 23, 2001 and continued until Nov. 9, 2001).

<sup>73</sup> See, e.g., Johnny Frank, *How to Cooperate with the Prosecutor*, N.J.L.J. 6, 24 (1995) ("Corporate cooperation formerly entailed making documents and employees available to government investigators. In many prosecutor's offices, however, such assistance in and of itself no longer qualifies as cooperation.").

<sup>74</sup> See Lisa A. Cahill, *Internal Investigations and Waiving Corporate Privilege*, 224 N.Y.L.J. 5 (2000); Jed S. Rakoff, *Coerced Waiver of Corporate Privilege*, 214 N.Y.L.J. 3 (1995); Zornow & Krakaur, *supra* note 8, at 152.

<sup>75</sup> See Rakoff, *supra* note 74, at 3 ("Counsel conducting the internal investigation on behalf of the company can demand that employees answer his inquiries upon pain of being discharged if they refuse to do so"); Harvey L. Pitt et al., *Director Duties to Uncover and Respond to Management Misconduct*, 11 INSIGHTS 5, 7 (1997) (noting that corporations can require employees who are "accused or suspected of improper conduct" to "cooperate with any internal inquiries by the company").

<sup>76</sup> See Zornow & Krakaur, *supra* note 8, at 152–53.

<sup>77</sup> See Rakoff, *supra* note 74, at 3 ("While the evidence of this increased aggressiveness is largely anecdotal, it is affirmed by virtually every defense counsel who practices in this field."); Zornow & Krakaur, *supra* note 8, at 156–58 (describing "[t]he brave new world" of defending a corporation in the face of the "newly aggressive stance of prosecutors").

<sup>78</sup> Cahill, *supra* note 74, at 5 ("It is no longer news to anyone that, as part of a

of the information gathered during the internal investigation,<sup>79</sup> to waive the attorney-client privilege and work-product protection,<sup>80</sup> to terminate the offending employees,<sup>81</sup> to replace management, and even to actively assist the government in covert investigations of employees, competitors, vendors, and clients.<sup>82</sup> To prosecutors, this “super-cooperation” is simply “good corporate citizenship.”<sup>83</sup> To corporations, it can be a minefield.

While avoiding indictment will be of paramount importance to most corporations, the expansive cooperation demanded by prosecutors is not without its perils. Most obviously, the information provided to prosecutors—particularly information that might otherwise be protected by privileged or as attorney

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cooperation deal, U.S. Attorney's Offices are increasingly requiring corporations . . . to disclose, at a minimum, the factual findings of an internal investigation.”)

<sup>79</sup> See Frank, *supra* note 73, at 24 (noting that prosecutors expect a cooperating corporation to furnish “its entire investigative file”); Molly McDonough, *Fessin Up Hard to Do, But Still Right Thing: Prosecutor*, CHI. DAILY L. BULL., Oct. 1, 1999, at 1 (reporting the U.S. Attorney for the Northern District of Illinois' observation that the best form of corporate cooperation involves “a company which has done its own investigation, complete with confessions and affidavits, and hands it to the government”).

<sup>80</sup> See Robert G. Morvillo, *The Decline of the Attorney-Client Privilege*, 218 N.Y.L.J. 3 (1997) (“The office of the United States Attorney for the Southern District of New York routinely coerces corporate waivers of the privilege by informing corporate managers that their failure to waive the privilege will be evaluated in determining whether the corporation has been sufficiently cooperative to avoid indictment and/or a severe guidelines sentence.”); Pomerantz, *supra* note 61 (former federal prosecutor noting that “[t]he request for a privilege waiver has become the rule rather than the exception”).

<sup>81</sup> See Tamara Loomis, *Privilege Waivers: Prosecutors Step Up Use of Bargaining Waivers*, 224 N.Y.L.J. 5 (2000) (reporting that federal prosecutors in the Southern District of New York (S.D.N.Y.) “often pressured corporations to fire employees who refuse to cooperate in its investigation”); Pomerantz, *supra* note 61 (former S.D.N.Y. prosecutor noting that a cooperating corporation “often is well advised” to “root out its corrupt employees, and cut them off from financial support and information”).

<sup>82</sup> See Frank, *supra* note 73, at 24 (noting that cooperation can entail “[s]upporting and participating in covert investigations of the corporation's employees, vendors, and clients” and “[a]ssisting the investigative team in conducting surprise work-site inspections, interviews of potential witnesses at their homes, search warrants, and arrests”).

<sup>83</sup> This practice of demanding “super-cooperation” from corporations (particularly privilege waivers) predates the 1999 DOJ policy statement. See *supra* note 39. Though the origins of the practice are unclear, at least some districts were demanding privilege waivers from corporations in the early 1990s. See Loomis, *supra* note 81 (noting that the U.S. Attorney's Office for the S.D.N.Y. has been requesting privilege waivers since the early 1990s).

work product—may expose the corporation to punishing civil liability. By disclosing privileged material to the government, the corporation will likely preclude itself from asserting its privileges in later civil proceedings.<sup>84</sup> The resulting disclosures may substantially increase the company's civil liability;<sup>85</sup> at a minimum, they will make it far easier for plaintiffs to enforce that liability.

Cooperation may also devastate corporate morale,<sup>86</sup> particularly if employees are terminated or prosecuted based on privileged statements made to the corporation.<sup>87</sup> When the misconduct is severe enough, cooperation may also imperil the positions of top management.<sup>88</sup>

For these reasons, a corporation's decision about whether to accede to prosecutorial demands for super-cooperation can be extraordinarily difficult. Some companies resist altogether, proclaiming the innocence of their employees (and, by extension, themselves). Other companies, while admitting their employees' guilt, resist prosecutorial demands to assist in the investigation. Still others, while nominally "cooperating" in the investigation, deny accusations of systemic problems and proclaim little need for organizational changes. For these companies, the price of resisting can be devastating. By contrast, other companies—including companies whose employees engaged in serious misconduct—have been able to avoid indictment altogether by cooperating thoroughly enough to demonstrate their "good corporate citizenship."

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<sup>84</sup> See Rakoff, *supra* note 74, at 3 ("[E]very federal circuit court that has addressed the issue, save one (the Eighth), has held that disclosure of a company's internal investigative files to the Government constitutes a waiver of privilege, with respect to those files, as to all other persons.") (citing cases).

<sup>85</sup> See Richard Gruner, *Avoiding Fines Through Offense Monitoring, Detection, and Disclosure: The Race for Amnesty*, 1230 *PLI/CORP.* 77, 115 (2000) (arguing that civil liabilities would often be imposed even absent disclosures to prosecutors).

<sup>86</sup> See *id.* at 115–16; see also Ellen S. Podgor, *White-Collar Cooperators: The Government in Employer-Employee Relationships*, 23 *CARDOZO L. REV.* 795, 803 (2002) ("Placing the employer and employee in an adversarial position, in an attempt to secure the benefits of cooperation, interferes with the overriding fiduciary employment relationship.")

<sup>87</sup> Employee mistrust of the corporation (and its lawyers) may also hamper future compliance efforts. See Zornow & Krakaur, *supra* note 8, at 156 (arguing that corporate cooperation "has the effect of chilling" counsel's inquiry into possible wrongdoing and "often has an adverse impact on the relationships among senior management and lower-level employees").

<sup>88</sup> See *infra* notes 113–115 and accompanying text.

