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CRIMINAL AND CIVIL INVESTIGATIONS: *UNITED STATES V. STEIN* AND RELATED ISSUES

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I. Introduction

The passage of the Sarbanes-Oxley Act of 2002 served as a coda of sorts to the dramatic stock market boom that began back in 1997 and ended as dramatically with the stock market meltdown of 2001-2002. It also marked the beginning of a reactionary era which may now have reached its own high-water mark. Sarbanes-Oxley served notice, appropriately, on all practitioners of loose financial accounting and purveyors of foggy public disclosure that Congress intended to throttle the permissive ethical climate that defined the go-go 1990s. To enforce Congress's mandate, the federal government gave its principal financial watchdog, the United States Securities and Exchange Commission ("SEC"), significantly greater license (and a lot more cash) to make sure that the reforms had the necessary legs and teeth. At the same time, and for the same reason, the United States Department of Justice ("DoJ") began ramping up its financial crimes prosecutions, often in tandem with those pursued by the SEC.

Given the excesses of the 1990s, this seemed like a good idea and in fact led to several important prosecutions. But it also bred government excess. The tactics devised by the SEC and DoJ to deal with the financial fraud issues of the day began to encroach on a defendant's right to defend himself within the parameters established by the Constitution and statutory and common law. The encroachment took the form of pressure on companies to cut off indemnification payments to officers and other corporate employees under government investigation, and often simultaneous pressure to waive the attorney-client privilege and attorney work product protections for the purposes of a corporation's interactions with the government. An overarching threat involved the crush of simultaneous civil and criminal investigations and prosecutions, in which the civil and criminal authorities worked as a tag-team to query, cajole and affirmatively intimidate respondents and defendants. These tactics often crossed the line that separates zealous prosecution from prosecutorial misconduct.

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This article analyzes the government's investigatory tactics in the Sarbanes-Oxley era and critically examines recent judicial decisions and administrative actions that have helped clarify the difference between proper and improper prosecutorial conduct regarding the above-noted topics.

II. The Evolution of Cooperation

A. Indemnification and Advancement

Indemnifying officers and directors for expenses they incur responding to government investigations is not, as is sometimes portrayed, a dodge designed to help corporate miscreants protect their pocketbooks.[1] To the contrary, it is an integral component of good corporate governance, uniformly sanctioned in one form or another by state corporation law. The tenor of the Delaware Code's indemnification provision is fairly representative and captures the notion of fair-play underlying other states' similar provisions:

> A corporation shall have power to indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative . . . by reason of the fact that the person is or was a director, officer, employee or agent of the corporation . . . against expenses (including attorneys' fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by the person in connection with such action, suit or proceeding if the person acted in good faith and in a manner the person reasonably believed to be in or not opposed to the best interest of the corporation, and, with respect to any criminal action or proceeding, had no reasonable cause to believe the person's conduct was unlawful.[2]

As the Delaware Supreme Court has explained, state indemnification laws "encourage[] corporate service by capable individuals by protecting their personal financial resources from depletion by the expenses they incur during an investigation or litigation that results by reason of that service."[3] Given the frequency with which public companies are sued for securities fraud upon any announcement of bad news, it does not take any imagination to conclude that rational and qualified persons would not join a board or accept a position as an officer with a company that did not offer indemnification and adequate D&O insurance coverage.

An extension of this policy has been the practice of advancement of legal and other expenses, whereby a corporation which is obligated to indemnify an officer pays that officer's legal fees directly.[4] Advancing an officer's expenses "provides corporate officials with immediate interim relief from the personal out-of-pocket financial burden of paying the significant on-going expenses inevitably involved with investigations and legal proceedings."[5] In the now-typical "mega" securities cases, an officer can find himself defending simultaneously private securities fraud and derivative litigation, and SEC and DoJ investigations and litigation. Given the significant legal expenses these multiple proceedings can generate, the corporation's indemnification of an officer and advancement of legal fees (before an ultimate determination of liability) can mean the difference between an adequate defense and no defense at all.

Contrary to the DoJ's apparent assumptions, however, advancement of expenses to officers is not a blank check offered unconditionally to errant corporate functionaries. Like the indemnification right itself, a corporation's agreement to advance expenses "is an inducement for attracting capable individuals into corporate service."[6] Requiring officers to personally fund their defenses can deter talented professionals from taking up the often uncertain obligations of public company stewardship. Moreover, before a corporation advances expenses to an officer, the officer must provide the corporation with an undertaking which may vary in the specifics but is always, in one form or another, an agreement to repay the

expenses advanced if the officer is ultimately found to be not entitled to indemnification.[7] While it is true that the officer receives the full benefit of his indemnification rights by having the corporation advance his attorneys' fees, the undertaking protects the corporation by requiring the same officer to repay these advanced expenses if he is found to be culpable.[8]

Against this backdrop, the increasingly aggressive anti-indemnification policies pursued by the DoJ and the SEC in recent years are a bit mysterious. The official framework for the DoJ's indemnification policy was established by the now-famous "Thompson Memorandum," named for its author, former Deputy Attorney General Larry D. Thompson. Contrary to the tone set by the Delaware Supreme Court,[9] the Thompson Memorandum depicts corporate indemnification as a shadowy activity designed to improperly "protect[] . . . culpable employees and agents."[10] As a result of this presumption, the Thompson Memorandum views indemnification as a strike against corporations seeking credit for cooperating in DoJ actions:

