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# Between Scylla and Charybdis: Ethical Dilemmas of Corporate Counsel in the World of the Holder Memorandum

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## 2009 Tabor Lecture

### **BETWEEN SCYLLA AND CHARYBDIS: ETHICAL DILEMMAS OF CORPORATE COUNSEL IN THE WORLD OF THE HOLDER MEMORANDUM**

**John Hasnas\***

In Homer's *Odyssey*, the Strait of Messina is beset by two fearsome sea monsters. On one side resides Scylla, a creature with twelve feet and six heads on long, snaky necks, each possessing three rows of razor sharp teeth, who devours whatever comes within her reach. A bowshot away on the other side, resides Charybdis, a creature who drinks down and belches forth the waters of the strait three times a day, creating whirlpools that are fatal to shipping. On his voyage home, Odysseus attempts to sail through the narrow strait, avoiding both the slavering jaws of Scylla and the whirlpools of Charybdis. He is unable to do so successfully.

This Lecture suggests that in the contemporary legal environment, corporate counsel as well as outside counsel who represent corporations<sup>1</sup> frequently find themselves in a situation analogous to that of Odysseus. The legal standard of corporate criminal liability coupled with current federal law enforcement policy can force attorneys who represent corporations to sail a vanishingly narrow strait between their professional obligation to represent their clients zealously within the bounds of the law and their personal moral obligations to deal with corporate employees honestly and justly.

Professional ethics concerns both the ethical obligations of individual actors within a system and the ethical quality of the system as a whole.

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<sup>1</sup> For purposes of concision and convenience, I will employ the term "corporation" to refer not merely to businesses that have gone through the formal process of incorporation, but to business organizations generally, regardless of their legal form. My remarks apply to counsel representing partnerships and other unincorporated business organizations as well as those representing corporations.

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When the focus is on the behavior of individual professionals, the inquiry addresses questions such as: What obligations do individual attorneys, physicians, clergymen, accountants, etc. take on when they assume their professional roles? What are and how do we determine the contours of these obligations? How can we demonstrate that they are genuine ethical obligations? When the focus is on the functioning of the system as a whole, however, the inquiry addresses questions such as: If all of the individual actors meet their professional obligations, will the result be good for society as a whole? Does the system function in a way that works an injustice or unreasonable hardship on any individuals or on particular segments of the community?

The questions associated with these two lines of inquiry are distinct, but related. If the system is ethically well-grounded, the individual professionals can feel confident that they are “doing the right thing” in a larger, societal sense by fulfilling their professional obligations under their profession’s codes of ethics. On the other hand, if there are questions about the ethical quality of the system as a whole, individual professionals will be able to repose less trust in their profession’s codes of ethics and will be more open to doubt about whether to adhere to their professional obligations in difficult cases.

An ideal system is one in which the collective goals of the system and the obligations and incentives of the individual professionals are aligned. Such a system is one in which individual professionals advance the well-being of society by meeting their professional obligations. Unfortunately, in the context of corporate criminal responsibility, the overarching goals of our adversarial system of justice and the obligations of individual attorneys under the Canon of Ethics are not well-aligned. This misalignment stands in sharp contrast to the situation that ordinarily obtains. For, when attorneys represent individual clients, the goals of our system of justice and the professional obligations of individual attorneys are mutually reinforcing.

Under the Canon of Ethics, attorneys assume a fiduciary obligation to their clients. They undertake to keep their clients’ communications confidential<sup>2</sup> and to zealously represent their clients’ interests<sup>3</sup> to the exclusion of the interests of both other individuals and society as a whole. Attorneys may depart from this fiduciary relationship only in a small and definitely identified class of exceptional cases.

It is easy to explain why individual attorneys are ethically bound to act in accordance with these undertakings. The duty arises from each attorney’s own freely given promise coupled with the basic ethical

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<sup>2</sup> MODEL CODE OF PROF’L RESPONSIBILITY EC 4-1 (1983).

<sup>3</sup> *Id.* at 7-1.

obligation to keep one's word. Clients are willing to confide in their attorneys and to pay them for their services because attorneys promise confidentiality and fiduciary representation. For an attorney to make such a promise, obtain information on the basis of the client's reliance upon it, and then use the information to serve any interest other than the client's would be the ethical equivalent of fraud.

Does requiring attorneys to maintain the obligations of confidentiality and exclusive representation serve the interests of the larger society as well? In an adversarial system of justice, when the client is an individual, the answer is yes.

