

## The Perils of Criminalizing Agency Costs

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## The Perils of Criminalizing Agency Costs

THE CRIMINAL PROSECUTIONS IN ENRON, WORLD COM, AND other cases have focused attention on the appropriate scope of criminal liability for business conduct. In many of these cases, the defendants were not thieves, at least not in the conventional sense, nor did they use the corporate form to endanger the public. Their crimes consisted of engaging in transactions or making statements that obscured the financial health of their firms, hurting mostly people who traded in the firms' shares. In some cases, particularly Enron, the conduct involved complex transactions that differed only marginally from what was generally considered at the time legal business behavior. Moreover, the defendants, not intending to destroy their firms in the least, desperately attempted to keep them afloat. The defendants may not have been heroes, but should they be considered criminals?

While these prosecutions unfolded, I commented on them in a series of posts on my weblog, Ideoblog, and as a guest on the Enron Forum held on The Conglomerate. These posts cover the same ground as my comments on October 13, 2006, at the University of Maryland School of Law's Roundtable on the Criminalization of Corporate Law but in somewhat greater depth. Accordingly, I have used these posts as the basis of the following discussion. This account preserves the contemporaneous flavor of the initial discussion, and accordingly has not been updated to reflect the many developments during its publication process.

### I. DEFINING CRIMINAL BEHAVIOR<sup>1</sup>

Depriving people of their liberty is the most serious thing our government can do, short of killing them. It is justified if we are very sure that the conduct deserves society's severest condemnation. If we are not certain, however, we risk diluting the moral force of the criminal law and instilling doubts concerning the system's fairness. Just as we do not tolerate reasonable doubt when convicting a particular defendant of the crime charged, similarly we make sure that the conduct the defendant has been charged with is in fact criminal.

One of the problems with criminalizing agency costs is that agents are almost always a little bit unfaithful. While Justice Cardozo said that "[n]ot honesty alone,

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\* Mildred Van Voorhis Jones Chair at University of Illinois College of Law.

1. This section is adapted from the posting of Larry E. Ribstein to The Conglomerate, [http://www.theconglomerate.org/2006/06/the\\_trouble\\_wit.html](http://www.theconglomerate.org/2006/06/the_trouble_wit.html) (June 1, 2006).

but the punctilio of an honor the most sensitive, is then the standard of behavior,"<sup>2</sup> we do not actually expect such a high standard of conduct. Firms might prefer a slightly unfaithful genius to a slavishly faithful fool. We do not want to spend \$100 to catch \$10 worth of cheating. This raises questions about when does an agent's unfaithfulness deserve some type of a sanction, and specifically, when does such conduct cross the line to criminal.

Disciplining agents also requires pinning responsibility for corporate failure on particular people within the organization. If someone should be criminally responsible for obscuring Enron's financial condition, who should it be? Should it be the midlevel executives who designed the misleading structures, the executive officers who signed-off on them, the independent directors who failed to object, the lawyers, accountants, banks, and other executives who enabled them, anybody who knew about them and did not speak up, the whistleblower who only told those within the organization, or all of the above?

Criminal law is not particularly well suited to make the sort of fine distinctions these cases require. Letting some of these people off while others spend their lives in jail creates a wide perception of injustice and sending all of them to jail dissipates the moral force of the criminal law. Moreover, as discussed in Part III, giving prosecutors such broad discretion as to which agents to charge creates opportunities for prosecutorial misconduct, the effects of which may be even worse than anything the corporate agents did. As discussed in Part IV, this line drawing puts heavy demands on fact finders who are unschooled in business.

## II. DETERRENCE<sup>3</sup>

Some say we need corporate criminal liability because it is the only sanction that can keep the Ken Lays and Jeff Skillings of the world honest. But there are serious questions whether the deterrent force of the criminal law is effective or desirable in this setting.

To begin with, we have to ask why somebody like Jeff Skilling would not only risk jail-time, but also enormous civil liability,<sup>4</sup> as well as loss of a prestigious job, a livelihood, and hard-earned reputation, just to lie to the shareholders. Of course,

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2. *Meinhard v. Salmon*, 164 N.E. 545, 546 (N.Y. 1928).