> [W]hile cases will differ depending on the circumstances, a corporation's promise of support to culpable employees and agents, either through advancing of attorneys fees, through retaining the employees without sanction for their misconduct, or through providing information to the employees about the government's investigation pursuant to a joint defense agreement, may be considered by the prosecutor in weighing the extent and value of a corporation's cooperation.[11]

Since at least 2004, the SEC has likewise taken a dim view of efforts by corporations to indemnify employees for the attorneys' fees they incur defending themselves in SEC enforcement investigations. In an injunctive action brought that year against Lucent Technologies, Inc. and several of its then-current and former employees, the SEC imposed a $25 million civil penalty on the company for its lack of "cooperation." The improper conduct cited by the SEC included the company's decision to "expand[] the scope of employees that could be indemnified against the consequences of [the] SEC enforcement action" after the company had reached an agreement with the SEC's staff to settle the case.[12] The SEC also noted that "Lucent . . . failed over a period of time to provide timely and full disclosure to the staff on a key issue concerning indemnification of employees."[13] The SEC's press release did not, however, distinguish between indemnification for payment of judgments (civil penalties) and attorneys' fees.[14]

In fact, Section 1103 of the Sarbanes-Oxley Act *may* have codified, intentionally or not, the views expressed by the SEC in Lucent, thereby establishing a court-enforceable means of prohibiting indemnification payments to corporate employees facing SEC scrutiny. Under Section 1103, the SEC may move to freeze payments to officers and directors, among others, during the course of a SEC investigation if it appears that the payments are "extraordinary," whether the payments are designated "compensation or otherwise."[15] The provision is intended to "prevent corporate executives from enriching themselves while a company is subject to a SEC investigation, but before the Commission has gathered sufficient evidence to file formal charges."[16] Further, the freeze contemplated by Section 1103 is automatically extended in the event the recipient is charged with a federal securities law violation before the freeze expires.[17] Because the Act does not define "extraordinary payment," the SEC can and has argued that that term includes indemnification.[18]

Officers who have been on the receiving end of government interference with their indemnification rights have begun to challenge the government's tactics, and the courts have responded.[19] In June 2006, Judge Lewis Kaplan of the United States District Court for the Southern District of New York issued a decision highly critical of the government in the most closely watched of those cases, *United States v. Stein*.[20] *Stein* arose from an investigation by the United States Attorney's Office ("USAO") for the Southern District of New York into accounting giant KPMG's alleged involvement in creating illegal tax shelters. Jeffery Stein, KPMG's former deputy chair and chief operating officer and a defendant in the ensuing criminal case, retired from the firm as a result of the investigation. On his way out the door,

however, Stein and KPMG entered into an indemnification agreement pursuant to which KPMG agreed to indemnify Stein for suits arising out of the investigation.[21] Later, during discussions between KPMG's lawyers and the USAO, the government strongly implied that it did not want KPMG to pay the legal fees of the KPMG employees under investigation.[22] KPMG understood the message clearly, and acted accordingly: "KPMG's decision to cut off all payments of legal fees and expenses to anyone who was indicted and to limit and to condition such payments prior to indictment upon cooperation with the government was the direct consequence of the pressure applied via the Thompson Memorandum through the USAO."[23]

In a thorough opinion that recounted in detail the exchange between the government and KPMG's lawyers, Judge Kaplan found that the government's conduct and the Thompson Memorandum from which it derived violated the Fifth and Sixth Amendment rights of those KPMG employees whose fees and expenses had been cut off. Specifically, he found that "the Thompson Memorandum . . . discourages and, as a practical matter, often prevents companies from providing employees and former employees with the financial means to exercise their constitutional rights to defend themselves. . . . It therefore burdens excessively the constitutional rights of the individuals whose ability to defend themselves it impairs and, accordingly, fails strict scrutiny."[24]

As important as the constitutional impropriety of the government's practice, Judge Kaplan observed, is the irrational premise on which it rests:

> There is no necessary inconsistency between an entity cooperating with the government and, at the same time, paying defense costs of individual employees and former employees. . . . [A] company may pay [defense costs] at the same time that it does its best to bare its corporate soul, stands at the government's beck and call to provide information and witnesses, and does a myriad of other things to aid the government and clean the corporate house. So it simply cannot be said that payment of legal fees . . . necessarily or even usually is indicative of an unwillingness to cooperate fully.[25]

The government was not, however, left totally vanquished. The court in *Stein* limited its ruling to payment of legal fees incurred after indictment, both because a defendant's Sixth Amendment rights attach only upon indictment and because the potential damage resulting from government pressure before indictment is more difficult to gauge.[26] The court also declined to order the government to pay for the defense costs previously denied to the individual KPMG defendants, holding that such relief was foreclosed by the doctrine of sovereign immunity.[27]

At a minimum, *Stein* offers the officer denied indemnification by a company "cooperating" with the government sound legal support for challenging that denial. Whether it and similar cases will change the way the government does business remains to be seen. In a speech at Harvard University's Kennedy School of Government delivered shortly before the *Stein* decision (but after it and similar cases were under way), SEC Commissioner Roel Campos signaled that the SEC, at least, has not been deterred by the recent rumblings from the federal bench. Discussing the relationship between corporations and the government in the Sarbanes-Oxley era, Commissioner Campos observed that "[s]elf reporting . . . , cooperation, independent investigation by the board, waiver of the attorney-client privilege, [and] whether or not to provide legal support to officers and employees . . . are all areas of huge consequence to the final resolution of [a prospective law enforcement or regulatory investigation]."[28]