Consider the following contrasting cases:

*Kidder.* In 1986, Rudolf Giuliani, then United States Attorney for the Southern District of New York, began a wide-ranging investigation into illegal insider trading on Wall Street.<sup>89</sup> Giuliani's key cooperator—Ivan Boesky—led Giuliani to Martin Siegel, a director at Kidder Peabody & Company.<sup>90</sup> Federal prosecutors soon learned that Siegel, Boesky, and others had participated in multiple illegal trading schemes (some of which directly benefited Kidder).<sup>91</sup> When the investigation became public in February 1987, Kidder had recently been acquired by General Electric, although GE had not taken an active role in managing its subsidiary.<sup>92</sup> Upon learning of the government's investigation, however, GE moved aggressively to assume control of Kidder and to cooperate fully with the investigation.<sup>93</sup> GE fired Kidder's top management, instituted extensive structural, managerial, and policy changes designed to prevent a recurrence of the misconduct, and rapidly settled civil charges with the SEC.<sup>94</sup> As a direct result of this cooperation, within four months federal prosecutors had announced that no criminal charges would be filed against Kidder.<sup>95</sup>

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<sup>89</sup> For a detailed examination of the insider-trading scandals of the 1980s, see JAMES B. STEWART, *DEN OF THIEVES* (Simon & Schuster 1992).

<sup>90</sup> See William Glaberson, *Wall St. Informer Admits His Guilt In Insider Trading*, N.Y. TIMES, Feb. 14, 1987, at A1.

<sup>91</sup> See *id.* According to the SEC, Kidder's profits from the illegal activity amounted to \$13.7 million. See James Sterngold, *Kidder Agrees To Pay \$25 Million To Settle Insider Trading Charges*, N.Y. TIMES, June 5, 1987, at A1.

<sup>92</sup> See Robert J. Cole, *G.E. Tightens Reins At Kidder, Peabody*, N.Y. TIMES, May 15, 1987, at D1. GE had purchased Kidder in June 1986, just eight months before it learned of the government investigation (when two top Kidder executives were arrested in Kidder's offices). See James B. Stewart & Janet Guyon, *Damage Control: How GE and Kidder Managed to Ward Off an Impending Disaster*, WALL ST. J., June 8, 1987, at 1.

<sup>93</sup> See Sterngold, *supra* note 91; Stewart & Guyon, *supra* note 92.

<sup>94</sup> See United States Attorney's Office, *Announcement of Decision Not to Prosecute Kidder, Peabody & Co.* (June 4, 1987), reprinted in *Press Releases Issued By United States Attorney, Southern District Of New York*, 1248 PLI/CORP. 197, 199-202 (2001). Kidder paid a \$25.3 million fine to the SEC. See Sterngold, *supra* note 91. According to one GE executive, the strategy was to transform Kidder so that it would be a different company that the one involved in the wrongdoing: "We were trying to convince [Giuliani] that the Kidder that existed then and had been involved in the Siegel situation wouldn't be the future Kidder[.]" See Stewart & Guyon, *supra* note 92, at 10.

<sup>95</sup> The press release announcing Giuliani's decision not to prosecute emphasized that Kidder's (and GE's) cooperation was a key reason for his

*Drexel.* Ivan Boesky also led federal prosecutors to Michael Milken, the "junk bond king" of Drexel Burnham Lambert.<sup>96</sup> Drexel's corporate reaction to the investigation could not have been more different than Kidder's.<sup>97</sup> As the investigation proceeded during 1987 and 1988, Drexel vigorously denied any wrongdoing, steadfastly defended its employees, and vowed to fight any charges.<sup>98</sup> Eventually, faced with the prospect of a RICO indictment, Drexel pleaded guilty to six counts of fraud and paid a \$300 million fine.<sup>99</sup> Within months, Drexel had ceased to exist, filing for bankruptcy, liquidating its assets, and laying off over 3,000 employees.<sup>100</sup>

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forbearance:

The decision by the United States Attorney was based on four principal factors: Kidder's full cooperation with the Government's investigation; Kidder's entry into a consent judgment with the SEC in the SEC's related investigation, which provides mechanisms to avoid the commission of securities violations in the future; structural, management and policy changes instituted at Kidder by Kidder's new owner, the General Electric Company; and the negative effect that charges against the firm would have on Kidder's thousands of innocent employees and the firm's legitimate activities. . . . The United States Attorney explained that because G.E. decided at an early stage to cooperate fully with the Government, began institution of vigorous structural, management, policy and trading reforms, and reached an appropriate agreement with the SEC, the public interest has well served; at this point a prosecution of Kidder is unnecessary.

*Announcement of Decision Not to Prosecute, supra* note 94. This forbearance was a marked change from Giuliani's position four months earlier, when he told Kidder officials that the firm would be indicted for insider trading. *See Stewart & Guyon, supra* note 92.

<sup>96</sup> Laurie P. Cohen, *With Signed Checks, Formal Guilty Plea, Drexel Ends Ordeal*, WALL ST. J., Sept. 12, 1989, at A3.

<sup>97</sup> Indeed, Giuliani's agreement not to prosecute Kidder was widely interpreted as a message "aimed at Drexel," which at the time was still resisting "any suggestion that they have problems that need fixing." Sterngold, *supra* note 91, at D4. Drexel obviously did not get the message.

<sup>98</sup> *See James B. Stewart & Daniel Hertzberg, Civil Charges Against Drexel and Milken To Be Sought by SEC Staff, Sources Say*, WALL ST. J., Jan. 26, 1988, at 3 (reporting that when the SEC staff notified Drexel of its recommendation to seek charges against the company, Drexel's spokesman stated: "Drexel has denied any wrongdoing, and has said its own investigations have produced no evidence of any wrongdoing by any of its employees.").

<sup>99</sup> Cohen, *supra* note 96; *see also* United States Attorney's Office, *Outline of Charges: United States v. Drexel Burnham Lambert Incorporated* (Jan. 24, 1989), reprinted in *Press Releases Issued by United States Attorney, Southern District of New York*, 1248 PLI/CORP. 197, 203 (2001).

<sup>100</sup> George Anders, *A Shadow of Itself, Drexel Comes Back from Bankruptcy*, WALL ST. J., Apr. 30, 1992, at C1. One prominent securities lawyer has noted that "[m]any observers believe that if the Drexel firm had chosen to cooperate with

*Salomon Brothers.* In June 1991, the Department of Justice and the SEC began investigating illegal purchases of government securities by Salomon Brothers, Inc.<sup>101</sup> In August, after conducting a “full investigation” Salomon acknowledged that its government bond trader, Paul Moser, had violated bidding rules at auctions in December, February, and May.<sup>102</sup> When it acknowledged the wrongdoing, Salomon suspended Moser and three of his associates and claimed that the four suspended employees acted “without the knowledge of management.”<sup>103</sup> As it turns out, Salomon’s top officers, including its Chairman, its Vice-Chairman, and its President, were told about the illegal bidding in April—well before the May auction at which the misconduct was repeated and four months before the wrongdoing was disclosed to regulators.<sup>104</sup> As Salomon reeled under the disclosures and the intensifying investigation, Warren Buffet—its largest shareholder—came to the rescue. Within days, Salomon’s top three officials had resigned, Buffet had become interim chairman, a new chief operating officer (who was unconnected with the scandal) had been appointed, and Salomon had begun cooperating with the authorities. Under Buffet’s leadership, Salomon not only provided documents and made employees available for interviews, it also waived its attorney-client privilege, provided detailed information about the firm’s own internal

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government prosecutors at the start, the firm would still be alive and prospering.” Arthur F. Mathews, *Defending SEC and DOJ FCPA Investigations and Conducting Related Corporate Internal Investigations: The Triton Energy/Indonesia SEC Consent Decree Settlements*, 18 NW. J. INT’L L. & BUS. 303, 429–40 (1998).