3. This section is adapted from the posting of Larry E. Ribstein to *The Conglomerate*, <http://www.theconglomerate.org/2006/06/deterrence.html> (June 1, 2006).

4. To be sure, civil liability is rarely imposed on corporate officers and directors. See generally Bernard Black, Brian Cheffins, & Michael Klausner, *Outside Director Liability*, 58 STAN. L. REV. 1055 (2006) (discussing the out-of-pocket liability risks facing outside directors and concluding that liability is rarely imposed). Most liability in corporate fraud cases is, oddly enough, assessed against the corporation itself, and therefore largely on innocent shareholders who may already have been hurt by the fraud. See Richard A. Booth, *Who Should Recover What in a Securities Fraud Class Action?* (Univ. of Md. Legal Studies Research Paper, Paper No. 2005-32, 2005), available at <http://ssrn.com/abstract=683197>. The entire structure of liability and settlement sometimes seems to conspire to take the brunt of liability off the insiders and place it on the insurers and the corporation they defrauded. See John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation* (Columbia Law Sch. Center for Law and Econ. Studies, Working Paper No. 293,

Skilling had a job and a livelihood to protect, but surely someone who has spent a lifetime taking calculated risks would understand that the truth will eventually come out, and that jail-time and disgrace are much worse than plummeting stock prices. Perhaps Skilling had no reason to believe jail was a possibility, in which case we risk unfairness to Skilling in order to teach a lesson to those who come later. But the fact that, even apart from jail, Skilling was willing to take such a desperate chance demonstrates something about the deterrent effect of criminal penalties in this setting.

As I have discussed previously,<sup>5</sup> the reason why individuals like Skilling take such big risks is that they are overconfident in their judgment and ability to control future events. In fact, it has been argued that the most self-confident executives have the best chance of making it to the top of high-flying firms like Enron.<sup>6</sup> These people might think that everything is going well in the face of evidence that would trouble more reasonable people. By the time they see that they have stretched the truth, it may be too late to avoid losing their jobs, reputations, and, perhaps, freedom. They then may not only have a strong self-preservation incentive to lie but may justify continued lies by reasoning that the shareholders are being misled by the market's fleeting judgments. To counteract this apparent phenomenon, they participate in a cover-up even when it has only a small tendency to succeed in the long run.

Even if we could increase criminal liability enough to achieve significant marginal deterrence for the most aggressively over-confident managers, it still may be a bad idea because of the risk of deterring beneficial corporate conduct. Cautious managers will want to stay very far away from conduct that has even the slightest chance of landing them in jail. As a result, they may avoid even productive transactions that could attract adverse public attention, particularly if one effect of that attention might be a criminal prosecution.

All of this is not to say that corporate criminals should escape punishment because they are not easily deterred—an argument that could apply to sociopaths—but that deterrence is not an especially good justification for punishment that is not warranted on other grounds.

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2006), available at <http://ssrn.com/abstract=893833>. If we want to ensure deterrence, this system, and not the criminal justice system, is the place to start.

5. See Larry E. Ribstein, *Market vs. Regulatory Responses to Corporate Fraud: A Critique of the Sarbanes-Oxley Act of 2002*, 28 J. CORP. L. 1, 19–22 (2002).

6. See Donald C. Langevoort, *The Organizational Psychology of Hyper-Competition: Corporate Irresponsibility and the Lessons of Enron*, 70 GEO. WASH. L. REV. 968, 969–71 (2002).

III. PROSECUTORS' AGENCY COSTS<sup>7</sup>

With all of the talk about evil corporate agents, we tend to forget about the government agents who try the cases and decide what cases to try. For many of these lawyers, Enron is not a disaster, but a launching pad into a lucrative big firm practice or a political career.<sup>8</sup> Prosecutors have little incentive to abort the launch by deciding not to prosecute. Although we want these agents to be motivated to win, we also want them to play by the rules, particularly because their mistakes have more serious consequences than dented portfolios.

