



Thursday, November 15, 2007

Government Oversight

Corporate Criminal Liability Run Amok

BY C. EVAN STEWART

I AM INFORMED that Minnie Pearl, the doyenne of the Grand Ole Opry, used to tell about a farmer who was in an automobile accident and sued the other driver for money damages. At trial, the defendant's lawyer, in cross-examining the farmer, asked: "Isn't it true that after the accident you said: 'I feel fine.?' " The farmer replied that he could not answer "yes" or "no," but needed to provide an explanation. The judge ruled he could do so, and so the farmer told the jury that the other car had caused both he and his cow to be thrown from his truck. When a policeman stopped to provide help, he first went over to the cow; upon seeing the cow in extreme pain, the officer pulled out his gun and shot him between the eyes. The policeman then came over to the farmer and asked him: "How do you feel?" The farmer (wisely) replied: "I feel fine."

If a visitor from another planet (or France) were to ask the question of how stands the current state of corporate criminal liability in the United States, a similarly opaque—it is "fine"—might be an appropriate response. But what does that mean?

Once Upon a Time in America

It was not so very long ago that the notion of vicarious liability in the criminal sphere was not embraced by American jurisprudence. A 1959 decision by the Supreme Court of Pennsylvania—

C. Evan Stewart is a partner at Zuckerman Spaeder, and an adjunct law professor at Fordham Law School and Brooklyn Law School.

*Commonwealth v. Koczvara*¹—is a good starting point to understand how there has been a sea change within just one lifetime.

John Koczvara owned and operated a bar in Scranton. Teenagers had, on occasion, come into his bar and knocked back a few beers. It was indisputable, however, that Mr. Koczvara had not been present when the underage drinking had taken place; nor was there any evidence that he was aware that minors had consumed beer at his bar. Prosecuted under the Pennsylvania Liquor Code, Mr. Koczvara was convicted at trial, sentenced to jail for three months, and fined \$500.

On appeal, the Pennsylvania Supreme Court's majority opinion noted at the outset that "[a]t common law, any attempt to invoke the doctrine of respondeat superior in a criminal case would have run afoul of our deeply ingrained notions of criminal jurisprudence that guilt must be personal and individual." Put another way, the specific requirement in criminal law that there be a finding of mens rea had traditionally barred the application of that doctrine (and taking that one logical step further, a corporation could not be guilty of a crime since it, by definition, could not have a guilty mind).

The court went on to delineate the "obvious" distinction between the application of respondeat superior in tort law, as opposed to criminal law: Tort law puts the monetary loss on the party best able to bear it; criminal law, on the other hand, is designed to punish anti-social behavior, to prevent its reoccurrence, and to deter others from mimicking the behavior.

Nonetheless, because the Pennsylvania Legislature strictly licensed and regulated "the highly dangerous business of selling intoxicated liquor" through the state's Liquor Code, the

majority concluded that the Legislature had clearly intended to impose criminal liability for violations of the Code. Based upon that conclusion, the majority reasoned that the only remaining question was whether such liability was intended to cover instances lacking knowledge or willful conduct. To answer that question the majority made a Solomonian ruling: criminal liability with a monetary sanction was permissible; criminal liability with a loss of freedom was not ("A man's liberty cannot rest on so frail a reed as whether his employee will commit a mistake in judgment.").

The minority ripped into the majority's bold delineation of criminal liability, first calling it "so novel, so unique, and so bizarre that one must put on his spectacles, remove them to wipe the lenses, and then put them on again in order to assure himself that what he reads is a judicial decision proclaimed in Philadelphia, the home of the Liberty Bell." The minority then went on to declaim "vicarious criminal liability," calling it a concept "as alien to American soil as the upas tree." The minority further viewed the property rights versus liberty rights dichotomy vis-à-vis criminal liability to be a "bouquet of inconsistency"—"if it is wrong to send a person to jail for acts committed by another, is it not wrong to convict him at all?"

