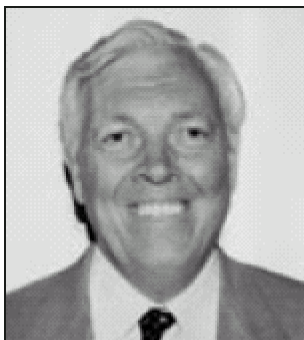
ASSOCIATION OF BUSINESS TRIAL LAWYERS
abtl
NORTHERN CALIFORNIA
REPORT
Volume 13 No. 3
SUMMER 2004

The Feeney Pit and the Pendulum: Swings in Criminalizing Securities Laws

Some thirty years ago, meetings of the multi-agency Organized Crime Strike Force in San Francisco consisted largely of listening to stories of drug raids in the Golden Triangle and other non-securities-related prosecutions. We attorneys at the SEC always referred criminal securities matters to the United States Attorney's Office in the Southern District of New York, owing to the unwillingness or inability of the United States Attorneys' offices in other districts to pursue such cases.



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How times have changed. In 2003, there were 246 securities-related prosecutions in 38 jurisdictions. During this period, the SEC has sought to bar 144 offending corporate executives and directors from holding positions with public companies. (Donaldson, Chairman of the SEC, *Senate Committee testimony re Sarbanes-Oxley* (Sept. 9, 2003).) The Justice Department budget for fiscal year 2003 included funds for 35 new assistant U.S. Attorneys to tackle corporate fraud — one-quarter of those prosecutors assigned to California. The number of prosecutors in San Francisco devoted to securities fraud increased by almost 50 percent.

This article analyzes the positive and negative aspects of this dramatic swing and makes cautious suggestions and predictions for the future.

The Sentencing Guidelines

The Organizational Sentencing Guidelines first created in 1991 accomplished Congress' goal of remedying what it perceived to be a "softness" on white collar crime by the federal judiciary, and conveyed substantial powers to federal prosecutors that can be used to encourage cooperation and guilty pleas from defendants. Since the guidelines often provide for extreme sentences, based largely on the amount of money lost by investors, persons not directly or knowingly involved in the alleged fraud may find themselves facing potential offense levels in the 40-plus range, translating to possible decades-long incarceration.

There is growing concern over reports of instances where individuals have materially changed their stories once offered the ability to plead to one or two counts for crimes other than the type of securities fraud at the heart of the allegations. (*See* Schacter & Stern, *Bringing Out the Rough Stuff*, 25 Nat'l L.J.No.47 (Aug. 11, 2003) at 15.) The carrot from the prosecution is the prospect of a "downward departure" from high-term sentences no longer subject to judicial discretion, depending upon the degree of "cooperation" given by the defendant — with cooperation measured at the time of sentencing. Given the hope of probation or a year or less in prison with possibly some time in a halfway house or home detention, compared with decades in prison, the impetus to bend the truth to implicate others becomes large.

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While being the first to plead guilty has always been the key to favored treatment, the extremes of the sentencing guidelines combined with the complexity of the financial issues involved in some of these cases invite injustice. The recent sentencing of Jamie Olis in the Dynegy case highlights the concern. Here, a mid-level executive who did not cooperate with the prosecution (read plead guilty and implicate others), received a 24- year sentence. (*United States v. Olis*, No. 03-CR-217-ALL (S.D.Tex., filed June 10, 2003.) Had he been sentenced for the same crime in 1999, his sentence would have been one-fourth as long. The significance of this is not to suggest that a 24-year sentence may not be appropriate under certain circumstances, but to question the repercussions of such sentencing.

The Feeney Amendment

On its face, the Prosecutorial Remedies And Other Tools To End The Exploitation Of Child Today Act of 2003 (the "PROTECT Act") is intended to intensify the penalties for child exploitation and to fund state kidnapping alert systems like the popular Amber Alert in California. (Pub.L.No. 108-21, 117 Stat. 650 (2003).) Instead, it appears to have become an example of the doctrine of unintended consequences. These consequences stem from an add-on known as the Feeney Amendment (*id*., 117 Stat. at 657), which in essence restricts federal judges from exercising their discretion with respect to the federal sentencing guidelines in criminal cases.

The Feeney Amendment's attempt to limit judicial sentencing departures applies to *all* federal sentencing matters, not just those involving child abduction or exploitation. (Cahill, *Tightening the Reins*, 2 ABA Journal Report 13 (April 4, 2003),*available* at EXIS,ABA Library, E-Report File.) Under the Feeney Amendment "downward departures" in sentencing are now to be tracked on a judge-by-judge basis through reporting to the Department of Justice both by the Judicial Commission and by the United States Attorneys' offices. The result is potential "blacklisting" of judges deemed too lenient in their interpretation of sentencing guidelines.