The risks inherent in prosecutorial incentives are compounded by the fact that what makes criminalizing agency costs problematic for the criminal justice system also makes corporate crime challenging for prosecutors. Prosecutors have to get the jurors to see the criminal conduct buried in the accounting and distinct from the run-of-the-mill unfaithfulness of their colleagues.

Prosecutors would naturally like some shortcuts to make their jobs easier. For example, prosecutors would like to be able to choose who says what at trial. They can motivate helpful witnesses by threatening them with hard time, because even a day in jail is a big deal for such people as they get scared easily. Prosecutors also need to keep those witnesses who are friendly to the defense from testifying. It helps to let defense-friendly witnesses know that they are potential defendants, without immunity from prosecution if they testify. In the Enron debacle, for example, there are approximately one hundred unindicted co-conspirators, including Jeff McMahon, former Enron treasurer, Greg Whalley, former Enron president, and David Duncan, former top Enron auditor at Arthur Andersen whose guilty plea was vacated after the Supreme Court reversed the Andersen conviction.<sup>9</sup> These people might have had some very interesting things to say about what they did or did not tell Ken Lay and Jeff Skilling about what was happening at Enron.

Prosecutors can also get the company to cooperate by hinting that it might go the Arthur Andersen way if it does not cooperate, including having to pay employees' defense costs. In the "Thompson Memorandum," Deputy Attorney General Larry Thompson ordered federal prosecutors to consider, when deciding whether to indict a business entity, the extent of the entity's cooperation in the investigation, including whether the defendant had advanced legal fees to employees, unless advancement was required by governing law.<sup>10</sup> The line between permissible leverage and questionable extortion in the government's conduct may be no brighter than the one between crime and ordinary business practices in the conduct the government is prosecuting.

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7. This section is adapted from the posting of Larry E. Ribstein to The Conglomerate, <http://www.theconglomerate.org/2006/06/prosecutors.html> (June 1, 2006).

8. See Carrie Johnson, *After Enron, Fighting Off the Job Offers*, WASH. POST, June 5, 2006, at D2.

9. John R. Emshwiller, *Will Enron Probe Spawn Further Criminal Cases?*, WALL ST. J., June 6, 2006, at C1.

10. Memorandum from Larry D. Thompson, Deputy Attorney General, to Heads of Dep't Components, U.S. Attorneys (Jan. 20, 2003).

IV. PASSING JUDGMENT<sup>11</sup>

As discussed in Part I, applying criminal law to agency costs requires the type of judgment that the criminal justice system is not well-designed to make. This is especially evident when one considers the difficulties involved in courts drawing these lines in actual cases.

For many judges and jurors, what goes on in an executive suite may just as well be happening on Mars. When people have to make judgments that transcend their experience and knowledge, they might engage in heuristic shortcuts. They might be influenced by, for example, resentment of the rich and powerful. Also, most people get their information about corporate executives from newspapers,<sup>12</sup> films,<sup>13</sup> and other media sources, which portray corporate executives as selfish, greedy, and irresponsible. In this environment, when the *Enron* jurors had to adjudicate responsibility for Enron's collapse and had before them two of the company's most prominent villains, there is little doubt about the inferences that the jurors had drawn.

This is not to say that executives should be able to avoid trial just because judges and jurors might get it wrong—that is a risk in every trial. But it does mean that, even if it is theoretically possible to distinguish criminal and non-criminal behavior in the agency-costs context, we need to be realistic about judges' and jurors' ability to make these distinctions and take into account the costs of potential error.

The problems of passing criminal judgment on the conduct of corporate agents crystallized in the wake of the guilty verdicts and Ken Lay's death following his conviction in the Enron trial. Nancy Rapoport, former Dean of the Houston University Law Center, reports she

*was walking around downtown Houston yesterday and passed by a convenience store . . . . On the wall nearest the store's door was the classic Houston Chronicle (collector's edition) headline, 'Guilty! Guilty!' It struck me that, if a downtown convenience store has that headline up on the wall after last week, then it's clear that Houston's still angry about the whole Enron mess. And that anger isn't just from employees and shareholders—it's from the hundreds of small businesses, like this store, that lost serious income from Enron's collapse.<sup>14</sup>*

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11. This section is adapted from the posting of Larry E. Ribstein to The Conglomerate, [http://www.theconglomerate.org/2006/06/judges\\_and\\_juri.html](http://www.theconglomerate.org/2006/06/judges_and_juri.html) (June 1, 2006).

