

A win for corporations facing prosecution

By Peter G. Verniero

Do business executives, and the firms they manage, have enforceable constitutional rights? Apparently at least one federal judge thinks so.

Lewis A. Kaplan, a U.S. district judge sitting in New York, recently issued the second of two rulings involving the government's investigation of alleged improprieties by the accounting giant KPMG and some of its senior partners. In the first decision, issued in June, the judge struck down portions of the guidelines used by federal prosecutors in determining whether to indict corporations.

Contained in a Justice Department memorandum written by then-Deputy Attorney General Larry D. Thompson in 2003, the guidelines spell out what corporations must do to be viewed as cooperating with federal investigators. As the judge noted, the Thompson memo is more of a mandate than a suggestion because prosecutors are required to follow it.

Any CEO or general counsel reviewing the Thompson memo cannot mistake its not-so-subtle message: Cooperate with the government or face possible corporate extinction.

It was precisely that message that the court found offensive. KPMG's normal business practice had been to reimburse executives for legal expenses incurred in an investigation. In the case before Kaplan, however, KPMG suspended that policy to demonstrate its cooperation with investigators.

In the court's view, that suspension impinged on the executives' ability to defend themselves, which, in turn, violated their constitutional rights. As the court succinctly put it: "The constitutional requirement of fairness in criminal proceedings not only prevents the prosecution from interfering actively with the defense, but also from passively hampering the defendant's efforts."

In the second decision, issued in late July, the same judge considered whether KPMG managers suffered undue pressure, prompting them to waive their rights by making incriminating statements to the government.

Again, the court focused on the Thompson memo, observing that it "makes clear that the failure of a business organization facing possible indictment to induce its personnel to submit to interviews by the government and to disclose whatever they know may be a factor weighing in favor of indictment of the entity."

Kaplan concluded that the government, working under the guise of the Thompson memo, went too far. The court did not mince words. It ruled that "the government here coerced KPMG to apply pressure" on the firm's partners "in order to secure waivers of constitutional rights that the government itself could not obtain."

Although both decisions are written in terms of individual rights, their likely effect (in Kaplan's courtroom at least) will be to temper the government's treatment of business entities whose activities are under review. Moreover, unless a federal appeals court overturns Judge Kaplan's rulings, it's a safe bet that other federal courts will consider the judge's reasoning in cases filed throughout the country.

What's the larger picture here? In this post-Enron era of heightened scrutiny of Wall Street, the pendulum might be swinging to a more measured approach. That seems to be the trend, of which the Kaplan decisions are a part.

As another example, an unprecedented coalition of lawyers, business leaders and civil libertarians recently convinced the U.S. Sentencing Commission to eliminate any suggestion in federal sentencing guidelines that corporations could receive lighter penalties by waiving the protection of the attorney-client privilege. Unless Congress disapproves the commission's action, which is unlikely, it will take effect in November.

No honest investor approves of corporate wrongdoing in any form. Whenever appropriate, the government must require business entities — and the executives who manage them — to account for their conduct. But investigators must treat such entities and individuals with the same degree of fairness as we would expect to occur in other areas.

For the past year some observers have been predicting that the federal judiciary would have to intervene if the government overreached in policing the marketplace. The courts now appear to be doing just that.

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