

White-Collar Defense

EXECUTIVE SUMMARY

Events such as 9/11 and the Enron scandal continue to have ripple effects on the government's policies and practices regarding the investigation and prosecution of white-collar crimes; the continued and growing use of deferred prosecution agreements, for example, is representative of the Department of Justice's current approach. The international and multinational nature of business has also encouraged the government to increasingly pursue Foreign Corrupt Practices Act cases.

Our panel of experts from Northern and Southern California discuss how these issues have affected their practice, as well as current trends in stock options investigations and prosecutions. They are Michael Farhang and Debra Wong Yang of Gibson, Dunn & Crutcher; Carolyn Kubota of O'Melveny & Myers; and Mark Beck and Walt Brown of Orrick, Herrington & Sutcliffe. The roundtable was moderated by freelance writer Bernice Yeung and reported for Barkley Court Reporters by Laurie Schmidt.

MODERATOR: As deferred prosecution agreements become increasingly *de rigueur*, what are some of the issues surrounding them?

KUBOTA: In my view, the government's increased use of deferred prosecution agreements (DPAs) and outside monitorships is an outgrowth of a larger trend arising out of 9/11, when the Department of Justice diverted tremendous resources to counterterrorism. One way the department has reacted to that shift is by effectively outsourcing enforcement work. DPAs, which are much more efficient than traditional investigations and prosecutions, are one manifestation of that.

DPAs are attractive to companies because they involve a lesser sanction than criminal conviction and lesser stigma than indictment or conviction. A company is also much more likely to survive a DPA than indictment or conviction. There's a further advantage to DPAs in that the cost of the enforcement is effectively borne by the company rather than taxpayers. But I think there are some disadvantages to DPAs, too. I think that prosecutors tend to use them too liberally in cases where the appropriate sanction is no sanction at all. Furthermore, because they don't involve an admis-

sion of guilt on the part of the company, they might also have a lesser deterrent value than traditional prosecutions.

YANG: Given the increasing globalization of business, the companies that we're discussing here are also much more complex, and as a result, the DPAs themselves are becoming more sophisticated.

In many situations, such as False Claims Act cases, there is also a parallel Corporate Integrity Agreement that's administered through a regulatory agency, and sometimes, it is not perfectly meshed with the DPA. So you have two government decrees, so to speak, that have contrary provisions. Companies need to consider whether or not that's going to be problematic for them since they're so used to dealing with the government agency and the Department of Justice separately.

The outside monitorships, as has been widely reported, have also increased. In large part that's a reflection of increased DPAs, but I also think that it's because of their growing complexity. The department doesn't have endless resources and is not designed to follow a case for years on end, so it needs to outsource part of the oversight by using outside monitors.

BROWN: The fact that Congress has introduced legislation related to DPAs and outside monitorships reflects and is responsive to a trend that does need addressing—that is, I think companies are far too willing to enter into a DPA as a form of resolution, regardless of the conduct at hand. I think that what we are seeing, on occasion, are prosecutors who perhaps aren't clear that they've got a provable criminal case, and they are extracting DPAs from companies whenever they can. Certainly, that issue needs to be addressed because we went from a paradigm where companies faced either an indictment or a declination, to this middle ground, which I do think is a reaction to both *Arthur Andersen* and to a shifting of resources, post-9/11. But currently, DPAs have become a default position in circumstances where it may not be appropriate. And yet, the large companies are often afraid to push back as much as they could or should because of a fear of indictment.

BECK: I agree with Walt [Brown]. Companies sometimes lack the resources, or the courage, to challenge the department—and agree to a resolution in a situation where they may have otherwise prevailed. This is “marketplace justice,” and some

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may say that it isn't justice at all. Some DPAs reflect real wisdom—resolving a mistake in a way that allows the company to carry on with business. But some agreements seem to be the product of poker playing, where strictures are imposed on a company that might otherwise have prevailed in the investigation if they had toughed it out.

FARHANG: A DPA also presents the question of whether a company should essentially cast aside potentially exposed senior executives before any facts have even been determined. That is, it's now in a company's interest to get separate representation for senior executives that may have potential criminal or civil exposure in terms of the issues under investigation, even before it's been determined whether there was any actual fault or culpability on their part.

The other problem that companies are facing with DPAs is that it's always going to be in the department's interest to determine if there's been a breach of the agreement. So the party that gets to decide whether the company has complied with the DPA is also, in fact, the party that is structuring the DPA.

