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Deferred Prosecution Agreements: A Better Option Than Indictment?

The Editor interviews ***Bryan Blaney,*** *former Assistant U.S. Attorney in New Jersey and Partner in the litigation and white collar criminal defense practices of Norris McLaughlin & Marcus P.A.*

Editor: We've read and heard a lot about "deferred prosecutions agreements" entered by some corporations. What are they? Has their use come about because of new legislation?

Blaney: Certainly not new law. In fact, the practice has long been a part of the prosecutor's toolkit. Most often deferred prosecution agreements have been used by prosecutors to obviate criminal indictments against individuals when the government sought to obtain financial restitution and restrict conduct, but did not view imprisonment as a necessary penalty. In the federal system, the practice is known as Pre-Trial Diversion, "PTD." Many state prosecutors have also long used the same tool, if by a different name.

Editor: Can you briefly describe the process by which this tool is invoked?

Blaney: It's pretty straightforward. Perhaps the easiest way to think about it is that the company goes immediately on "probation" for its offenses. It is then obligated to meet specified terms and conditions of probation as if these terms had been imposed by the court upon conviction after a trial or entry of a plea agreement. Most often, those "probation" terms will include: (1) payment of financial restitution to identified victims; (2)

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the restriction, prohibition and/or modification of a specified activity – conformance with which will be supervised by a court-approved monitor. (This person could be a probation officer, but more often – in the instance of corporation defendants – the person is a private, independent monitor who has a background and expertise in the corporation's underlying business practices. That person is appointed subject to the prosecutor's approval, and paid by the corporation.); and (3) cooperation in any ongoing investigations (whether against other persons or other corporations) that are also being conducted by the government. If the corporation fails to meet the terms of its "probation," then it will be subject to an actual filing of a criminal indictment, the certainty – given the admissions that were most likely required from the corporation in order to obtain the deferred prosecution – that the indictment will result in a true criminal conviction, and also the certainty that the conviction will result in greater penalties. Of course, the difference to the corporation is that although it is obligated to abide by the "probation" terms, it is never formally charged with (or actually convicted of) any crime – that is, neither a substantially reduced felony offense, nor even a misdemeanor.

Editor: Why are we hearing more of the use of that tool in today's corporate environment?

Blaney: The increased use of deferred prosecution of corporations is almost certainly a result of the government's increased attention to corporate crime that followed the fraud crisis that occurred in 2001 and 2002 with the Enron and WorldCom collapses and the government's subsequent recognition that the criminal conviction of a corporation – and, indeed in many instances, even the return of criminal charges against a corporation – can result in substantial negative and unwarranted collateral damage to employees, investors and other entities who had no involvement in the alleged criminal acts, probably didn't know about them and *couldn't* have precluded them in any event.

A good example of such damage was the fall-out from the Arthur Andersen prosecution. Arthur Andersen, Enron's accountant, was indicted for obstruction of justice because of the firm's destruction of Enron documents. About 28,000

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people in this country – and no doubt a multitude worldwide – lost their jobs and pensions because of the Arthur Andersen indictment. And, although the corporation was convicted at trial, the conviction was overturned by the Supreme Court, and the Justice Department ultimately chose not to pursue further prosecution. The large number of people who lost their jobs and pensions, however, had no recourse. There was no recovering their jobs and pensions. I think that cases like the Arthur Anderson prosecution caused prosecutors to take note of such consequences, and perhaps spurred the increased use of corporate deferred prosecutions.

Editor: Should that analysis give major corporations (and their shareholders) confidence that accusations of wrongdoing against a corporation will always be resolved by deferred prosecution?

Blaney: No, I don't think that the federal (or any state) government is prepared to give blanket immunity from criminal prosecution to all publicly traded corporations. On the contrary, I'm sure that prosecutors will proceed with prosecuting such cases when they conclude that the activity that is the subject of the charged misconduct is particularly egregious and is so embedded in the corporate culture that it cannot realistically be terminated or modified. We can only hope that prosecutors will be cautious in the exercise of their authority.