B. Waiver of Attorney-Client Privilege and Work Product Protection

The DoJ's Thompson Memorandum also provides the foundation for that agency's policy governing demands for subjects of criminal investigations to waive the attorney-client privilege and attorney work

product protection. The Memorandum cites waiver of available privileges as "[o]ne factor the prosecutor may weigh in assessing the adequacy of a corporation's cooperation" and grants prosecutors authority to "request a waiver in appropriate circumstances."[29]

The SEC's answer to the Thompson Memorandum's pronouncement on waiver is the so-called "Seaboard Report," which arose from a cease-and-desist proceeding brought against an individual corporate officer in October 2001. In its release announcing the proceeding, the SEC made a point of noting that it chose not to pursue the parent corporation of the subsidiary for which the officer worked.[30] In explaining why, the SEC listed, among other factors, that the company did "not invoke the attorney-client privilege, work product protection or other privileges or protections with respect to any facts uncovered in the investigation."[31] Elaborating on this, the Seaboard Report noted that,

> [i]n some cases, the desire to provide information to the Commission staff may cause companies to consider choosing not to assert the attorney-client privilege, the work product protection and other privileges, protections and exemptions with respect to the Commission. The Commission recognizes that these privileges, protections and exemptions serve important social interests. In this regard, the Commission does not view a company's waiver of a privilege as an end in itself, but only as a means (where necessary) to provide relevant and sometimes critical information to the Commission staff.[32]

There are signs, however, that the government's aggressive waiver tactics have begun to fall out of favor. In an October 21, 2005 memorandum, then-Acting Deputy Attorney General Robert D. McCallum, Jr., revisited that portion of the Thompson Memorandum governing waiver of attorney-client privilege and work product protection. Specifically, the McCallum Memorandum sought to normalize the DoJ's approach to waiver requests by requiring federal prosecutors to "obtain approval from the United States Attorney or other supervisor before seeking a waiver of the attorney-client or work product protection."[33] Further, in a statement before a Congressional sub-committee in March 2006, McCallum made clear that, while the DoJ will continue to seek waivers in the appropriate circumstances, "[d]isclosure . . . is not required to obtain credit for cooperation in all cases," and that "under our process, waivers of privileges should not be 'routinely' sought."[34]

Perhaps more promising is a recent change in the Federal Sentencing Guidelines scheduled to become effective in November 2006. On April 5, 2006, the United States Sentencing Commission voted to delete language in the commentary to the Sentencing Guidelines that authorized and encouraged prosecutors to require corporations to waive the attorney-client privilege and work product protection as a condition for receiving "cooperation credit" in government investigations.[35] Also heartening is a proposal by the Advisory Committee on the Federal Rules of Evidence to codify the so-called "selective waiver" doctrine, "under which a client could disclose a privileged or protected communication to the government, while continuing to assert it against other parties."[36] The Advisory Committee's proposed Federal Rule of Evidence provides, in part, that "[i]n a federal or state proceeding, a disclosure of a communication or information covered by the attorney-client privilege or work product protection – when made to a federal public office or agency in the exercise of its regulatory, investigative, or enforcement authority – does not operate as a waiver of the privilege or protection in favor of non-governmental persons or entities."[37] The Committee Note to the proposed rule explains that "[a] rule protecting selective waiver in [the] circumstances [set forth in the proposed rule] furthers the important policy of cooperation with government agencies, and maximizes the effectiveness and efficiency of government investigations." The Note also clarifies that the protection afforded by rule would not be conditioned on obtaining a confidentiality agreement from the government.[38]

Whether this retrenchment will result in a long-term softening of the DoJ's approach to waivers remains to be seen. The recent indictment of class-action stalwart Milberg Weiss Bershad & Schulman

suggests not; according to the firm, its refusal to provide access to privileged communications led directly to its indictment.[39] It is also unclear whether any change in the criminal context will spill over to the SEC's enforcement activities. In a speech delivered in November 2005, the SEC's Director of Enforcement, Linda Thomsen, remarked that the DoJ's approach to waiver is different from, and more aggressive than, the SEC's.[40] At first blush, this claim seems plausible: the language of the Seaboard Report is, on its face, less absolute than the Thompson Memorandum. In remarks earlier this year at the PLI's annual SEC Speaks conference, however, another high-ranking Enforcement official gave no hint that the SEC planned to change its approach on the waiver issue. To the contrary, Walter Riciardi, District Administrator of the SEC's Boston District Office, reiterated that, "[t]o demonstrate that the organization is doing the right thing, it's perfectly appropriate for the organization to decide that it's appropriate to waive privilege. It may not be in the best interest of individuals . . . but they're not represented by the same lawyer as the organization."[41] As noted above, this sentiment was echoed by Commissioner Campos in his recent speech at Harvard University's Kennedy School of Government.

