Tuesday, October 21
4:30 pm-6:00 pm

702 Personal Liability Risks Facing In-house Counsel

Paul Laskow
Vice President, Secretary, and General Counsel
AAA Mid-Atlantic Insurance Group

Robert M. Talley
President-Corporate, General Counsel, and Secretary
Johnson Matthey, Inc.

Eric A. Tilles
Assistant General Counsel/Manager Ethics and Compliance
Arkema, Inc.

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Faculty Biographies

Paul Laskow

Paul Laskow is vice president, secretary, and general counsel of AAA Mid-Atlantic, Inc. and the wholly owned companies of its insurance group. He manages the corporate legal department and is responsible for the staff counsel in the litigation law department. In addition to serving as secretary for the parent and subsidiary companies, he is lead ethics officer for the organization. Mr. Laskow came to the organization as vice president and general counsel of the AAA Mid-Atlantic Insurance Group companies and has since expanded his responsibilities to include oversight of the delivery of all legal services organization-wide. He also serves in the offices of secretary and general counsel of the upstream holding company, Auto Club Partners, Inc., which with three other auto clubs has a total of more than 5 million members.

Prior to joining AAA, Mr. Laskow worked in the international law department of CIGNA, Philadelphia. He has also served as vice president and general counsel of the Insurance Federation of Pennsylvania; chief counsel for the Pennsylvania Insurance Department in Harrisburg, PA, and assistant US attorney for the Eastern District of Pennsylvania in Philadelphia.

Mr. Laskow is also chairman of Mid-Atlantic Foundation for Safety & Education, a 401(c)(3) charity affiliated with AAA Mid-Atlantic and supported by its members.

Robert M. Talley

Robert M. Talley is president – corporate, general counsel, and secretary with Johnson Matthey Inc. based at the Johnson Matthey North American Corporate offices located near Philadelphia. Nearly 200 years in existence, the Johnson Matthey group's principal activities are the manufacture of autocatalysts and pollution control systems; catalysts and components for fuel cells; pharmaceutical materials and services; process catalysts and fine chemicals; the refining, fabrication and marketing of precious metals; and the manufacture of colors and coatings for the glass and ceramics industries. In addition to being responsible for the legal affairs of Johnson Matthey's North American operations, Mr. Talley also holds other executive positions and serves as a director on the boards of Johnson Matthey's US legal entities, serves on the North America compliance committee, group corporate social responsibility committee, and is responsible for the US anti-money laundering program.

He was previously with US Steel in senior human resources management positions and the legal department based in Pittsburgh.

He has been an active member of ACC and ACC's Delaware Valley (DELVACCA) chapter. He has been a member of the DELVACCA board of directors, 1st vice president, president and immediate past President. He served on the 2008 ACC nominating committee.

Mr. Talley graduated from the College of New Jersey (formerly Trenton State College) and received his JD, cum laude, from Temple University School of Law.

Eric A. Tilles

Eric Tilles is assistant general counsel and manager of ethics and compliance at Arkema Inc., where he is responsible for providing legal advice concerning all aspects of employment, labor, employee benefits, ethics and compliance, equal employment opportunity, executive compensation, immigration law, occupational safety and health, and security, and for the day-to-day management of the company's ethics and compliance program.

Prior to working at Arkema, Mr. Tilles was an associate general counsel at the University of Pennsylvania/University of Pennsylvania Health System, and an associate at the law firm of Morgan, Lewis and Bockius. He clerked for Chief Judge A. Leon Higginbotham at the United States Court of Appeals for the Third Circuit and for Senior Judge James L. Latchum in the District of Delaware.

Mr. Tilles has been a lecturer-at-law at the University of Pennsylvania Law School where he taught employment discrimination law. He is co-chairperson of ACC's Delaware Valley chapter's ethic and compliance committee.

Mr. Tilles received his BS from the New York State School of Industrial and Labor Relations at Cornell University and his JD from the University of Pennsylvania Law School.

A Long Expected Party

- Strict liability for in-house counsel?
- *Miller v. McDonald*, 2008 WL 1002035 (Bankr. D. Del. Apr. 9, 2008) suggests yes.
- Court permits corporate VP/GC to be sued for breach of fiduciary duty because management allegedly failed to implement and ensure use of an adequate system for the detection and reporting of corporate misconduct.

What Is A Gatekeeper Anyway?

- SarbOx 307 – “report up”
- Your clients are the shareholders
  - **“In every transaction you handle, every governance problem you tackle, and every shareholder communication you write, keep in mind that America’s investor’s are depending on you.”**
    - » Christopher Cox, Chairman, SEC, Address to the 2007 Corporate Counsel Institute (Mar. 8, 2007)

How Did We Get Here?

- 2001-02 Corporate meltdowns
- SEC – lawyers are “gatekeepers”
- DOJ – fraud cannot happen without “complicity”
- SarbOx Section 307
- ABA Model Rules of Professional Conduct
- Stock Options

SEC’s 3 Factors:

1. The extent to which the decision-making process depended on the lawyer.
   - Did the lawyer prepare the filing?
2. The nature of the legal judgments made by the lawyer.”
   - Is the answer to a legal question (or the need to seek further legal advice) clear?
3. Whether the attorney’s conduct occurred in the context of an SEC enforcement proceeding or other investigation.
   - The SEC recognizes “this is where the adversarial nature of the lawyer’s role most needs protection.”

DOJ

- Corporate Fraud Task force formed 2002.
- SarbOx provides basis for criminal liability:
  - Certification of Periodic Reports
  - Securities Fraud
  - Altering Documents
  - Retaliation
  - Obstruction of Justice

SEC Update

- August 14 – SEC announces that former Apple GC Nancy Heinen will pay $2.2M.
- August 8 – SEC announces Alliance Transcription attorney to pay $220,000 for unregistered stock transactions.
- July 22 – SEC files complaint against HCC GC for backdating options.
- May 14 – SEC files complaint against Broadcom, including GC, for backdating

Stock Options Redux

- True danger – prosecuting attorneys may now be considered commonplace
  - "[T]he backdating scandal serves as a reminder that, even though in-house counsel may have avoided the full stare of SEC attention in the past, those days are over."
    - ACC Reports: In-House Counsel In The Liability Corsshairs, September 2007

DOJ Update

- Neways, Inc. corporate counsel charged in scheme to defraud the US by hiding $4M in corporate income. 1 year in prison.
- US Wireless GC pled guilty to transferring company assets offshore.

Lessons Learned from the Front Lines: Point/ Counterpoint

A. Background

1. Gold and Silver refinery
2. Opened early 1980s
3. About 75 employees
4. Wastewater treatment plant
5. Involves Management
6. Decentralized structure

Lessons Learned

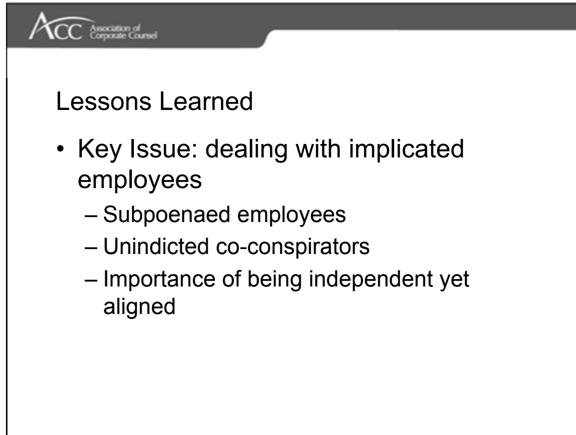
- EHS Audits
  - Conducted under legal privilege
  - Activity identified
  - Action taken
- The Whistleblowers: Disgruntled terminated employees banded together to “take the plant down”

Lessons Learned:

- The Wastewater Discharge Permit
  - Unduly stringent limit
  - Limited ability to test
  - History of exceedences
  - Shift to silver with greater selenium (Se) levels
    - Uncertainty of concentration

Lessons Learned

- Should the Company Investigate?
- Investigation done:
  - Under privilege
  - Develop defenses
  - Make any proper disclosures timely and as necessary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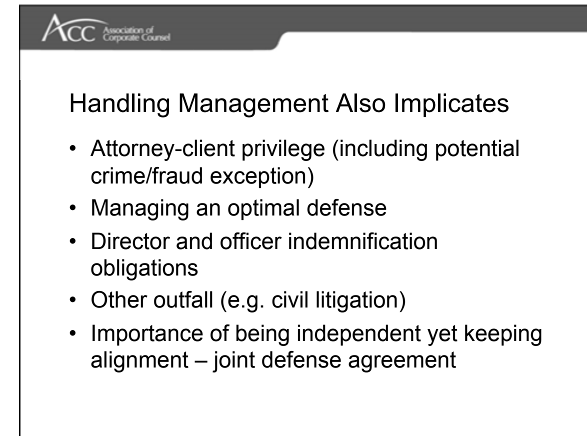
Lessons Learned
• Key Issue: dealing with implicated employees
– Subpoenaed employees
– Unindicted co-conspirators
– Importance of being independent yet aligned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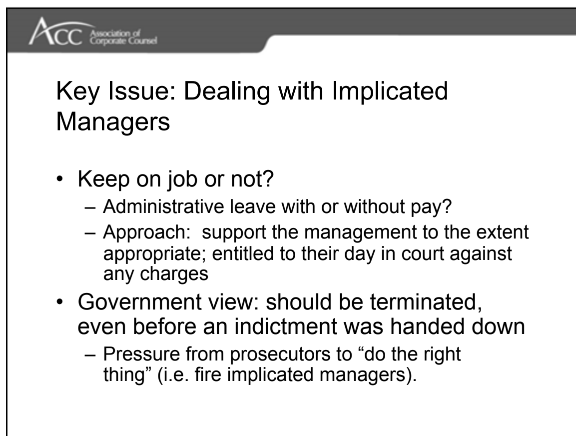
Handling Management Also Implicates
• Attorney-client privilege (including potential crime/fraud exception)
• Managing an optimal defense
• Director and officer indemnification obligations
• Other outfall (e.g. civil litigation)
• Importance of being independent yet keeping alignment – joint defense agreement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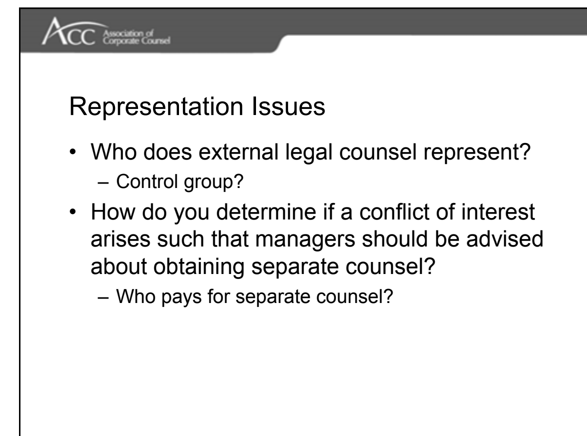
Key Issue: Dealing with Implicated Managers
• Keep on job or not?
– Administrative leave with or without pay?
– Approach: support the management to the extent appropriate; entitled to their day in court against any charges
• Government view: should be terminated, even before an indictment was handed down
– Pressure from prosecutors to "do the right thing" (i.e. fire implicated managers).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Representation Issues
• Who does external legal counsel represent?
– Control group?
• How do you determine if a conflict of interest arises such that managers should be advised about obtaining separate counsel?
– Who pays for separate counsel?