12. See generally Larry E. Ribstein, *The Public Face of Scholarship*, 85 WASH. U. L.Q. (forthcoming 2007), available at <http://ssrn.com/abstract=897590> (discussing journalists' biases and coverage of business).

13. See generally Larry E. Ribstein, *Wall Street & Vine: Hollywood's View of Business* (Univ. of Ill. Law & Econ. Working Paper Series, Working Paper No. LE05-010, 2005), available at <http://ssrn.com/abstract=563181> (discussing anti-capitalist bias in film).

14. See posting of Nancy Rapoport to The Conglomerate, [http://www.theconglomerate.org/2006/06/scenes\\_from\\_dow.html](http://www.theconglomerate.org/2006/06/scenes_from_dow.html) (June 1, 2006).

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This has all happened before.<sup>15</sup> For example, following the bursting of the South Sea Bubble three hundred years ago:

*Nobody blamed the credulity and avarice of the people—the degrading lust of gain, which had swallowed up every nobler quality in the national character, or the infatuation which had made the multitude run their heads with such frantic eagerness into the net held out for them by scheming projectors. These things were never mentioned. The people were a simple, honest, hard-working people, ruined by a gang of robbers, who were to be hanged, drawn, and quartered without mercy. This was almost the unanimous feeling of the country.*<sup>16</sup>

Far from being a time of sober reflection, Ken Lay's post-conviction death triggered a wave of vituperation. Washington Post columnist Henry Allen expressed disappointment that Lay's victims would not have the satisfaction of hearing about Ken Lay being raped by his cellmate.<sup>17</sup> When I criticized Lay's likely life sentence for his crimes, commentators responded with statements like "I hope Lay is burning in hell,"<sup>18</sup> "Lay certainly did do more harm than a murderer,"<sup>19</sup> and "Lay certainly caused billions of dollars of people's pensions to disappear."<sup>20</sup> Yet as discussed in Part V, this animosity toward Lay was entirely out of proportion to what Lay actually did and the damage he caused.

### V. PERCEPTION VS. REALITY

The people who reacted so violently to the guilty verdicts and Lay's death were oblivious to what Lay was actually convicted of—not for setting up a big Ponzi scheme, but for lying about it at the tail end. Some people bought Enron at that point because they did not know the truth, which may have been partly Lay's fault. But every share of stock that was bought was also sold (though most of Lay's wealth was still in Enron at the end). A lot of people were hurt by hanging on to their

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15. See Larry E. Ribstein, *Bubble Laws*, 40 Hous. L. Rev. 77, 77–78 (2003) (explaining the "centuries-old cycle of capital market booms followed by busts and regulation").

16. CHARLES MACKAY, *EXTRAORDINARY POPULAR DELUSIONS AND THE MADNESS OF CROWDS*, 72–73 (L.C. Page & Co. 1932) (1852).

17. Henry Allen, *Ken Lay's Last Evasion*, WASH. POST, July 6, 2006, at C1 (stating that "none of [Lay's] victims will be able to contemplate that . . . he might be spending long nights locked in a cell with a panting tattooed monster named Sumo, a man of strange and constant demands").

18. Posting of Larry Ribstein to Ideoblog, [http://busmovie.typepad.com/ideoblog/2006/07/what\\_did\\_lay\\_do.html#comment-1936805](http://busmovie.typepad.com/ideoblog/2006/07/what_did_lay_do.html#comment-1936805) (July 5, 2006, 23:18 EST) (quoting a comment to Professor Ribstein's original posting).

19. Posting of Larry Ribstein to Ideoblog, [http://busmovie.typepad.com/ideoblog/2006/07/what\\_did\\_lay\\_do.html#comment-19384596](http://busmovie.typepad.com/ideoblog/2006/07/what_did_lay_do.html#comment-19384596) (July 6, 2006, 14:00 EST) (quoting a comment to Professor Ribstein's original posting).