C. Legal Checks on Government Overreach

While the government's zeal may be lauded by the public, there are constitutional prohibitions against overly aggressive prosecution. The most relevant are the longstanding constitutional protections accorded defendants under the Fifth and Sixth Amendments, which embody a defendant's constitutional right to control his or her own defense and form the principal bulwark against prosecutorial misconduct. Judge Lewis Kaplan's recent opinion in *United States v. Stein* explains how these constitutional protections work in the context of government investigations. At bottom, *Stein* stands for the proposition that prosecutorial tactics can cross the line, and when they do the government violates a defendant's right to due process and assistance of counsel.[42]

Due process under the Fifth Amendment encompasses both procedural and substantive protections. Under procedural due process (and other constitutional protections in the Bill of Rights) defendants are guaranteed fairness throughout the criminal process.[43] Included in this guarantee is a defendant's general right to control his or her own defense without government interference, which in turn includes the right to choose defense counsel.[44] Further, as a general matter, prosecutors are required to conduct themselves fairly in every aspect of their dealings with defendants.[45] To be protected under substantive due process, a right must be "deeply rooted in this Nation's history and tradition and implicit in the concept of ordered liberty . . . ."[46] While the Supreme Court has yet to expressly recognize fairness in criminal proceedings as a *fundamental* right, as the court noted in *Stein*, "the Supreme Court's repeated recognition of the constitutional mandate of fairness in criminal proceedings strongly suggests that this right is 'fundamental.'"[47]

When, for example, a corporation ceases or refuses to advance expenses or indemnify an officer because the government threatened to indict the company if it made such payments, the government has violated the officer's due process rights because the denial of these payments will, in almost all cases, adversely affect the officer's ability to mount an effective defense.[48] As the court in *Stein* pointed out, complex prosecutions by the government can involve millions of pages of documents, seemingly endless pre-trial motion practice and trials that last several months.[49] An adequate defense in such a case could cost well over a million dollars, a price tag out of the reach of all but a handful of individuals.[50] Moreover, the enormous leverage the government gains in the name of cooperation is out of all proportion to the supposed misconduct it is intended to counterbalance, given that indemnification and advancement of fees are not "necessarily or even usually . . . indicative of an unwillingness to cooperate fully."[51]

Heavy-handed investigatory tactics may also run afoul of the Sixth Amendment's right to effective assistance of counsel. The Sixth Amendment's Assistance of Counsel Clause requires that a defendant "be afforded the right to assistance of counsel before [the defendant] can be validly convicted and punished."[52] More specifically, it protects a defendant's right to choose his or her lawyer or lawyers[53]

and to use his or her own money to put on a defense,[54] without the fear that the government will use the exercise of these rights against the defendant at trial.[55] The proper inquiry should focus on how the government's actions affect the adversarial nature of the proceeding.[56] The practices recommended by the Thompson Memorandum violate the Sixth Amendment because they "undermine[] the proper functioning of the adversary process that the Constitution adopted as the mode of determining guilt or innocence in criminal cases," and because the government does not have an adequate justification to interfere with a criminal defendant's right "to obtain resources lawfully available to them in order to defend themselves."[57]

III. Parallel Proceedings

A. Legitimate and Illegitimate Coordination

In addition to the threats posed by government encroachment on indemnification rights, the attorney-client privilege and attorney work product protection, coordination of civil and criminal prosecutions presents a distinct set of obstacles for corporations and individuals facing government scrutiny. The federal securities laws authorize the government to bring simultaneous civil and criminal actions for suspected violations of those laws, creating the possibility of concurrent civil and criminal investigations and prosecutions involving the same facts and parties.[58] Such parallel proceedings are an increasingly common occurrence in federal securities cases and present unique challenges for lawyers counseling clients subject to simultaneous civil and criminal liability. The first and probably most important decision counsel faces usually comes early in the investigatory process, when corporate representatives are called upon to provide formal or informal testimony, usually to the SEC. Whether or not the fact is made explicit by SEC enforcement staff, testifying before the staff can lead to criminal prosecution because the staff can, and often does, share the information it gathers during its investigation with the United States Attorney and other criminal authorities and regulatory bodies.

Parallel proceedings are not a new development. Courts historically have held that, when the SEC and United States Attorney pursue parallel proceedings, they are legitimately exercising their independent investigatory powers.[59] Parallel proceedings, the theory goes, enable the SEC to act promptly to protect the public interest and the integrity of the financial markets while the United States Attorney investigates whether that same conduct constitutes a crime.[60] But while parallel proceedings usually serve legitimate and important ends, they can also open the door to undue government pressure and outright prosecutorial misconduct.

In investigations where the SEC and the USAO work closely together there has always been the potential for the latter to overstep its bounds by crossing the line between passive recipient of information gathered in a civil investigation to active collector of that information. In most circumstances, the documentary evidence and information collected by the SEC during an enforcement investigation must be kept confidential and, in the ordinary course, may only be reviewed by the SEC.[61] However, federal statues and regulations expressly provide that the SEC may share the results of its investigation with other state and federal government agencies such as the United States Attorney.[62] Thus, the United States Attorney may reap the rewards of the SEC's labor by building a criminal case based almost entirely on the fruits of the SEC's civil investigation, without providing the constitutional guarantees typically afforded defendants in criminal proceedings. The threat lies in the ability of the United States Attorney to "undermine rights that would exist in a criminal investigation by conducting a de facto criminal investigation using nominally civil means."[63]

B. Judicial Backlash: The Recent Decisions

In two recent cases, courts examined whether purported parallel proceedings were, in fact, truly parallel. In these decisions, the courts concluded that when the DoJ directs or controls a SEC

investigation, a criminal defendant's ability to exercise his or her constitutional rights may effectively be circumvented. The constitutional rights at issue include the Fourth Amendment's protection against seizure without a warrant,[64] the Fifth Amendment's guarantee of due process and its protection against self incrimination,[65] and the Sixth Amendment's guarantee of a speedy trial.[66] Though it may be difficult for the public and the courts to muster much sympathy for the likes of Andy Fastow or Bernie Ebbers, it is not a cliché that individuals accused of crimes remain innocent until proven guilty. That concept continues to be a bedrock principle of our constitutional system, as was confirmed recently by *United States v. Scrushy*[67] and *United States v. Stringer*.[68]