<sup>101</sup> See Michael Siconolfi et al., *The Big Squeeze: Salomon’s Admission Of T-Note Infractions Gives Market a Jolt*, WALL ST. J., Aug. 12, 1991, at A1. Treasury Department regulations bar individual bidders from purchasing more than 35% of the treasury notes offered in any particular auction. By submitting unauthorized bids in the name of Salomon customers, Salomon was able to far exceed the 35% limit, sometimes reaching as high as 85%. See Michael Siconolfi & Laurie P. Cohen, *The Treasury Auction Scandal at Salomon: A Chronology: How It All Unfolded*, WALL ST. J., Aug. 19, 1991, at A4.

<sup>102</sup> See Siconolfi & Cohen, *supra* note 101.

<sup>103</sup> See Siconolfi et al., *supra* note 101.

<sup>104</sup> See Michael Siconolfi et al., *Top Salomon Officials Knew About Illegal Bid*, WALL ST. J., Aug. 15, 1991, at C1. When the firm admitted that its top officials had known of the misconduct, it claimed it intended to disclose the wrongdoing sooner, but just did not get around to it. See *id.* (quoting the firm’s press statement: “Management immediately determined that this matter must be communicated to the government; however, due to a lack of sufficient attention to the matter, this determination was not implemented promptly”).



investigation, and, as described by federal prosecutors, took “decisive and extraordinary actions to restructure its management to avoid future misconduct.”<sup>105</sup> Nine months later, when federal prosecutors announced that Salomon would not be prosecuted, the United States Attorney specifically credited Salomon’s “exemplary” and “unprecedented” cooperation.<sup>106</sup> Indeed, Salomon’s cooperation has become the gold standard of what prosecutors expect from corporations under investigation.<sup>107</sup>

*Cooper Companies.* In early 1992, at the same time that Salomon was engaging in its “exemplary” cooperation, federal prosecutors began investigating allegations that the chairman of Cooper Companies had been involved in a scheme to profit from inside tips on junk bond trades.<sup>108</sup> Cooper Companies’ approach was the polar opposite of Salomon’s.<sup>109</sup> During the investigation, both the chairman and the company proclaimed

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<sup>105</sup> United States Attorney’s Office, *Department of Justice and SEC Enter \$290 Million Settlement With Salomon Brothers in Treasury Securities Case* (May 20, 1992), reprinted in *Press Releases Issued by United States Attorney, Southern District of New York*, 1248 PLI/CORP. 197, 211–14 (2001); see also Mathews, *supra* note 101, at 419. Buffett also set out to change Salomon’s famously aggressive character. See Michael Siconolfi & Laurie P. Cohen, *Sullied Solly: How Salomon’s Hubris and a U.S. Trap Led To Leaders’ Downfall*, WALL ST. J., Aug. 19, 1991, at A1 (“Mr. Buffett [told Salomon’s managing directors that] any action by Salomon even approaching impropriety won’t be tolerated. ‘Anything not only on the line, but near the line, will be called out,’ a senior managing director said Mr. Buffett told them.”).

<sup>106</sup> *Department of Justice and SEC Enter \$290 Million Settlement with Salomon Brothers in Treasury Securities Case*, *supra* note 105, at 213; Otto Obermaier, *Do the Right Thing; But if a Company Doesn’t, It Can Limit the Damage*, BARRON’S, Dec. 14, 1992, at 18 (noting that Salomon was not prosecuted because “the board removed the chief executive officer and several subsidiary officers, instituted procedures for ethics and compliance, and gave every indication that it was turning over a new leaf”).

<sup>107</sup> See Otto G. Obermaier, *Drafting Companies to Fight Crime*, N.Y. TIMES, May 24, 1992, at 11 (then-U.S. Attorney pointing to Salomon’s “exemplary” cooperation and noting that “[g]ood corporate citizenship is now defined by expanded obligations”).

<sup>108</sup> See Diana B. Henriques, *Cooper Companies and Former Head Are Indicted*, N.Y. TIMES, Nov. 11, 1992, at D1. The scheme allegedly resulted in \$3.6 million in profits, some of which went to the company and some of which went to the chairman and his family. See *id.* In the interest of full disclosure, I should note that as a young associate doing white collar defense work in the early 1990s, I helped represent Cooper Company’s chairman during the investigation and ensuing trial in which Cooper Companies was a co-defendant.

<sup>109</sup> See Obermaier, *supra* note 106, at 18 (then-U.S. Attorney contrasting the responses of Salomon and Cooper Companies to federal investigations).

their innocence.<sup>110</sup> In late 1992, when the chairman was indicted for racketeering, money laundering, and fraud, the company was indicted as well.<sup>111</sup> In explaining the charges against the company, the United States Attorney noted that the company had “done little, if anything, to rectify the wrongdoing of the individuals associated with the company.”<sup>112</sup> Cooper Companies was eventually convicted of seven counts of fraud<sup>113</sup> and ordered to pay a \$1.8 million fine,<sup>114</sup> an amount that constituted a “genuine threat to the financial viability of the company.”<sup>115</sup>

*Prudential Securities.* In mid-1993, federal prosecutors began investigating whether brokers at Prudential Securities committed fraud in the sale of limited partnerships in the 1980s.<sup>116</sup> By the time the criminal investigation began,

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<sup>110</sup> See Floyd Norris, *Analyst Pleads Guilty in Junk Bond Scheme*, N.Y. TIMES, May 22, 1992, at D5 (reporting that the company’s spokesman responded to the first public accusations of wrongdoing by saying, “The company denies any wrongdoing and is unaware of any wrongdoing on the part of its officers or employees”); Jonathan M. Moses, *Cooper Cos., Former Executive Charged In Junk Bond Insider-Trading Case*, WALL ST. J., Nov. 11, 1992, at B9 (reporting that the company’s attorney responded to its indictment by saying that the “company ‘intends vigorously to defend itself against’ the allegations”).

<sup>111</sup> See Henriques, *supra* note 108; Moses, *supra* note 110.

<sup>112</sup> See Moses, *supra* note 110 (quoting then-U.S. Attorney Otto Obermaier). In particular, authorities complained that the company failed to remove the chairman and his brother “from positions of authority after they had refused to cooperate both with the Federal investigations and with the company’s own internal investigation,” failed to take any action “to recover the company’s misappropriated trading profits,” and allowed the chairman “to issue false and misleading news releases” after the investigation became public. Diana B. Henriques, *Cooper Companies to Pay in Fraud Case*, N.Y. TIMES, Dec. 13, 1994, at D5.

<sup>113</sup> See Diana B. Henriques, *Cooper’s Ex-Chairman Convicted in Fraud Case*, N.Y. TIMES, Jan. 14, 1994, at D3. When the company was convicted, the United States Attorney emphasized that its fate turned on its lack of cooperation:

United States Attorney Mary Jo White said yesterday it was ‘regrettable that the innocent investors of the Cooper Companies Inc. must suffer as a result of today’s verdict.’ She added, ‘It must be understood that corporations like the Cooper Companies, who do little if anything to rectify the prior wrongdoing of their employees, will be held accountable.’

*Id.*

<sup>114</sup> See Henriques, *supra* note 112.

<sup>115</sup> David M. Zornow, *Should Companies Turn Themselves In?*, 212 N.Y.L.J. S3 (1994).