20. Posting of Larry Ribstein to Ideoblog, [http://busmovie.typepad.com/ideoblog/2006/07/what\\_did\\_lay\\_do.html#comment-19388018](http://busmovie.typepad.com/ideoblog/2006/07/what_did_lay_do.html#comment-19388018) (July 6, 2006, 17:33 EST) (quoting a comment to Professor Ribstein's original posting).

stock too long, but they were not hurt by Lay. If he had told the truth at his first opportunity, or even just remained conspicuously quiet, they just would have gotten hurt sooner.<sup>21</sup>

The difference between the reality and perception of Lay's conduct is exemplified in a New York Times article printed immediately after Lay's conviction that discussed the twists and turns in Lay's prosecution.<sup>22</sup> Although the reporters spin the story as a drama in which heroic government lawyers dramatically pull off a win against all odds, an alternative narrative emerges about a prosecution team out to get Lay at all costs because he had already been convicted in the court of public opinion.<sup>23</sup> As the reporters note, "[t]he public widely perceived the criminal case against Mr. Lay to have been a 'can't lose' proposition."<sup>24</sup> The prosecution's task was to serve up something that matched that perception. At stake were some promising careers on the other side of the revolving door.<sup>25</sup>

The Enron task force first focused on the Enron partnerships, including LJM.<sup>26</sup> But as Leslie Caldwell, initial task force head, said "We realized very fully early on that Lay was not involved in the decision-making day to day and that we weren't going to be able to prove his involvement in the structuring of transactions like LJM."<sup>27</sup>

The task force next tried to prove that Lay engaged in insider trading when he sold Enron shares back to the company. But the reporters note that "[t]here was no clear evidence that Mr. Lay had actively tried to deceive Enron's board, and he could contend that he had relied on Enron lawyers to approve all of his trades."<sup>28</sup> Moreover, prosecutor Sam Buell stated that "[t]he insider-trading characterization of these sales just never seemed sustainable, except on some very broad theory that, when you know things at a company aren't going well, you can't sell."<sup>29</sup> In other words, Lay did not possess material non-public information.

Still undaunted, the team thought they might try Lay for looting Enron by pulling \$100 million out of the company as it deteriorated. The reporters said

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21. See posting of Larry E. Ribstein to Ideoblog, [http://busmovie.typepad.com/ideoblog/2006/07/what\\_did\\_lay\\_do.html](http://busmovie.typepad.com/ideoblog/2006/07/what_did_lay_do.html) (July 5, 2006, 18:44 EST). Indeed, Chief Justice Roberts recently expressed skepticism about allowing even civil recovery for this sort of injury. He remarked at oral argument in *Merrill Lynch, Pierce Fenner & Smith, Inc. v. Dabit* that "what [plaintiffs] want to do is cash in on the fraud . . . [T]heir claim is that they didn't get to sell the stock at an inflated price to somebody who didn't know about the fraud. That's the damages that they want to collect. And that seems to be an odd claim to recognize." Transcript of Oral Argument at 29, *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 126 S. Ct. 1503 (2006) (No. 04-1371).

22. See Alexei Barrionuevo & Kurt Eichenwald, *The Enron Case that Almost Wasn't*, N.Y. TIMES, June 4, 2006, § 3, at 1.

23. Posting of Larry E. Ribstein to Ideoblog, [http://busmovie.typepad.com/ideoblog/2006/06/two\\_narratives\\_.html](http://busmovie.typepad.com/ideoblog/2006/06/two_narratives_.html) (June 4, 2006, 11:23 EST) (discussing and analyzing the New York Times story).

24. Barrionuevo & Eichenwald, *supra* note 22.

25. See Johnson, *supra* note 8, at D2.

26. Barrionuevo & Eichenwald, *supra* note 22.

27. *Id.*

28. *Id.*

29. *Id.*

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“[p]rosecutors were cagey, never signaling to Mr. Lay’s defense team that they had abandoned the insider-trading theory and replaced it with a new allegation.”<sup>30</sup> As noted above, however, Lay had the company’s approval. This is the part that is so tricky about criminalizing agency costs. Unlike a robbery, the agent often has the principal’s explicit or implicit consent for the relevant conduct. It is possible to second-guess the corporate approval process, but these subtle distinctions are not an appropriate basis for criminal prosecution.