1. *United States v. Scrushy*

In the first of these cases, *United States v. Scrushy*, the former CEO of HealthSouth, Richard Scrushy, was indicted and later acquitted of charges stemming from much publicized accounting improprieties at HealthSouth. During Scrushy's criminal trial, a SEC accountant testifying for the government revealed that the DoJ had had significant involvement in developing the strategy for Scrushy's deposition and the SEC's investigation generally.[69] The USAO directed the SEC's staff to change the location of Scrushy's deposition before the SEC to facilitate bringing a perjury charge against Scrushy in the future. Additionally, the USAO defined the parameters of the SEC's deposition questioning by dictating what questions the SEC could and could not ask, and shaped the scope of the questioning to conceal the criminal authorities' interest in Scrushy.[70] The extensive input into and control over the SEC's investigation by the USAO was carried out without Scrushy ever being informed that he was the target of a criminal investigation.[71] After these facts came to light, Scrushy moved to suppress the transcripts of his SEC deposition. The court granted the motion, holding that "the Government ha[d] departed from the proper administration of criminal justice in procuring the Defendant's deposition testimony."[72] In reaching its conclusion, the court found that the previously parallel civil and criminal investigations had "improperly merged" when the USAO coached the SEC regarding the questions to be asked at Scrushy's deposition, dictated the deposition's location, and recruited a SEC accountant to participate in witness interviews in the criminal investigation.[73]

Against this factual background, the court held that, when a SEC investigation intersects and becomes "inescapably intertwined" with a parallel criminal investigation such that the "commingling" negates the independence of the parallel investigations, the government has departed from the proper administration of justice.[74] In arriving at this holding, the court focused on the fact that "the Government did not inform the defendants at the time of their civil depositions by the SEC that criminal prosecutions were looming that targeted them as defendants," and that the United States Attorney's conduct deprived Scrushy of the opportunity to exercise his Fifth Amendment right against self-incrimination:

> [T]he danger of prejudice flowing from testimony out of a defendant's mouth at a civil proceeding is even more acute when he is unaware of the pending criminal charge . . . . When a defendant *knows* that he has been charged with a crime, or that a criminal investigation has targeted him, he can take actions to prevent the providing of information in an administrative or civil proceeding that could later be used against him in the criminal case. When a defendant does not know about the criminal investigation, the danger of prejudice increases. Failing to advise Mr. Scrushy or his attorneys about a criminal investigation of which he was a target, and that the deposition had been moved to accommodate the need of the U.S. Attorney's office to bring into the criminal investigation one of the very S.E.C. investigators who was questioning Mr. Scrushy, *and* the change of the deposition's location for venue purposes cannot be said to be in keeping with the proper administration of justice. Our justice system cannot function properly in the face of such cloak and dagger activities by those charged with upholding the integrity of the justice system.[75]

The court ultimately declined to address the constitutional implications of the government's conduct. Instead, it held that the government manipulated the existence of simultaneous civil and criminal proceedings such that permitting the government to rely on Scrushy's SEC testimony in his criminal case would "depart from the proper administration of justice."[76] The SEC testimony was suppressed, and Scrushy was not convicted in that case.

2. *United States v. Stringer*

In the second recent case examining the boundaries of permissible cooperation between civil and criminal authorities, *United States v. Stringer*, the court took the dramatic step of dismissing the DoJ's securities fraud and conspiracy indictments rather than simply suppressing evidence improperly gathered during a SEC investigation.[77] Early on in its investigation, the USAO met with the SEC's staff which gave the USAO five notebooks of documents and a detailed memorandum setting forth the SEC's legal and factual analyses of the case.[78] Ten days after that meeting, in October 2000, the Assistant U.S. Attorney heading up the criminal investigation wrote a memo in which he noted that the case "warrants prosecution" and the "probability of [criminal] prosecution is very high."[79] At no time between October 2000 and the eventual disclosure of the existence of a criminal investigation in February 2003 were the defendants notified that they were the targets of a criminal investigation.[80]

Moreover, the SEC's staff met regularly with the criminal prosecutors to discuss the SEC's investigation as it progressed.[81] At each of these meetings the criminal prosecutors affirmatively made the decision to allow the SEC's staff to continue handling the case and to continue to rely on the work product the staff generated.[82] One Assistant U.S. Attorney noted in writing that the strategy had "provided good investigative results, at little cost to us" and that the "SEC's investigation continues to suggest that this case will produce a criminal prosecution."[83] Further, as in *Scrushy*, the USAO formulated a plan to create a record based on the SEC's investigative materials to support a future perjury case.[84]

In light of the prosecutors' conduct, the *Stringer* defendants moved to dismiss their criminal indictments or, in the alternative, to suppress the statements made to the SEC.[85] The defendants argued that the SEC and USAO worked together on a single investigation, with the latter hiding behind the SEC in order to deprive the defendants of their Fourth and Fifth Amendment rights.[86] According to the defendants, if they had been notified of the possibility of the criminal prosecution they would have sought a stay of the civil proceedings, would not have produced documents and would have considered exercising their Fifth Amendment right not to incriminate themselves.[87] The court agreed, concluding that the investigations were not "parallel" at all, but rather closely coordinated, with the USAO intentionally hiding its intentions "behind the guise of a civil prosecution" and "resorting to subterfuge to maintain the secrecy of its involvement."[88] The court also noted that

