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Department of Justice Sets Forth Criteria for Use in Deciding to Criminally Charge Corporations

In a document entitled "Federal Prosecutions of Corporations," the U.S. Department of Justice (DOJ) issued guidelines to all U.S. attorneys detailing factors that should be considered when deciding to prosecute a corporation (guidelines). The guidelines were produced by an *ad hoc* working group put together by the DOJ, comprising representatives of U.S. attorneys' offices and other federal criminal enforcement lawyers. Corporations being investigated for violations of federal law may use these guidelines in attempting to avoid a criminal prosecution.

Nature and Seriousness of the Wrongdoing

The first factor concerns the gravity of the wrongdoing. In making this determination, federal prosecutors will give weight to "the specific policy goals and incentive programs established by the respective [Justice Department] Divisions and regulatory agencies." For example, the DOJ's antitrust division's strict corporate leniency policy offers clemency only to the "first company through the door" with a voluntary disclosure, but no credit is given for a company's maintenance of a compliance program. Thus, the nature and seriousness of a corporation's criminal activity partially depends on the policies sought to be achieved by agencies with regulatory authority over the activities being investigated.

Pervasiveness of the Misconduct

The guidelines state that where corporate misconduct was carried out by many employees or condoned by the company's top managers, even minor wrongdoing may serve as a basis for a criminal prosecution. Management plays a significant role in this determination because it "is responsible for a corporate culture in which criminal conduct is either discouraged or tacitly encouraged." On the other hand, the guidelines suggest that where a company maintains a compliance program, a single act by a rogue employee may not be an appropriate basis for an indictment.

The mere existence of a compliance program will not shield a corportion from criminal liability.

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Criminal History

The criminal history of the corporation under investigation also will be evaluated by federal prosecutors. Accordingly, the government will examine a company's history of similar violations including criminal, civil, and regulatory actions brought against it in the past. The guidelines explain that an indictment may be "particularly appropriate" where previous non-criminal warnings or sanctions failed to prompt a company to take sufficient measures to avoid similar wrongdoing in the future.

Disclosure and Cooperation

Two significant factors in charging decisions concern whether a corporation disclosed its lawbreaking in a timely fashion, and whether it is willing to cooperate with investigators. Prosecutors assessing disclosure and cooperation will evaluate the corporation's willingness: (1) to identify the culprits, including senior executives; (2) to make witnesses available; (3) to disclose the complete results of its internal investigation; and (4) to waive the attorney-client and work product privileges.

"[A] corporation, like a natural person, is expected to learn from its mistakes."

The guidelines state that "[a] corporation's promise of support to culpable employees or agents, either through the advancing of attorneys fees, through retaining 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." Moreover, prosecutors should consider a company's willingness to waive applicable privileges in assessing disclosure and cooperation given the government's need to obtain witness statements without negotiating individual immunity agreements.

Compliance Program

The guidelines also instruct prosecutors to weigh the effectiveness of a corporate compliance program. However, the guidelines stress that the mere existence of a compliance program will not shield a company from criminal liability. In fact, the commission of crimes by employees "in the face of a compliance program may suggest that corporate management is not adequately enforcing its program." In evaluating the design and effectiveness of a compliance program, prosecutors will measure: (1) the program's comprehensiveness; (2) the extent and pervasiveness of the wrongdoing; (3) how many employees were involved and how high up in the company they were; (4) the seriousness, duration, and frequency of the lawbreaking; (5) any remedial measures – restitution, discipline, and program revision – undertaken by the company; and (6) the promptness of any voluntary disclosure and extent of any cooperation. Lastly, prosecutors should consider the sufficiency of the staffing of a company's compliance department.

Restitution and Remediation

The guidelines recognize a company's readiness to make restitution and to take other remedial actions, which may increase its chances of avoiding prosecution. Along with the previous two criteria, this factor seeks to foster specific deterrence of future wrongdoing by the company under investigation. Efforts to make restitution constitute evidence of acceptance of responsibility. Similarly, the taking of concrete steps to discipline employees regardless of rank and to create or improve a compliance program as a remedial measure should weigh against a prosecution.

Collateral Effects

The guidelines encourage prosecutors to consider the collateral consequences of a criminal conviction before indicting a company. Specifically, they should factor in the possible harm to innocent employees, officers, and shareholders. On the other hand, "the possible unfairness of visiting punishment for the corporation's crimes upon shareholders may be of much less concern where those shareholders have substantially profited, even unknowingly, from widespread or pervasive criminal activity."