Law is concerned with interpersonal human conflict. Human beings have both limited knowledge and limited ability to distance themselves from their own goals. Hence, we are aware that we do not have access to objective truth. As illustrated by the famous Akira Kurosawa movie, *Rashomon*,<sup>4</sup> we know that our perceptions of reality are affected by our interests. The foundation of the adversarial system of justice is the belief that letting each party tell his or her story to an impartial decision-maker will get as close to the truth as is humanly possible. This belief is justified, however, only if all parties are able to tell their story effectively. This, in turn, implies that for the system to work, all parties to a legal dispute need access to a skilled advocate who can make sure that their side of the story is adequately presented. For such an advocate to be able to perform his or her function effectively, the advocate needs the client's full confidence—the client's willingness to relate all the details of the case no matter how unfavorable, embarrassing, or threatening to the client's future interests they may be. Only one who undertakes a fiduciary obligation to the client and guarantees to preserve the client's confidential communications can generate this level of confidence. Thus, supplying each potential litigant with an expert representative who has undertaken the obligations described in the Canon is necessary to make the system function as designed.

The idea underlying an adversarial system of justice is that individuals pursuing their own interests within a properly structured system will produce the optimal outcome for society. The clash of well-represented opposing parties will burn away falsehood and biased judgment to reveal the truth and produce a just result. This is an invisible-hand mechanism. When the system properly aligns the incentives of the litigants with the goals of justice, the individual litigants, each thinking only of his or her own advantage, are led as if by an invisible hand to produce just outcomes.

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<sup>4</sup> For those of us who do not like reading subtitles, the Hollywood-Paul Newman version of the film, *THE OUTRAGE* (MGM (Warner) 1964), will do.

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The invisible hand is usually associated with Adam Smith's description of a market in *The Wealth of Nations*.<sup>5</sup> Smith argued that when individuals pursue self-interest within the incentives of a free, competitive market, the common good is more effectively achieved than it would be if each actor was striving to realize it him- or herself. The reason for this is that the combination of the limitations on human knowledge that make it impossible for us to take all consequences of our actions into account and our ineradicable prejudices and partiality make it difficult to achieve the common good directly. Precisely the same type of argument undergirds our system of justice. The limitations on human beings' knowledge and impartiality means that we are more likely to produce justice when we do not aim at it directly, but allow it to emerge from a process that tends to cancel out errors and prejudices.

There are many grounds on which this argument for the adversarial system may be criticized. Evaluating such criticisms would take us well beyond the scope of this Lecture, however. For present purposes, I will simply assert that, by and large, I believe the argument to be a good one, and hence, I am supportive of an adversarial system of justice. Within such a system, attorneys can feel confident that by adhering to their professional obligations to their clients, they are also benefitting society as a whole. And the importance of this confidence cannot be gainsaid. For, it is crucially necessary to help attorneys weather the criticism and scorn they receive when they represent unpopular clients.

My confidence that there is a proper alignment between the goal of justice and the professional obligations of attorneys is limited to those

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<sup>5</sup> ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 356 (R.H. Campbell & A.S. Skinner eds., Liberty Classics 1981). Smith states:

As every individual, therefore, endeavours as much as he can both to employ his capital in the support of domestick industry, and so to direct that industry that its produce may be of the greatest value; every individual necessarily labours to render the annual revenue of the society as great as he can. He generally, indeed, neither intends to promote the publick interest, nor knows how much he is promoting it. By preferring the support of domestick to that of foreign industry, he intends only his own security; and by directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention. Nor is it always the worse for the society that it was no part of it. By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it. I have never known much good done by those who affected to trade for the publick good. It is an affectation, indeed, not very common among merchants, and very few words need be employed in dissuading them from it.

*Id.*

cases in which the client is an individual, however. I am much less sanguine about the situation when the client is a corporate entity. Under present federal criminal law and law enforcement policy, an attorney representing a corporation has reason to doubt whether the zealous representation of his or her client really serves the ends of justice—whether he or she is doing the right thing by adhering to his or her professional obligation. This doubt does not arise from any flaw inherent in the adversarial system of justice, but from perverse incentives introduced into the justice system by a misguided Supreme Court decision and the actions of our present Attorney General during his previous tenure with the Department of Justice.

The misguided Supreme Court decision is the 1909 case of *New York Central & Hudson River R.R. Co. v. United States*.<sup>6</sup> In that case, the Court held that corporations could be criminally convicted for the crimes of their employees under a respondeat superior theory of liability. This means that a corporation is guilty of the crimes committed by any of its employees acting within the scope of their employment for the benefit of the corporation.

Why do I call this decision misguided? Consider the following. If corporate employees violate the criminal law while working within the scope of their employment, they may be prosecuted as individuals. This is perfectly sensible. Working within a corporation does not insulate one from the consequences of his or her wrongdoing. Under *New York Central*, if corporate employees violate the criminal law while working within the scope of their employment, their corporation may be prosecuted as well. Why?

The justification for respondeat superior liability in tort is not available. Employees are often judgment-proof, and hence cannot be deterred from engaging in risky activity that they believe will earn them rewards from their employer by the threat of civil liability. Respondeat superior tort liability creates an incentive for employers to deter such conduct by their employees. But this justification does not apply in the criminal context because no employee is criminally “judgment-proof.” All are subject to the threat of criminal punishment for criminal activity. Further, in *New York Central*, the Court itself recognized that the justification for respondeat superior tort liability is the need to do corrective justice. The Court stated that such liability

is not imputed because the principal actually participates in the malice or fraud, but because the act is done for the benefit of the principal, while the agent is

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<sup>6</sup> 212 U.S. 481 (1909).