Gone With the Wind

This slope, once stepped upon, became very slippery. Starting in the 1960s, society increasingly turned to the criminal laws to address problems that once had been handled by other means (e.g., the securities laws, consumer protection laws, worker protection

laws, environmental laws). Accompanying that trend line were two corollary trends: 1) viewing criminal law and tort law as increasingly indistinguishable (i.e., fraud—a doctrine grounded in tort law—is now, for the most part, also viewed as a criminal tag); and 2) the granting of significantly broadened criminal and regulatory powers to the government to go after “wrongdoers.”

The ultimate in the American legal establishment—the American Law Institute—weighed in favor of this state of affairs. The ALI’s Model Penal Code was written to provide that a court may hold a corporation criminally liable if the criminal conduct was “authorized, requested, commanded, performed or recklessly tolerated by the board of directors or by a high managerial agent acting in behalf of the corporation within the scope of his office or employment.”²

The 1980s and 1990s seemed to bring this new liability to full flower, with the government flexing its criminal muscles to ultimately bring down (in chronological order): E.F. Hutton; Drexel Burnham; Salomon Brothers; and Daiwa Bank (each of these companies—after the criminal process was completed—ultimately ceased operating in the United States as stand-alone businesses). The Hutton case is particularly instructive insofar as the Justice Department stated publicly that it indicted the company because it could not prove the guilt of individual corporate officials.

After the millennium, the “crisis in capitalism” symbolized by Enron, WorldCom, Adelphia, etc. took all this to an entirely new level. Congress reflexively enacted Sarbanes-Oxley,³ the New York Attorney General discovered he had unprecedented powers (both criminal and civil) under the state’s Martin Act (passed in 1921) to deal with real (and imagined) corporate wrongdoing,⁴ and the Justice Department decided to destroy Enron’s outside auditor, Arthur Andersen.

That certain of Andersen’s employees had their hands in the proverbial Enron cookie jar seems clear;⁵ and for the most part, those individuals have paid a heavy price for their actions.⁶ Not content to stop there, the government indicted the entire company. Andersen stood trial and was convicted of obstruction of justice. That conviction ended the “life” of the corporate entity, and put 85,000 people out of work.

Nearly three years later, the U.S. Supreme Court overturned the conviction.⁷ Two charges to the jury were at issue. In the first, the judge instructed the jury that even if the company “honestly and sincerely believed that its conduct was lawful, you may find...[Andersen]

guilty.” In the second charge, the jury was told to convict if it found that Andersen intended to “subvert, undermine, or impede” the government’s investigatory process by suggesting to employees that they comply with the company’s document-retention policy.

These instructions, the Supreme Court ruled, were seriously flawed and mandated reversal of Andersen’s criminal conviction (which had come after seven days of deadlocked deliberations, an *Allen* charge—an admonition to try harder—from the judge, and then an additional three days of deliberation). The latter instruction was improper because it deleted reference to any type of “dishonesty” (as had been part of the standard jury charge) and added the concept that it would be sufficient to a finding of guilt that Andersen had merely “impeded” the government’s fact-finding ability. The former instruction was flawed because it essentially eliminated the element of criminal intent; as the Supreme Court noted, the instruction required so “little culpability” that “it covered innocent conduct.”

Legal vindication, of course, led to few (if any) raucous celebrations. Eighty-five thousand people could not go back to work for Arthur Andersen.

Brave New, Cautious, World

Whether it was because of the Supreme Court’s ruling in *Arthur Andersen*, or the natural swinging of the prosecutorial pendulum, or because of some third cause, the federal government’s knee-jerk impulse to go after companies criminally appears to have abated somewhat. But only somewhat.⁸

In its place has arisen the increasingly popular protocol of deferred prosecution agreements (DPAs), as well as non-prosecution agreements. DPAs in particular have had their own problems and inconsistencies in application (some would argue abuses);⁹ but if one were forced to choose between a corporate indictment and a DPA, that would hardly be a close call.

Another mini-trend in the wake of the federal government’s recent “sensitivity” about indicting companies is a more aggressive approach in the prosecution of individual corporate executives. And while the KPMG litigation before U.S. District Judge Lewis A. Kaplan is one prime example, because so much attention has been focused on that saga,¹⁰ we will pass on that for a less well-known, but even more important and cautionary saga.