<sup>116</sup> See Michael Siconolfi, *Prudential Securities Partnerships Are Now Subject of U.S. Criminal Inquiry*, WALL ST. J., June 18, 1993, at A4. In particular, as it eventually admitted, Prudential sold over \$1.4 billion in limited partnership investments by lying to investors about the structure of the investments and the risks that accompanied them. United States Attorney’s Office, *Announcement of*

Prudential had already spent several years fighting off securities regulators and angry investors.<sup>117</sup> In the early stages of the criminal investigation, Prudential did not take a "Salomon-like" approach. By the end of 1993, however, the criminal investigation had widened its scope. In particular, prosecutors had begun focusing on alleged wrongdoing with Prudential Securities parent company, Prudential Insurance Company, at the time the nation's largest insurance company.<sup>118</sup> Prudential's approach soon changed. It demoted its long-time general counsel (the only senior executive remaining at the firm from the 1980s), began a wide-ranging shake up of its brokerage management, and eventually started cooperating with the criminal investigation.<sup>119</sup> By October 1994, Prudential had worked out a deal with federal prosecutors that allowed it to avoid indictment. In announcing the deal, the United States Attorney specifically pointed to four factors that influenced her decision: that Prudential had cooperated during the investigation and had acknowledged its own wrongdoing, that all of the individuals responsible for the wrongdoing had left the company, that Prudential had agreed to substantial civil fines and restitution, and that an indictment could "cause crippling collateral consequences to thousands of innocent employees and investors."<sup>120</sup> Prudential did, however, pay a price for its initial reluctance to cooperate. Unlike Salomon, Prudential was required to agree to a "deferred prosecution," a formal agreement pursuant to which Prudential admitted its

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*Filing of Criminal Complaint Against Prudential Securities Incorporated* (Oct. 27, 1994, reprinted in *Press Releases Issued By United States Attorney, Southern District of New York*, 1248 PLI/CORP. 197, 219-23 (2001)).

<sup>117</sup> See Kurt Eichenwald, *Prudential Reported to Seek a Settlement with S.E.C.*, N.Y. TIMES, Mar. 5, 1993, at D1.

<sup>118</sup> See Kurt Eichenwald, *Prudential Fraud Scandal Reaches to Parent Company*, N.Y. TIMES, Nov. 11, 1993, at D1; Kurt Eichenwald, *U.S. Broadening Prudential Criminal Inquiry*, N.Y. TIMES, Dec. 30, 1993, at D1; Michael Siconolfi & Greg Steinmetz, *Prosecutors Are Examining Involvement by Prudential Insurance on Partnerships*, WALL ST. J., Nov. 15, 1993, at C1.

<sup>119</sup> See Michael Siconolfi, *Prudential Unit Strips Schechter of Legal Duties: General Counsel Leaves Post Amid Widening Inquiry Into Partnership Deals*, WALL ST. J., Dec. 31, 1993, at 3 (describing the demotion as a "sudden shift" that "stunned Wall Street executives"); see also Kurt Eichenwald, *Shake-Up Under Way at Prudential*, N.Y. TIMES, June 6, 1994, at D1.

<sup>120</sup> See Press Releases of United States Attorney, Southern District of New York, *supra* note 116, at 219-20; Kurt Eichenwald, *Brokerage Firm Admits Crimes in Energy Deals*, N.Y. TIMES, Oct. 28, 1994, at A1.

wrongdoing in court and accepted a form of voluntary probation for three years.<sup>121</sup>

*Daiwa Bank.* In July of 1995, Daiwa Bank discovered that one of its employees in New York had lost \$1.1 billion through scheme in which he engaged in unauthorized bond trading and then covered his losses by selling bonds belonging to the bank and its customers.<sup>122</sup> The scheme, which had lasted for eleven years, was concealed by the employee through countless false statements in the bank's records.<sup>123</sup> After the bank learned of the misconduct, it waited almost two months to inform regulators.<sup>124</sup> Even after disclosing the loss, the bank resisted the full cooperation demanded by prosecutors.<sup>125</sup> As a result, it

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<sup>121</sup> See Press Releases of United States Attorney, Southern District of New York, *supra* note 116, at 219-20; Eichenwald, *supra* note 119 (noting that Prudential's admission came "[a]fter more than three years of denying that it broke the law"). The deferred prosecution agreement required Prudential: (1) to contribute \$330 million (on top of \$330 already paid) into a restitution fund; (2) to install an independent "ombudsman" to receive and report on allegations of misconduct; (3) to retain an independent law firm to review the adequacy of its compliance controls; and (4) to fully and truthfully cooperate "in any criminal investigations, including voluntarily providing any requested records and unlimited access to governmental authorities to [Prudential's] facilities, documents and employees." United States Attorney's Office Press Release, *supra* note 116, at 219-20. The agreement also required Prudential's parent companies to cooperate. *See id.*

<sup>122</sup> See Peter Truell, *A Japanese Bank Is Indicted in U.S. and Also Barred*, N.Y. TIMES, Nov. 3, 1995, at A1. Another disclosure: as an Assistant United States Attorney in the Southern District of New York in the mid-1990s, I participated in the investigation and prosecution of Daiwa Bank and its officers and employees.

<sup>123</sup> The scheme began when the trader sought to cover-up a \$200,000 loss from authorized trading. Eleven years and 30,000 trades later that loss had grown to \$1.1 billion. The trader was able to cover-up his losses because, in a breach of standard security, he was entrusted both with making the trades and accounting for them in the bank's books. *See An Unusual Path to Big-Time Trading*, N.Y. TIMES, Sept. 27, 1995, at D6.

<sup>124</sup> See Peter Truell, *Daiwa Bank Admits Guilt in Cover-Up*, N.Y. TIMES, Feb. 29, 1996, at D1. During that time, the bank actively explored ways in which it could conceal the losses from regulators. *See* Truell, *supra* note 122 (reporting that "the bank even considered concealing the whole trading loss at a company in the Cayman Islands" before that plan "was 'ultimately rejected by Daiwa's senior management as not feasible'" (quoting the indictment)). Even when it did disclose the losses, the bank "attributed them to a rogue trader and did not mention that it had known about the losses" for almost two months. *See id.*

<sup>125</sup> Then-United States Attorney Mary Jo White has explained that her office made repeated attempts to obtain the bank's cooperation in the investigation of the trading loss, "but no meaningful cooperation was ever given." *See* Mathews, *supra* note 100, at 439 (quoting *Daiwa Pleads Guilty to 16 Felonies, Pays a \$340 Million Criminal Fine*, CORP. CRIME. REP., Mar. 4, 1996, at 3).

was indicted within weeks on multiple charges of conspiracy, fraud, obstruction, falsification of bank records, and misprision of felony.<sup>126</sup> When Daiwa pleaded guilty four months later, it was ordered to pay a \$340 million fine.<sup>127</sup> By that time, it had already been expelled from the United States by bank regulators.<sup>128</sup> At sentencing, the prosecution was explicit about the reason Daiwa was prosecuted—it had failed to cooperate like a “good corporate citizen”:

“[If the employee’s crimes] were all that were involved in this case, and had Daiwa reported timely those crimes, it is unlikely Daiwa would have been charged at all. . . . [T]he fine of this magnitude is justified, in part, because Daiwa had steadfastly refused to provide any meaningful cooperation in the investigation of this matter. While providing cooperation is not required by law, the government routinely rewards corporations that provide timely and genuine cooperation to the government in investigating the criminal conduct of its employees.”<sup>129</sup>

Other corporations have fared similarly under this prosecutorial view of “good corporate citizenship.”<sup>130</sup> And

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<sup>126</sup> See Truell, *supra* note 122.

<sup>127</sup> See Truell, *supra* note 124.

<sup>128</sup> See Truell, *supra* note 122.

<sup>129</sup> See Mathews, *supra* note 100, at 439 (quoting sentencing statement of Assistant United States Attorney Reid Figel); see also Abromowitz & Bohrer, *supra* note 8 (noting that Mary Jo White, the U.S. Attorney who prosecuted Daiwa, “brought a series of highly publicized prosecutions against a number of major corporations” with “the stated objective of changing corporate culture to encourage honesty and promote greater emphasis on internal controls and compliance” and to put forth the message that “corporations should put good citizenship ahead of their business interests”).