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acting within the scope of his employment in the business of the principal, and “justice requires that the latter shall be held responsible for damages to the individual who has suffered by such conduct.”<sup>7</sup>

Indeed, it is a commonplace in tort that corrective justice may require one who is without personal fault but who has caused or benefitted from an injury to an innocent party to pay compensation to restore the injured party to his or her previous condition. But this is irrelevant to criminal liability in which corrective justice is not at issue. What is needed in the context of the criminal law is a justification for punishment, not restitution.

Ethicists often grapple with the question of whether corporations as opposed to individuals can be held morally responsible for actions. Many argue that they cannot.<sup>8</sup> Some argue that they can.<sup>9</sup> Among the latter, some argue that corporations are morally responsible for corporate policy—for the output of the corporation’s internal decision structure.<sup>10</sup> Others contend that corporations are morally responsible for the actions of their employees when they maintain a corporate culture that encourages wrongdoing.<sup>11</sup> But none have argued that corporations are morally responsible for the crimes of their employees when they have done everything in their power to prevent such wrongdoing and maintain an ethical corporate culture.

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<sup>7</sup> *Id.* at 493 (emphasis added).

<sup>8</sup> See, e.g., JOHN R. DANLEY, *Corporate Moral Agency: The Case for Anthropological Bigotry*, in BUSINESS ETHICS 202 (W. Michael Hoffman & Jennifer Mills Moore eds., 2d ed. 1990); JOHN LADD, *Persons and Responsibility: Ethical Concepts and Impertinent Analyses*, in SHAME, RESPONSIBILITY, AND THE CORPORATION 77 (Hugh Curtler ed., 1986); Michael Keely, *Organizations as Non-persons*, 15 J. VALUE INQUIRY 149 (1979); Larry May, *Vicarious Agency and Corporate Responsibility*, 43 PHIL. STUD. 69 (1983); Manuel Velasquez, *Debunking Corporate Moral Responsibility*, 13 BUS. ETHICS Q. 531 (2003).

<sup>9</sup> See THOMAS DONALDSON, CORPORATIONS AND MORALITY 30 (Prentice-Hall 1982); PATRICIA H. WERHANE, PERSONS, RIGHTS, AND CORPORATIONS 59 (Prentice-Hall 1985); Peter A. French, *The Corporation as a Moral Person*, 16 AM. PHIL. Q. 207, 211 (1979); Michael J. Phillips, *Corporate Moral Personhood and Three Conceptions of the Corporation*, 2 BUS. ETHICS Q. 435, 453 (1992). See also David T. Ozar, *The Moral Responsibility of Corporations*, in ETHICAL ISSUES IN BUSINESS: A PHILOSOPHICAL APPROACH 294 (Thomas Donaldson & Patricia Werhane eds., 1979); Kenneth E. Goodpaster & John B. Mathews, Jr., *Can a Corporation Have a Conscience?* 60 HARV. BUS. REV. 132, 135 (1982); Robert J. Rafalko, *Corporate Punishment: A Proposal*, 8 J. BUS. ETHICS 917, 924 (1989).

<sup>10</sup> See French, *supra* note 9, at 211.

<sup>11</sup> See, e.g., Pamela Bucy, *Corporate Ethos: A Standard for Imposing Corporate Criminal Liability*, 75 MINN. L. REV. 1095, 1103-05 (1991); Ann Foerschler, *Corporate Criminal Intent: Toward a Better Understanding of Corporate Misconduct*, 78 CAL. L. REV. 1287, 1287-88 (1990); Jennifer Moore, *Corporate Culpability Under the Federal Sentencing Guidelines*, 34 ARIZ. L. REV. 743, 767-73 (1992).

Yet, the respondeat superior liability authorized by *New York Central* holds corporations criminally liable for the actions of their employees taken within the scope of their employment no matter what. Under *New York Central*, the corporation is liable even if the employee's conduct is against corporate policy and contravenes the employee's explicit instructions.<sup>12</sup> Under *New York Central*, the corporation is liable even if the corporation has the most pristine corporate culture and has undertaken the most vigorous efforts to prevent employee wrongdoing. Under *New York Central*, the corporation is *strictly* liable for the crimes of its employees.

But *New York Central* is not misguided merely as a matter of *moral* responsibility. The decision also cannot be justified as a matter of *criminal* responsibility. The purpose of the criminal law is punishment. But vicarious corporate criminal liability serves none of the purposes of punishment.