Non-Criminal Alternatives

The final criteria is the existence of non-criminal alternatives that will provide sufficient deterrence, punishment, and rehabilitation. These sanctions include

suspension, civil penalties, restitution, being barred from future federal contracts, and being denied the benefit of federal programs. As part of this criteria, the guidelines instruct prosecutors to weigh the strength of the appropriate regulatory agency's interest in the case, the agency's ability and willingness to take enforcement action, the likely sanction, and how a non-criminal disposition would affect the interests of federal law enforcement.

Second Circuit Establishes Guidelines for Application of Offensive Collateral Estoppel in Civil Cases Based on Prior Criminal Proceedings

In two civil cases, the Second Circuit addressed the application of the doctrine of collateral estoppel, otherwise known as issue preclusion, based upon predicate findings in a prior criminal proceeding involving the defendant. Both cases concerned whether a plaintiff in a civil action may bar the defendant from relitigating issues that were decided in a preceding criminal action. In these cases, the Second Circuit drew a sharp distinction between preclusion based on criminal liability and preclusion based on sentencing findings.

SEC v. Monarch Funding Corp., 192 F.3d 295 (2d Cir. 1999)

In *SEC v. Monarch Funding Corp.*, the Securities and Exchange Commission (SEC) filed a civil action against an individual for violations of the federal securities laws. Those same violations formed the predicate acts for a parallel criminal prosecution of the defendant under the Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. § 1961.

In the criminal case, the jury acquitted the defendant of the RICO charges, but convicted him on related obstruction of justice charges. Following the conviction, the judge enhanced the defendant's sentence based on a finding that he had committed securities fraud and engaged in an eight-year conspiracy to cover it up. Subsequently, the SEC moved for summary judgment in the civil action on the grounds that collateral estoppel barred the defendant from relitigating his securities fraud liability by virtue of the prior sentencing findings. The district court ruled in favor of the SEC.

The Second Circuit reversed on appeal. The court held that the application of offensive collateral estoppel in a civil action to findings in a prior sentencing proceeding is not per se prohibited, but should be presumed improper. To be considered fair, "the issue previously litigated must have been necessary to support a valid and final judgment on the merits." *Id.* at 304. The Second Circuit concluded this test was not satisfied because the sentencing judge's finding that the defendant had violated the securities laws was not necessary to the judgment in that action.

New York v. Julius Nasso Concrete Corp., 202 F.3d 82 (2d Cir. 2000)

The Second Circuit revisited these issues in *New York v. Julius Nasso Concrete Corp.* In this civil action, the state charged various construction contractors with violating the federal antitrust laws by engaging in a bid-rigging conspiracy with the governing body of New York's five organized crime families. One year after this suit, the United States brought a criminal RICO action based on the same facts. After a jury found the individual defendants guilty in the criminal action, the state moved for summary judgment in the antitrust action, contending that the guilty verdicts and the sentencing findings collaterally estopped the defendants from relitigating those issues in the civil case.

The Second Circuit concluded that the defendants were collaterally estopped from challenging antitrust liability based on the prior criminal convictions. The court explained that "a criminal conviction, whether by jury verdict or guilty plea, constitutes estoppel in favor of the [plaintiff] in a subsequent civil proceeding as to those matters determined by the judgment in the criminal case." However, the court reaffirmed the principle announced in *SEC v. Monarch Funding Corp.* that precluding relitigation of issues on the basis of prior sentencing findings in a criminal case is presumed

Application of offensive collateral estoppel in a civil action to findings in a prior sentencing proceeding should be presumed improper.

to be improper, and it remanded for a determination of causation.

Qui Tam Provisions of the False Claims Act Held to Violate the Constitution

Riley v. St. Luke's Episcopal Hospital, 196 F.3d 514 (5th Cir. 1999)

The Fifth Circuit reached a momentous decision in *Riley v. St. Luke's Episcopal Hospital* that could have deep ramifications for litigants under the False Claims Act ("FCA"), 31 U.S.C. § 3729 et seq.[1] Because of the potential implications of this case and a split within the circuits, the entire Fifth Circuit recently agreed to rehear the case *en banc*. See *Riley v. St. Luke's Episcopal Hospital*, 196 F.3d 561 (5th Cir. 1999).

The Second Circuit concluded that the defendants were collaterally estopped from challenging antitrust liability based on the prior criminal convictions.