> [t]he USAO identified potential criminal liability and a few targets in the beginning of the investigation, and elected to gather information through the SEC instead of conducting its own investigation. The government was concerned that the presence of a criminal investigation would halt the successful discovery by the SEC, witnesses would be less cooperative and more likely to invoke their constitutional rights, and that the rules of criminal discovery would be invoked . . . . The delay by the USAO was not for the purpose of reviewing evidence gathered by the SEC to make an informed decision as to whether the case warranted prosecution. From the beginning, the USAO consistently held the position that a criminal prosecution was likely . . . . The strategy to conceal the criminal investigation from defendants was an abuse of the investigative process.[89]

This abuse violated the defendants' rights in two ways. First, the prosecutors violated the defendants' due process rights when the SEC and USAO failed to inform defendants that they had been identified as "targets" of the criminal investigation and failed to alert them to the possibility of criminal exposure beyond the warnings provided in the SEC's standard Form 1662.[90] The court concluded that, in light of the USAO's active role in the investigation, a cursory reference to the possibility of information sharing between agencies provided insufficient warning and "[could] not have much significance where the defendant was, so to speak, then within the sight of the government and did not receive an explanation of the import of the inquiry."[91] Second, the court determined, "it is a due process violation if government agents make affirmative representations as to the nature or existence of parallel proceedings or otherwise use trickery or deceit."[92] Ultimately, the court concluded that "[a] government agency may not develop a criminal investigation under the auspices of a civil investigation [because] it would be a flagrant disregard of individuals' rights to deliberately deceive or lull someone into incriminating themselves in a civil context when activities of an obvious criminal nature are under investigation."[93]

IV. Conclusion

The recent decisions in *Stein, Scrushy* and *Stringer* and the revamped Federal Sentencing Guidelines all seem to point toward a softening approach (court-enforced, if necessary) to corporate fraud investigations by the SEC and DoJ. Other initiatives like the proposed revisions to Federal Rule of Evidence 502 provide further evidence of a trend toward greater protection of defendants' rights. These changes are for the best. The latitude granted the SEC and DoJ in the wake of Sarbanes-Oxley, while perhaps necessary in some cases, often resulted in corner-cutting and served the near-term ends of those agencies rather than the larger policy goals envisioned by Congress. Nor did that latitude ensure demonstrably greater protection to the investing public.

It may, however, be premature to eulogize the aggressive tactics employed by the government over the past few years. Section 1103 of the Sarbanes-Oxley Act, for example, may provide a statutory means for the government to regain what it recently lost in court. Further, it does not appear that agency officials intend to willingly embrace the underpinnings of the recent adverse court decisions. To the contrary, statements by both the SEC and the DoJ point to the opposite conclusion. Going forward, however, those confronted with the two-fisted tactics of the Sarbanes-Oxley-era federal government now have a few more tools to help them enforce their right to face their accusers on something approaching even ground.

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1. Nor is it an invention of the Enron era. As U.S. District Court Judge Lewis Kaplan pointed out in his recent decision addressing the propriety of indemnification, the principle and its policy underpinnings date back to the nineteenth century. *See United States v. Stein*, No. S1 05 Crim. 0888 (LAK), 2006 WL 1735260, at *15 (S.D.N.Y. June 26, 2006).

2. 8 Del. C. § 145(a) (2006).

3. *Homestore, Inc. v. Tafeen*, 888 A.2d 204, 211 (Del. 2005).

4. Unless otherwise noted, the term "officers" as used in this article refers generally to current and former corporate officers and directors.

5. *Homestore*, 888 A.2d at 211.

6. *Id.*

7. *See, e.g.,* 8 Del. C. § 145(e).

8. *Id.*

9. *See supra* note 3.

10 Memorandum from Larry D. Thompson, Deputy Att'y Gen., to Heads of Department Components United States Att'y, Principals of Federal Prosecution of Business Organizations (Jan. 20, 2003) (available at http://www.usdoj.gov/dag/cftf/corporate_guidelines. htm).

11. *Id.*

12. *See* SEC Press Release No. 2004-67, Lucent Settles SEC Enforcement Action Charging the Company With $1.1 Billion Accounting Fraud (May 17, 2004) (available at http//www.sec.gov/news/press/2004-67.htm).

13. *Id.*

14. *See id.* The SEC's silence on this point suggests that Lucent's warning applies to legal fees and costs as well as judgments, since the SEC has "long taken the position that corporations cannot indemnify" for judgments levied against corporate functionaries found liable for violating certain provisions of the Securities Act of 1933. *See Raychem Corp. v. Federal Insurance Co.*, 853 F. Supp. 1170, 1176 (N.D. Cal. 1994). Similarly, courts have long held that employees found liable for violating certain provisions of the Securities Exchange Act of 1934 may not be indemnified for resulting judgments. *See id.*

15. 15 U.S.C. § 78u-3(c) (2002).

16. James Hamilton & Ted Trautman, SARBANES-OXLEY MANUAL: A HANDBOOK FOR THE ACT AND SEC RULES ¶ 617 (2d ed. 2005).

17. *Id.*

18. In the SEC's 2002 complaint against WorldCom, for example, the SEC defined "extraordinary payment" to include "severance payments, bonus payments, or indemnification payments." See First Amended Complaint, SEC v. WorldCom, Inc., No. 02 Civ. 4963 (S.D.N.Y. 2002) (http://www.sec.gov/litigation/complaints/comp17829.htm).

