TRACE

Private Settlements, Public Concerns: Judicial Scrutiny of Deferred Prosecution Agreements

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Executive Summary

Deferred Prosecution Agreements ("DPAs") and Non-Prosecution Agreements ("NPAs") have become a mainstay of corporate criminal prosecutions over the past ten years. Under a DPA, the government brings formal charges against a defendant, but then refrains from prosecuting the company in exchange for the defendant's agreement to toll the statute of limitations, accept a statement of facts, pay restitution and penalties and undertake other compliance reforms. (An NPA is largely the same as a deferred prosecution agreement, except that the company is not formally charged with wrongdoing). The agreements usually last a few years during which time the company may have to employ an outside monitor to oversee its compliance and reform efforts.

Since 2000, the Department of Justice ("DOJ") has entered into hundreds of publicly disclosed DPAs or NPAs. Virtually all corporate cases involving violations under the Foreign Corrupt Practices Act ("FCPA"), for example, are settled through either a DPA or NPA. And yet despite their prevalence, DPAs remain intensely controversial. Some claim that they provide too much leniency to corporate wrongdoers, while others say just the opposite, that they are overly burdensome and prone to prosecutorial overreaching.

Out of this conflict has emerged a new role for federal judges, who previously did not involve themselves in alternative prosecutorial agreements between defendants and the US government. Of late, however, judges are beginning to take-on a larger oversight role to ensure the fairness of these agreements. This too has spurred disagreement, especially among those who view judicial scrutiny of DPAs as an infringement of a prosecutor's discretionary powers.

We at TRACE are keenly aware of how important DPAs and NPAs have been in the rise of FCPA enforcement over the last decade, which is why we have chosen to look back at that progression in light of recent developments. In this report, we focus on what role judges play in the approval of the terms and conditions of deferred prosecution agreements. For both government enforcers as well as the companies who are party to these agreements, increased judicial scrutiny of DPAs is likely to have significant impact on the negotiation process of corporate bribery investigations. And as DPAs become adopted elsewhere outside of the United States, this tension between government prosecutors and judges is likely to play out with recurring frequency.

Hundreds of controversial DPAs in recent years have resulted in a new oversight role for federal judges.

Background History

Deferred prosecution agreements originated in the United States about one hundred years ago, but only became more commonplace in the 1960s and 70s as the rise of the War on Drugs meant more convicted juveniles and clogged dockets. The increase in juvenile crime led prosecutors to turn to DPAs as an alternative form of punishment. Instead of convicting a minor of a felony, prosecutors could offer these young defendants conditional release based on rehabilitation, restitution and supervision.

It wasn't until the early 1990s, however, that the US government would offer a DPA to a corporation. In 1994, Prudential Securities, the financial services arm of the insurer Prudential Financial, was under investigation for engaging in securities fraud related to the sale of certain oil and gas partnerships. Then-United States Attorney for the Southern District of New York Mary Jo White hesitated from pursuing a formal prosecution against the company in light of the fact that an indictment would likely result in the loss of 18,000 jobs and harm investors. Instead, White decided to offer Prudential a deferred prosecution agreement: in return for full cooperation in the inquiry and admitting wrongdoing, the company could avoid trial.

A significant precedent was set by Prudential, but in the years that followed it was still unclear when the government would offer corporations DPAs as an alternative remedy in criminal cases. That trend began to change in 1999 when then-Deputy Attorney General Eric Holder released a memorandum titled "Federal Prosecution of Corporations" laying out eight factors to be used by government attorneys when deciding whether to prosecute a corporation. More change would come, inadvertently, in 2002 when the DOJ indicted accounting firm Arthur Anderson regarding its auditing of Enron. Anderson, which was charged with obstruction of justice for shredding documents during the investigation of the company, was quickly convicted and lost the right to audit any other public companies.