<sup>130</sup> For example, in 1993, the government declined to prosecute Sequa Corporation and its wholly owned subsidiary Chromalloy Turbine Corporation for fraud in the manufacture and repair of airplane parts. In announcing the decision, then-U.S. Attorney Mary Jo White stated that she was declining to prosecute “because Sequa and Chromalloy decided to cooperate fully with the Government; began institution of vigorous structural, management, and policy reforms; and reached an appropriate agreement with the FAA.” See United States Attorney’s Office, *Announcement of Decision Not to Prosecute Sequa Corporation* (June 24, 1993); reprinted in *Press Releases Issued by United States Attorney, Southern District of New York*, 1248 PLI/CORP. 197, 211–14 (2001). Contrast Sequa’s fate with the fate of Bankers Trust, which admitted in 1997 that high-ranking officials had been operating a “slush fund” of unclaimed customer money that was then falsely booked as income to inflate revenue and meet budgeted projections. See Betty Santangelo & Suzanne Berman, *Did Bankers Trust Alter the Rules?*, N.Y.L.J., Nov. 20, 2000, at S4; Benjamin Weiser, *Bankers Trust Admits Diverting Unclaimed Money*, N.Y. TIMES, Mar. 12, 1999, at A1. Although the bank eventually

although each of the cases discussed above occurred in the Southern District of New York, prosecutorial rewards for good corporate citizenship (and punishment for corporate recalcitrance) are not limited to that district.<sup>131</sup> Indeed, with the publication of *Federal Prosecutions of Corporations*, the Southern District of New York's practices have become Department of Justice Policy.<sup>132</sup>

Some clear lessons emerge from these cases. Most obviously, a corporation that denies wrongdoing and resists a criminal investigation is far more likely to be indicted than a corporation that cooperates with prosecutors. More particularly, a corporation's chances of avoiding indictment are much greater if the cooperation admits its responsibility for the wrongdoing, terminates the wrongdoers, rids itself of the top management in charge at the time of the wrongdoing, and waives its privileges so that its cooperation can be free and unfettered.

Among these factors, perhaps the most important in facilitating a corporation's full cooperation is a change in top management. Each of the corporations discussed above that avoided indictment—Kidder, Salomon, and Prudential—had experienced significant management changes *before* embarking on its course of cooperation.<sup>133</sup> Indeed, without a change in top

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disclosed the misconduct to prosecutors and regulators, it did so two years after state regulators first started asking questions about missing unclaimed funds. See Timothy L. O'Brien, *The Deep Slush at Bankers Trust*, N.Y. TIMES, May 30, 1999, § 3, at 1. Moreover, even after the bank disclosed the violations and began "cooperating" with prosecutors, it continued to minimize the involvement of its executives in the scam. See *id.*; Santangelo & Berman, *supra*. Indeed, it appears that some of the bank executives who participated in the bank's early "cooperation" with the authorities did not initially disclose their own involvement in the slush fund scheme. See Weiser, *supra*.

<sup>131</sup> For example, in 1997, the Central District of California investigated allegations that a partner at the accounting firm of Coopers & Lybrand had committed multiple crimes in connection with the personal financial statements of Arizona's governor (including bid-rigging, perjury, and obstruction of justice). Coopers was not charged, however, because of its exemplary conduct following notification of possible wrongdoing, its public acceptance of responsibility, its ongoing cooperation with investigators, its restitution payments, its agreement to perform community service, and its agreement to institute nationwide ethics training for its professionals. F. Joseph Warin & Jason C. Schwartz, *Deferred Prosecution: The Need for Specialized Guidelines for Corporate Defendants*, 23 J. CORP. L. 121, 126 (1997).

<sup>132</sup> See *supra* note 62.

<sup>133</sup> William Laufer has criticized corporate cooperation on the grounds that

management, it can be nearly impossible for a corporation to fully cooperate, because the top managers will essentially be cooperating against themselves. Which brings me to my final point.

### III. VICARIOUS SNITCHING

All this talk of "corporations" cooperating can obscure one important fact. Corporations don't cooperate; people do. It is the corporation's officers—its general counsel, its CEO, and its board members—who must decide whether and to what extent the corporation will cooperate. And that decision is inevitably tied up with the decision-makers' self-interest.

In some cases, the self-interest of the corporate decision-makers will be obvious, as when the corporate decision-makers themselves are under investigation. For example, in the Cooper Companies case, the alleged wrongdoer was the chairman himself.<sup>134</sup> The board, which at the time included three of the chairman's relatives,<sup>135</sup> was not likely to insist on a course of cooperation that would have entailed "turning" on its own chairman.<sup>136</sup>

In other cases, the self-interest of the corporate decision-makers will be less direct. Board members may not be concerned about criminal prosecution, but they may be concerned about individual civil liability for failing to adequately monitor employees.<sup>137</sup> And because cooperation will

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most "corporate deviance" is related to the "actions of top management" and "to organizational processes, decisions, structures, hierarchy, and culture," not just to the individual actions of a few wrongdoers. See William J. Laufer, *Corporate Prosecution, Cooperation, and the Trading of Favors*, 87 IOWA L. REV. 643, 657-58 (2002) ("If there is a prototypic case of reverse whistle-blowing, it is with an organization in which senior management winks at the illegal behavior of subordinate employees when under significant pressure to meet revenue or profit objectives."). While Laufer's criticism has undeniable force, it ignores the extent to which changes in top management are often an essential part of, or prerequisite to, corporate cooperation.

<sup>134</sup> See *supra* notes 108-16 and accompanying text.

<sup>135</sup> See Diana B. Henriques, *A Wall Street Parable with No Heroes*, N.Y. TIMES, Aug. 2, 1992, § 3, at 1.

<sup>136</sup> The chairman's brother, at the time the Chief Operating Officer and a member of the board, was also alleged to have participated in the wrongdoing. See Moses, *supra* note 110, at B9 (describing SEC enforcement action against the two brothers).

<sup>137</sup> See *In re Caremark International Inc. Derivative Litigation*, 698 A.2d 959, 968-70 (Del. Ch. 1996) (finding that corporate directors may be exposed to personal

likely entail privilege waivers, board members may increase their own personal liability by waiving the corporation's privilege.<sup>138</sup> Board members may also be driven by personal loyalties—to the chief executive who appointed them, to the top manager who made the company profitable, or to the company's workforce as a whole.<sup>139</sup> At the most basic level, board members may be simply concerned with maintaining their own positions, which could be imperiled by cooperation-driven management changes.<sup>140</sup>

A corporation's decision about whether to cooperate is difficult enough;<sup>141</sup> it is essential that the decision be made by

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liability for failing to adequately monitor employee-wrongdoers); Brown, *supra* note 20. For example, John Gutfreund, the CEO of Salomon until Warren Buffet took over, was eventually charged by the SEC with failing to properly supervise employees. The board of Cooper Companies was similarly "publicly criticized" by the SEC "for failing to take measures that precluded misconduct from recurring." Harvey L. Pitt et al., *supra* note 75, at 5 (citing *In re Gutfreund*, [1992 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 85,067, at 85,597 (Dec. 3, 1992) (Gutfreund) & *In re Cooper Companies*, [1994–1995 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 85,472, at 86,601 (Dec. 12 1994)). George Ball, who headed Prudential Securities when its employees were misleading investors in the 1980s and under whose leadership the company resisted the criminal investigation, *see supra* notes 116–18 and accompanying text, was also investigated by the SEC for charges of failing to supervise his employees. *See* Patrick McGeehan, *Investigation of Prudential Securities By U.S. Attorney Ends Without Charges*, WALL ST. J., Nov. 29, 1996, at A2 (noting that the SEC was ultimately unable to bring civil charges because the statute of limitations had run).