Indemnification Issues

- Scope
  - Delaware
  - Pennsylvania
- Advancement of Expenses
  - Mandatory
    - Bylaws, Articles
    - Contract
  - Permissive
    - State law

The Government Investigation

- The elephant moves slowly but deliberately
  - Government investigation spanned over four years
  - Broad, virtually unfettered prosecutorial discretion among government prosecutors
- Key focus:
  - Lying, cheating, stealing (deceit)
  - Impact on the environment
  - Company culture – is there an effective compliance and ethics program in place such that any non-compliance might be an exception to the rule (rogue employee defense)

Insurance Claim Issues

- Notice Issues
  - When does the claim arise?
  - Beware of exclusions
    - Pollution defense
    - Wrongdoing
  - Apportionment
  - Recoupment issues
  - Is the company covered?
    - What about expenses incurred by the company on behalf of covered employees?

Investigation (cont.)

- Grand jury proceedings
- Plant disruption severe
- Produced hundreds of thousands of pages of documents
- Cost of eDiscovery – the downside of having too many back-up tapes
- Current and former employees called before private grand jury proceedings
- Foreign executives
- VP / General Counsel issued subject letter
- Responsible corporate officer theory pursued aggressively
- JMI officers and directors
- Knowledge and authority are key elements
- Efforts to obtain jurisdiction over foreign parent successfully defended against

Investigation (cont.)

- Approach reflected widespread national attack on government attorney-client privilege waiver policy
  - – Thompson/McNulty/Filip/(Specter?)
- DoJ stated policy: seek waiver as the price of "cooperation" (a company's "timely and voluntary disclosure of wrongdoing and its willingness to cooperate with the government's investigation" are factors for determining whether to file charges against a company).
  - Principles of Federal Prosecution of Business Organizations (Deputy Attorney General Larry Thompson, 2003)

Prosecution

- Federal Grand Jury handed down indictment of JMI and two managers March 2006 – 29 counts
- PR issues
  - – EPA press release – claimed impact on environment
  - – Press contacts
  - – Customers
  - – Employees
- DoJ POLICY: THE POST-INDICTMENT OFFER IS NEVER BETTER THAN THE PRE-INDICTMENT OFFER

Results

- Various Government theories effectively dispelled
- Falsification of reports
- Obstruction of justice
- 56 counts threatened; 29 actually issued
- Government missteps

Defense: Successful Ultimate Long-Shot

- In August 2007, the EPA Debarment officer issued Suspension Notice to company, foreign parent and two managers.
  - – Aggressively and effectively opposed this resulting in a highly unusual withdrawal of the suspension in October 2007.
- Permit defects – challenged in state court successfully
- February 2008 DoJ concedes substantial portion of the indictment counts in federal court; seeks resolution

Lessons Learned

- EHS Audit Program identified issues
  - Chief Legal Officer and EHS Auditors must have clear authority to investigate and enforce compliance, including taking prompt remedial actions
- External legal counsel
  - * Important to select carefully
- Government permits – Never assume they're valid and enforceable (although everyone does)
- DOJ Prosecutors –
  - Virtually unfettered discretion
  - Mistakes caused DoJ to lose confidence in its case

Now What?

- Indemnification
- Insurance Coverage

Life After Indictment

- Compliance program – expanded June 2005
- Important for compliance to do lessons learned training / case study for all managers
- Increased awareness of EHS audit findings and tracking of actions against main action points
- Ongoing SLC operational changes – Selenium no longer a problem
- Management changes
- Broader awareness of issues

Indemnification

- Where to Look
- Get Close to the Directors
- What is the scope?
  - Parties
  - Subject Matter – ethics & disciplinary?
  - Subsidiaries and affiliates
  - Pro Bono
- Who and what gets paid
- When paid
- What can go wrong
  - no advancement
  - reimbursing the advancement

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ARTICLE XII

LIMITATION OF LIABILITY,
INDEMNIFICATION AND INSURANCE

Section 1. A Director of the Club shall not be personally liable for monetary damages as such for any action taken, or any failure to take action, unless the Director has breached or failed to perform the duties of his office under Section 8363 of the Pennsylvania Directors' Liability Act, as from time to time amended, or any successor provision, and the breach or failure to perform constitutes self-dealing, willful misconduct or recklessness. This provision shall not apply to the responsibility or liability of a Director pursuant to any criminal statute or the liability of a Director for payment of taxes pursuant to local, State or Federal law. This Section 1 shall be applicable to any action taken or any failure to take any action on or after January 27, 1987.

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Section 2. The Club shall indemnify any Officer, Director or member of a Regional or Advisory Board (or employee or agent designated by majority vote of the Board of Directors to the extent provided in such vote) who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceedings, whether civil, criminal, administrative or investigative (including action by or in the right of the Club) by reason of the fact that the employee is or was an Officer, Director or member of a Regional or Advisory Board (or employee or agent) of the Club or is or was serving at the request of the Club as a director or officer (or employee or agent) of another corporation, partnership, joint venture, trust employee benefit plan or other enterprise, against expenses including attorneys' fees, judgments, fines and amounts paid in settlement, actually and reasonably incurred by said employee in connection with such action, suit or proceeding. Officers and directors of subsidiaries of the Club shall be deemed to be persons acting as an officer or director of another corporation at the request of the Club. Indemnification pursuant to this Section shall not be made in any case where the act or failure to act giving rise to the claim for indemnification is determined by a court to have constituted willful misconduct or recklessness. Expenses incurred by an Officer, Director, member of a Regional or Advisory Board, employee or agent entitled to be indemnified by this Section in defending a civil or criminal action, suit or proceeding may be paid by the Club in advance of the final disposition of such action, suit or proceeding upon receipt of an undertaking by or on behalf of such person to repay such amount if it shall ultimately be determined that said employee is not entitled to be indemnified by the Club. The indemnification and advancement of expenses provided

Comment [p1]: To make reimbursement to one of a loss already incurred by him.

Comment [p2]: Recently amended to move the parenthesis and place employees on equal footing with Officers.

Comment [p3]: Better than insurance? Depends on form.

Comment [p4]: Would this reach pro bono service on a nonprofit board with the approval of an officer? How explicit must the "request" for service be?

Comment [p5]: No deductible or limit on amount. Better than insurance?

Comment [p6]: While criminal investigations may be defended pursuant to indemnification and advanced payments, the employee may be liable for advances if found guilty.

Comment [p7]: Probably want to bargain for "shall"."

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by, or granted pursuant to, this Section 2 shall continue as to a person who has ceased to be a Director, Officer, member of a Regional or Advisory Board, employee or agent of the Club and shall inure to the benefit of the heirs, executors and administrators of such person. This Section 2 shall not be effective with respect to any action, suit or proceeding commenced prior to January 27, 1987.

Section 3. The Club may purchase and maintain insurance on behalf of persons who are or were Directors, Officers, employees or agents of the Club, are or were serving at the request of the Club as a director, officer, employee or agent of another corporation, partnership, joint venture, trust, employee benefit plan or other enterprise against any liability asserted against them and incurred by them in any such capacity, or arising out of their status as such, whether or not the Club would have the power to indemnify them against such liability under provisions of this Article. Furthermore, the Club may create a fund of any nature, which may, but need not be, under the control of a trustee, or otherwise secure or insure in any manner its indemnification obligations referred to in Section 2 hereof.

Comment [p8]: But see, *Schoon v. Troy Corporation*, 2008 WL 821666 (Del. Ch. Mar. 28, 2008, right to advancement may be revoked by amendment as not vested until litigation commences.

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Insurance Coverage

- D&O
- E&O
- ELPL

D&O: Vice President, Secretary & GC?

- Sharing limits of coverage (*must you advise against this?*)
- CLO v. GC "D&O acting *solely* in their capacity as such"
- May exclude professional services to company as opposed to others – "what is a wrongful act"
- May have "insured v. insured" exclusion.
- May buy endorsement for all counsel but awkward fit and dilutes limits. Typically just counsel.

ELPL

- Indemnifies insured or company to the extent it indemnified insured
- Typically cover GC and all others in legal function: "for negligent act, error, omission, breach of duty, misstatement or misleading statement *in the performance of legal services*."
  - Covers PI e.g., false arrest, privacy violations, defamation.
- Not sharing limits with all those officers but sharing with spouse
- Excludes dishonest, fraudulent, criminal or malicious act or omission, intentional violation of law, profit-taking not entitled, actions by employer (defense costs covered)
- Defense costs within limits.
- Extended reporting is within limits. 3yrs for 200%.
- Covers moonlighting & pro bono *legal services*
- Does not cover fines or penalties but does cover punitive damages where allowed by law (Chubb form)

E&O

- Employer claims (tactical v. truly aggrieved)
- Consider definition of "wrongful act" "professional services" "claim"
- Endorsement with exclusion

ELPL (cont.): What are "legal services"?

ABA

- *"In recent testimony before the FTC, the President of the American Bar Association stated that "a threshold problem with the delivery of legal services [is] [w]hat constitutes legal information as opposed to legal advice? "This issue hindered the efforts of other committees established by the American Bar Association, including those looking at multi-disciplinary practice, multi-jurisdictional practice, and the unauthorized practice of law. Defining the practice of law has been a difficult question for the legal profession for many years. The emergence of new technologies such as the Internet has expanded the number of ways in which legal advice and information can be disseminated, which has increased the complexity of the task."*
  - Comments of FTC to ABA, December 20, 2002.

ABA – Who Practices Law?