The prosecutors still were not ready to give up. They tried to show that Lay attempted to get the Bush administration to help the company as it was collapsing in 2001—a story that was floating around at the time. Unfortunately for this theory, Alan Greenspan, Commerce Secretary Donald L. Evans, and Treasury Secretary Paul H. O’Neill all reported telephone calls from Lay, but could provide no evidence of wrongdoing.

Then in spring 2003, the prosecutors finally found the magic key—they would show that Enron was weaker than what Lay’s public statements portrayed. It is not surprising that the prosecutors only came across this theory after rejecting so many others. After all, at the time of making the statements, Lay had only recently come back on board. He must have thought at the time that the company was still viable. This would leave only a narrow window at the tail end of the drama when it was credible that Lay’s statements did not reflect his sincere belief.

The reporters note, however, that the prosecutors had help in proving fraud—grand jury statements by former Enron treasurer and convicted felon Ben Glisan that Lay was lying when he made upbeat statements about Enron in 2001.<sup>31</sup> The reporters do not mention the rest of Glisan’s story.<sup>32</sup> Glisan decided to go to jail right away in exchange for a deal that he hoped would send him to Club Fed. The government instead sent him to solitary confinement in a harsher facility, evidently hoping to soften him up for more cooperation in netting the big Enron fish. Glisan was, indeed, negotiating for a shorter prison term and better conditions. Although Glisan was initially sentenced to five years beginning in 2003, following his testimony against Lay, he was released to home confinement in September 2006, and from custody entirely in January 2007.<sup>33</sup>

Once the prosecution team finally had a theory, it brought extra firepower on board to nail it down, including prosecutors Sean Berkowitz and John Hueston. Hueston came up with the theory of Lay’s use of bank loans to buy stocks on margin—a breach of contract with the banks that also happens to be a criminal

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30. *Id.*

31. *Id.*

32. See Posting of Tom Kirkendall to Houston’s Clear Thinkers, <http://blog.kir.com/archives/003178.asp> (June 2, 2006, 5:21 EST).

33. Posting of Larry E. Ribstein to Ideoblog, [http://busmovie.typepad.com/ideoblog/2006/06/two\\_narratives\\_.html](http://busmovie.typepad.com/ideoblog/2006/06/two_narratives_.html) (June 4, 2006, 11:23 EST).

violation of federal banking law. Hueston then built the case that Lay was lying about Enron's financial condition.<sup>34</sup>

The troubling story that emerges from these facts is that the prosecutors were determined to get Lay, who had already been convicted by public opinion for being associated so closely with Enron. The prosecutors looked long and hard and finally found Ben Glisan, whom the jury was willing to believe despite his questionable provenance. There were other potential witnesses with other potential stories, but the government was willing neither to free them from the threat of indictment nor grant them immunity. The prosecutors' search for some wrongdoing and the string of false starts are starkly inconsistent with the public's view that the evil Enron defendants, and Lay in particular, were so clearly responsible for ruining millions of people and deserved the harshest punishment.

#### VI. THE DENOUEMENT: THE KPMG DECISION

Even if public opinion still favors corporate criminal prosecutions such as *Enron*, the courts may have the last word on excesses in prosecuting corporate crime. On June 26, 2006, Judge Lewis Kaplan of the federal district court in New York sternly rebuked the government lawyers prosecuting the mammoth tax shelter case against KPMG.<sup>35</sup> The opinion established an important principle for future cases—that criminal law must respect the importance of the complex sets of contracts and incentive devices that make firms work.<sup>36</sup>

In the KPMG case, the government indicted sixteen people who worked for KPMG defendants and a couple of others for allegedly conspiring to make and sell bogus tax shelters. Prodded by prosecutors, KPMG cut off advancement of these defendants' legal fees. Judge Kaplan held a hearing on the KPMG defendants' claim that the government pressure on KPMG was improper.