<sup>138</sup> *See supra* notes 32–33 and accompanying text.

<sup>139</sup> For example, Drexel's steadfast loyalty to its junk bond star Michael Milken made cooperation with the government's investigation effectively impossible. *See supra* note 96–99 and accompanying text.

<sup>140</sup> Of course, board members and top officers will also have significant personal incentives to pursue corporate cooperation. For one, full corporate cooperation may be the best way for board members' to minimize their personal liability. For example, in discussing director liability, the *Caremark* court noted board members obligation to account for the "powerful incentives for corporations today to have in place compliance programs to detect violations of law, promptly to report violations to appropriate public officials when discovered, and to take prompt, voluntary remedial efforts." *See In re Caremark*, 698 A.2d at 969. Corporate cooperation may also allow board members to shield themselves from the criminal investigation by "offering up" the offending employees. *See* Laufer, *supra* note 30, at 648 (describing the process of "reverse whistle blowing" in which "an organization, typically through the acts of senior management, identifies culpable employees and offers evidence against them in a trade with prosecutors for corporate leniency or possible amnesty").

<sup>141</sup> Notwithstanding the starkly contrasting fates of firms that cooperated (e.g., Kidder, Salomon, and Prudential) and firms that did not (e.g., Drexel, Cooper, and Daiwa), it is not *always* the case that cooperation will be in a firm's best interest. In particular, if the government is not yet aware of the corporate



officers who are as disinterested as possible. When Warren Buffet moved quickly to turn Salomon into an “exemplary” cooperator, he was not concerned with avoiding personal liability, preserving his own professional position, or maintaining personal loyalties to any of Salomon’s managers. Instead, he was concerned with preserving his investment (and, by extension, all shareholder value). It was this disinterest that enabled Buffet to move quickly and decisively. Similarly, the management at GE was able to approach the government’s investigation without concern for personal liabilities or personal loyalties. Like Buffet, GE was concerned only with preserving its investment.<sup>142</sup>

Of course, when a company is faced with a government investigation and must decide whether to engage in “super cooperation,” it may not have a disinterested decision-maker available.<sup>143</sup> Arthur Andersen is the prime example of a company that—despite its apparent efforts to cooperate—was unable to satisfy prosecutors that it was a “good corporate citizen.” This failure stemmed in large part from Andersen’s refusal (or inability) to change its management in weeks following Enron’s collapse. As a result, Andersen found itself indicted and ultimately destroyed—the first organizational casualty in Enron’s aftermath.<sup>144</sup>

Since its founding in 1913, Arthur Andersen was one of this country’s most prestigious and successful accounting firms.<sup>145</sup>

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wrongdoing, the firm must weigh the risks of voluntary disclosure (particularly the increased risk of civil liability) against the likelihood that the wrongdoing will remain undiscovered. If the wrongdoing is never discovered—and we have no way of knowing how often corporations discover but do not disclose wrongdoing—the corporation may not suffer at all. Obviously, a decision to keep the wrongdoing under wraps is extraordinarily risky, because the adverse consequences of eventual discovery will be that much more severe, as Daiwa Bank painfully learned. See *supra* notes 122–30 and accompanying text.

<sup>142</sup> See *supra* notes 89–95 and accompanying text.

<sup>143</sup> Even so-called “independent” committees of a corporate board may be populated with board members who have both concerns about individual liability and personal loyalties to top management.

<sup>144</sup> The best and most detailed exposition of Andersen’s rise and collapse appears in a four-part special report in the Chicago Tribune entitled *A Final Accounting*. See Flynn McRoberts et al., *The Fall of Andersen*, CHI. TRIB., Sept. 1, 2002, at 1; Flynn McRoberts et al., *Civil War Splits Andersen*, CHI. TRIB., Sept. 2, 2002, at 1; Flynn McRoberts et al., *Ties to Enron Blinded Andersen*, CHI. TRIB., Sept. 3, 2002, at 1; Flynn McRoberts et al., *Repeat Offender Gets Stiff Justice*, CHI. TRIB., Sept. 4, 2002, at 1.

<sup>145</sup> See *The Fall of Andersen*, *supra* note 144, at 1 (describing Andersen’s

By 2001, Andersen had developed a long-standing and lucrative relationship with Enron.<sup>146</sup> When Enron's financial structure began collapsing in the late summer of 2001, Andersen was stuck right in the middle, as it became more and more apparent that Enron's impressive profits resulted from accounting tricks that concealed massive losses.<sup>147</sup> On October 16, Enron announced a one-time charge of over \$1 billion stemming from losses in its off-balance sheet partnerships.<sup>148</sup> Investors and regulators reacted immediately.<sup>149</sup> On October 18, Enron announced that the SEC had begun an informal inquiry into its accounting practices.<sup>150</sup>

Andersen's response upon learning of the SEC investigation was to begin a systematic and massive destruction of Enron related-documents.<sup>151</sup> For over two weeks, Andersen auditors

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founding and history).

<sup>146</sup> Enron was one of Andersen's largest clients. In 2000 alone, Andersen billed Enron \$58 million for auditing and consulting services. See *Ties to Enron Blinded Andersen*, *supra* note 144, at 1.

<sup>147</sup> See Kurt Eichenwald, *Enron's Collapse: The Story Behind its Rise and Fall*, N.Y. TIMES, Jan. 13, 2002, at A1, 26–27 (discussing in detail the practices that eventually caused Enron to collapse). By October, Enron and Andersen were arguing about how to disclose the massive losses that were hidden in off balance sheet partnerships. See *Ties to Enron Blinded Andersen*, *supra* note 144, at 1. As word of the impending announcement reached Andersen's headquarters in Chicago, the firm began preparing itself for the fallout. See *id.* On October 9, 2002, Andersen hired the law firm of Davis Polk and Wardwell to represent it in expected litigation relating to Enron. See *Hearing Before the Subcomm. on Oversight and Investigations of the Comm. on Energy and Commerce House of Representative No. 107-80*, 107th Cong., 2d Sess. 30 (Jan. 24, 2002) (testimony of senior Andersen executive C.E. Andrews), available at <http://energycommerce.house.gov/107/action/1107-80.pdf>.

<sup>148</sup> See *Ties to Enron Blinded Andersen*, *supra* note 144, at 1.

<sup>149</sup> On October 16, 2002, Enron's stock was trading at \$33 per share (down from a high of \$90 in August 2000). See Enron Historical Price Lookup, available at [http://www.corporate-](http://www.corporate-ir.net/ireye/ir_site.zhtml?ticker=ENE&script=340&layout=6&item_id=ENE)

[ir.net/ireye/ir\\_site.zhtml?ticker=ENE&script=340&layout=6&item\\_id=ENE](http://www.corporate-ir.net/ireye/ir_site.zhtml?ticker=ENE&script=340&layout=6&item_id=ENE); *Ties to Enron Blinded Andersen*, *supra* note 144, at 1. By the end of October, the share price had dropped to under \$14. By the end of November, the price had dropped to under \$1 per share. See Enron Historical Price Lookup, *supra*; Rebecca Smith & John R. Emshwiller, *Running on Empty: Enron Faces Collapse As Credit, Stock Dive and Dynegy Bolts*, WALL ST. J., Nov. 29, 2001, at A1.

<sup>150</sup> See *Ties To Enron Blinded Andersen*, *supra* note 144, at 1.