The reaction to this amendment has been swift and fierce. Although the Feeney Amendment has been constitutionally upheld (*see U.S. v. Bordon*, 300 F. Supp. 2nd 1288 (S.D. Fla 2004)) (Feeney Amendment challenged in part based on the alleged violation of the Constitution's separation of powers requirement), opposition to it has been widespread and not limited to individual judges and defense counsel. The opposition includes the Judicial Conference of the United States, the U.S. Sentencing Commission and the American Bar Association. (*See, e.g*., Letter from A. Carlton, President of the ABA, to Sen. Hatch (April 1, 2003), http://www.abanet.org/poladv/letters/108th/sent040103.html,) This loss of discretion has led to the resignation of some federal district judges, who strongly believe that *de novo* review by the circuit courts of appeal does not give an equivalent impression of the live testimony and evidence in a courtroom. (Post, *Two U. S. Judges Fire at "Feeney,"* 26 Nat'l L. J. No. 23 (Feb. 9, 2004), at 4.)

The United States Supreme Court, in its just issued opinion of *Blakely v. Washington,* struck down the sentencing guidelines of Washington State. This decision effectively forces the courts to revisit the federal guidelines as well. It will hopefully result in more judicial sentencing discretion, while letting the guidelines guide.

Representing a Business Entity and/or an Individual

Defense counsel's strategic analysis differs substantially where a business entity is a potential defendant in addition to the individuals who may be targets. Historically, in securities-related cases, the practice has been not to indict the entity. This too is changing, leading to profound consequences to individuals when the company cooperates with the government.

The shift towards corporate cooperation can be seen in an SEC Section 21(a) report. Exchange Act Release No. 34-44969, 77 SEC Docket (CCH) 220 (Oct. 23. 2001). This report sets forth the so-called Seaboard Guidelines on cooperation, an ironic bit of publicity since Seaboard's cooperation led to a case ultimately brought only against an individual. Among the thirteen factors the SEC will consider in determining the sufficiency of the level of cooperation are whether the corporation turned over investigative information to the SEC, whether the entity distanced itself from individuals suspected of the wrongdoing, and (though not actually required) whether the corporation agreed to waive the attorney-client privilege with respect to the company's internal investigation(s) and knowledge of information concerning the suspected individual wrongdoers.

The net impact of the SEC's definition of cooperation is to make the company in effect an investigative arm of the government. This may not be a bad thing from the point of view of the investing public and the company itself, but certainly can wreak havoc on those individuals who find themselves abandoned (or worse) by their now former employer. In practice, such cooperation often involves bringing in separate investigative counsel — usually counsel to the audit committee — and lessening or removing the involvement of the company's regular counsel.

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Apart from the waiver of attorney-client privilege issue, the effect on individuals trying to establish their innocence can be profound. This impact can start with the refusal of the employer to share information of any sort with the individual and his or her counsel. In its more extreme form, it involves willingness by the company to provide interview summaries and other information derived from its investigation to the regulatory authorities while denying access to this same information to counsel for the potential individual targets.

Adding to the complexity of the situation for the individual is the increasing inability to obtain cooperation from other defense counsel. In the current climate, one must assume that there are parallel proceedings with the SEC and the relevant United States Attorney's Office in all securities fraud cases. Defense counsel experienced in dealing with white collar criminal matters have a greater tendency to assert their clients' right against self-incrimination than do civil practitioners, resulting in limited or no information sharing. And where the criminal enforcement process results in the stay of civil discovery, individuals and their counsel may be denied their ability to obtain information necessary to present a defense.

Increasing Risk of Guilty Pleas From Inability to Fund Defense Costs

Another emerging trend is the inability to finance one's defense in a major government fraud action. While this has always been a problem for individuals and entities with limited resources, the problem is particularly acute when facing parallel proceedings brought by multiple agencies — situations frequently accompanied by civil class actions and derivative litigation.

Complicating matters further is the increasing tendency of insurance carriers not only to decline coverage, but to pursue separate proceedings seeking to establish that no coverage obligation exists. In some cases, insurance carriers return premiums with the announcement that the policy is rescinded, relying on certain exclusions now being more aggressively pursued. This is especially problematic in cases where restated financials are involved, giving the carrier the argument that it relied in issuing the coverage on a more favorable body of financial data than was in fact present.