- A person is presumed to be practicing law when engaging in any of the following conduct on behalf of another:
  - *Giving advice or counsel to persons as to their legal rights or responsibilities or to those of others;*
  - *Selecting, drafting, or completing legal documents or agreements that affect the legal rights of a person;*
  - *Representing a person before an adjudicative body, including, but not limited to, preparing or filing documents or conducting discovery; or*
  - *Negotiating legal rights or responsibilities on behalf of a person.*

ABA Model Definition

- *[T]he application of legal principles and judgment with regard to the circumstances or objectives of a person that require the knowledge and skill of a person trained in the law.*

Different State Approaches

- a. **Arkansas**: *Research by authorities by able counsel and by this court has failed to turn up any clear, comprehensive definition of what really constitutes the practice of law. Courts are not in agreement. …The practice of law is difficult to define. Perhaps, it does not admit of exact definition.* Arkansas Bar Association v. Block (1959)

- b. **Delaware**: I*n general, one is deemed to be practicing law whenever he furnishes to another advice or service under circumstances which imply the possession and use of legal knowledge and skill. The practice of law includes 'all advices to clients, and all actions taken for them in matters connected with the law'…* Marshall-Steele v. Nanticoke Memorial Hospital, Inc. (1999)

- c. **Minnesota**: *The line between what is and what is not the practice of law cannot be drawn with precision. Lawyers should be the first to recognize that between the two there is a region wherein much of what lawyers do every day in their practice may also be done by others without wrongful invasion of the lawyers field.* Cowern v. Nelson, (1940)

ments and preservation of the insurers' right to subrogation, because such duties were ministerial. Failure of cooperation with respect to a claim establishes only that an insurer may have a defense to payment of that claim and would not affect an insurer's obligation regarding other claims. Further, the court held that denying executory status to the policies in issue would not impact the rights or remedies of the insurer.

This court finds that, because the premiums are paid, the policy coverage periods have expired, and the remaining obligations of the insureds are ministerial, the Asbestos Insurance Policies are non-executory contracts and therefore, do not fall under § 365 of the Bankruptcy Code.[32]

CONCLUSION

For the reasons discussed, the court will overrule the objections of the Objecting Insurers and the Certain Underwriters at Lloyds, London and London Market Companies regarding assignment and preemption on the ground that the assignment of rights in certain insurance policies to the Asbestos Trust, as provided in part by Section 4.3 of the Plan, is valid and enforceable under § 524(g), § 541(c)(1), § 1123(a)(5)(B) and § 1129(a)(1) of the Bankruptcy Code, and that the Bankruptcy Code preempts any anti-assignment contractual provisions and applicable state law.

An appropriate order will be entered.

ORDER

AND NOW, this *19th* day of March, 2008, for the reasons stated in the foregoing Memorandum Opinion, **IT IS HEREBY ORDERED, ADJUDGED AND DECREED** that the assignment of rights in certain insurance policies to the asbestos trust, as provided in part by Section 4.3 of the Fourth Amended Joint Plan of Reorganization For Debtors and Debtors–In–Possession (As Modified), Doc. No. 13360, is valid and enforceable pursuant to §§ 524(g), 541(c)(1), 1123(a)(5)(B) and § 1129(a)(1) of the Bankruptcy Code notwithstanding anti-assignment provisions in or incorporated in the policies and applicable state law. The Objections of the Objecting Insurers and of Certain Underwriters at Lloyds, London and London Market Companies, all as defined in the Memorandum Opinion, are **OVERRULED.**

It is **FURTHER ORDERED** that counsel for Debtors shall immediately serve a copy of this Memorandum Opinion and Order on all parties on the current Service List and any other parties in interest and shall file proof of service forthwith.

32. Debtors have acknowledged their remaining ministerial obligations under the policies and have agreed to perform them. If they fail, all coverage defenses are preserved pursuant to the insurance neutrality provisions described, *infra.*

WORLD HEALTH ALTERNATIVES, INC., et al., Debtors.

George L. Miller, Chapter 7 Trustee for World Health Alternatives, Inc., et al., Plaintiff,

v.

Richard E. McDonald, Marc Roup, John C. Sercu, Bruce Hayden, Frederick R. Jackson, Sr., John W. Higbee, Brian T. Licastro, Mark B. Rinder and Deana J. Seruga, Defendants.

Bankruptcy No. 06–10166(PJW). Adversary No. 07–51350.

United States Bankruptcy Court, D. Delaware.

April 9, 2008.

Background: Chapter 7 trustee brought adversary proceeding against former officers and directors for corporate debtors, alleging, inter alia, breach of fiduciary duty, aiding and abetting breach of fiduciary duty, aiding and abetting waste of corporate assets, aiding and abetting fraud, negligent misrepresentation, fraudulent transfer, equitable subordination, and professional negligence. Former vice president, who also purportedly was former in-house general counsel, moved to dismiss.

Holdings: The Bankruptcy Court, Peter J. Walsh, J., held that:

(1) trustee stated claim for breach of fiduciary duty;

(2) trustee stated claim for waste of corporate assets;

(3) trustee stated claims for aiding and abetting breach of fiduciary duty and aiding and abetting fraud;

(4) allegations stated claim for negligent misrepresentation;

(5) fraudulent transfer claims did not satisfy fraud pleading rule;

(6) dismissal without prejudice of equitable subordination claim was warranted; and

(7) allegations stated claim for professional negligence.

Motion to dismiss granted in part and denied in part.

1. Corporations ⟹640

Under both Florida and Delaware law, Florida law governed claim for breach of fiduciary duty against former vice president and purported general counsel for corporation that was incorporated in Florida, given that claim involved corporation's internal affairs.

2. Corporations ⟹640

Under both Delaware and Florida law, issues involving corporate internal affairs are governed by the law of the state of incorporation.

3. Bankruptcy ⟹2162

Heightened pleading requirements for averments of fraud did not apply to Chapter 7 trustee's claim for breach of fiduciary duty against former vice president and purported general counsel for corporate debtor, which alleged a breach of duty of care by failing to implement adequate monitoring system or by failing to use such a system to safeguard against corporate wrongdoing. Fed.Rules Civ.Proc. Rule 9(b), 28 U.S.C.App.(2000 Ed.).

4. Bankruptcy ⟹2162

Heightened pleading requirements for averments of fraud apply to a breach of fiduciary duty claim based on defendant's fraudulent conduct. Fed.Rules Civ.Proc. Rule 9(b), 28 U.S.C.App.(2000 Ed.).

5. Bankruptcy ⟹2162

Chapter 7 trustee's complaint stated claim against corporate debtor's former vice president of operations for breach of fiduciary duty under Florida law when complaint alleged that former vice president, who also was alleged to have served as in-house general counsel, failed to implement adequate internal monitoring system or, if such system was implemented, failed to use that system to safeguard against corporate wrongdoing, notwithstanding former vice president's contention that such allegations could support claim only against corporate directors, not corporation's officers.

6. Corporations ⟹307

Although Delaware law does not impose fiduciary duty on employees generally, it does impose fiduciary duties on corporate officers.

7. Corporations ⟹307

Under both Delaware and Florida law, both officers and directors owe fiduciary duties to the corporation.

8. Corporations ⟹312(5)

Under Delaware law, waste of corporate assets entails an exchange of corporate assets for consideration so disproportionately small as to lie beyond the range at which any reasonable person might be willing to trade.

9. Corporations ⟹319(6), 320(7)

Under Delaware law, plaintiff asserting claim for waste of corporate assets may survive at complaint stage of action even when motivations for challenged transaction are unclear by pointing to economic terms so one-sided as to create inference that no person acting in good-faith pursuit of corporation's interests could have approved such terms.

10. Bankruptcy ⟹2162

Under Delaware law, Chapter 7 trustee's complaint stated claim for waste of corporate assets against corporate debtor's former vice president of operations and purported general counsel, even though former vice president-general counsel was not financial officer and was not alleged to have benefited personally from alleged expenditures, which included leasing private jet flight time, absorbing monthly lease payments for luxury vehicles of corporation's president and chief executive officer (CEO), and paying large bonus to one officer at times when corporation had negative net income, given that former vice president-general counsel was alleged to have been aware of alleged corporate waste but took no action to prevent it.

11. Bankruptcy ⟹2162

Chapter 7 trustee's complaint stated claim against corporate debtor's former vice president and purported general counsel for aiding and abetting corporate waste when complaint alleged that former vice president-general counsel had knowledge of wasting of corporate assets by corporation's president and board chairman but took no action to correct it or to establish guidelines for corporate expenditures.

12. Fraud ⟹30

Under Florida law, elements of claim for aiding and abetting of breach of fiduciary duty are (1) a fiduciary duty, (2) a breach of this duty, (3) knowledge of the breach by the alleged aider and abettor, and (4) the aider and abettor's substantial assistance or encouragement of the wrongdoing.

13. Fraud ⟹30

To allege claim for aiding and abetting a fraud under Florida law, plaintiff must plead (1) the existence of the underlying fraud, (2) that defendant had knowledge of the fraud, and (3) that defendant provided substantial assistance to advance the commission of the fraud.

14. Bankruptcy ⟹2162

Under Florida law, Chapter 7 trustee's complaint stated claims against corporate debtor's former vice president-general counsel for aiding and abetting breach of fiduciary duty and aiding and abetting fraud, when complaint alleged that individual who served as corporation's president, chairman of the board, principal financial officer, and principal accounting officer committed numerous acts of fraud and breach of fiduciary duty, including making false statements in filings with Securities and Exchange Commission (SEC), that former vice president-general counsel failed to implement and maintain financial controls and proper checks and balances so as to ensure that information provided by former president-chairman to third parties was complete, fair, and accurate, and that former vice president-general counsel joined former president-chairman in his pattern of fraud by making misrepresentations, or by confirming former president-chairman's misrepresentations, to creditors and investors.

15. Fraud ⟹13(3)

Claim of negligent misrepresentation contains four elements: (1) a misrepresentation of a material fact, (2) the representor either knew of the misrepresentation, made the misrepresentation without knowledge as to its truth or falsity, or made the representation under circumstances in which he ought to have known of its falsity, (3) the representor intended the representation to induce another to act on it, and (4) injury resulted to the party acting in justifiable reliance on the misrepresentation.

16. Bankruptcy ⟹2154.1

Bankruptcy trustee does not have standing to assert claims on behalf of an estate's creditors.

17. Bankruptcy ⟹2154.1

Chapter 7 trustee had standing to assert negligent misrepresentation claim against former vice president and purported general counsel for corporate debtor on behalf of creditors and bankruptcy estate.

18. Bankruptcy ⟹2162

Allegations that purported general counsel for corporate debtor negligently performed his duties, resulting in false representations being made about corporation's financial affairs in its press releases and filings with Securities and Exchange Commission (SEC) that purported general counsel should have known to be false, stated claim for negligent misrepresentation.

19. Fraudulent Conveyances ⟹263(1)

Even though pleading of a claim for constructive fraudulent conveyance does not need to reach the same level of stringency as that for fraud, a mere recitation of the statute is not enough.

20. Bankruptcy ⟹2724

Chapter 7 trustee failed to satisfy fraud pleading rule in asserting fraudulent conveyance claims against corporate debtor's former vice president-purported general counsel under Bankruptcy Code and Pennsylvania law when trustee alleged that debtor received less than reasonably equivalent value in exchange for indemnification agreement, but did not allege that former vice president-purported general counsel received any indemnification benefits pursuant to agreement, and thus that any transfer of property occurred. 11 U.S.C.A. § 548; Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.App.(2000 Ed.); 12 Pa.C.S.A. §§ 5104, 5105.