To see why, please note that corporations are subject only to financial sanctions. Because corporations have no bodies, they cannot be incarcerated. They may be fined, which constitutes the direct application of a financial penalty. They may have licenses revoked or otherwise have their freedom to transact business restricted, but such measures merely constitute the indirect application of a financial penalty—they are punitive only to the extent that they reduce the corporation's profitability. They may be liquidated, which can be thought of as a corporate death sentence. But because corporations are not literally living things, any "execution" is entirely metaphorical. Liquidation is to be feared only because of the financial losses that result from it.

Who pays when a financial loss is imposed upon a corporation? To the extent that such a loss cannot be passed along to consumers, it is the owners of the corporation, the shareholders, who incur the penalty. The defining characteristic of modern corporation is the separation of ownership and control. The shareholders, who own the corporation, have no direct control over or knowledge of the behavior of the corporate employees who commit criminal offenses. Hence, inflicting punishment on a corporation's shareholders is punishing those who are personally innocent of wrongdoing for the offenses of others.<sup>13</sup> How can

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<sup>12</sup> *New York Central & Hudson River R.R. Co. v. United States*, 212 U.S. 481, 493 (1909); *United States v. Hilton Hotels Corp.*, 467 F.2d 1000, 1007 (9th Cir. 1972).

<sup>13</sup> My arguments are intended to apply to business organizations generally, not merely to those that have undergone the formal process of incorporation. Hence, with regard to incorporated business organizations, this point must be adapted to the relevant organizational form. For example, in the case of limited partnerships, the issue would concern punishing the firm's innocent limited partners rather than innocent shareholders. In this regard, it must be admitted that in those business organizations in which there is

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punishing the innocent advance any of the legitimate purposes of punishment?

It cannot. Consider retribution first. Retribution justifies imposing sanctions only on those who have acted in a blameworthy way. Retribution clearly justifies punishing corporate employees who commit a criminal offense. It cannot justify punishing corporate shareholders who are innocent of personal wrongdoing. A criminal justice system based exclusively on a retributivist theory of punishment would expressly exclude such vicarious criminal liability.

What about deterrence? All but the staunchest retributivists would argue that a major purpose of criminal punishment is to deter wrongdoing. But not by any means. Specifically, not by punishing the innocent. In the Anglo-American criminal justice system, deterrence refers to inflicting punishment on a *wrongdoer* to discourage others from committing similar offenses. It does not refer to punishing the innocent to pressure them into suppressing the criminal activity of their fellow citizens.

There is a sense in which threatening to inflict punishment on a corporation's innocent owners for the crimes of the corporation's employees can be said to deter crime. Fear of the financial penalty to be visited on the corporation can motivate management to attempt to suppress criminal activity by corporate employees. But this form of deterrence is no different in principle from more venial and obviously unacceptable forms of punishment. Much of the crime attributable to teenagers could undoubtedly be deterred by punishing parents for their children's offenses. The Nazis sought to deter acts of resistance by punishing innocent members of the communities in which such acts occurred. Although such measures may be effective, they generally are not and should not be permitted in a liberal criminal justice system. Threatening innocent shareholders with punishment for the offenses of culpable corporate employees may be an effective means of reducing criminal activity within business organizations, but it does not constitute the type of deterrence that can justify criminal punishment in a liberal legal regime.

Punishment is sometimes justified on the basis of its rehabilitative effect. But rehabilitation refers to imposing treatment on a wrongdoer designed to reform his or her character to ensure better behavior in the future. One cannot rehabilitate the innocent. Threatening those who

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true shared control among all parties—e.g., certain general partnerships—there may be no question of punishing the innocent because all parties are personally culpable. However, in such cases, punishing the firm as a corporate entity would be pointless because all members of the firm would be subject to conviction as individuals.

have not engaged in wrongful conduct with punishment in order to make them “behave better” is not rehabilitation. It is coercing them to act in the way that the coercive agent believes that they should. “Rehabilitating” the innocent is simply depriving them of their liberty.

There is no doubt that the threat of corporate criminal liability can influence managers to adopt legal compliance programs and to otherwise try to produce a corporate environment that discourages criminal activity by its employees. But such governmental action is not rehabilitation, and as a matter of principle, it is not distinct from the practices of the old Soviet Union and Mao’s China in which those whose conduct was unacceptable to the government were sent to psychiatric hospitals and “re-education” camps. Threatening innocent shareholders with punishment for the offenses of culpable corporate employees may be an effective means of producing a general improvement in “corporate culture,” but it is not a form of rehabilitation that can justify criminal punishment in a liberal legal regime.

Now, consider the practical effect of the *New York Central* standard of corporate criminal liability. Under *New York Central’s* respondeat superior liability, there is nothing a corporation can do to ensure that it is not guilty of a criminal offense. Corporate counsel know that no matter how good their firm’s internal controls, they cannot guarantee either that there will be no intentional violations of law by rogue employees or that, in today’s highly-regulated business environment where many offenses do not require intentional conduct, there will be no inadvertent violations of law. Corporate counsel also know that because under the *New York Central* standard the corporation’s good behavior is no defense, the corporation can be convicted whenever such violations occur. Further, as illustrated by the fate of Arthur Andersen, criminal indictment can be a corporate death sentence. Any company dependent upon its reputation for honest dealing or government contracting from which it can be debarred must avoid indictment at all costs. Therefore, the financial health and frequently the continued existence of the corporation can rest on whether the corporation is indicted.