A Banana Republic

Starting in 1997, Chiquita Brands International began to make payments to a

A Slippery Slope

Commonwealth v. Koczvara

Bar owner is prosecuted under Pennsylvania Liquor Code over presence of minors and sale of beer to them at his bar. He was convicted at trial, sentenced to jail for three months and fined \$500. On appeal, his conviction and fine were upheld, but his prison sentence was held invalid.



1959

ARTHUR ANDERSEN

The government indicts the entire company of Arthur Andersen, Enron’s outside auditor. A subsequent conviction for obstruction of justice ended the life of the corporate entity and put 85,000 people out of work.

2002

2003

Officials at Chiquita Brands International decide to “self-report” the company’s payments to an organization, listed as a terrorist, which was threatening employees of its Colombian subsidiary.

2007

Chiquita pleads guilty to transacting business with a terrorist group, and pays a \$25 million fine.

On Aug. 1, the officials who were responsible for reporting the wrongdoing (including its general counsel) become “subjects” of a federal grand jury.



Colombian paramilitary organization that was threatening to kidnap or kill employees of Chiquita’s Colombian subsidiary. Four years later (while payments were still on-going), the State Department listed that organization as a foreign terrorist organization.

Chiquita’s Audit Committee was aware of the payments (in the words of one director: “If [we] didn’t do it, [our] people were going to get killed.”), as was the company’s outside auditor (which disclosed them in public filings). But it was not until late February 2003 that Chiquita

(by serendipity) learned that the paramilitary organization had been designated a terrorist by the State Department. That discovery triggered in-house and outside lawyers into action, analyzing the legality of said payments and flagging the issue up to Chiquita's top management and its directors, one of whom included Roderick Hills (a former chairman of the SEC).

Notwithstanding that key individuals were divided as to what was legally mandated, the Chiquita Board determined that "the right thing to do was self-report." And so on April 24, 2003, Mr. Hills (along with Chiquita's general counsel and the company's outside lawyer) went to the Justice Department to "self-report" and seek guidance on what to do going forward. Unfortunately, there did not seem to be much of a meeting of minds on that latter objective. It appears that Justice Department officials acknowledged Chiquita was in a "complicated situation," but also stated that the payments did constitute a violation of federal law. The Chiquita representatives believed that DOJ had not made a definitive decision on how Chiquita should handle its "complicated situation" (e.g., that it had to cease payments immediately); as such, the company continued to make payments from May 2003 until February 2004 (while periodically also checking in with the Justice Department).

In March 2004, DOJ lawyers, believing that Chiquita "shouldn't be treated any differently than 19-year-old drug dealers," launched a full court legal press against Chiquita (which included the FBI swooping in on a board meeting to hand-deliver grand jury subpoenas). Three years later, the company pleaded guilty to transacting business with a terrorist group, and paid a \$25 million fine. That was not the end of the matter, however. On Aug. 1, 2007, The Wall Street Journal reported (in a front-page story) that Mr. Hills and other Chiquita officials (including the CEO and the General Counsel) were "subjects" of the federal grand jury.¹¹

Huh? In the face of years of prosecutors' and regulators' policies and exhortations to reward corporate self-reporting, not only did the company take a hit but the senior corporate personnel who self-reported were now facing possible criminal sanctions. Ultimately, and only after what appears to have been an intense lobbying effort on behalf of the extraordinarily well-connected Mr. Hills, Justice Department lawyers submitted a sentencing memorandum to the U.S. District Court in Washington in September stating that "[i]n the exercise of its prosecutorial discretion, the United States has decided not to...bring additional charges in

this matter."¹² A bullet was dodged in this case, perhaps based upon certain "intangibles." But who knows whether those same "intangibles" will come into play next time?