21. Bankruptcy ⟹2724

Chapter 7 trustee failed to plead with sufficient specificity, under fraud pleading rule, claim that money transfers made by corporate debtor to vice president-purported general counsel were fraudulent transfers under Bankruptcy Code and Pennsylvania law, given that trustee simply noted that transfers did not involve payroll or stock issuance and did not indicate why transfers were effected, that amounts of most of disputed transfers permitted reasonable conclusion that transfers represented business expense reimbursements, and that trustee did not allege that transfers were made in the absence of transfer of value to debtor from vice president-purported general counsel. 11 U.S.C.A. § 548; Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.App.(2000 Ed.); 12 Pa.C.S.A. §§ 5104, 5105.

22. Bankruptcy ⟹2972

Dismissal without prejudice of Chapter 7 trustee's equitable subordination claim against corporate debtor's former officer was warranted when trustee did not allege that former officer had filed claim against debtor in its bankruptcy case.

23. Attorney and Client ⇨109

Under Pennsylvania law, complaint stated claim for professional negligence against corporation's in-house general counsel by alleging that he failed to provide oversight and advice that would have prevented corporation from submitting filings to Securities and Exchange Commission (SEC) which included material misrepresentations, that he was or should have been aware of malfeasance and misdealing and discrepancies in corporation's revenue but took no actions to remedy or ameliorate such problems until after corporation's president resigned, and that, due to his alleged negligence, corporation suffered damages.

24. Attorney and Client ⇨105.5

Under Pennsylvania law, elements for a professional negligence claim are (1) the employment of the attorney or other basis for his duty to act as an attorney, (2) the failure of the attorney to exercise ordinary skill and knowledge, and (3) that such negligence was the proximate cause of damage to plaintiff.

25. Attorney and Client ⇨107

An attorney must act with a proper degree of skill, and with reasonable care and to the best of his knowledge.

Francis G.X. Pileggi, Sheldon K. Rennie, Carl D. Neff, Fox Rothschild LLP, Wilmington, DE, Edward J. DiDonato, Fox Rothschild LLP, Philadelphia, PA, for the trustee, George L. Miller.

Michael D. DeBaecke, Blank Rome LLP, Wilmington, DE, Norman E. Greenspan, Evan H. Lechtman, Blank Rome LLP, Philadelphia, PA, for Defendant Brian T. Licastro.

MEMORANDUM OPINION

PETER J. WALSH, Bankruptcy Judge.

This opinion is with respect to defendant Brian T. Licastro's ("Licastro") motion (Doc. # 98) to dismiss the complaint pursuant to Federal Rule of Civil Procedure 12(b)(6) and Federal Rule of Bankruptcy Procedure 7012. For the reasons stated below the Court will deny the motion with respect to Counts I, II, III, IV, V, VII, and XIII, and grant the motion with respect to Counts IX, X, XI, and XII.[1]

BACKGROUND

The facts contained in this section are as set forth in the First Amended Complaint ("Complaint"). (Doc. # 113.) The Complaint is a rather comprehensive document, consisting of 257 paragraphs covering 46 pages.

The Parties

The Debtors in this chapter case are World Health Alternatives, Inc. and affiliated entities (collectively, "World Health" or "Company"). World Health was a Florida corporation that maintained its principal place of business in Pittsburgh, Pennsylvania. World Health provided healthcare staffing services to hospitals and other healthcare facilities nationwide. (Doc. # 113, ¶ 6.)

World Health filed its chapter 11 petition on February 20, 2006. The case was converted to a chapter 7 case on October 31, 2006 and George L. Miller ("Trustee") was appointed the chapter 7 trustee.

The Defendants are Richard E. McDonald ("McDonald") who served as president, chairman of the board, principal financial officer and principal accounting officer of World Health from its inception as a public company on February 20, 2003 until June 23, 2004 at which time he became chief executive officer; Marc D. Roup ("Roup") who was World Health's chief executive officer until his resignation on June 23, 2004; John C. Sercu ("Sercu") who served as World Health's chief operating officer from May 2004 until on or about August 16, 2005 when he became chief executive officer after McDonald's resignation; Bruce Hayden ("Hayden") who served as World Health' chief financial officer from July 18, 2005 through August 24, 2005; Frederick R. Jackson, Sr. ("Jackson") who served as a member of World Health's board of directors throughout the relevant period; John W. Higbee ("Higbee") who served as a member of World Health's board throughout the relevant period; Brian T. Licastro ("Licastro") who served as World Health's vice president of operations and in-house general counsel, on a de facto and/or formal basis;[2] Mark B. Rinder ("Rinder") who served as a financial consulting advisor to World Health; and Deana J. Seruga ("Seruga") who served as World Health's corporate comptroller during all relevant times.

World Health's Board of Directors consisted of three members: McDonald, Jackson, and Higbee. Jackson and Higbee were appointed by McDonald in 2004. The board did not hold annual meetings in 2003 or 2004, and thus, public shareholders did not elect any directors. (Doc. # 113, ¶ 64.) Allegedly, McDonald had general authority to execute Jackson's signature on board-related documents. Therefore, he had the power to execute documents on behalf of the majority of the board. (Doc. # 113, ¶¶ 65–66.)

Company's Growth and Financing—2003–2004

On February 20, 2003, World Health became a public company. (Doc. # 113, ¶ 9.) It underwent a "reverse merger" to acquire 100% of the common stock of Better Solutions, Inc. ("Better Solutions"), a healthcare staffing company, from its founders and co-owners, McDonald and Roup. (Doc. # 113, ¶ 29.) World Health provided McDonald and Roup with 33,000,000 shares of newly-issued World Health common stock, making them the controlling shareholders of World Health, owning approximately 82% of its outstanding shares. (Doc. # 113, ¶ 30.)

As of March 31, 2003, World Health had assets totaling $245,727 and negative shareholders equity of $91,762. Sales for the three months ended March 31, 2003 totaled $942,887, and World Health reported a net loss of $395,016, or $0.01 per share. (Doc. # 113, ¶ 32.)

In December 2003, World Health redeemed 8,000,000 shares of common stock each from McDonald and Roup. (Doc. # 113, ¶ 33.) In its Form 8–K filing with the Securities and Exchange Commission (the "SEC") on December 8, 2003, World Health stated that the purpose of the redemption was to reduce the long term

1. Counts VI and VIII are claims against defendant Richard E. McDonald only, therefore not relevant to this motion.

2. Licastro does not admit or deny that he was the in-house general counsel and in his reply brief he requests that I ignore the exhibits attached to the Trustee's answering brief that label Licastro as general counsel. He is correct in that regard. However, this is a motion to dismiss and in a number of places the Complaint specifically asserts that in addition to being a vice-president Licastro was the general counsel. (Doc. # 113, ¶¶ 20–23.) The Complaint states it and in a motion to dismiss the court must accept the allegations as true unless the defendant presents evidence showing the allegation to be false. (*Rocks v. City of Phila.*, 868 F.2d 644, 645; *Morse*, 132 F.3d at 906). Licastro has not done that in his motion papers.

delutive effect on World Health's future earnings per share. (Doc. # 113, ¶ 35.)

Through the redemption, World Health obtained sufficient authorized shares to execute a strategy of future growth. The center piece of the strategy was a series of private placement transactions ("PPT"). From December 2003 through December 2004 World Health executed numerous PPTs, through which it issued common and preferred stock, warrants for the purchase of common stock, and convertible debentures. (Doc. # 113, ¶¶ 35–36.) It purportedly raised approximately $38 million through these financial transactions. (Doc. # 113, ¶ 38.) Additionally, World Health allegedly received approximately $6.9 million from the exercise of warrants issued in connection with these PIPE transactions. (Doc. # 113, ¶ 39.)

Throughout 2003 and 2004, and one instance in 2005, World Health used the funds raised to make the following acquisitions:

(1) Superior Staffing Solutions, Inc., December 22, 2003.
(2) Pulse Healthcare Staffing, Inc., April 30, 2004.
(3) Care For Them Inc., May 7, 2004.
(4) Curley and Associates, LLC, June 1, 2004.
(5) Travel Nurse Solutions, Inc. ("TNS"), October 14, 2004.
(6) J & C Nationwide Inc., November 15, 2004.
(7) Parker Services, Inc., December 31, 2004.
(8) Universal Staffing Group, Inc., July 27, 2005.

Debt Obligations

By the end of 2004, World Health used up all of the funding it raised through the PPTs. To continue its ongoing operation and acquisitions, World Health procured secured debts from CapitalSource Finance, LLC. ("CSF") to refinance outstanding indebtedness and provide additional liquidity. (Doc. # 113, ¶¶ 68–70.) On February 14, 2005, World Health and CSF entered into a series of agreements ("CSF Agreement"). (Doc. # 113, ¶ 70.) The CSF Agreement included a term loan ("CSF Term Loan") in the amount of $7,500,000 and a revolving credit facility that provided a maximum loan amount of $37,000,000. (Doc. # 113, ¶ 72.) World Health and each of its subsidiaries were co-borrowers under the CSF Agreement. The obligations under the CSF Agreement were secured by substantially all of World Health and its subsidiaries' assets. (Doc. # 113, ¶ 73.)

In addition to the CSF Agreement, World Health had incurred other obligations. First, pursuant to the TNS acquisition, World Health pledged substantially all of its assets to secure approximately $2.5 million in secured obligations due and owing to the sellers ("Seller Parties"). The Seller Parties agreed to subordinate all of their rights to payments and liens to those of CSF. (Doc. # 113, ¶¶ 76–77.)

World Health received notice from the Internal Revenue Service (the "IRS") that on or about February 7, 2006 the IRS filed liens in favor of the United States on all properties and rights to property belonging to a California subsidiary. (Doc. # 113, ¶ 78.) The IRS alleged that as of February 3, 2006 that subsidiary was indebted to the United States for approximate $1,256,241.27. (Doc. # 113, ¶ 79.) Furthermore, the IRS notified World Health that on or about February 7, 2006 it filed liens in favor of the United States on all properties and rights to property belonging to another subsidiary. The IRS alleged that as of February 2, 2006 that subsidiary was indebted to the United States in the approximate amount of

$2,274,316.23. (Doc. # 113, ¶¶ 80–81.) The IRS tax liability amounted to in excess of $4,000,000.

Corporate Waste

The Trustee alleges that since 2003 Defendants engaged in and/or allowed the routine waste of World Health's limited resources on expensive and unnecessary luxuries for their personal benefits. (Doc. # 113, ¶ 82.) One instance was World Health leasing 25 hour of flight time on a private jet from Marquis Jet for a payment of $112,939.70. (Doc. # 113, ¶ 83.) In 2004, World Health spent another $114,181.11 on six different chartered flights. (*See* Doc. # 113, ¶ 88.)