This brings us to the second element of the problem—the policy of the Department of Justice (DOJ) governing the criminal indictment of corporations. This policy is contained in a memorandum originally drafted by Attorney General Eric Holder when he was Deputy Attorney General during the Clinton Administration.<sup>14</sup> It has been revised and

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<sup>14</sup> See Memorandum from Deputy Att’y Gen. Eric H. Holder, Jr., to Heads of Dep’t Components & United States Att’ys, *Principles of Federal Prosecution of Business Organizations* (June 16, 1999).

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reissued several times being called respectively, the Holder, Thompson,<sup>15</sup> McNulty,<sup>16</sup> and Filip Memorandum.<sup>17</sup> Now that Attorney General Holder has returned to the DOJ, I will refer to the memorandum by its original designation as the Holder Memorandum. The Holder Memorandum lists the factors prosecutors are instructed to consider in deciding whether to indict a corporation. These factors include whether the corporation has an effective compliance program<sup>18</sup> and whether the corporation cooperates with the investigation of its employees' wrongdoing.<sup>19</sup>

What makes a compliance program an effective one? It must be "adequately designed for maximum effectiveness in preventing and detecting wrongdoing by employees," a characteristic that depends in part on seriousness of the program's "disciplinary action against past violators" and the "promptness of any disclosure of wrongdoing to the government."<sup>20</sup>

What constitutes cooperation? As recently as three years ago, cooperation was defined in terms of "the corporation's willingness to identify the culprits within the corporation, including senior executives; to make witnesses available; to disclose the complete results of its internal investigation; and to waive attorney-client and work product protection,"<sup>21</sup> and its refusal to support employees under investigation "either through the 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

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<sup>15</sup> Memorandum from Deputy Att'y Gen. Larry Thompson, to Heads of Dep't Components & United States Att'ys, *Principles of Federal Prosecution of Business Organizations* (Jan. 20, 2003) [herein after Thompson Memo].

<sup>16</sup> Memorandum from Deputy Att'y Gen. Paul J. McNulty, to Heads of Dep't Components & United States Att'ys *Principles of Federal Prosecution of Business Organizations* (Dec. 16, 2006) available at [http://www.usdoj.gov/dag/speeches/2006/mcnulty\\_memo.pdf](http://www.usdoj.gov/dag/speeches/2006/mcnulty_memo.pdf).

<sup>17</sup> Memorandum from Deputy Att'y Gen. Mark R. Filip, to Heads of Dep't Components & United States Att'ys, *Principles of Federal Prosecution of Business Organizations* (Aug. 28, 2008) available at <http://www.justice.gov/dag/readingroom/dag-memo-08282008.pdf> [hereinafter Filip Memo].

<sup>18</sup> The memorandum instructs prosecutors to consider "the existence and effectiveness of the corporation's pre-existing compliance program" and "the corporation's remedial actions, including any efforts to implement an effective corporate compliance program or to improve an existing one[.]" *Id.* at 4.

<sup>19</sup> The Memorandum instructs prosecutors to consider "the corporation's timely and voluntary disclosure of wrongdoing and its willingness to cooperate in the investigation of its agents," and "to replace responsible management, to discipline or terminate wrongdoers, to pay restitution, and to cooperate with the relevant government agencies." *Id.*

<sup>20</sup> *Id.* at 15.

<sup>21</sup> Thompson Memo, *supra* note 15, at 5.

pursuant to a joint defense agreement.”<sup>22</sup> However, due to the uproar over forced waivers of attorney-client and work product privilege and a finding that coercing a corporation into refusing to pay its employees’ attorney’s fees constituted a violation of the Sixth Amendment,<sup>23</sup> the DOJ now defines cooperation as “the corporation’s willingness to provide relevant information and evidence and identify relevant actors within and outside the corporation, including senior executives.”<sup>24</sup> This includes turning over the factual results of all internal investigations and a refusal to aid suspected employees in mounting a defense.

The effect of the *New York Central* standard of corporate liability coupled with incentives in the Holder Memorandum is to place corporations and their employees in an adversarial relationship. As should be apparent from the way the DOJ defines compliance programs and cooperation, the only way for a corporation to reduce its prospects of being indicted when an employee comes under investigation for possible criminal activity is to sign on as a deputy prosecutorial agent. This state of affairs creates a considerable divergence between what is good for the corporation and what is good for its employees.