19. *See* Nathan Koppel, *U.S. Urges Companies to Stop Funding Staff Legal Fees*, WALL ST. J., March 29, 2006 at B1. In addition to the Stein case, discussed herein, Koppel cites cases in New Hampshire against former executives of Enterasys Networks, Inc., in Alabama against the former CEO of HealthSouth Corp., and in New York against Symbol Technologies. *See id.*

20. S1 05 Crim. 0888 (LAK), 2006 WL 1735260 (S.D.N.Y. June 26, 2006).

21. *Id.* at *4. KPMG would likely have indemnified Stein even without the agreement, as it was KPMG's "longstanding voluntary practice . . . to advance and pay legal fees . . . in those situations where separate counsel was appropriate to represent the individual in any civil, criminal or regulatory proceeding involving activities arising within the scope of the individual's duties and responsibilities as a KPMG partner, principal or employee." *See id.*

22. *Id.* at *7.

23. *Id.* at *14.

24. *Id.* at *21.

25. *Id.* at *20.

26. *Id.* at *27-28.

27. *Id.* at *29-30.

28. Roel C. Campos, Commissioner, United States Securities and Exchange Comm'n, Remarks at Harvard University, Kennedy School of Government (May 9, 2006).

29. Thompson Memorandum, *supra* note 10.

30. *See* Securities Exchange Act of 1934 Release No. 44969, Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions (Oct. 23, 2001) (http//www.sec.gov/litigation/investreport/34-44969.htm).

31. *Id.*

32. *Id.* at n.3.

33. Memorandum from Robert D. McCallum, Jr., Acting Deputy Att'y Gen., to Heads of Department Components United States Att'y, Waiver of Corporate Attorney-Client and Work Product Protection (Oct. 21, 2005).

34. *Oversight Hearing on White Collar Enforcement (Part I): Attorney-Client Privilege and Corporate Waivers: Hearing Before the Subcomm. on Crime, Terrorism, and Homeland Security of the H. Comm. on the Judiciary*, 109th Cong. 2 (2006) (statement of Robert D. McCallum, Jr., Assoc. Att'y Gen. of the United States) (available at http://judiciary.house.gov/media/pdfs/mccallum030706.pfd).

35. Sentencing Guidelines for the United States Courts, 71 Fed. Reg. 28,063, 28,073 (May 15, 2006).

36. *See McKesson HBOC, Inc. v. Superior Court*, 15 Cal. App. 4th 1229, 1240 (2004). For a discussion of the selective waiver doctrine see Ted S. Helwig & David S. Slovick, *The Dilemma Remains: The Collateral Effect of Disclosing Attorney-Client Privileged Communications and Attorney Work Product to Government Agencies*, 26 FUTURES & DERIVATIVES L. REP. No. 5 (2006).

37. Proposed FED. R. EVID. 502(c) (2006).

38. *See* Committee Note to Proposed FED. R. EVID. 502(c).

39. Leigh Jones, *Milberg Weiss Case Highlights Waiver Controversy*, NAT'L L.J., June 1, 2006 (available at http://www.law.com/jsp/article.jsp?id=1149066334834).

40. Rachel McTague, *Thomsen Defends SEC's Policy On Waiver of Attorney-Client Privilege*, 37 SEC. REG. & L. REP. No. 46, 1914, 1914 (Nov. 21, 2005).

41. Richard Hill, *Thomsen Says Division 'Tough But Fair' in Pursuing Wrongdoers*, 38 SEC. REG. & L. REP. No. 11, 419, 420 (Mar. 13, 2006).

42. *See Stein*, 2006 WL 1735260 at *33.

43. *Id.* at 23.

44. *See id.* at 16-17.

45. *United States v. Stringer*, 408 F. Supp.2d 1083, 1089 (D. Or. 2006) (government may not use a civil proceeding to deceive defendants into incriminating themselves in a civil proceeding when "activities of an obvious criminal nature are under investigation"); *see also United States v. Lovasco*, 431 U.S. 783, 795 n.17 (1977) (prosecutors may not intentionally delay an indictment to prejudice the defendant); *United States v. Gonzales*, 164 F.3d 1285, 1292 (10th Cir. 1999) (prosecutors may not obstruct a defendant's access to a potential witness); *Briscoe v. LaHue*, 460 U.S. 325, 327 n.1 (1983) (prosecutors may not knowingly offer false evidence).

46. *See, e.g., Washington v. Glucksberg*, 521 U.S. 702, 721 (1997).

47. *Stein*, 2006 WL 1735260 at *18.

48 *Id.* at *28.

49. *Id.*

50. *Id.* at *19 n.163.

51. *Id.* at *29 (noting that a company may pay these costs to "aid it in keeping and hiring competent and honest employees" or because the employee had served the company).

52. *Martinez v. Court of Appeal of Cal.*, 528 U.S. 152, 154 (2000).

53. *Wheat v. United States*, 486 U.S. 153, 164 (1988).

54. *Caplin & Drysdale, Chartered v. United States*, 491 U.S. 617, 624 (1989).

55. *Stein*, 2006 WL 1735260 at *22 (citing *Escobedo v. Illinois*, 378 U.S. 478, 490 (1964)).

56. *United States v. Cronic*, 466 U.S. 648, 657 n.21 (1984).

57. *Stein*, 2006 WL 1735260 at *24 (finding a violation "regardless of the legal standard of scrutiny applied").

58. *See, e.g.*, Section 24 of the Securities Act of 1933 (15 U.S.C. § 77x), Section 32(a) of the Securities Exchange Act of 1934 (15 U.S.C. § 78ff), Section 49 of the Investment Company Act of 1940 (15 U.S.C. § 80a-48), and Section 217 of the Investment Advisors Act of 1940 (15 U.S.C. § 80b-17).