According to World Health's SEC Form 10–KSB (as amended) for 2003 ("2003 Annual Report"), at the time of the chartering, World Health had a gross revenue of $3,093,337 and a negative net income of $33,094 (before adjustment for taxes). At the close of fiscal year 2003, World Health had $177,699 in cash and $1,516,265 in total current assets. Thus, the Trustee alleges that Defendants caused and/or allowed World Health to squander nearly 7.5% of the total current assets on leasing 25 hours of flight time on a private jet. (Doc. # 113, ¶¶ 83–86.) Another example of the alleged waste was World Health paying monthly leases for Roup's and McDonald's luxury cars. (Doc. # 113, ¶ 87.) The monthly payments were $2,207.38 and $2,045.72, respectively. (Doc. # 113, ¶ 87.)

During this time World Health was executing its PPT to raise approximately $40 million to fund its operations and growth. According to its SEC Form 10–KSB (as amended) for 2004 ("2004 Annual Report") World Health had a net loss of $13,427,523 for the fiscal year. (Doc. # 113, ¶ 89.)

Fraudulent Activities

The Trustee pleads that World Health's management never implemented a system that allowed them to report any accounting and reporting abnormalities in World Health's financial reports, books, or records. (Doc. # 113, ¶¶ 98–100.) The following fraudulent activities allegedly occurred as a result.

(a) 2002 IRS Reporting

As early as 2002 McDonald commenced a scheme of manipulating the IRS. McDonald would "cut and past" documents to demonstrate that payments were made to the IRS to satisfy outstanding taxes. Then, he would fax these cut-and-pasted documents to the IRS as evidence of alleged payment of taxes. In actuality, these payments were never made and taxes owed by one of the subsidiaries remained due and outstanding. (Doc. # 113, ¶¶ 98–100.)

(b) Related Party Loan Account

McDonald created a related party loan account to offset discrepancies that would occur when funds were not appropriately paid. (Doc. # 113, ¶¶ 106–07.) For example, he would reward himself with excessive bonuses that World Health could not satisfy, instead of taking the cash, McDonald would increase the value of the related party loan. (Doc. # 113, ¶ 107.) In addition, when payroll tax checks were issued by World Health, McDonald would not remit the checks to the IRS and enter an offsetting line-item into the related party loan account to hide the discrepancy. (Doc. # 113, ¶ 108.)

On August 16, 2004, World Health issued a press release announcing its second quarter of 2004 results. In it World Health listed a $1,518,571 related party loan liability. (Doc. # 113, ¶ 109.) In its August 23, 2004 Form 10–QSB filing with the SEC, again it listed the related party loan as a $1,518,571 liability. (Doc. # 113, ¶ 111.) By the third quarter of 2004 the

related party loan listed in Form 10–QSB had increased to $3,644,307. (Doc. # 113, ¶ 112.)

On March 29, 2005, World Health announced the financial results for year-end 2004. The press release listed a lower amount for the related party loan, $3,010,420, in World Health's current liabilities. (Doc. # 113, ¶ 113.) The 2004 Annual Report confirmed the lower amount of $3,010,420. (Doc. # 113, ¶ 114.) The apparent reduction was the result of World Health beginning to "repay" the purported loan. (Doc. # 113, ¶ 116.) By the first quarter 2005 the related party loan liability had decreased to $1,089,949. (Doc. # 113, ¶ 118.)

(c) Misrepresentations in Financial Statements

McDonald misrepresented his educational background in several SEC filings. For example, in the 2003 Annual Report he described his educational background as follows:

> Mr. McDonald received the following degrees in Business Administration:(a) In April 1996, a Bachelor of Science Degree from the University of Pittsburgh; (b) in May 2000, a Master's Degree from Bridgewater University located in London, England; and (c) in May 2001, a Doctoral Degree from Bridgewater University.

(Doc. # 113, ¶ 121.) However, this representation was false. On July 15, 2004, McDonald signed and filed a Form 8–K with the SEC stating:

> [I]t was confirmed that Mr. McDonald did attend the University of Pittsburgh but the records available at the time could not confirm that he graduated with a B.S. degree.

(Doc. # 113, ¶ 123.) The Form 8–K stated that all educational credentials should be deemed removed from McDonald's biography. McDonald had not graduated from the University of Pittsburgh, and Bridgewater University is an unaccredited school that offers degrees over the internet for very little work. (Doc. # 113, ¶ 123.)

From the third quarter of 2003 to June of 2004, McDonald signed and filed certifications as chief executive officer with each Form 10–QSB and 10–KSB filed with the SEC pursuant to § 302 and § 906 of the Sarbanes–Oxley Act of 2002. (Doc. # 113, ¶ 124.) Roup also signed and filed certifications as chief financial officer with each Form 10–QSB and 10–KSB filed with the SEC from the third quarter of 2003 until his resignation in June of 2004. (Doc. # 113, ¶ 124.) The certifications stated that they each had reviewed the reports, and based on their knowledge the reports do not contain any untrue, omission, or misleading statement of material fact, and based on their knowledge the reports fairly presented in all material respects the financial condition of World Health. (Doc. # 113, ¶ 124.) The Trustee alleges that these certifications were false and misleading. (Doc. # 113, ¶ 126.)

Defendants released false information regarding the financial viability of World Health to the public, therefore, to World Health's creditors. On March 29, 2005, Defendants issued a press release announcing World Health's results for the fourth quarter and year-end 2004. For the fourth quarter, World Health reported sales of $22,553,603, an increase of 2244% over sales reported for fourth quarter of 2003. World Health attributed the growth to acquisitions and organic growth. Defendants reported that World Health experienced gross profit for the fourth quarter of $3,928,592, and increase of 802% compared to the fourth quarter of 2003. For the year, World Health reported sales of $40,339,739 compared to sales of $3,693,337 for 2003. Gross profit for the year was

$10,242,997, compared to $1,599,794 in 2003. Total assets as of December 31, 2004 were reported as $100,697,761 compared to $5,301,358 in 2003. Shareholder's equity increased to $36,018,763 compared to $2,184,551 in 2003. In the press release, McDonald stated:

> The Company achieved critical mass in the fourth quarter, substantially through strategic acquisitions and strong organic growth. We now offer all of the product lines that are integral to staffing the healthcare industry, making us a 'one-stop' staffing solution for an entire healthcare system. We have established a national reach and expect the benefits to include additional client contracts, a deeper talent pool of consultants and stronger financial performance. We have also reduced our overall debt and improved our financial and operating position.
>
> . . .
>
> The first quarter of 2005 has also yielded excellent results so far and put us on schedule to meet our goals for the year. We expect our first quarter earnings to be $.08 to $.10 per share on revenues of $39 million to $42 million. Overall, we believe we are well positioned to meet the increasing demand for healthcare staffing services that the Company has been experiencing and we reiterate our guidance for 2005 of $200 million in revenues and $.50 to $.55 in net earnings.
>
> . . .
>
> The Company expects to report a corresponding non-cash, beneficial increase in earnings in the first quarter of 2005 as a result of having incurred in the fourth quarter of 2004 certain non-cash expenses associated with preferred stock transactions recognized in the fourth quarter.
>
> . . .
>
> By incurring certain non-cash expenses in 2004, we have, in our estimation, positioned the Company for a profitable 2005. The financing we completed with CapitalSource Finance LLC in February 2005 to refinance existing indebtedness should provide us with the working capital and flexibility needed for us to grow our revenues to over half a billion dollars within the next two years through organic growth and acquisitions.

Defendant Sercu added:

> We are on track and continue to execute our plan to become the premier healthcare staffing Company [sic] in the market. We have exceeded our organic growth expectations and continue to experience the benefits of our integration efforts. Our key performance metrics are increasing and all divisions are seeing the results of efforts to improve profitability. (Doc. # 113, ¶ 128.) The Trustee alleges that McDonald and Sercu's statements were false and misleading because World Health lacked adequate internal controls and was, therefore, unable to ascertain its true financial condition and could not properly ascertain its debt or its tax liabilities. (Doc. # 113, ¶ 129.)

On April 15, 2005, World Health filed its 2004 Annual Report with the SEC. It reiterated the results stated in the March 29, 2005 press release. The 2004 Annual Report also contained McDonald's certifications pursuant to §§ 302 and 906 of the Sarbanes–Oxley Act of 2002. The Trustee claims that these reports were false and misleading because World Health lacked adequate internal controls and was, therefore, unable to ascertain its true financial condition. (Doc. # 113, ¶¶ 130–31.)

On May 13, 2005, World Health issued a press release announcing it was changing the financial results released for the fourth quarter and fiscal year 2004 after deter-

mining that "large, non-cash expenses in connection with a preferred stock transaction that occurred in December 2004" were improperly recorded. The press release quoted McDonald as stating:

> We recorded the non-cash expenses in the fourth quarter of 2004 because we wanted to utilize a conservative reporting approach until we could consult with the Office of the Chief Accountant [of the SEC] and confirm that our position that the preferred stock conversion and redemption features did not create a need for any derivative accounting was correct. Additionally, the Company determined that the warrants associated with the transaction were a liability and therefore the $3,003,591 fair value of the warrants was recorded as a liability. The Company believed it was important to pursue this matter to increase the transparency of its financial reporting and better enable the market to evaluate the Company's financial results in 2004 and in the future. This positive restatement completes the Company's review of this matter as referenced in our 10–KSB for 2004.

The press release further stated that World Health was filing a Form 10–KSB/A later that day setting forth revised financial statements that would exclude the large, non-cash expenses relating to the preferred stock transaction. According the press release, "[a]s a result, the Company's earnings for the quarter and fiscal year ended December 31, 2004 increased to 14 cents." A comparison of the Form 10–KSB/A filed on or about May 18, 2005 with the March 29, 2005 press release announcing showed the opposite. The restatement merely reduced World Health's reported loss by 14 cents per share, from $0.81 per share to $0.67 per share. (Doc. # 113, ¶ 133.)

On May 16, 2005, World Health filed Form 10–QSB with the SEC for the period ended March 31, 2005. The report noted that:

> Effective December 15, 2004, the Company closed on a financing transaction with a group of private investors ("Investors") of up to $11,825,000. The financing consisted of two components: (a) 12,823 shares of Series A Convertible Preferred Stock with a principal amount of $12,823,000 at a dividend rate of 8% per annum and (b) Warrants registered in the name of each Investor to purchase up to a number of shares of common stock of the Company equal to 25% of such Investor's Subscription Amount divided by the subscription amount of $3.00 per share. The Investors have the right to purchase an aggregate of 1,068,-583 shires [sic] of the Company's restricted common stock. The Warrants have an exercise price equal to the closing price of the Company's common stock on the day prior to the closing ($3.86). The Warrant, which expires five years from the date of issuance, results in proceeds of $4,124,730 to the Company upon its exercise. The dividends are cumulative until December 31, 2006, and will be paid from an escrow established at closing if the Investors elect to be paid in cash. Under certain circumstances the Company may elect to pay the dividend in shares of the Company's common stock.
>
> The Preferred Stock is convertible into shares of Common Stock of the Company at a conversion price of $3.00 per share, which would result in the issuance of 4,274,333 shares of the Company's common stock if all shares were converted.