What the government hadn't accounted for was how devastating the collateral consequences of the Anderson conviction would be to the company. After 89 years in business, Anderson had to shut down and an estimated 75,000 people lost their jobs. Even after the Supreme Court unanimously reversed the decision three years later because of improper jury instructions, the damage was already irreversible. The fall of one of the "Big Five" accounting firms shook the confidence of the entire accounting industry, and the government was left to ponder whether the outcome had been worth it. "They clearly reassessed themselves after Arthur Andersen," reflected Mary Jo White, speaking in an interview she gave to Corporate Crime Reporter in 2005.[1] "The Justice Department realized in very concrete stark terms – do I really want these kinds of consequences. Are we really serving the public interest?"

After Anderson, the government released a second memorandum on corporate prosecutions, authored by then-Deputy Attorney General Larry D. Thomson, announcing that the government would focus on the defendant's cooperation in deciding whether to seek a conviction. More than anything, the "Thomson Memo" signaled a policy shift – that the government would now consider deferring prosecution to companies able to show cooperation in an investigation. Since release of the Thomson Memo in 2003, the DOJ's use of deferred prosecution agreements has become practically pro forma in corporate prosecutions.

1. *Corporate Crime Reporter*, Volume 19, *Interview with* Mary Jo White, Partner, Debevoise & Plimpton, New York, New York, 19.48.10, (December 12, 2005).

Continued Controversies

From the perspective of a company facing criminal prosecution, deferral agreements offer a welcome alternative to the corporate "death sentence" posed by an indictment, trial, and possible conviction. For the government, deferred prosecutions are equally attractive, presenting a speedier and less expensive resolution without sacrificing penalties and substantive compliance reforms by the company. Yet despite these advantages, DPAs have courted significant controversy over the last ten years.

Early on, corporate defense lawyers raised due process concerns regarding the fact that most DPAs required companies to waive their attorney-client privilege. Once a company waived the privilege, information revealed to in-house or outside counsel could be used down the road against individual employees or in a civil plaintiff suit. Companies were also often pressured to cut off legal fees for employees who were involved in related investigations. As one judge pointed out, these issues raised serious Fifth and Sixth Amendment rights issues for corporate defendants.[2]

These concerns led the DOJ in 2006 to release the "McNulty Memo," authored by then-Deputy Attorney General Paul McNulty. The memo made clear that privilege waivers and consideration of a corporation's advancement of attorney fees should only be used as a bargaining tool in extremely rare cases. In 2008, the DOJ released the "Filip Memorandum," which explicitly stated that prosecutors were prohibited from requesting privilege waivers or preventing legal fee advancements by companies to their employees.

Even so, concerns regarding the fairness of deferred prosecution agreements persisted. Among the most contentious issues has been the selection of corporate monitors, often a required condition for settlement. Not only can independent corporate monitors be disruptive to business, they are extremely expensive. In the past, prosecutors had complete discretion in selecting who the independent monitors would be, leading to calls of impropriety and favoritism. That issue came to a head in the aftermath of a deferred prosecution agreement between then-New Jersey U.S. Attorney Chris Christie and Zimmer Holdings, Inc., a medical device company alleged to have paid kickbacks to surgeons. As part of the settlement, Zimmer agreed to have former Attorney-General John Ashcroft (and Chris Christie's former boss) serve as the corporate monitor of the company. Public outrage boiled over when it was disclosed that Zimmer was asked to pay Mr. Ashcroft's firm approximately $52 million in legal fees for just 18 months of service.

In 2009, Bill Pascrell, Democratic Congressman from New Jersey, introduced The Accountability in Deferred Prosecution Act aimed at taking the selection of federal monitors out of the hands of U.S. Attorneys and imposing judicial oversight of deferred prosecution agreements. The bill required government prosecutors to file each and every deferred prosecution agreement in an appropriate United States district court, which would then have to approve the actual agreement between the parties. Although the bill never made it out of committee, the public hearings surrounding the bill were often colorful and politically heated, as Christie was then running for the office of New Jersey state governor and was forcefully questioned by members of Congress on improprieties in the Zimmer case.

The hearings drew national headlines to deferred prosecution agreements, causing many around the country who had never heard of them before to now question whether they were vulnerable to government abuse.