BECK: Before this trend continues, there needs to be public debate. I think it's a positive thing that Congress is getting involved because it will provide a forum to talk about the pros and cons of DPAs, and it creates the possibility that some protective legislation and some standards will be put in place.

FARHANG: I agree. It's going to be very important for the department and Congress to strive to give companies better predictability over what kinds of cases will and will not be brought, and what kinds of cases are appropriate for DPAs and which aren't. DPAs can be such a huge expense and undertaking for a company, and the risk of failure can be great.

MODERATOR: What is the current status of stock options investigations and prosecutions?

FARHANG: The Department [of Justice] has taken a fairly conservative approach in that it has chosen to charge cases where there is clear culpability. As a result, I think the criminal courts have become concerned with the question of how to sentence defendants under the new regime of the sentencing guidelines advisory and under the standards for loss calculation.

For example, in the *Brocade* prosecution (*United States v. Gregory Reyes*), Reyes, the company's former CEO, was convicted of securities violations relating to a backdating scheme. There was a great attempt by the government to get the loss calculation into what could have been billions of dollars by using market capitalization theories and investor loss theories. And the court essentially took a conservative approach by saying that unless there is greater certainty of the actual loss, the court was not going to accommodate global presumptions or inexact estimates.

It seems the court is returning to the sentencing jurisprudence under the guidelines that have existed for years. So the real question is: In future stock options backdating prosecutions and sentencing, how is the government going to prove a loss if they are seeking greater sentences?

KUBOTA: The difficulty the department is facing in coming up with a rational method for determining loss in these stock options cases seems related to the declining importance of the Federal Sentencing Guidelines under recent U.S. Supreme Court decisions. Loss is a simple concept if you're talking about theft of a postal money order, but if you are talking about a *Brocade*-type scheme, how do you calculate loss? In cases like *Brocade*, the concept of loss just isn't up to the task of measuring the wrongfulness—or lack of wrongfulness—of the offense. The federal courts are returning to a more individualized sentencing scheme, and I think that's a good thing.

BROWN: What I find interesting are some of the ancillary issues that have come out of some of the stock options investigations and prosecutions. In the *Brocade* case, one of the government's key witnesses was *Brocade*'s own outside counsel, who conducted the internal investigation and who then testified about his interview of Reyes during the investigation. I think it's a reminder of how the information gathered during an internal investigation can end up finding its way into a criminal prosecution.

There has been some derivative litigation in Delaware and elsewhere that is starting to address privilege issues that arise out of these internal investigations; in particular, there is a question as to whether or not a special committee that has been conducting an investigation and is authorized to report to the board is somehow waiving its privilege when it does so.



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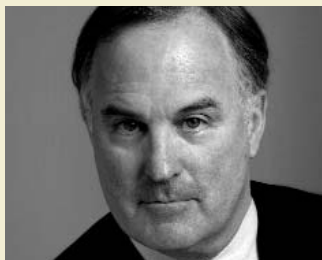
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BECK: With regard to actions brought against counsel, and enforcement efforts that target both in-house and outside counsel, it's clear that as a result of Sarbanes-Oxley, the Securities and Exchange Commission (SEC) sees lawyers as gatekeepers. There is no question that the SEC is taking a number of lawyers to task for not living up to that particular challenge. So it is a perilous time for lawyers, given the regulations that now govern any number of these issues.

KUBOTA: I think it's part of a trend that arose out of the Thompson Memo, the McNulty Memo and the *United States v. Christi Sulzbach* case, where the government brought civil False Claims Act charges against the former general counsel of Tenet Healthcare. Not only is the department willing to insist on a waiver of the attorney-client and work product privileges to resolve cases against companies, but it's also willing to use the information that results from those waivers to charge company executives either civilly or criminally. One consequence of that has been a trend away from putting legal advice related to sensitive enforcement issues in writing. In my view, there are real costs associated with that.

YANG: I think what we're seeing is that the Department [of Justice] is actually moving toward going after the "enablers," as they call it; meaning, the lawyers and the accountants. There have only been a few lawyers who have been prosecuted in the last couple of years, and there is criteria and an extremely high hurdle that a prosecutor with the department has to jump over, but the department is doing it.