(Doc. # 113, ¶ 134.) The Trustee believes that these statements were false and misleading because Defendants were unable to correctly account for World Health's convertible debt and warrants associated with its preferred stock, and was in breach of its existing financing agreements. (Doc. # 113, ¶¶ 135.)

The Form 10–QSB for the period ended March 31, 2005 contained McDonald's certifications pursuant to §§ 302 and 906 of the Sarbanes–Oxley Act of 2002. The Trustee alleges that the certifications were false and misleading because Defendants failed to implement adequate internal controls at World Health, thus, unable to ascertain its true financial condition. (Doc. # 113, ¶¶ 135–36.)

World Health's false and misleading financial reporting became public in the second half of 2005. On July 18, 2005, World Health announced Hayden as the Chief Financial Officer. (Doc. # 113, ¶ 137.) On August 16, 2005, World Health first indicated that it had discovered fraudulently reported financial results. On that date, World Health unexpectedly and abruptly announced that McDonald had resigned as president and chief executive officer "for health and family reasons." World Health appointed Sercu as acting chief executive officer. It also announced that it had notified the SEC that it would not file its 10–Q for the second quarter of 2005 on time. (Doc. # 113, ¶ 138.)

The Trustee alleges that the above described conduct reflects materially false and misleading information because they failed to disclose the following material adverse facts that Defendants knew or should have known:

(a) Defendants engaged in improper accounting practices. Defendants admitted that World Health's prior financial reports were materially false and misleading when it announced that it was going to restate the financial results for 2004 and 2005.

(b) There were discrepancies in the financial statement on the recognition of a convertible debenture and warrant agreement associated with World Health's preferred stock.

(c) There was underpayment of tax liabilities in excess of $4,000,000.

(d) Irregular reports to World Health's lenders resulted in excess funding under World Health lending arrangements of approximately $6.5 million.

(e) World Health was in breach of existing financing documents.

Defendants were increasing or knew of the increase in the revenue reported in publicly-filed financial statements by including funds received from the exercise of warrants. The inclusion of such non-revenue amounts significantly increased the reported revenue and artificially inflated World Health's reported financial performance. (Doc. # 113, ¶¶ 143–44.)

(d) Double Borrowing on Receivable

The Trustee alleges that World Health executed a scheme to "borrow" twice on certain account receivable. World Health maintained numerous Master Factoring Agreements with Advance Payroll Funding ("Factoring Agreements"). The Factoring Agreements allowed World Health to receive instant cash in an amount equal to a percentage of the "sold" accounts receivable, subject to adjustment. (Doc. # 113, ¶ 146.)

The problem with the Factoring Agreements was that the "factored" accounts receivable were included in the CSF Agreements' borrowing base calculation. Thus, World Health was able to borrow a percentage of these accounts receivable from CSF, even though the receivables were already "sold" and World Health no longer retained the right to collect on the receivables. (Doc. # 113, ¶ 148.) Also, World Health was not using payments re-

ceived to satisfy its obligations under the CSF Agreements. (Doc. # 113, ¶ 147.)

Furthermore, when World Health prepared the borrowing base calculation for the CSF Agreements, it provided the reports to McDonald, who would then forward the information to CSF. The Trustee claims that McDonald altered the value of accounts receivable used in the borrowing base calculation before forwarding the documents to CSF. (Doc. # 113, ¶¶ 149–50.) The Trustee also claims that members of World Health's management, including Roup, Sercu, Higbee, Jackson, Licastro, and Seruga became aware of or should have been aware of the malfeasance and misdealing and discrepancies in World Health's revenues. They, however, did not take any action consistent with their fiduciary duties to remedy or ameliorate the discrepancies until after McDonald's resignation. (Doc. # 113, ¶ 151.) The Trustee points to World Health's statement that its reports to its lenders were "irregular" as an admission that management intentionally falsified those reports. (Doc. # 113, ¶ 152.)

Indemnification Agreement

On August 29, 2005, World Health filed a Form 8–K with the SEC announcing that it had entered into an Indemnification Agreement with each of World Health's executive officers and directors who were named Defendants in several securities class actions.[3] (Doc. # 113, ¶ 154.) The Indemnification Agreement purportedly included Hayden, Sercu, Licastro, Higbee, Jackson, and Rinder (collectively "Indemnified Defendants"). (Doc. # 113, ¶¶ 154–55.) It covered against costs associated with shareholder fraud lawsuits, including attorney's fees and damages that the Indemnified Defendants may otherwise have to pay. (Doc. # 113, ¶ 155.)

The Trustee alleges that the provisions of the Indemnification Agreement constituted a fraudulent conveyance to the Indemnified Defendants. (Doc. # 113, ¶ 159.) He contends that no consideration was provided by the Indemnified Defendants in exchange for the Indemnification Agreement. (Doc. # 113, ¶ 158.) Although the announcement was made on August 29, 2005 the Indemnification Agreement was dated August 21, 2005, one day prior to the filing of the first securities class action. The announcement also came approximately 60 days before the revelation that World Health was undertaking an investigation of its accounting systems because of inadequate controls, examining past financial statements for possible restatement, and withholding its financial statements for the third quarter of 2005 because of problems with the accounting systems. (Doc. # 113, ¶ 156.)

World Health's Collapse

On August 24, 2005, World Health filed a Form 8–K with the SEC announcing that the management discovered approximately $22 million in debt of which it was not previously aware. On September 9, 2005, World Health announced that it had retained Alvarez & Marsal LLC, a global professional services firm specializing in turnaround management, to work with World Health's board of directors and management to evaluate the business plan and strategic capital structure of World Health. (Doc. # 113, ¶ 162.) On September 13, 2005, World Health filed a Form 8–K announcing it was aware of the SEC's formal investigation involving it. (Doc. # 113, ¶ 163.) On September 23, 2005, World Health filed a Form 8–K announcing that Bristol Investment Fund, Ltd. notified World Health that it was in default of the terms of the Convertible Debentures and related warrants to purchase common stock issued in May of 2005 due to breaches by World Health of the terms of the Debenture and Purchase Agreement. Bristol notified it of a demand for payment of $6,288,373 plus interest and costs. (Doc. # 113, ¶ 164.) A securities law class action complaint was filed in the United States District Court for the Western District of Pennsylvania. World Health filed its chapter 11 petition on February 20, 2006. The case was converted to a chapter 7 case on October 31, 2006 and the Trustee was appointed.

3. It also announced that Hayden had resigned as Chief Financial Officer. (Doc. # 113, ¶ 160.)

The Complaint

The Complaint alleges 13 counts: (I) breach of fiduciary duty against all Defendants; (II) aiding and abetting breach of fiduciary duty against all Defendants; (III) corporate waste against all Defendants; (IV) aiding and abetting waste of corporate assets against all Defendants; (V) negligent misrepresentation against all Defendants; (VI) fraud against McDonald; (VII) aiding and abetting fraud against all Defendants other than McDonald; (VIII) turnover of property of estate against McDonald; (IX) fraudulent transfer under 11 U.S.C. §§ 548 and 550 against McDonald, Sercu, Hayden, Jackson, Higbee, Licastro, and Rinder; (X) fraudulent transfer under Pennsylvania Uniform Fraudulent Transfer Act, § 5104 against McDonald, Sercu, Hayden, Jackson, Higbee, Licastro, and Rinder; (XI) fraudulent transfer under Pennsylvania Uniform Fraudulent Transfer Act, § 5105 against McDonald, Sercu, Hayden, Jackson, Higbee, Licastro, and Rinder; (XII) equitable subordination; and (XIII) professional negligence against Licastro. (Doc. # 113, ¶¶ 173–257.)

STANDARD OF REVIEW

Licastro moves to dismiss the Complaint pursuant to Rule 12(b)(6) of the Federal Rule of Civil Procedure, which is made applicable to this case by Rule 7012 of the Federal Rules of Bankruptcy Procedure. In considering a motion to dismiss under Rule 12(b)(6), courts must accept as true all allegations in the complaint and draw all reasonable inferences in the light most favorable to the plaintiff. *Morse v. Lower Merion Sch. Dist.*, 132 F.3d 902, 906 (3d Cir.1997); *Rocks v. Philadelphia*, 868 F.2d 644, 645 (3d Cir.1989). A motion to dismiss should be granted if "it appears to a certainty that no relief could be granted under any set of facts which could be proved." *D.P. Enters. Inc. v. Bucks County Cmty. Coll.*, 725 F.2d 943, 944 (3d Cir.1984).

DISCUSSION

(a) Breach of Fiduciary Duty Claim (Count I)

[1, 2] Both parties agree, Florida law should govern the breach of fiduciary duty claim (Count I). (*See* Doc. # 99, p. 9; Doc. # 104, p. 11.) Under Delaware and Florida laws, issues involving corporate internal affairs are governed by the law of the state of incorporation. *Select Portfolio Serv. Inc. v. Evaluation Solutions, LLC*, No. 3:06–CV–582–J33 MMH, 2006 WL 2691784, at *9 (M.D.Fla. Sept.20, 2006); *In re Circle Y Yoakum Texas*, 354 B.R. 349, 359 (Bankr.D.Del.2006) (citing *Vantage-Point Venture Partners 1996 v. Examen, Inc.*, 871 A.2d 1108, 1115 (Del.2005)). A breach of fiduciary duty claim involves the internal affair of a corporation. *Coleman v. Taub*, 638 F.2d 628, 629, n. 1 (3d Cir. 1981). Thus, because World Health was incorporated in Florida, Florida law governs this claim.

[3] Licastro argues that the fiduciary claim should be dismissed because the Trustee did not plead the claim with particularity. (*See* Doc. # 99, pp. 9–11.) He cites Florida law requiring a plaintiff of a breach of fiduciary duty claim to demonstrate with particularity the facts which purportedly created the breached duty. *See Parker v. Gordon*, 442 So.2d 273, 275 (Fla. 4th DCA, 1983). In addition, he asserts that federal courts have heightened the pleading requirement of Federal Rules of Civil Procedure Rule 9(b) for breach of fiduciary duty claims which rely on allegations of fraudulent conduct. *See Am. Mobile Commc'ns, Inc. v. Nationwide Cellular Serv., Inc.,* No. 91 Civ. 3587, 1992 WL 232058, *6 (S.D.N.Y. Sept. 3, 1992); *Frota v. Prudential–Bache Sec. Inc.*, 639 F.Supp. 1186, 1193 (S.D.N.Y.1986). Licastro contends that the Complaint did not contain any specific allegation of him breaching his fiduciary duty to the shareholders or the Company. Rather, the Trustee grouped Licastro with the other Defendants who are officers of World Health and imputed his breach based on the lack of conduct or misconduct of the group.