A former nurse at a Houston hospital filed this *qui tam* action, alleging that eight health care providers violated the FCA by submitting false Medicare and Medicaid claims for reimbursement from the federal government. The FCA's *qui tam* provisions allow individual citizens, known as "relators," to sue for fraud on behalf of the government and to collect a portion of the government's recovery. To initiate a *qui tam* action, a relator must serve on the government a copy of the complaint and a written disclosure of the information possessed. The attorney general then must decide, within 60 days, whether to intervene and proceed with the action. See 31 U.S.C. § 3730(b). If the government chooses not to intervene, the relator may continue the case even if he or she has not suffered a personalized injury (i.e., the only harm is to the government).[2]

In *Riley*, the government decided not to intervene and the relator proceeded with the action. The district court granted the defendants' motion to dismiss on constitutional grounds and the plaintiff appealed. In affirming the dismissal, the Fifth Circuit held that those portions of the FCA's *qui tam* provisions, which permit actions by uninjured relators when the government does not intervene, violate the U.S. Constitution's Take Care Clause and the constitutional doctrine of separation of powers.[3]

The Take Care Clause states that "[the Executive] shall take care that the laws be faithfully executed." U.S. Const. art. II, § 3. The Fifth Circuit concluded that the prosecution of the government's claims by individuals wholly outside of the executive branch, who have not suffered an injury themselves, violates this clause. The separation of powers doctrine bars one branch of government from intruding on the constitutionally-granted powers of another branch. In this regard, the Fifth Circuit held that the legislative branch had stripped the executive branch of its exclusive prosecution power by allowing uninjured relators to bring suit on behalf of the government.

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1 Congress enacted the FCA in 1863 to combat widespread fraud by government contractors during the Civil War. See *Riley*, 196 F.3d at 517. The act, which was amended in 1943 and 1986, provides that anyone who presents a false money claim to the federal government shall be liable for double or treble damages and civil penalties of up to $10,000 per false claim. See 31 U.S.C. § 3729.

2 When an FCA action is primarily conducted by the attorney general, the relator may receive between 15% and 25% of the proceeds, plus reasonable expenses. See 31 U.S.C. § 3730(d)(1). If the attorney general declines to intervene, the relator is entitled to 25% to 30% of the recovery. See *id.* § 3730(d)(2).

3 The Fifth Circuit's decision contradicts that of other courts. See, e.g., *United States ex. rel. Taxpayers Against Fraud v. General Elec. Co.*, 41 F.3d 1032 (6th Cir. 1994); *United States ex rel. Kelly v. Boeing Co.*, 9 F.3d 743 (9th Cir. 1993); *United States ex rel. Kreindler & Kreindler v. United Technologies Corp.*, 985 F.2d 1148 (2d Cir. 1993); *United States ex rel. Fallon v. Accudyne Corp.*, 921 F. Supp. 611 (W.D. Wis. 1995); *United States ex. rel. Robinson v. Northrop Corp.*, 824 F. Supp. 830 (N.D. Ill. 1993); *United States ex rel. Burch v. Piqua Eng'g, Inc.*, 803 F. Supp. 115 (S.D. Ohio 1992); *United States Dep't of Housing and Urban Dev. ex rel. Givler v. Smith*, 775 F. Supp. 172 (E.D. Pa. 1991); *United States ex rel. Truong v. Northrop Corp.*, 728 F. Supp. 615 (C.D. Cal. 1989); *United States ex rel. Newsham v. Lockheed Missiles & Space Co.*, 722 F. Supp. 607 (N.D. Cal. 1989); *United States ex rel. Stillwell v. Hughes Helicopters, Inc.*, 714 F. Supp. 1084 (C.D. Cal. 1989).

The implications of this decision could be enormous given that the FCA owes much of its success to the filing and prosecution of *qui tam* actions. Depending upon the ultimate decision, government contractors may have a new weapon to fight *qui tam* suits under the FCA.[4]

4. The Supreme Court also recently weighed in on the constitutionality of the FCA's *qui tam* provisions. In *Vermont Agency of Natural Resources v. United States ex rel. stevens*, 120 S. Ct. 1858 (2000), the Court held that a *qui tam* plaintiff has standing to sue under Article III of the U.S. Constitution, even when the government does not intervene in the action. However, the court expressly declined to reach the issues decided in *Riley*-namely, whether the FCA's *qui tam* provisions violate the take Care Clause and the separation of powers doctrine. *See Vermont Agency*, 120 S. Ct. at 1865 n.8. As a result, the Fifth Circuit's decision in *Riley* remains valid law at the present time.

Private Citizens May Be Considered a Public Official Under the Federal Bribery Solicitation Statute

United States v. Kenney, 185 F.3d 1217 (11th Cir. 1999)

In *United States v. Kenney*, a jury convicted the defendant of soliciting a gratuity as a public official in violation of 18 U.S.C. § 201(b)(2)(A). This statute makes it unlawful for a public official to demand, seek, or accept anything of value in return for being influenced in an official act, or because of an official act performed or to be performed. The district court had denied the defendant's motion to dismiss the indictment on the ground that he was not a "public official" under the statute and the defendant appealed his subsequent conviction to the Eleventh Circuit.