Let’s consider several examples, beginning with the question of employee privacy. Do employees have any right to privacy in the workplace? They certainly do not possess anything like the right to privacy they have in their own homes. Employers are entitled to monitor employees’ conduct in the workplace to ensure they are capable of doing their jobs and are in fact doing them. It is reasonable to believe that employees waive their right to privacy with regard to employment-related matters when they enter into the employment relationship. However, merely accepting employment does not give employers *carte blanche* to investigate non-job-related aspects of their employees’ lives. Doing so not only violates employees’ residual right to privacy, but, to the extent that the employees are aware that their activities may be monitored at all times, creates an oppressive working environment.

To reduce its chances of being indicted should employees come under investigation, a corporation must have an effective compliance program that is “adequately designed for maximum effectiveness in preventing and detecting wrongdoing by employees . . . .”<sup>25</sup> Yet, white collar crime almost always consists of crimes of deception. Such crimes are necessarily designed to be indistinguishable from legal behavior. What level of monitoring would be required for the corporation’s

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<sup>22</sup> *Id.* at 6 (footnote omitted).

<sup>23</sup> *See* *United States v. Stein*, 541 F.3d 130 (2d Cir. 2008).

<sup>24</sup> *Filip Memo*, *supra* note 17, at 7.

<sup>25</sup> *Id.* at 15.

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compliance program to be maximally effective in preventing and detecting such disguised wrongdoing? By necessity, the level of monitoring would have to be more intrusive than that required merely to monitor job performance. How much more intrusive? There is no clear answer to this question, but recent developments may provide some insight. For example, Deloitte and Touche LLP markets a service preparing psychological profiles of employees to aid corporations in detecting those more likely to commit fraud,<sup>26</sup> and Wal-Mart has hired former FBI, CIA, and DOJ officials to conduct internal investigations of its employees.<sup>27</sup> Such developments suggest that meeting the DOJ's definition of an effective compliance program is largely incompatible with maintaining proper respect for employees' right to privacy.

Next, consider the question of confidentiality. To run an ethical business, managers have to know what is going on in the firm. Most businesses attempt to acquire information of potential wrongdoing by promising employees who come forward confidentiality. Such promises of confidentiality usually come in one of two forms. First, corporations create confidential lines of communication that circumvent the ordinary corporate chain of command, such as employee hotlines or organizational ombudsmen. Second, corporations encourage their employees to provide information to corporate counsel under the protection of the attorney-client privilege. But what happens when these confidential channels generate information that suggests possible criminal activity within the firm? In order to reduce its risk of corporate indictment, the corporation must cooperate with government investigations. Cooperation requires the corporation to provide the government with "the facts known to the corporation about the putative criminal misconduct under review."<sup>28</sup> Although since 2008, the DOJ will no longer request waiver of attorney-client or work-product privilege,<sup>29</sup> it still requires corporations to disclose the facts generated by the corporation's internal investigations, whether made to corporate counsel, employee hotline, or corporate ombudsman. As a result, the corporation must choose between protecting itself against indictment and honoring its promise of confidentiality.

One might assume that an ethical corporation can avoid this dilemma by refusing to make promises of confidentiality that it knows it

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<sup>26</sup> See Karen Richardson, *Find the Bad Employee: A Tool Can Do It, Privacy Issues Aside*, WALL ST. J., Feb. 1, 2006, at C3.

<sup>27</sup> See Michael Barbaro, *Bare-Knuckle Enforcement for Wal-Mart's Rules*, N.Y. TIMES, March 29, 2007, at A1.

<sup>28</sup> Filip Memo, *supra* note 17, at 9.

<sup>29</sup> *Id.*

will later have to breach. But that will not work. The maintenance of a confidential mechanism for reporting possible criminal conduct is the hallmark of an effective compliance program.<sup>30</sup> Failure to promise confidentiality essentially guarantees that a corporation's compliance program will not be considered an effective one. Hence, corporations have the strongest possible incentives to both make and breach promises of confidentiality.

Now consider the question of organizational justice. Do corporations have any ethical obligations to support their employees who come under suspicion of criminal wrongdoing? Perhaps not, if they know that their employees knowingly and intentionally violated the law. But what if the corporation does not know this? Don't loyal employees who come under suspicion have some claim to fair treatment by their employer? Aren't they entitled to a minimal presumption of innocence in the sense that no adverse action be taken against them in the absence of adequate evidence of wrongdoing? But to be considered cooperative by the DOJ, corporations must essentially sign on as deputy prosecutors. Helping those employees, who the DOJ considers culpable, to mount a defense; refusing to sanction employees who elect not to speak to prosecutors; providing employees with information about what the government is investigating; and entering into joint defense agreements with employees that may disable the corporation from "providing some relevant facts to the government"<sup>31</sup> may all be regarded by the DOJ as "limiting [the corporation's] ability to seek . . . cooperation credit."<sup>32</sup> How can managers afford their employees even a modicum of due process while threatening them with termination if they refuse to cooperate with prosecutors and doing everything in their power to aid in their prosecution? Given the DOJ's definition of cooperation, corporations' best chances of avoiding indictment directly conflict with any duty they may have to protect their employees against potentially ungrounded criminal accusations.