[4] While it is true that there is a heightened pleading requirement for a breach of fiduciary duty claim based on fraudulent conduct of a defendant, that is not the case here. The basis for the Trustee's claim is that Licastro breached his duty of care by failing to implement an adequate monitoring system and/or the failure to utilize such system to safeguard against corporate wrongdoing. *See In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 967–71 (Del.Ch.1996); *Stone v. Ritter*, 911 A.2d 362, 370 (Del.2006). Even though Florida law governs this claim, Delaware law is still relevant because "[t]he Florida courts have relied upon Delaware corporate law to establish their own corporate doctrines." *Connolly v. Agostino's Ristorante, Inc.*, 775 So.2d 387, 388 n. 1 (Fla.Dist.Ct.App.2000) (citing *Int'l Ins. Co. v. Johns*, 874 F.2d 1447, 1459 n. 22 (11th Cir.1989)).

[5] The Trustee relies on *ATR–Kim Eng Fin. Corp. v. Araneta*, No. 489–N, 2006 WL 3783520 (Del.Ch., Dec.21, 2006) for his position. In *Araneta*, the court found two defendants who were directors and officers of the company liable for not stopping the company's majority shareholders and fellow director from transferring the company's assets to members of his family, a violation of his fiduciary duties. *See id.* at *1, 19, 23–25. The court cited the Delaware Supreme Court's *Stone* decision for directors' liability:

> *Caremark* articulates the necessary conditions predicated for director oversight liability: (a) the directors utterly failed to implement any reporting or information system or controls; or (b) having implemented such a system or control, consciously failed monitor or oversee its operation thus disabling themselves from being informed of risks or problems requiring their attention.

Id. at *24 (citing *Stone*, 911 A.2d at 370). The court reasoned that:

> One of the most important duties of a corporate director is to monitor the potential that others within the organization will violate their duties. Thus, a "director's obligation includes a duty to attempt in good faith to assure that a corporate information and reporting system, which the board considers to be adequate, exists." Obviously, such a reporting system will not remove the possibility of illegal or improper acts, but it is the directors' charge to "exercise a good faith judgement that the corporation's information and reporting system is in concept and design adequate to assure the board that appropriate information will come to its attention in a timely manner as a matter of ordinary questions, so that it may satisfy its responsibility."

Id. at *23–24 (quoting *Caremark*, 698 A.2d at 970).

The Trustee alleges that as the vice president of operation and in-house general counsel to World Health, Licastro was responsible for failing to implement any internal monitoring system and/or failing to utilize such system as is required by *Caremark* and *Araneta*. The material misrepresentations contained in World Health's SEC filings are examples of such failure. Since the SEC adopted a final rule pursuant to § 307 of the Sarbanes–Oxley Act, effective August 5, 2003, a general counsel has an affirmative duty to inspect the truthfulness of the SEC filings. 17 C.F.R. Part 205 (Jan. 29, 2007). Section 307 addresses the professional responsibilities of attorneys. It directs the SEC to issue rules that "set[ ] forth minimum standards of professional conduct for attorneys appearing and practicing before the Commission in any way in the representation of issuers." Sarbanes–Oxley Act § 307, 15 U.S.C. § 7245 (2005). The standards must contain a rule requiring "an attorney to report evidence of a material violation of securities law or breach of fiduciary duty or similar violation by the issuer up-the-ladder within the company." *Id.* Therefore, the Trustee appropriately asserts that Licastro as the in-house general counsel and the only lawyer in top management of World Health during the relevant period, had a duty to know or should have known of these corporate wrong doings and reported such breaches of fiduciary duties by the management.

[6] In his reply brief, Licastro takes a different tact and argues that Delaware law does not support the breach of fiduciary duty claims against officers because the *Caremark* line of cases all addressed the fiduciary duties of directors, not officers. Licastro asserts: "The Trustee has sought to drastically broaden the scope of *Caremark* by expanding liability for allegedly failure of oversight to not just corporate directors, but also to corporate officers and employees. Delaware law does not recognize this principle." (Doc. # 126, pp. 1–2.) That statement is both correct and wrong. It is correct that Delaware law does not impose fiduciary duty on "employees" generally, but it is incorrect that it does not impose failure of oversight (fiduciary duty) as to officers. Of course, Licastro was not just an "employee"; he was an officer in two respects, vice president of operations and general counsel. *See* Sarah Helene Duggin, *AALS Annual Meeting Article: the Pivotal Role of the General Counsel In Promoting Corporate Integrity and Professional Responsibility,* 51 St. Louis U.L.J. 989, 1014–15 (2007)("Many perhaps most, general counsel are corporate officers. Titles such as 'vice president and general counsel' or 'vice president, legal affairs' are common.... As vice presidents ..., in addition to their professional obligations, general counsels owe fiduciary allegiance to the corporation as officers."); Lyman P.Q. Johnson & Mark A. Sides, *Corporate Governance and the Sarbanes–Oxley Act: The Sarbanes–Oxley Act and Fiduciary Duties*, 30 Wm. Mitchell L.Rev. 1149, 1205–06 (2004) ("Although often overlooked, corporate officers, including senior officers such as the ... General Counsel, Executive Vice Presidents, ... and others are 'agents' of the corporation. Agency is a fiduciary relationship. Even though senior officers of corporations typically have employment agreements, they still occupy a fiduciary status in relation to the corporate principal."). Thus, in this respect I believe Licastro is wrong.

While it is true that all of the cases relied upon by the Trustee involved di-

rectors' conduct, not officers', I believe the *Caremark* decision itself suggests that the same test would be applicable to officers. In the *Caremark* opinion the court, when addressing the meaning of the prior decision of *Graham v. Allis–Chalmers Mfg. Co.,* 188 A.2d 125, 130–31 (Del.1963), stated: "The case can be more narrowly interpreted as standing for the proposition that, absent grounds to suspect deception, neither *corporate boards nor senior officers* can be charged with wrongdoing simply for assuming the integrity of employees and the honesty of their dealing on the company's behalf." *Caremark,* 188 A.3d at 969 (emphasis added). Also, in *Miller v. U.S. Foodservice, Inc.,* 361 F.Supp.2d 470, 477 (D.Md.2005), the court, in reliance upon the Delaware decision of *Aronson v. Lewis,* 473 A.2d 805, 812 (Del.1984), stated: "While generally courts do not second-guess corporate decision-making and directors and officers enjoy the presumption of the business judgment rule, the rule can be overcome by allegations of gross negligence." *Miller,* 361 F.Supp.2d at 477. *In re Walt Disney Co. Derivative Litigation,* No. Civ. A. 15452, 2004 WL 2050138, at *3 (Del.Ch. Sept.10, 2004), clearly suggests that Licastro is wrong on this point:

> To date, the fiduciary duties of officers have been assumed to be identical to those of directors. With respect to directors, those duties include the duty of care and the duty of loyalty. There has also been much discussion regarding a duty of good faith, which may or may not be subsumed under the duty of loyalty. Ovitz became an officer of Disney on October 1, 1995 when he became President of the corporation, and he became a director on January 22, 1996. Therefore, upon becoming an officer on October 1, 1995, Ovitz owed fiduciary duties to Disney and its shareholders.

Id. at *3 (internal citation omitted).

Other courts have also applied the Delaware law and recognized that officers owe fiduciary duties to the corporation. In *Stanziale v. Nachtomi* (*In re Tower Air, Inc.*), the Third Circuit Court of Appeals upheld the bankruptcy trustee's claims against Tower Air's directors and officers. Count two alleged that Tower Air's officers breached their fiduciary duty to act in good faith, *inter alia,* by failing to tell the directors about maintenance problems, and by failing to address the maintenance problems. 416 F.3d 229, 234 (3d Cir.2005). The Third Circuit held that "[t]he officers' passivity in the face of negative maintenance reports seems so far beyond the bounds of reasonable business judgement that its only explanation is bad faith." *See id.* at 234, 239. *See In re Greater Southeast Cmty. Hosp. Corp.,* 353 B.R. 324, 339 (Bankr.D.D.C.2006) (The defendant corporation was incorporated in Delaware and the court applied Delaware law. "The directors of Delaware corporations have a triad of primary fiduciary duties.... With respect to the obligation of officers to their own corporation and its stockholders, there is nothing in any Delaware case which suggest that the fiduciary duty owned is different in the slightest from that owed by directors.").

[7] "Florida law has [also] long recognized that corporate officers and directors owe duties of loyalty and a duty of care to the corporation." *Welt v. Jacobson (In re Aqua Clear Tech., Inc.),* 361 B.R. 567, 575 (Bankr.S.D.Fla.2007). In *Cohen v. Hattaway,* the court expressly stated that "[c]orporate directors and officers owe a fiduciary obligation to the corporation and its shareholders and must act in good faith and in the best interest of the corporation." 595 So.2d 105, 107 (Fla.Dist.Ct.App. 1992) (quoting *Tillis v. United Parts, Inc.,* 395 So.2d 618 (Fla.Dist.Ct.App.1981)). Thus, it is clear that under both Delaware and Florida law both officers and directors owe fiduciary duties to the corporation.

(b) Waste of Corporate Assets Claim (Count III)

[8–10] The standard for adjudicating a waste of corporate assets claim (Count III) is well settled in Delaware. The Delaware Supreme Court held: "[W]aste entails an exchange of corporate assets for consideration so disproportionately small as to lie beyond the range at which any reasonable person might be willing to trade." *Brehm v. Eisner,* 746 A.2d 244, 263 (Del.2000). At this phase, however, "[t]he doctrine of waste ... allows a plaintiff to pass go at the complaint stage even when the motivations for a transaction are unclear by pointing to economic terms so one-sided as to create an inference that no person acting in a good faith pursuit of the corporation's interests could have approved the terms." *Sample v. Morgan,* 914 A.2d 647, 670 (Del.Ch.2007); *Harbor Fin. Partners v. Huizenga,* 751 A.2d 879, 893 (Del.Ch. 1999) ("[T]he fundamental basis for a waste claim must rest on the pleading of facts that show that the economics of the transaction were so flawed that no disinterested person of right mind and ordinary business judgment could think the transaction beneficial to the corporation.").

The expenditures in question occurred in two time periods: (1) In 2003, World Health leased 25 hours of private flight time from Marquis Jet for $112,939.70 and absorbed monthly lease payments of $2,207.38 and $2,4045.72 for Roup and McDonald's luxury automobiles, respectively. During this time, World Health had a negative net income of $33,094.00 and only $117,699 of cash available. (2) In 2004, it incurred $114,181.11 private flight costs, and during one of its acquisitions, World Health paid Sercu $500,000 bonus and 1,000,000 shares of its stock. These expenditure were made while World Health had a net loss of $13,427,523 for fiscal year 2004, according to its 2004 Annual Report. Licastro contends that the waste of corporate assets count should be dismissed because the alleged instances were not for his personal benefits and he was not involved. He also asserts that there is nothing in the pleadings that proves the alleged incidents amount to expenses so one sided that no reasonable business person would consider them adequate. (Doc. # 99, p. 12.)