The defendant had worked for BDM International, Inc. (BDM), a government contractor who supplied acquisition management and engineering personnel to assist the U.S. Air Force in procuring and approving materials and equipment. In particular, the defendant's job required him to serve as the "eyes and ears" of the Air Force during the administration of a contract with a runway equipment manufacturer. The defendant reported the status of the contract, progress made, and any problems encountered by the contractor. Although the defendant did not possess authority to bind the government, he provided advice, evaluated technical data, and his recommendations were given great weight by decision-makers.

The federal bribery solicitation statute defines the term "public official" as follows:

> [A] Member of Congress, delegate, or resident commissioner, either before or after such official has qualified, or an officer or employee or person acting for or on behalf of the United States, or any department, agency or branch of government thereof, including the District of Columbia, in any official function, under or by authority of any such department, agency, or branch of Government, or a juror.

18 U.S.C. § 201(a)(1). In *Dixson v. United States*, 465 U.S. 482, 496 (1984), the Supreme Court held that the definition of public official extends beyond government employees and contractors to include private individuals who "occupy a position of public trust with official federal responsibilities." To be considered a public official, a private individual "must possess some degree of official responsibility for carrying out a federal program or policy." *Id.* at 499.

The Eleventh Circuit expanded the reach of this definition in Kenney. The court held that "[i]n order to be considered a public official a defendant need not be the final decision maker as to a federal program or policy." It is sufficient that the defendant makes recommendations that influence the outcome of a federal decision. *See Kenney*, 185 F.3d at 1221-22. Based on the facts summarized above and the broad definition put forth, the Eleventh Circuit rejected the defendant's argument that he was not a public official and affirmed his conviction.

The defendant's job required him to serve as the "eyes and ears" of the Air Force during the administration of a contract.

Private Sector Honest Services Fraud is Actionable under 18 U.S.C. § 1346

United States v. deVegter, 198 F.3d 1324 (11th Cir. 1999), *rehearing en banc denied*, —F.3d — (11th Cir. 2000)

This criminal action arose from corruption by a financial advisor and an investment banker in a county's selection of an underwriter for a municipal bond transaction. The indictment alleged that the county had decided to take advantage of favorable interest rates by refunding some of its bonds, which required an underwriter. The county hired deVegter, a financial advisor, to recommend an underwriter. Richard Poirier Jr. was a member of Lazard Freres & Co., an investment bank that wanted to act as senior managing underwriter.

The paradigm case of honest services fraud is the bribery of a public official.

Poirier allegedly offered to pay deVegter for his intervention in helping Lazard gain the contract. Without informing the county of his financial interest, deVegter accepted the offer and helped Lazard land the contract. The government charged deVegter and Poirier with a conspiracy to commit wire fraud in violation of 18 U.S.C. § 371, wire fraud in violation of 18 U.S.C. § 1343, and private sector honest services fraud in violation of 18 U.S.C. § 1346.

The district court sustained the indictment's conspiracy and wire fraud counts, but dismissed the counts based on section 1346. The court concluded that section 1346 applies to private sector honest services fraud only when the defendant has breached a clear fiduciary duty, which the indictment had not alleged. The government appealed, contending that the indictment adequately alleged a violation of the county's right to the "honest services" of the financial advisor in charge of selecting the underwriter. The Eleventh Circuit agreed and reversed.

The paradigm case of honest services fraud is the bribery of a public official. Public officials inherently owe a fiduciary duty tothe public to make government decisions in the public's best interests.[4] Although these duties ordinarily do not encompass private sector relationships, section 1346 may extend to the defrauding of some private sector duties of loyalty. For example, private sector honest services fraud may occur when a purchasing agent, broker, union leader, or another with a fiduciary duty to his or her employer or union, accepts kickbacks or sells confidential information.[5] To establish a case of private sector honest services fraud, the government must show that the defendant had a fiduciary duty to the victim, breached that duty, and should have reasonably foreseen that the victim might suffer economic harm as a result of the breach.

Based on these standards, the Eleventh Circuit determined that the indictment sufficiently alleged that the defendants intentionally breached a fiduciary duty to the county and that economic harm was a reasonably foreseeable result of the fraudulent scheme. It thus remanded the case for trial.

4 *See deVegter*, 198 F.3d. at 1328; *United States v. Jain*, 93 F.3d 436, 442 (8th Cir. 1996).

5 *See deVegter*, 198 F.3d at 1329 (providing examples).

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