<sup>151</sup> On October 12, shortly after Davis Polk was hired to represent Andersen in the expected litigation, Andersen attorney Nancy Temple sent an e-mail to a partner in the Houston office suggesting that he "remind" everyone of the firm's "document retention policy." Temple's e-mail also contained a copy of the policy, which instructed that all non-final drafts and memos should be destroyed. See Kurt Eichenwald, *Andersen Is Said to Rule Out Plea*, N.Y. TIMES, Mar. 14, 2002, at A1.

and staffers in Houston worked around the clock feeding paper into shredders and deleting e-mails and computer files.<sup>152</sup> The shredding didn't stop until November 9, one day after Andersen received a subpoena from the SEC.<sup>153</sup>

As SEC and Congressional investigations of Enron picked up steam during November and December, Andersen's leadership remained confident that it could weather the crisis.<sup>154</sup> Joseph Berardino, Andersen's managing partner and CEO, publicly pledged that Andersen would cooperate fully with the investigators, would acknowledge whatever mistakes it may have made, and would make whatever changes were necessary to restore public trust in the firm.<sup>155</sup>

Then, in early January, top Andersen officials learned about the document destruction binge that had occurred during the early stages of the SEC investigation.<sup>156</sup> Andersen moved quickly to minimize the damage: it immediately notified the Department of Justice and the SEC of the shredding and deletions, and shortly thereafter it publicly announced the document destruction and that it would fire David Duncan, the partner in charge of the Enron team, and demote several other partners.<sup>157</sup> It brought in reputable former public officials to

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On October 23, after learning of the impending SEC inquiry, David Duncan, the Andersen partner in charge of the Enron account, convened a mandatory meeting of Andersen's Enron team. Duncan told his staff that Andersen would need to assist Enron in responding to the SEC's investigation. He also instructed them to comply with the "document retention policy." The massive shredding began that afternoon. *See Ties to Enron Blinded Andersen*, *supra* note 144, at 1.

<sup>152</sup> *See Ties to Enron Blinded Andersen*, *supra* note 144, at 1 (reporting that "[w]ithin three days, in Houston and other Andersen offices with Enron-related work, more than a ton of documents would be discarded—more than is usually shredded in a year—and roughly 30,000 e-mails and computer files would be deleted").

<sup>153</sup> *See id.* After Andersen attorney Temple notified the Houston office of the subpoena, a secretary sent an office-wide e-mail announcing "stop the shredding." Ken Brown et al., *Paper Trail: Andersen Fires Partner It Says Led Shredding of Enron Documents*, WALL ST. J., Jan. 16, 2002, at A1.

<sup>154</sup> *See Repeat Offender Gets Stiff Justice*, *supra* note 144, at 1 (reporting that Andersen CEO Joseph Berardino was confident that "Andersen would survive the crisis, just as it had other embarrassing audits . . . throwing itself on the mercy of Congress and federal investigators").

<sup>155</sup> *See Joe Berardino, Enron: A Wake-Up Call*, WALL ST. J., Dec. 4, 2001, at A18; *Remarks of Joseph F. Berardino, Managing Partner—Chief Executive Officer, Andersen, U.S. House of Representatives, Comm. on Financial Services* (Dec. 12, 2001), available at <http://financialservices.house.gov/media/pdf/121201jb.pdf>.

<sup>156</sup> *See Repeat Offender Gets Stiff Justice*, *supra* note 144, at 1.

<sup>157</sup> *See id.*; Brown et al., *supra* note 153, at A1.

help burnish its image: first former Senator John Danforth to “review” its document retention policy, and later former Federal Reserve Chairman Paul Volker to head up an independent board that would recommend changes to Andersen’s audit practices.<sup>158</sup>

Predictably, Andersen’s possible obstruction of justice soon became the focus of criminal investigators. Andersen’s strategy—not unlike the strategies used by Kidder, Salomon, and Prudential—was to pin the blame on a few wrongdoers and to avoid indictment of the firm by fully cooperating against those wrongdoers.<sup>159</sup> Andersen’s task was complicated, however, by its spotty record. In recent years, Andersen had been the auditor for several large corporations—including Sunbeam and Waste Management—that had to restate their earnings after admitting fraud in their accounting statements.<sup>160</sup> To prosecutors, then, Andersen looked less like a legitimate firm victimized by a rogue employee, and more like a recidivist offender who had not learned lessons from its previous transgressions.<sup>161</sup>

If Andersen were to avoid indictment, it needed to do more than just “cooperate.” It needed to convince prosecutors that that it was a new firm, that it had changed its character so that an accounting scandal like Enron would not happen again. It needed to change itself the way Warren Buffet changed Salomon. And that is where Andersen failed.

As Andersen negotiated with federal prosecutors in early March 2002, it emphasized what it viewed as its “good corporate citizen” response to the wrongdoing by its employees: it had reported the wrongdoing itself; it had terminated the prime culprit and was prepared to terminate others who had been involved; it had produced 100,000 of pages of documents; its

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<sup>158</sup> See Jonathan Weil, *Questioning the Books: Andersen Retains Volcker in Effort to Boost Its Image*, N.Y. TIMES, Feb. 4, 2002, at A8.

<sup>159</sup> See Brown et al., *supra* note 153, at A1.

<sup>160</sup> See Alex Berenson & Jonathan D. Glater, *A Tattered Andersen Fights for Its Future*, N.Y. TIMES, Jan. 13, 2002, § 3, at 1 (noting that Andersen paid over \$100 million to settle lawsuits relating to its Sunbeam audits); *Civil War Splits Andersen*, *supra* note 144, at 1 (recounting Andersen’s role in the Waste Management accounting fraud, for which Andersen paid the SEC a \$7 million fine, although without admitting fault).

<sup>161</sup> See Kurt Eichenwald, *Miscues, Missteps and the Fall of Andersen*, N.Y. TIMES, May 8, 2002, at C1; *Repeat Offender Gets Stiff Justice*, *supra* note 144, at 1.

executives had testified before Congress; it had hired an outside law firm to conduct an internal investigation; and it was prepared to continue fully cooperating.<sup>162</sup>

Prosecutors, though, remained unconvinced of Andersen's "good corporate citizenship" for two reasons. First, Andersen was unwilling to admit that the wrongdoing extended beyond a few employees in its Houston office.<sup>163</sup> In short, it was unwilling to admit that it was at fault *as an organization*. Second, and closely related, Andersen was unable to convince prosecutors that it regarded the document destruction as serious misconduct.<sup>164</sup> Both of these failings can be traced to the fact that Andersen was negotiating with the prosecutors without having changed its top management. To admit organizational fault, to admit that things were fundamentally wrong with Andersen's corporate ethos,<sup>165</sup> Andersen's top

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<sup>162</sup> See *Repeat Offender Gets Stiff Justice*, *supra* note 144, at 1 (recounting Andersen's arguments at the final meeting between Andersen and the Department of Justice before Andersen was indicted); Richard B. Schmitt et al., *Behind Andersen's Tug of War With U.S. Prosecutors*, WALL ST. J., Apr. 19, 2002, at C1 (same).

<sup>163</sup> See Letter from Richard J. Favretto, Mayer, Brown, Rowe & Maw, Attorneys for Arthur Andersen LLP, to Michael Chertoff, Assistant Attorney General, U.S. Department of Justice (March 13, 2002), available at <http://www.fei.org/download/lettertojusticedepartment2.pdf> (on file with author) (arguing that "the expedited effort to destroy documents was confined to a relatively few partners and employees of the firm and was almost entirely limited to the Houston office").

<sup>164</sup> See *Repeat Offender Gets Stiff Justice*, *supra* note 144, at 1 ("To prosecutors, Andersen's idea of a resolution—indict a few bad auditors but not the firm—was another example of its cavalier attitude. They were convinced the firm's bosses were unrepentant, that they regarded civil penalties and promised reforms as mere tolls to be paid on the road to ever-greater profits."); Eichenwald, *supra* note 161, at C1 (noting that "the government had concerns that some at Andersen did not appreciate how serious the matter was").