2. *United States v. Stein,* 435 F.Supp 2d 330, 362 (S.D.N.Y. 2006).

The Increased Role of Judges

What level of judicial involvement in deferred prosecution agreements is appropriate, if any, has also been a subject of growing debate over the last decade. As a pre-trial tool, DPAs are a manifestation of a US Attorney's discretionary power to decide whether and how to prosecute a defendant. Unlike a plea agreement however, where the court must accept the defendant's plea and inform them of their rights, DPAs are negotiated in private and are not governed by the Federal Rules of Criminal Procedure.[3] As such, it is said that DPAs reflect the prosecutor's inherent autonomy from the judiciary branch.

Procedurally, however, DPAs require at least some form of judicial participation, whether it be to implement one of the DPA's substantive provisions, such as a waiver of the indictment, or simply to file the agreement with the court. Traditionally, judges who were presented with DPAs accepted them almost as a matter of pure formality. These days, however, that no longer seems to be the case, and judges are taking on an increasingly activist role in deciding whether to approve the out-of-court agreements. As one federal judge in North Carolina cautioned the parties to a DPA this past January, "Why are you coming to court if you can do it all by yourself? If you are basically telling me you don't need me, I'm just window dressing, why are you coming to court?"[4] Another judge, defending his decision to question a DPA, reminded the parties that the court was not, as he put it, "a potted plant."[5]

Critics of DPAs have therefore long looked to judges to police their use. In an article written in October 2005, Benjamin M. Greenblum, now an attorney at the law firm of Williams & Connolly LLP, wrote that "[n]arrowly tailored but effective judicial involvement could curb prosecutorial overreaching, minimize the negative externalities of the corporate deferral process, and ensure that deferral achieves its purpose."[6]

On the other side of the political spectrum, one organization called "Occupy Wall Street - Alternative Banking Group" filed an amicus brief in 2011 in support of a court's decision to block a deferral agreement between the Securities and Exchange Commission ("SEC") and Citigroup Global Markets. Citigroup was accused of knowingly selling risky mortgage-backed securities in 2007, and Judge Jed S. Rakoff refused the SEC's DPA in part because of its failure to require Citigroup to "admit or deny" the charges against it. It was the first time a federal judge had ever halted a DPA. And although Citigroup's appeal is still before the Second Circuit, the SEC nonetheless revisited its prior policy and announced recently that certain companies would now be required to admit wrongdoing in cases of "egregious intentional conduct or widespread harm to investors."[7]

Other federal judges have since begun to follow Judge Rakoff's lead. Earlier this year, Judge Terrence Boyle halted an $8 million settlement agreement with WakeMed for false Medicare billing until the parties explained in writing why the DPA was in the public's interest. Judge Richard Leon of the D.C. Circuit Court has been particularly careful before agreeing to accept deferral agreements, waiting nine months before giving his approval for an FCPA-related settlement with Tyco International and almost two and a half years before finally approving another FCPA-related settlement with IBM. Other district court judges to have postponed settlement agreements include Judge Victor Marrero in New York and Judge John Kane in Colorado.[8]

3. *Cf.* Federal Rule of Criminal Procedure 11(c)(1)(A) and United States Sentencing Guidelines Section 6B1.2.
4. Transcript of Docket Call at 3, United States v. WakeMed, No. 5:12-CR-398-BO-1 (E.D.N.C. Jan. 17, 2013).
5. *U.S. v. HSBC Bank USA N.A., et al.,* No. 12 CR 763 (JG) (*"HSBC"*), slip op. at 6 (E.D.N.Y. July 1, 2013).
6. Greenblum, Benjamin, *What Happens to a Prosecution Deferred? Judicial Oversight of Corporate Deferred Prosecution Agreements,* 105 Colum. L. Rev. 1863, 1900 (October 2005).
7. Jean Eaglesham and Andrew Ackerman, "SEC Seeks Admissions of Fault," *Wall Street Journal* C1 (June 19, 2013).
8. See "Rakoff's revenge," *The Economist* (April 13, 2013).