The poster child for this problem is the recent KPMG LLP case. Between 1996 and 2003, KPMG marketed several tax shelters designed to allow wealthy investors to avoid federal taxes. In July, 2001, the Internal Revenue Service "listed" two of these tax shelters, putting taxpayers on notice that the IRS considers them suspect and subject to challenge in tax

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<sup>30</sup> Indeed, in the Sarbanes-Oxley Act, Congress required publicly traded companies to establish procedures for "the confidential, anonymous submission by employees of the issuer of concerns regarding questionable accounting or auditing matters." Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 301, 116 Stat. 745, 776 (2002) (emphasis added).

<sup>31</sup> Filip Memo, *supra* note 17, at 13.

<sup>32</sup> *Id.*

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court. The IRS did not, in fact, challenge any of KPMG's shelters in court. Hence, whether the shelters are legal or not has never been officially determined. In 2003, Congress began an investigation of potentially abusive tax shelters including those marketed by KPMG. KPMG defended the marketing of its shelters before Congress, sending one of its partners to testify as to their legality. Subsequently, the DOJ opened a criminal investigation into KPMG's marketing of the shelters.

In response to the DOJ investigation, KPMG took the following measures. It agreed not to assert any legal privilege including its attorney-client and work product privileges and to disclose all information in its possession regarding the actions of its present and former partners, agents, and employees that the government deemed relevant. It agreed to identify any witnesses that may have information relevant to the investigation and to use its best efforts to induce its present and former partners and employees to provide information and testimony to the government. It refused to advance the legal fees of any partner or employee who refused to cooperate with federal investigators.<sup>33</sup> It refused to enter into any joint defense agreements with any of its present or former partners or employees. It agreed to inform the government which documents its partners and employees were requesting to prepare their defenses. It refused to inform its partners and employees of the documents it was supplying to the government to aid in their prosecution. It placed on leave, reassigned, or forced the resignation of many of its tax partners. It officially stated that a number of its tax partners engaged in unlawful fraudulent conduct and agreed not to make any statement, in litigation or otherwise, that is inconsistent with that assertion or to retain any employee who makes such a statement.<sup>34</sup> And it agreed to pay a \$456,000,000 fine.<sup>35</sup> KPMG took

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<sup>33</sup> This was in conformity with the provision in the Thompson Memorandum (the predecessor of the McNulty and Filip Memoranda) that permitted prosecutors to consider the payment of such fees as a lack of cooperation. The currently operative Filip memorandum does not permit such consideration.

<sup>34</sup> The latter had the practical effect of threatening any KPMG employ who testifies for the defendants with termination, significantly undermining the defendants' ability to mount a defense.

<sup>35</sup> The facts of this account of the KPMG case are taken from David N. Kelley, U.S. Attorney for the Southern District of New York, Deferred Prosecution Agreement (Re: KPMG) (Aug. 26, 2005), available at <http://www.justice.gov/usao/nys/pressreleases/August05/kpmgdpagmt.pdf>; Press Release, Internal Revenue Service, KPMG to Pay \$456 Million for Criminal Violations (Aug. 29, 2005), available at <http://www.irs.gov/newsroom/article/0,,id=146999,00.html>; Laurie P. Cohen, *In the Crossfire: Prosecutor's Tough New Tactics Turn Firms Against Employees*, WALL ST. J., June 4, 2004, at A1; Editorial, *KPMG in Wonderland*, WALL ST. J., Oct. 6, 2005, at A14; Leonard Post, *Deferred Prosecution Deal Raises Objections*, NAT'L. L. J., Jan. 30, 2006 at 4.

these measures to avoid the type of federal indictment that destroyed Arthur Andersen, LLP.<sup>36</sup>

In this context, consider the professional obligations of attorneys representing corporate clients. Corporate counsel have a fiduciary duty to their client to zealously pursue its legal interests in preference to all others. But their client is the corporation. Therefore, they are obligated to do what is in the best interest of the corporate entity. In the context of criminal investigations, what is in the best interest of the corporation is, to use the current idiom, “to throw the employees under the bus.” Lawrence Thompson, who as Deputy Attorney General reissued the Holder Memorandum as the Thompson Memorandum, is now general counsel of PepsiCo. In a manner perfectly consistent with his authorship of the Thompson Memorandum, Thompson recently stated that to fulfill his duty to zealously represent his corporate client when it becomes the subject of a federal criminal investigation, his job would be to get the government off PepsiCo’s back as quickly and efficiently as possible—which means cooperating fully with prosecutors as a means to terminating the investigation.<sup>37</sup>