59. *See, e.g., United States v. Kordel*, 397 U.S. 1, 11 (1970) ("It would stultify enforcement of federal law to require a governmental agency . . . to choose either to forgo recommendation of a criminal prosecution once it seeks civil relief, or to defer civil proceedings pending the ultimate outcome of a criminal trial."); *SEC v. First Fin. Group of Tex, Inc.*, 659 F.2d 660, 666-67 (5th Cir. 1981) ("[t]here is no general federal constitutional, statutory, or common law rule barring the simultaneous prosecution of separate civil and criminal actions by different federal agencies against the same defendant involving the same transactions. . . . The simultaneous prosecution of civil and criminal actions is generally unobjectionable because the federal government is entitled to vindicate the different interests promoted by different regulatory provisions even though it attempts to vindicate several interests simultaneously in different forums."). *But see United States v. Parrott*, 248 F. Supp. 196, 201-02 (D.D.C. 1965) (the "[g]overnment may not bring a parallel civil proceeding and avail itself of civil discovery devices to obtain evidence for subsequent criminal prosecution").

60. *SEC v. Dresser Indus., Inc.*, 628 F.2d 1368, 1375 (D.C. Cir. 1980); *First Fin. Group*, 659 F.2d at 667.

61. *See* 17 C.F.R. § 203.2 (2006).

62. *See id.*; 17 C.F.R. § 240.24c-1 (2006) ("[t]he Commission may, in its discretion and upon a showing that such information is needed, provide nonpublic information in its possession to any of the following persons if the person receiving such nonpublic information provides such assurances of confidentiality as the Commission deems appropriate . . . federal, state, local or foreign government or any political subdivision, authority, agency or instrumentality of such government . . . ."). The SEC is also explicitly authorized by both the Securities Act of 1933 and the Securities Exchange Act of 1934 to transmit information derived from its investigations to the DoJ. *See* 15 U.S.C. § 77t(b) ("The Commission may transmit such evidence as may be available concerning [acts or practices which may constitute a violation of the Act] to the Attorney General who may, in his discretion, institute the necessary criminal proceedings under this subchapter . . . ."); 15 U.S.C. § 78u(d)(1) ("The Commission may transmit such evidence as may be available concerning such acts or practices as may constitute a violation of any provision of this chapter or the rules or regulations thereunder to the Attorney General, who may, in his discretion, institute the necessary criminal proceedings under this chapter.").

63. *United States v. Scrushy*, 366 F. Supp.2d 1134, 1140 (N.D. Ala. 2005).

64. *See, e.g., Parrott*, 248 F. Supp. at 201 (D.D.C. 1965) (where defendants challenged the use of documents collected in a civil case for prosecution of a criminal case as a violation of the Fourth Amendment's right to be free from warrantless searches, the court noted it could "see no difference between a search conducted after entrance has been gained by stealth or in the guise of a business call, and a search for criminal purposes conducted under the guise of an examination for purely civil purposes") (quoting *United States v. Guerrina*, 112 F. Supp. 126, 129 (E.D. Pa. 1953)); *Stringer*, 408 F. Supp.2d at 1084-85 (defendants sought to dismiss a criminal indictment based on documents turned over in the SEC's civil case in violation of their Fourth Amendment rights).

65. *See, e.g., Scrushy*, 366 F. Supp.2d at 1139 (defendant argued his Fifth Amendment right against self incrimination was violated when he testified in a civil proceeding without being fully informed of pending criminal investigation against him); *Stringer*, 408 F. Supp.2d at 1085, 1087 (same).

66. *See Parrott*, 248 F. Supp. at 199, 203 (delay between discovery of alleged criminal scheme and the bringing of an indictment may violate the Sixth Amendment's guarantee of a speedy trial. "The constitutional guarantee protects against undue delays in presenting a formal charge as well as delays between indictment and trial.").

67. 366 F. Supp.2d 1134.

68. 408 F. Supp.2d 1083.

69. *Scrushy*, 366 F. Supp.2d at 1135-36.

70. *Id.* at 1135-37.

71. *Id.* at 1137. A "target" is "a person as to whom the prosecutor or the grand jury has substantial evidence linking him or her to the commission of a crime and who, in the judgment of the prosecutor, is a putative defendant." United States Attorneys' Manual ("USAM") 9-11.151. According to the USAM, the DoJ has a "longstanding policy [of advising] witnesses who are known 'targets' of the investigation that their conduct is being investigated for possible violation of Federal criminal law." *Id.*

72. *Scrushy*, 366 F. Supp.2d at 1137.

73. *Id.*

74. *Id.* at 1140.

75. *Id.* at 1139-40 (internal quotations and citations omitted, emphasis in original).

76. *Id.* at 1140.

77. 408 F. Supp.2d at 1089 ("[d]ismissal of an indictment is warranted if the alleged governmental misconduct is so grossly shocking and so outrageous as to violate the universal sense of justice. The conduct involved in this case meets that standard.") (internal quotations and citations omitted).

78. *Id.* at 1085.

79. *Id.*

80. *Id.* at 1086-87.

81. *Id.* at 1086.

82 .*Id.*

83. *Id.*
84. *Id.*
85. *Id.* at 1084.
86. *Id.* at 1084-85, 1087.
87. *Id.*
88. *Id.* at 1088.
89. *Id.* at 1087-88.
90. *Id.* at 1088.
91. *Id.* (internal quotations and alterations omitted).
92. *Id.* at 1089.
93. *Id.* (internal quotations omitted).

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