What actual authority judges have to block the terms of DPAs is still up for debate though. The Citigroup decision currently pending before the Second Circuit may provide some clarity on the matter, although at least one other court has already published a ruling that provides precedent in favor of judicial interference in DPAs. The case involved a 2011 DPA between the DOJ and HSBC Bank USA ("HSBC"). As part of the agreement, HSBC admitted various anti-money laundering violations and agreed to forfeit $1.256 billion. The DOJ and HSBC filed the DPA in the Eastern District of New York, and requested that Judge John Gleeson defer the prosecution of HSBC under the Speedy Trial Act for the purpose of allowing HSBC to comply with the terms of the agreement. At a status conference in December 2012, however, Gleeson asked the parties to brief the court as to the adequacy of the DPA. In its response, HSBC argued that the only question before the court was the deferral under the Speedy Trial Act, not the agreement itself. Seven months later, Judge Glesson issued a ruling accepting the terms of the DPA, but noted that the court had "supervisory authority" to reject the DPA should it have wanted to.[9] Of special significance was the fact that the parties had chosen to file the DPA with the court. "[B]y placing the DPA on the Court's radar screen in the form of a pending criminal matter," writes Gleeson, "the parties have submitted to far more judicial authority than they claim exists."[10]

What Lies Ahead

The trend towards increased judicial scrutiny of settlements between government enforcement agencies and corporations is unlikely to abate any time soon. Parties to deferral agreements will always have to rely on the courts to enforce their agreements, meaning that tension will always exist between necessary deference to prosecutors and the need for judicial oversight. This tension is likely to affect the negotiation of DPAs, as both corporations and government agencies must now be cognizant of the fact that the terms in their agreements will have to be able to withstand a judge's watchful eye.

This new dynamic of judicial supervision may lead some corporate defendants to try to avoid deferred prosecution agreements altogether and seek out alternative out-of-court settlement options. One obvious alternative is a non-prosecution agreement. Because NPAs are maintained by the parties rather than being filed with a court, they are not subject to the same judicial oversight as DPAs. Traditionally, however, NPAs have only been reserved for companies that have shown exceptional cooperation during an investigation, such as those companies who have come forward voluntarily.[11] Given that courts have recently asserted themselves more actively in evaluating DPAs, it will be interesting to note whether the US government will now offer NPAs in more varied settlement situations.

A second alternative to DPAs are administrative proceedings. Rather than filing a case in federal court, government agencies may instead choose to bring actions before an administrative law judge. And although administrative law judges do not exercise full judicial powers, they can order penalties that substantially mirror regular federal sentencing guidelines. SEC administrative law judges, for example, can order disgorgement of ill-gotten gains, civil penalties, censures, and cease-and-desist orders against parties brought before them. This summer, Debevoise & Plimpton released a client alert noting that in 2011, four of the five FCPA cases that the SEC pursued alone, i.e. without a parallel criminal case being filed by the DOJ, were resolved through administrative actions.[12] Most recently, the SEC's $153 million

9. *Supra* note 5 at 6.
10. *Supra* note 5 at 13.
11. *See e.g., SEC Announces Non-Prosecution Agreement With Ralph Lauren Corporation Involving FCPA Misconduct,* SEC Press Release, (April 22, 2013) available at http://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171514780#.UjOHNsbkubU.
12. Debevoise & Plimpton FCPA Update Vol. 4, No. 12, p. 6 (July 2013), available at http://www.debevoise.com/files/Publication/3e511c8c-de2b-414d-91e1-f2efbf339f0a/Presentation/PublicationAttachment/0fe134c8-4fd1-4061-b22d-00bdc48bceb9/FCPA_Update_July_2013.pdf (hereinafter "Debevoise & Plimpton FCPA Update").