Judge Kaplan ruled that the government's conduct violated the defendants' Fifth Amendment right to a fair trial and Sixth Amendment right to counsel.<sup>37</sup> Although the government insisted that KPMG made its own decision on advancement of expenses,<sup>38</sup> this claim undermined clear government policy to prevent advancement expressed in the Thompson Memorandum.<sup>39</sup> The court held that "KPMG's decision to cut off all payments of legal fees and expenses to anyone who was indicted and to limit and condition such payments prior to indictment upon cooperation with the government was the direct consequence of the pressure applied by the Thomp-

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34. See Barrionuevo & Eichenwald, *supra* note 22.

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

36. *Id.*; see Posting of Larry E. Ribstein to Tech Central Station Daily, <http://www.tcsdaily.com/article.aspx?id=070606E> (July 6, 2006) (discussing *Stein*).

37. *Stein*, 435 F. Supp. 2d at 356–73.

38. *Id.* at 351.

39. *Id.* at 368–69.

son Memorandum and the USAO.<sup>40</sup> Judge Kaplan accordingly rebuked the government for letting “its zeal get in the way of its judgment. It has violated the Constitution it is sworn to defend.”<sup>41</sup> The court concluded that the government’s conduct was not justified by its law enforcement interests or by the fact that advancement might indicate obstruction or lack of full cooperation, noting the extraordinary burden that it would place on individual defendants in mammoth cases like this if they are unable to get their firms to advance expenses.<sup>42</sup>

The most interesting aspect of the KPMG opinion concerned the intersection of contract rights and criminal law. The court noted that the defendants had an expectation of advancement based on KPMG’s past practices, which “arguably” gave rise to an implied contract.<sup>43</sup> The court said that “[t]he law protects such interests against unjustified and improper interference. Thus, both the expectation and any benefits that would have flowed from that expectation—the legal fees at issue now—were, in every material sense, their property, not that of a third party.”<sup>44</sup> The court accordingly used its “ancillary jurisdiction” to order KPMG to advance defendants’ fees.<sup>45</sup>

It is important to emphasize that this is not a mere dispute about the contractual right to indemnification. The defendants needed constitutional rights because their contract rights could not stand up to the government’s intimidation. Judge Kaplan emphasized on the first page of his opinion that advancement and reimbursement of legal expenses are among “three principles of American law” that are at issue in the case,<sup>46</sup> noting one court’s statement that advancement is “an especially important corollary to indemnification as an inducement for attracting capable individuals into corporate service.”<sup>47</sup>

The court’s holding will not solve all of the problems of corporate criminal liability. The government still retains significant power to coerce cooperation from defendants. Moreover, the tax shelters in the case pose a particularly complex problem of drawing the line between criminal behavior and simply aggressive and ultimately unsuccessful tax planning that is similar to what tax advisers do everyday. Even if the firm’s conduct might be characterized as criminal, it is still necessary to apportion responsibility within the firm among those who designed the tax shelters, gave advice to clients, and spoke to the IRS. Nevertheless, Judge Kaplan’s opin-

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40. *Id.* at 353.

41. *Id.* at 336.

42. *Id.* at 371, 378.

43. *Id.* at 356 n.119.

44. *Id.* at 367.

45. *Id.* at 378. The court held that, because KPMG was not a party to the case, the defendants would have to sue KPMG for the fees, and would get an expedited hearing. *Id.* at 379. The defendants have done so. See Complaint for Advancement, *United States v. Stein*, 435 F. Supp. 2d 330 (S.D.N.Y. 2006) (No. 1:06-cv-5007-LAK), 2006 WL 2922089.

46. *Stein*, 435 F. Supp. 2d at 335.

47. *Id.*

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ion is important because it recognizes that even the criminal justice system must recognize the parties' contract and property rights and business realities.

#### VII. CONCLUSION

The recent criminal prosecutions in the wake of Enron and other corporate collapses pose significant problems for our criminal justice system. Wrongdoing in these cases is subtle, blame difficult to apportion, and the facts hard to find. This puts the same type of pressure on prosecutors as on corporate agents to bend the rules and risks imposing convictions based on misconceptions about business instilled by the media. It is time for a reexamination of whether the benefits of criminalizing agency costs are worth the costs.