For persons and entities without substantial resources, there often appears to be little alternative to "cooperating" when this is the only avenue to obtaining a lesser sanction or a non-prosecution commitment. Public Defenders' offices offer little comfort to individuals in such situations.

Complications of Cooperating with the Government

The conflict between the requested cooperation sought by the SEC in its October 2001 report on "cooperation" and that sought by the Department of Justice gives rise to immense difficulty in deciding what, if anything, to say before or when the government calls. Deputy Attorney General Larry Thompson's January 20, 2003 memo on Principles of Federal Prosecutions of Business Organizations updates the Key 1999 "Holder Memorandum." Of particular note is the extent to which an entity's active willingness to assist in prosecution of alleged wrongs can reward the assisting entity. Relevant quotes from section VI entitled "Charging a Corporation: Cooperation and Voluntary Disclosure" of this memo highlight the issue and difficulties it presents:

> One factor the prosecutor may weigh in assessing the adequacy of a corporation's cooperation is the completeness of its disclosure including, if necessary, a waiver of the attorney-client and work product protections, both with respect to its internal investigation and with respect to communications between specific officers, directors and employees and counsel.… Prosecutors may, therefore request a waiver in appropriate circumstances. The Department does not, however, consider waiver of a corporation's attorney-client and work product protection an absolute requirement, and prosecutors should consider the willingness of a corporation to waive such protection when necessary to provide timely and complete information as one factor in evaluating the corporation's cooperation.

Moreover, it appears now that cooperating with the government itself is not enough. In the recent criminal investigation of former executives of Computer Associates, the government pursued and the court approved guilty pleas to obstruction of justice charges based on the fact that the executives lied to lawyers hired by the company to conduct an internal corporate investigation, who then passed on the false information to prosecutors. Berenson, *Case Expands Type of Lies Prosecutors Will Pursue*, N.Y. Times, May 17,2004,at C1, available at LEXIS, News Library, NY Times File.

Evolution of the No-Intent Crime

The onset of the Sarbanes-Oxley legislation, coupled with case law eroding traditional concepts of criminal intent, can leave targets with no clear idea of whether they have a realistic chance of defending themselves. This leads to more pleas when perhaps more trials, or even more declinations to prosecute, should be the result.

The U.S. Supreme Court enunciated the "responsible corporate officer doctrine" in *U.S. v. Dotterweich*, 320 U.S. 277 (1943) and *U.S.v.Park*,421

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U.S. 658 (1975), providing a narrow exception from the normal criminal intent standard required of the government in cases involving violations of public welfare statutes (*i.e*., Food, Drug and Cosmetic Act). The rationale was that "penalties commonly are relatively small [for violating these statutes] and conviction does no grave damage to an offender's reputation." *Morrissette v.U.S.*,342 U.S. 246, 256 (1952).

Now, the Sarbanes-Oxley Act requires CEOs and CFOs of public companies to certify that certain reports filed with the SEC fairly present the financial condition of the company. 15 U.S.C.A. § 17241; 17 C.F.R. §§ 229.302 and 229.308. This certification requirement and others like it in the Act essentially greatly expand the responsible corporate officer doctrine by requiring the corporate officer, in effect, to agree in advance to abandon a "lack of knowledge" defense.

Conclusion

We are now observing two pendulum swings: one toward increasing difficulty and risk for entities and individuals asserting legitimate defenses that could lead to declinations to prosecute (but not necessarily avoiding civil fraud allegations by the SEC); and the other toward a growing realization that unfairness and possible violation of constitutional rights may be involved. The securities enforcement function at both civil and criminal levels should consider the perfect storm created for potential targets by joint proceedings and extreme but differing agency interpretations of what constitutes cooperation.

Traditionally, the enforcement agencies looked to defense counsel for assistance in performing their roles, correctly citing limited resources and the need for such assistance. When the stakes become as high as they are at present, however, much of this assistance is lost behind assertion of the Fifth Amendment privilege. The broad adverse reaction to the Feeney Amendment, and juror reluctance to convict in complex accounting cases, may be harbingers of at least a swing back to a slightly less aggressive posture, where civil penalties or lesser criminal sanctions would suffice. This may be a more appropriate approach than expending time and resources to present claims based on obstruction of justice or other claims not specifically identified as violations of the securities laws.

While the current environment is understandable in light of the many excesses of recent years, it should not blind us to the reality that lives are destroyed when the criminal and civil securities regulatory processes emphasize efficiency at the expense of fairness. Good and effective prosecution hinges not only on counting the number of consents, pleas and convictions. It also depends on making sure that individuals and their counsel are not so constrained from presenting their positions that justice is lost.

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