Editor: Are there ways that corporations can position themselves more favorably to obtain a "deferred prosecution" resolution if the need arises?

Blaney: Absolutely. The best and necessary first step, however, is to put the corporate house in order *before* the receipt of a grand jury's subpoena or a target letter from a U.S. attorney's office. Those steps include the creation and implementation of a well documented compliance regimen and a system of routine checks and reviews to assure that changes in the market place – whether positive because of new technology or new products, or negative because of a downturn in the economy due to world events – don't alter corporate conduct in a manner that could prove harmful. That regimen also has to be constructed with a keen awareness not only of the corporate business strategy and identified areas for growth but also a clear understanding of the applicable regulatory and criminal code provisions. Corporations benefit from a compliance program that includes internal checks and balances and clearly supports and protects "whistle blowers."

After a subpoena or target letter has been issued, a good result for the corporation also requires a timely and focused response, followed by careful negotiations with the decision-making prosecutor to limit the negative consequences likely to occur. The corporation's representative will also need a great understanding of the applicable regulatory scheme and/or criminal code in order to address the prosecutor's identified concerns. He or she will also need a good ability to evaluate facts and reasonably articulate the reasons that justify minimizing, or possibly eliminating, charges of corporate culpability.

In both of these *before* and *after* steps, the corporation will benefit from a hiring a firm that has a strong, experienced corporate practice and an equally strong and experienced litigation and white collar defense practice.

Editor: **All of what you've said about deferred prosecution agreements sounds positive. Are there any downsides to a corporation's entering such an agreement?**

Blaney: Much depends upon how exposed the corporation is because of improper practices that can be fairly attributed to it. In addition, there is also no doubt that the tool can be subject to overly aggressive use by a prosecutor who might be unreasonable in his demands. For example, the terms of an agreement might require waiver of all attorney/client privileges, cooperation in testifying against a significant business partner, and even cooperation in testifying against individual officers of the corporation itself. Each of those conditions, if complied with, could result in a substantial disruption of business. The consequences to individuals within the corporation, who find themselves at odds with a corporation that is compelled to "turn on its own" in order to save itself, are also substantial. Finally, because of the huge fines and restitution costs that are assessed, as well as the costs imposed to pay the monitor (who at least for some time will effectively be running the business), the decision to accept a deferred prosecution agreement could prove onerous. For those reasons, the deciding factor in whether or not to accept such an agreement must be a careful evaluation to determine whether the corporation can either offset, or survive, an actual prosecution.

Editor: Is the use of this technique likely to diminish now that the Enron, Worldcom and related cases are completed?

Blaney: No, not at all. Revisiting my earlier statements, Enron and WorldCom were catalysts producing a more focused prosecution of corporate criminal activity; those cases, however, did not spur the use of deferred prosecutions. Indeed, and much to the contrary, the aggressive use of that tool didn't take hold until some years after Enron. The use may have been spurred by the Supreme Court's decision to overturn Arthur Andersen's conviction in 2005, and the obvious collateral harms that happened there. At least for now, however, the use of deferred prosecutions seems to be growing – substantially. I note, for example, statistics reported in a recent edition of the *Corporate Crime Reporter* which confirmed that the practice gained some momentum in 2006 (*i.e.*, five years *after* Enron) during which 20 cases of deferred prosecutions were filed; that number jumped 70 percent in the next year, 2007, during which 34 such instances were reported. Those numbers tell me that the practice will be with us for a while.

Editor: Do you think that the growth in using deferred prosecutions will continue at that rate?

Blaney: If I were to guess, I would say that the recent subprime mortgage meltdown could prove to be fertile ground for the use of this tool. The arena of corporations, companies and partnerships that were involved in that market – either as lenders, brokers or investment firms/hedge funds that bundled and marketed those instruments as securities – and the resulting substantial losses of money to homeowners and investors could well place some of those financial corporations in the viewfinders of a number of state and federal prosecutors. Stay tuned!