Conclusion

One could argue (pretty effectively, I think) that the best motivator for good corporate behavior is making examples of corporate individuals who purposefully cross the line—unlike a fictitious corporate entity (which physically exists only by way of a mailbox in Delaware), flesh and blood people are folks who can go to jail, have their lives and reputations ruined, etc. Bringing down a company by criminal charges, on the other hand, usually only hurts innocents—uninvolved employees, shareholders, the local community, etc.¹³

Now we seem to have the "best" of both worlds: going after companies, but short of a "lights-out" indictment; and going after individuals with increasing vigor—even those who have tried to do the "right thing" by self-reporting corporate wrongdoing.¹⁴ And while this might be a good development for the white collar defense bar, is it really a "fine" state of affairs?

Perhaps we should harken back to an earlier era for guidance. When one of America's greatest prosecutors, Emory Buckner, died, The New York Times wrote in his obituary:

Buckner realized that he who wields the instruments of justice wields the most powerful instruments of government. In order to assure their just and compassionate use, a prosecutor must have an almost priest-like attitude toward his duties. Buckner practiced this attitude without deviation.

Amen.



1. 397 Pa. 575, 155 A.2d 825, 1959 Pa. LEXIS 493 (1959).

2. In 1985, the ALI issued as a comment to Section 2.07 of its Model Penal Code the following:

The law of corporate criminal responsibility is of comparatively recent origin, the modern development having occurred almost entirely within the last century and a quarter. In the early years the recognition of corporate responsibility was inhibited by certain***conceptual notions. The most persistent***was the idea that a corporation might not be held for a crime involving criminal intent. The modern development, however, has proceeded largely without reference to any intelligible body of principle and the field is characterized by the absence of articulate analysis of the objectives thought to be attainable by imposing criminal fines on corporate bodies.

3. See C. Evan Stewart, "Caveat 'Reformers': Lessons Not to Be Learned From Enron's Collapse," BNA Securities Regulations & Law Report (Feb. 25, 2002); C. Evan Stewart, "Sarbanes-Oxley: Panacea or Quagmire for Securities Lawyers," New York Law Journal (March 21, 2003).

4. See C. Evan Stewart, "When the Government Comes Knocking," New York Law Journal (March 14, 2005). In the words of one of the Attorney General's key operatives, "[W]e are living in a completely new regulatory world." Id.

5. See C. Evan Stewart, "Andersen: Reviewing Ethics of Document Shredding," New York Law Journal (April 15, 2002).

6. For example, David Duncan, the Andersen partner in charge of the Enron account, paid a criminal price for his role. On the other hand, while the career of Arthur Andersen lawyer, Nancy Temple, was certainly left in tatters, her potential criminal liability (at least publicly) has yet to be resolved.

7. *Arthur Andersen LLP v. United States*, 544 U.S. 696 (2005).

8. The McNulty Memorandum, for example, does not really represent a serious shift in prosecutorial enthusiasm for corporate indictments. See C. Evan Stewart, "'Carnacking' the Future," New York Law Journal (Feb. 15, 2007).

9. Id. See also R. McTague, "Washington Lawyers Call for Guidance by DOJ on Corporate Fraud Investigations," BNA Securities Regulations & Law Report 1384 (Sept. 17, 2007).

10. See supra note 8; see also C. Evan Stewart, "Can the U.S. Capital Markets Be Saved by Tinkering With the Legal Profession?" The Metropolitan Corporate Counsel (June 2007).

11. See L. Cohen, "Chiquita Under the Gun," The Wall Street Journal (Aug. 2, 2007). Among the witnesses called before the grand jury to give testimony against Mr. Hills et al. was Chiquita's outside counsel.

12. See L. Cohen, "Chiquita Ex-Officials Won't Face Charges," Wall Street Journal B2 (Sept. 12, 2007).

13. See J. Hasnas, "Do Nothing," Wall Street Journal A9 (Sept. 16, 2006); J. Baker, "Corporations Aren't Criminals," Wall Street Journal A18 (April 22, 2002).

14. The whole Hewlett-Packard brouhaha also seems to fit into this Kafkaesque world of executives trying to do the right thing (advised by counsel), only to face criminal penalties (real or threatened). See P. Dunn, "The HP Investigation," Wall Street Journal A12 (Oct. 11, 2006).



ZUCKERMAN SPAEDER LLP
www.zuckerman.com

1540 Broadway, Suite 1604
New York, NY 10036-4039
212.704.9600