<sup>165</sup> Indeed, the federal prosecutors were not the only observers to conclude that Andersen's ethical problems ran deeper than a few partners and spread much wider than its Houston office. A detailed examination of Andersen's rise and fall by the *Chicago Tribune*, see *supra* note 144, traced Andersen's problems to a gradual but persistent dilution of the firm's fabled ethos of independence and integrity:

Andersen's leaders have portrayed the firm as the innocent victim of overzealous prosecutors and a dishonest client. But a close examination of Andersen's collapse reveals a very different story. In the 1990s, the firm embarked on a path that valued hefty fees ahead of bluntly honest bookkeeping, eroding Andersen's good name. Andersen shunted aside accountants who failed to adapt to the firm's new direction. In their place, Andersen promoted a slicker breed who could turn modestly profitable auditing assignments into consulting gold mines. Repeatedly, Andersen rewarded those involved with the firm's most troubled clients, while

managers would have had to admit their own fault and their own failings. Not surprisingly, the “full cooperation” offered by Andersen’s top managers did not extend to cooperating against themselves. As a result, Andersen was indicted for obstruction of justice and the firm quickly fell apart.<sup>166</sup>

In the weeks following its indictment, as Andersen struggled to stay intact, it took some concrete steps toward changing its character. Paul Volcker’s independent board proposed sweeping changes to the firm’s structure, management, and policies.<sup>167</sup> Joseph Berardino, the Managing Partner and CEO, who had charted Andersen’s response to the Enron fiasco, resigned.<sup>168</sup> The firm even agreed to a deferred prosecution, such as the one imposed on Prudential.<sup>169</sup> For Andersen though, it was too little, too late. Even as plea discussions continued in fits and starts over the next few weeks,<sup>170</sup> the indictment had sealed the firm’s fate. Before it

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guardians of the company’s legacy . . . were shown the door. In an early-90’s purge, the new leaders forced out roughly one of every 10 auditing partners and neutered Andersen’s elite corps of in-house ethics watchdogs, who for decades had been the firm’s final word on accounting matters large and small.

*The Fall of Andersen*, *supra* note 144, at 1; *see also* Jonathan D. Glater, *Lone Ranger Of Auditors Fell Slowly Out of Saddle*, N.Y. TIMES, Apr. 20, 2002, at C1, (reporting that “Andersen accountants and alumni” attribute the firm’s ethical failings not to “rogue accountants,” but rather to “steadily increasing pressure to bring in more revenue as competition grew” and as “clients became much more aggressive, demanding that accountants sign off on results that supported frothy stock prices”).

<sup>166</sup> *See* Robert Manor & Naftali Bendavid, *Andersen to Cut Jobs As Many Partners Flee*, CHI. TRIB., Apr. 5, 2002, at 1 (reporting massive layoffs at Andersen in the wake of its indictment); Schmitt et al., *supra* note 63 (reporting that Andersen was indicted on March 7, 2002, although the indictment was not announced until March 14).

<sup>167</sup> Melita Marie Garza & Delroy Alexander, *Volcker Plans ‘New Andersen’: Ex-Fed Chief Seeks To Have Indictment, SEC Probe Dropped; Firm’s Employees March In Loop*, CHI. TRIB., Mar. 23, 2002, at 1.

<sup>168</sup> Tom Fowler, *Andersen CEO to Step Down*, HOUS. CHRON., Mar. 27, 2002, at 1.

<sup>169</sup> *See supra* note 121 and accompanying text. Andersen first proposed accepting a deferred prosecution in a March 13, 2002 letter to prosecutors—six days after the indictment had been returned, but one day before it was unsealed. *See Andersen Letter*, *supra* note 163.

<sup>170</sup> *See, e.g.*, Delroy Alexander & Robert Manor, *Andersen Divided on Options; Fight or Plead Scenarios Leave Partners At Odds*, CHI. TRIB., April 12, 2002, at 1; Eichenwald, *supra* note 161; Tom Fowler, *Trial Likely As Government Rejects Latest Andersen Bid*, HOUS. CHRON. Apr. 26, 2002, at 3; *Deferred Settlement in Works, Sources Say*, HOUS. CHRON., April 16, 2002, at 4; Richard B. Schmitt et al.,

was convicted,<sup>171</sup> Andersen had all but ceased to exist.<sup>172</sup>

It is, of course, impossible to know whether Andersen would have been able to avoid indictment by aggressively moving to change its organizational character (or at least to change the face of its organization). Andersen's effort to prove its "good corporate citizenship" was also complicated by the fact that Andersen is not a corporation at all, but a partnership.<sup>173</sup> Unlike Salomon, Kidder, and Prudential, Andersen did not have an outside investor or parent company who could assume its leadership and instantly give it a new face. But the steps Andersen took after the indictment—particularly Berardino's resignation and Volcker's willingness to assume control of the firm—show that it was possible. By waiting until after the indictment to take those steps, however, Andersen missed its best chance to avoid the fate that befell it.

### CONCLUSION

Not every corporation facing a criminal investigation must shed its top management to survive.<sup>174</sup> But for high-profile companies faced with high-profile investigations, the lessons from Andersen (and Kidder, Drexel, Solomon, Cooper,

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*Glitches Imperil Possible Deal For Andersen*, WALL. ST. J., Apr. 17, 2002, at C1; Schmitt et al., *supra* note 162, at C1.

<sup>171</sup> Andersen was convicted of one count of obstruction of justice on June 15, 2002. See Kurt Eichenwald, *Andersen Guilty in Effort to Block Inquiry on Enron*, N.Y. TIMES, June 16, 2002, at A1. Ironically, the jury's verdict may have been based not on David Duncan's massive shredding operation, but on one document that was not shredded, in which Andersen attorney Temple suggested that Duncan revise a memo to eliminate the word "misleading" as a description of Enron's accounting practices. See *Repeat Offender Gets Stiff Justice*, *supra* note 144, at 1. That the jury's verdict may have indirectly vindicated Andersen's position on the shredding only emphasizes that Andersen's fate rested on the indictment, not the conviction. On October 16, 2002, Andersen was sentenced to a \$500,000 fine and five years probation. See *Arthur Andersen is Fined \$500,000*, N.Y. TIMES, Oct. 17, 2002, at C3.

<sup>172</sup> See *Repeat Offender Gets Stiff Justice*, *supra* note 144, at 1 ("In many ways, [the trial] was a formality; all but dead, Andersen could do little but defend its once-proud name.").

<sup>173</sup> See *Alexander & Manor*, *supra* note 170, at 1 (recounting disagreements among Andersen partners about whether the firm should plead guilty or fight the charges).

<sup>174</sup> Indeed, many corporations have avoided indictment—or survived indictment—with top management intact. See Anup Agrawal et al., *Management Turnover and Governance Changes Following the Revelation of Fraud*, 42 J.L. & ECON. 309, 310 (1999) (citing examples).

Prudential, and Daiwa) are stark. First, a corporation's best hope to avoid indictment is to engage in "super cooperation" that will convince prosecutors of its "good corporate citizenship." Second, that "super cooperation" may be irrevocably hampered if the firm does not quickly change its top management.

The dilemma for the corporation—and the paradox of vicarious snitching—is that the people deciding whether and how the corporation should cooperate are the very top managers whose fates may be at issue. In a sense, Kidder, Solomon, and Prudential were lucky to have a major shareholder or parent company who could assume control of the cooperation and ensure that top management was ousted. By contrast, companies that are more closely controlled by corporate insiders will find themselves institutionally restrained in their efforts to provide the kind of effective cooperation that prosecutors increasingly demand. As Andersen's demise vividly demonstrates, that restraint can sometimes be fatal.