FCPA settlement with French company Total S.A. in July was resolved through an administrative proceeding. The Debevoise alert concludes that "[i]t would not be surprising to see a distinct trend toward use of administrative proceedings as the resolution method of choice for the SEC in the future, particularly as long as Article III federal judges…continue to express concerns about various features of SEC settlements[.]"[13]

The Global Perspective

While their use continues to be debated here in the United States, a new chapter for DPAs is now being written in the international arena. In April, the United Kingdom adopted the 2013 Crime and Courts Act, permitting UK prosecutors to use DPAs in dealing with corporate white collar offenses. In adopting DPAs, the hope is that more British corporations will self-report potential criminal wrongdoing while UK prosecutors will avoid the uncertainty, expense, complexity and length of full criminal trials. But although modeled after their US counterparts, UK DPAs are different in several important respects. Perhaps most notable is that the UK Act specifically incorporates judicial oversight into its design. Before the terms of the agreement are even finalized, there is a preliminary hearing before a judge where the prosecutor seeking a DPA must show the British court why the DPA is in the interests of justice and that the proposed terms are fair, reasonable and proportionate.[14] As envisioned, judges are meant to be intimately involved in the drafting process of DPAs.

A new chapter for DPAs is now being written in the international arena.

Steven W. Fleming of the law firm Jones Day has advocated for Australia to introduce DPA legislation similar to the UK's. "The introduction into Australian law of an equivalent DPA system together with transparent prosecutorial guidelines, would provide Australian companies with greater assurance as to both the process and outcome if they determine to self-report potentially corrupt conduct," writes Fleming.[15] If more countries follow the UK's lead, the new international norm for deferred prosecution agreements may be a tri-party negotiation process between corporate defendants, prosecutors and judges.

13. Debevoise & Plimpton FCPA Update, p. 7.
14. See "Deferred Prosecution Agreements: Crime and Courts Act 2013" *The Bribery Library* (May 1, 2013), available at http://www.briberylibrary.com/deferred-prosecution/deferred-prosecution-agreements-crime-and-courts-act-2013/.
15. Steven W. Fleming, "Time for Australia to introduce DPA legislation" (June 5, 2013), available at http://www.lexology.com/library/detail.aspx?g=0cc04a9b-3640-46da-91bb-c8e09b22dd79.

Conclusion

The use of DPAs in the corporate criminal context is a remarkably dynamic process. First introduced in 1994, DPAs are today the preferred method for prosecutors to address corporate criminal behavior. But because they are negotiated in private, many have criticized DPAs as improperly opaque or unfair. On the other hand, that they are negotiated out of the public eye is also a main reason that DPAs are so widespread, providing the government and corporate defendants the flexibility to resolve criminal disputes without risking the collateral consequences that might result from an open trial. Over time, their use has evolved to respond to these various criticisms, such as the independent selection of corporate monitors or no longer asking defendants to waive the attorney-client privilege.

That judges are now weighing-in on the propriety of deferred prosecution agreements has become a new reality for government prosecutors and corporate defendants, changing not only the way deferred prosecution agreements are negotiated, but whether they are entered into at all. As this trend continues, we should expect to see some turn to other alternative dispute methods to resolve allegations of criminal misbehavior, such as non-prosecution agreements or administrative proceedings. Even so, it is unlikely that DPAs will fall out of favor anytime soon, and they are probably still the best compromise solution to the "Arthur Anderson problem" of criminal convictions. For defense lawyers, however, it will become increasingly important, especially in high-publicity cases, to structure DPAs that are able to withstand judicial scrutiny. And as judicial oversight of DPAs becomes formalized in foreign jurisdictions, companies should expect this trend to only grow bigger for the foreseeable future.

About TRACE

TRACE provides an end-to-end, cost-effective and practical solution for anti-bribery and third party compliance for global organizations. The *TRACE Anti-Bribery Compliance Solution* offers multinational companies and their commercial intermediaries an unparalleled membership program, scalable and customizable training options and risk-based due diligence and advisory services. TRACE International is a non-profit membership organization that pools resources to provide members with anti-bribery compliance support while TRACE Incorporated offers both members and non-members customizable risk-based due diligence, in-person training and consulting services. With a shared mission to advance commercial transparency, TRACE International and TRACE Incorporated provide companies with one complete anti-bribery compliance solution.

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