Now recall the questions that we must ask ourselves to evaluate the ethical quality of the adversarial system of justice as a whole. The first was: If all of the individual actors meet their obligations, will the result be good for society as a whole? In the case of attorneys representing corporations, there is no reason to believe this will be the case. The justification for maintaining a fiduciary relationship between attorneys and their clients was that in an adversarial system of justice, truth is best discovered by sifting the clashing accounts of opposing parties. But the *New York Central* standard of liability coupled with DOJ enforcement policy incentivizes corporations to be deputy prosecutorial agents. In effect, corporations are punished for presenting an account of events at odds with the prosecution’s, and rewarded for actions that make it more difficult for their individual employees to air their side of the story by putting on a defense. In circumstances in which the best interests of the corporation lies in suppressing rather than presenting an adversarial

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<sup>36</sup> Most of the indictments of KPMG employees were ultimately dismissed as entailing violations of the defendants’ Fifth and Sixth Amendments rights. *See United States v. Stein*, 541 F.3d 130 (2d Cir. 2008). The *Stein* decision is chiefly responsible for the DOJ dropping the requirements that corporations waive attorney-client privilege and refrain from advancing employees’ attorney’s fees to be considered cooperative in the 2006 McNulty and 2008 Filip Memoranda.

<sup>37</sup> Lawrence Thompson, Deputy Att’y Gen., Remarks at a Round Table Discussion at The Heritage Foundation, Following His Address on The Future of the Attorney-Client Relationship in White-Collar Prosecutions (Nov. 30, 2006).

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viewpoint, the fiduciary relationship to the client does not advance the truth-finding and justice-seeking goals of the justice system.

The second question was: does the system function in a way that works an injustice or unreasonable hardship on any individuals or on particular segments of the community? In the case of attorneys representing corporations, there is good reason to believe the answer to this question is yes. If attorneys representing corporations act as Lawrence Thompson recommends, there will be considerable injustice and hardship on any corporate employee suspected of a crime—think of the situation of a potentially innocent employee in KPMG’s tax department—and if compliance programs are oppressive enough, perhaps on employees in general.

The answers to these two questions suggest that there is a considerable misalignment between the professional obligations of attorneys representing corporations and the overarching goals of the justice system. As long as the incentives created by the *New York Central* standard of corporate criminal liability and the Holder Memorandum are operating, attorneys representing corporations who act in accordance with their professional obligations are not necessarily serving the interests of justice. With these perverse incentives in place, the invisible hand built into our system of justice will lead us astray.

Conversely, when attorneys representing corporations perceive that they are not necessarily “doing the right thing” in the larger, societal sense by conforming their behavior to their professional standards and code of ethics, their commitment to fulfilling their professional obligations will wane. Not all attorneys who represent corporations are as sanguine about the actions they are called on to perform as is Lawrence Thompson. Many feel highly conflicted about sacrificing the interests of the corporation’s employees to protect the corporate client. Corporate counsel frequently describe the personal anguish involved in giving the “Upjohn warning.”<sup>38</sup> This is the statement they make to corporate employees before interviewing them, informing them that anything the employees communicate is protected by attorney-client privilege, and noting that the client is the corporation. In giving this ethically required warning, corporate counsel know that most employees do not understand that they are being told that the corporation will reveal whatever the employees communicate whenever it is in the corporation’s interest to do so, no matter how damaging it may be to the employees. But to give the employees more than the ethically required

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<sup>38</sup> The name is derived from the case of *Upjohn v. United States*, 449 U.S. 383 (1981), in which the Supreme Court held that corporations are entitled to the protection of the attorney-client privilege.

notification—to explain that only the corporation *and not the employees* is protected by the attorney-client privilege—would dry up the sources of information corporate counsel need to protect the corporation’s interests. And it is the corporation’s interests that corporate counsel are obligated to zealously pursue.

Having identified the problem, I’m afraid I have no solutions to offer to attorneys who represent corporations. The ideal solution would be to eliminate vicarious corporate criminal liability. Doing so would instantly resolve the misalignment. However, this would require either a Supreme Court decision reversing a century-old precedent that serves as the basis of modern corporate criminal law enforcement or an Act of Congress that would be publicly perceived as going soft on corporate criminals. Neither of these constitutes a likely scenario. Another solution would be for Attorney General Holder to have an epiphany and change DOJ policy on corporate indictment to one focused on a corporation’s efforts to maintain an ethical corporate culture rather than its efforts to help convict its own employees. But given that the metric by which success is measured at the DOJ is one’s conviction rate, this is probably equally unlikely to happen.

In the absence of such radical reforms, attorneys who represent corporations are caught in a difficult situation. They are bound by their oaths to zealously represent their corporate clients. Yet in doing so, they may often be called on to treat the individual employees of the corporation unjustly and retard the effectiveness of the adversarial system of justice as a whole. Confronted with the task of navigating between violating their professional obligations on the one hand and being responsible for the unjust treatment of corporate employees on the other, attorneys who represent corporations may be well able to identify with Odysseus as he entered the Strait of Messina. Odysseus was unable to navigate the Strait unscathed. Apparently, neither can attorneys representing corporations.

Under such circumstances, what can an ethical attorney do? I’m afraid that I have nothing to offer to such an attorney other than, “the best you can.”