

The Impact on Shareholders and Other Constituents

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CRIMINALIZATION OF CORPORATE LAW

The Impact on Shareholders and Other Constituents

I WOULD LIKE TO TALK ABOUT THE EFFECT OF CRIMINAL sanctions on the rank and file employees of the corporation.

First, and most obviously, if the criminal sanction leads to the bankruptcy of a corporation, or financial distress for the corporation, the corporation may be forced to downsize its workforce. Employees may lose their jobs and their benefits. Unfortunately, we have seen several examples of this tragedy over the last few years, in cases like *Enron*¹ and *KPMG*.²

But the criminal sanction does not necessarily have to lead to downsizing for employees to be negatively impacted. If the corporation's criminal activity is highly publicized, the future employment prospects of innocent employees may also be damaged, simply because the individuals have been affiliated with that sanctioned corporation. As Jill Fisch discussed earlier, being criminally investigated or criminally charged is vilifying to a corporation.³ At the same time, it can be stigmatizing to the corporation's employees.⁴ The resumes of these employees will always reflect that they worked for a sanctioned corporation. How could that not impact their job prospects?

But more importantly, criminal sanctions may lead to unfair treatment for these rank and file employees. Specifically, management of a corporation that is seeking to avoid prosecution may sacrifice employees to demonstrate cooperation with the Government. We have spent some time today talking about the Thompson Memorandum⁵ and the significance of corporate cooperation with the Department of Justice. When you take a look at the Thompson Memorandum, it sets forth a list of

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1. *Tittle v. Enron Corp.*, 463 F.3d 410 (5th Cir. 2006).

2. *Jeffrey Stein v. KPMG, LLP*, No. 06-4358-CV, 2007 WL 91350 (S.D.N.Y. Jan. 8, 2007); see also Howard Gleckman, Amy Borrus & Mike McNamee, *Inside the KPMG Mess*, BUSINESS WEEK ONLINE, available at http://www.businessweek.com/bwdaily/dnflash/sep2005/nf2005091_2144_db016.htm (last visited Feb. 7, 2007).

3. Jill Fisch, *Criminalization of Corporate Law*, 2 J. BUS. TECH. L. __ (2007).

4. *Id.*

5. Memorandum from Larry D. Thompson, Deputy Attorney Gen., to Heads of Dep't Components, U. S. Attorney Gen. (Jan. 20, 2003), available at http://www.usdoj.gov/dag/cftf/corporate_guidelines.htm (last visited Feb. 7, 2007).

factors that will be considered, including whether the corporation appears to be protecting its culpable employees and whether, for example, the corporation has disciplined the wrongdoers.⁶

If the Government is judging cooperation by how quickly a corporation disciplines employees suspected of wrongdoing, corporations may feel pressured to terminate employees quickly. However, it takes time for a corporation to investigate the facts and determine with some degree of reliability whether its employees have broken the law. If the corporation is more concerned with appearing to cooperate with the Government than with conducting a thorough investigation, it might rush to judgment. Innocent employees might be unfairly terminated.

Furthermore, as discussed earlier, this potential unfairness can be exacerbated if the company decides to demonstrate compliance with the Thompson Memorandum by not advancing expenses for the legal defense of these employees. A decision not to advance legal expenses is particularly devastating for the rank and file employees of the corporation, such as middle managers, who probably do not have the resources necessary to pay for their own defense, in what could be a very sophisticated and drawn out prosecution.

In addition, the pressure to cooperate with the Government may also adversely affect the working relationship between the corporation and its employees. Earlier today, Ellen Podgor talked about the breakdown in trust.⁷ Employees who believe that they will be sacrificed by their employer in a criminal investigation will not trust their employer. They will be less invested in the corporation. Morale will suffer, and, undoubtedly, so will the profitability of the corporation.

The breakdown in trust is not caused solely by the Thompson Memorandum's pressure on the corporation to cooperate with the Government. Criminalizing certain behavior can also cause senior management to be less trustful of their rank and file employees. We have all seen some recurring fact patterns, especially in false accounting cases or financial fraud cases, where the Government has claimed that the board relied too heavily on the honesty and integrity of the corporation's employees and/or that the board did not pay sufficient attention to red flags that allegedly would have led to the uncovering of the fraud. Clearly, the message that is being sent to directors is that they should think twice before trusting the corporation's employees. That seems unfortunate and it appears to be in conflict with the policies underlying corporate statutes such as DGCL Section 141(e),⁸ which provide that a board is entitled to rely in good faith on the statements of their employees.⁹ Because of the criminalization of corporate law, rank and file employees may find that they now work in environments where they distrust senior management, and senior management distrusts them.

6. *Id.* at 3, 11.

7. Ellen Podgor, *Criminalization of Corporate Law*, 2 J. BUS. TECH. L. __ (2007).

8. DEL. CODE ANN. tit. 8, § 141(e) (2006).

9. *Id.*