BECK: I think it's also interesting to note that traditionally, the epicenter of these cases has been Northern California, although it appears that several actions may be brought in Los Angeles this year. But the biggest surprise has been how many stock option cases have been shut down. Some of us, Walt [Brown] included, have been involved in a number of internal investigations, and some of those have resulted in litigation. But if you look at the statistics of the nearly 200 cases under investigation, most have not resulted in any enforcement action at all.

MODERATOR: What trends are you seeing in the white-collar criminal arena?

YANG: I'm seeing more cases in the health care

"Deferred prosecution agreements have become a default position in circumstances where it may not be appropriate."

area. I believe that there's been increased funding related to health care investigations and prosecutions in various United States Attorney's offices around the country, so I think we will continue to see it grow.

I currently see a lot of kickback cases because I think they are somewhat easier to prove. The number of awards and civil penalties that have been paid in various False Claims Act cases in the health care arena have continued to creep upwards.

What may be happening is that there's a body of prosecutors who are very quickly educating themselves as to how to put these cases together. And given that there's generally a large dollar amount attached and sometimes increased penalties, and Health and Human Services helps investigate the case, it allows these cases to move more quickly. In addition, because there is both a criminal and a civil side to these cases, the corporation still faces exposure because even if a prosecutor can't make a criminal case, the government can still recover some civil monies, sometimes trebled.

KUBOTA: One thing that I have noticed in the health care area, and other areas as well, is more activism by state attorneys general. Most states now have their own False Claims Acts that also carry treble damages. These cases can be difficult because many state attorneys general don't have experience in this area or well-developed guidelines for handling these kinds of cases. Another thing we've seen on this front is attorneys general banding together in enforcement actions to increase their leverage.

YANG: The other area that you'll probably see growth in is the Foreign Corrupt Practices Act



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(FCPA). And that reflects the multinational, international aspect of businesses. I think for those of us on the West Coast, certain Asian countries are of extreme interest to the Department [of Justice] because this country does a tremendous amount of business there, and because these countries don't always have the same ethical and compliance practices in place that we have in the United States.

FARHANG: I agree that there has been a marked increase in the FCPA enforcement actions in the last couple of years. As Debra [Wong Yang] pointed out, the growing international nature of many U.S. companies creates a need for better compliance systems on the part of these companies; in-house counsel at large public companies are going to have to work closely with outside counsel to form compliance programs that can help them get ahead of the problem so they don't find themselves facing an FCPA issue that has arisen in a foreign subsidiary or a foreign branch of that company.

Some of these legal issues are trickier than one might expect. For example, in certain countries, facilities that we don't normally associate with government-run enterprises are, in fact, government owned. Hospitals are one example. So companies can run into trouble in the FCPA area without realizing it because of local conditions and governmental structures.

KUBOTA: I've seen two trends emerging in the FCPA area. One is a trend towards prosecuting individuals in addition to corporations for FCPA violations. And the other is department's initiation of proactive, industry-wide reviews.

BROWN: Another area I think where you're going to continue to see more prosecutions, especially in Northern California, is in the area of intellectual property crime. In particular, we continue to see a number of trade secret investigations as well as counterfeiting cases, and they are beginning to have an increasing international flavor to them as well.

You are seeing cooperation amongst domestic law enforcement agencies with law enforcement abroad where some of this activity may be going on. Those prosecutions have been uniquely driven by the victims. For example, here in the Silicon Valley, we see very seasoned and sophisticated in-house counsel, many of whom were former federal prosecutors, who are focused on bringing intellec-

“The Department of Justice is willing to use information that results from privilege waivers to charge company executive either civilly or criminally.”

tual property violations to the attention of law enforcement. I think this is something that we're going to see continuing to trend upward.

BECK: So whereas 10 or 20 years ago, we were looking at enforcement efforts in the aerospace and savings-and-loan realms, and stock options more recently, we are now looking at a rather substantial investment by the Department [of Justice] and SEC in FCPA investigations. The total number of enforcement actions has increased dramatically over the past four years. And the potential penalties are enormous. It is also interesting that many countries have passed parallel legislation, so a bribery allegation can implicate U.S. and foreign laws at the same time. We need to be increasingly prepared to conduct internal investigations here and abroad. ■

UPCOMING ROUNDTABLES

Issue Date	Topic	Roundtable Occurs In
JUNE	Real Estate	April
JULY	Intellectual Property	May
AUGUST	Employment	June
SEPTEMBER	Diversity	July
OCTOBER	Securities	August
NOVEMBER	Product Liability	September
DECEMBER	Climate Change	October

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