The call on this count is a close one. There is no allegation that Licastro personally benefitted from the alleged expenditures. Licastro's role was vice president of operations and general counsel. Because he was not a financial officer his knowledge of the alleged wasteful spending for personal benefit to other officers and directors would seem not to be readily discernable. However, given the fact that we must view the allegation in the light most favorable to the Trustee, I believe the motion should be denied with respect to this count.

While Licastro may not have been actively engaged in these alleged wasteful expenditures, the Complaint alleges that "Defendants actively engaged in and/or allowed routine waste of the Company's limited resources," and the "directors, officers and other senior management[s] knew or should have known about the above referenced mismanagement and waste and they exhibited a substantial and systematic failure to control and monitor the accrual of unnecessary expenses." (Doc. # 113, ¶¶ 82, 91.) Because the Complaint alleges that Defendants, including Licastro, "allowed" and "knew or should have known" the corporate waste, it follows that the Complaint is asserting that Defendants, including Licastro, were aware of the alleged corporate waste and took no action,

as fiduciaries, to prevent such conduct. Also, it is conceivable that no person acting in good faith in pursuit of World Health's interest would approve chartering expensive flights, leasing luxury automobile, and granting large bonuses to certain directors and officers while World Health was experiencing negative net income. Thus, the motion to dismiss will be denied as to the corporate waste count.

(c) Aiding and Abetting Claims (Counts II, IV, VII)

[11] The Trustee alleges that Licastro aided and abetted in the corporate waste (Count IV) and in McDonald's breaching his fiduciary duty (Count II) and fraud (Count VII). With respect to aiding and abetting waste of corporate assets count, for the reasons set forth above, I believe that the Complaint alleges that Licastro had knowledge of the wasting of assets and took no action to correct it or to establish guidelines for corporate expenditures. In his role as general counsel, it seems highly likely that he would have been consulted as to guidelines for out of the ordinary expenditures. To the extent other officers directly caused those expenditures to be made, one can infer, and the Complaint so alleges, that Licastro was aware of them.

[12–14] With respect to the aiding and abetting of the breach of fiduciary duty claim, the Trustee must allege: (1) a fiduciary duty; (2) a breach of this duty; (3) knowledge of the breach by the alleged aider and abetter; (4) the aider and abettor's substantial assistance or encouragement of the wrongdoing. *In re Caribbean K Line, Ltd.,* 288 B.R. 908, 919 (S.D.Fla. 2002). For aiding and abetting a fraud, the Trustee must plead: (1) the existence of the underlying fraud; (2) that the defendant had knowledge of the fraud; and (3) that the defendant provided substantial assistance to advance the commission of the fraud. *ZP No. 54 Ltd. P'ship v. Fid. and Deposit Co. of Md.,* 917 So.2d 368, 371 (Fla.App.2005).

With respect to these two claims, I would first note that McDonald served as president, chairman of the board, principal financial officer, and principal accounting officer. (Doc. # 113, ¶ 9.) The Complaint sets forth numerous and specific acts of fraud and breach of fiduciary duty by McDonald. These include numerous instances of false statements in SEC filings. As I stated above, since the SEC adopted the final rule pursuant to § 307 of the Sarbanes–Oxley Act, general counsels have a duty to inspect the truthfulness of the companies' SEC filings. The Complaint also alleges that Defendants, including Licastro, failed to implement financial controls and proper check and balances, including failure to maintain checks and balances to ensure that the information provided by McDonald to third parties was complete, fair, and accurate. Furthermore, the Complaint alleges that Licastro joined McDonald in his pattern of fraud by making misrepresentation, or confirming McDonald's misrepresentations, to creditors and investors. (Doc. # 113, ¶ 216.) And also, Licastro provided substantial assistance to McDonald by failing to properly report misrepresentations that were knowingly false. (Doc. # 113, ¶ 217.) The Complaint set for enough allegations to support the claim at this stage.

(d) Negligent Misrepresentation Claim (Count V)

[15] The Trustee asserts one count of negligent misrepresentation (Count V). A claim of negligent misrepresentation contains four elements: (1) a misrepresentation of a material fact; (2) the representor either knew of the misrepresentation, made the misrepresentation without knowledge as to its truth or falsity, or must have made the representation under circumstances in which he ought to have known of its falsity; (3) the representor must have intended the representation to induce another to act on it; and (4) injury must result to the party acting in justifiable reliance on the misrepresentation. *Gibbs v. Ernst,* 538 Pa. 193, 647 A.2d 882, 890 (1994)

Licastro contends that the count should be dismissed for the following reasons. First, the Trustee lacks standing to bring this claim because he is pursuing it on behalf of World Health's creditors. The creditors were the only ones who relied upon and were harmed by the purported misrepresentations. (Doc. # 126, p. 12.) Second, the Complaint does not allege Licastro made any specific misrepresentation. (Doc. # 126, p. 12.) Third, the Trustee failed to allege Licastro had knowledge of the misrepresentations. (Doc. # 99, p. 15.)

[16, 17] Licastro is correct in that a bankruptcy trustee does not have standing to assert claims on behalf of an estate's creditors. *See Caplin v. Marine Midland Grace Trust Co.,* 406 U.S. 416, 434, 92 S.Ct. 1678, 32 L.Ed.2d 195 (1972). Here, however, the Trustee is bringing the claim on behalf of the creditors and the debtor estate. (Doc. # 113, ¶ 202.) The Complaint alleges that a class action derivative suit was filed against World Health as a result of various misrepresentations and World Health had to pay $2.7 million to settle it. The law suit is just one of the cognizable injuries that the debtor suffered because of the misrepresentations.

[18] As for the rest of the arguments, it seems to me that the same allegations that were made with respect to the aiding and abetting counts apply here. The misrepresentations were the press releases and SEC filings. (Doc. # 113, ¶ 198.) As the in-house general counsel, Licastro should have reviewed these matters and should have undertaken an examination of the Company's affairs to ascertain the trustfulness of these disclosures. In other words, the Complaint is saying that if Licastro properly performed his duty as in-house counsel, these misrepresentation would not have been made and the resulting harm would have been avoided. I believe the allegation is based on Licastro having "made the representation under the circumstance in which he ought to have known of its falsity." (Doc. # 104, p. 26) That is, Licastro is alleged to have been negligent in the performance of his duties as general counsel. This properly sets forth a cause of action.

(e) Fraudulent Transfer Claims (Counts IX, X, XI)

[19] The Trustee also alleges three counts of fraudulent transfers (Counts IX, X, XI). With respect to Licastro, these three counts rest on just two facts: (1) the Indemnification Agreement and (2) a total of 10 money transfers from World Health to Licastro. (Doc. # 113, ¶¶ 230–31). I believe these three counts woefully do not satisfy the requirement of Rule 9(b). Rule 9(b) requires that "in all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity." Even though pleading a constructive fraudulent conveyance does not need to reach the same level of stringency as that for fraud, a mere recitation of the statute is not enough. *See Global Link Liquidating Trust v. Avantel (In re Global Link Telecom Corp.),* 327 B.R. 711, 717–18 (Bankr.D.Del.2005) (citing *Hassett v. Zimmerman (In re O.P.M. Leasing Servs., Inc.),* 32 B.R. 199, 203 (Bankr. S.D.N.Y.1983)).

[20] With respect to the Indemnification Agreement, without any particulars, the Trustee claims that World Health received less than reasonably equivalent value in exchange for it. The Complaint, however, does not allege that Licastro received any indemnification benefits. Absent the receipt of any benefits under the Indemnification Agreement, the Complaint does not show that World Health transferred any of its property (money or other property) to Licastro. It appears that the Indemnification Agreement was entered into when it became apparent that there were going to be securities law actions filed against some or all of the directors and officers of World Health. However, as pointed out by Licastro, and not challenged by the Trustee, Licastro was not a defendant in the securities law actions.

Furthermore, the Indemnification Agreement appears to have rather conventional terms, including:

> *Excluded Action or Omissions.* To indemnify the Indemnitee whose acts or omissions were found by judgment or adjudication to be material to the cause of action and constituted (i)a violation of criminal law, unless the person reasonably believed the conduct was lawful or had no reasonable cause to believe it was unlawful; (ii) a transaction in which the person derived an improper benefit or, in the case of a director, a circumstance under which the liability provisions of F.S. 607.0834 are applicable; or (iii) willful misconduct or conscious disregard for the best interests of the Company in a proceeding by or in the right of the Company to procure a judgment in its favor or in a proceeding by or in the right of a shareholder.

(Doc. # 99, Ex. A, pp. 5–6.) Such indemnification commitments, whether in by-laws or by separate agreements, are almost universal for commercial corporate enterprises. And, of course, most states, if not all of them, have comprehensive statutory provisions authorizing such benefits for officers and directors. Florida is no exception. *See* Fla. Stat. § 607.0850 (2007).

The Trustee relies heavily on two reported decisions, namely, *e2 Creditors' Trust v. Farris (In re e2 Communications, Inc.),* 320 B.R. 849 (Bankr.N.D.Tex.2004), and *Boles v. Filipowski (In re Enivid, Inc.),* 345 B.R. 426 (Bankr.D.Mass.2006). These two cases are factually inapposite.

In re e2 Communications stands for the unremarkable proposition that a debtor's release of a cause of action against an officer is a transfer of property of the debtor. 320 B.R. at 855. The facts in *In re e2 Communications,* are distinctly different from the matter before me. In that case, the president was the largest shareholder of the corporate debtor. The debtor began experiencing cash flow difficulties and the president transferred to the debtor $620,000. *Id.* at 851. With respect to that transfer, the debtor executed five promissory notes together with a security agreement. *Id.* A separate corporation owned by the president provided consulting services to the debtor for $15,000 a month. *Id.* That corporation had a claim against the debtor arising out of the consulting agreement. That claim, in the amount of $200,000, was assigned to the president. *Id.* at 851–52. The debtor and the president entered into a contribution and release agreement that provided: (1) the five notes and the assigned claim were consolidated into a replacement note in the principal amount of $821,804; (2) the president conveyed his stock back to the debtor as a contribution to capital and (3) the parties exchanged mutual limited releases. *Id.* Subject to certain specific exceptions (for example, the president's duty of loyalty and good faith in dealing with the debtor at the time he was the president and

majority shareholder), the debtor granted the president a broad release of any claims, liabilities, damages, losses etc. which the debtor had against the president. *Id.* In addressing the president's motion for summary judgment with respect to the trustee's preference and fraudulent conveyance counts, the court denied the summary judgment motion in holding that, contrary to the president's arguments, the release of causes of action was a transfer of the debtor's property. *Id.* at 855. The court observed:

> Common sense suggests that a release of claims is a "transfer" of property—i.e., a method of "disposing of or parting with" property, as the releasing party gives up the right to assert the claims in the future.

Id. at 856. Unlike *In re e2 Communications,* the Trustee here has not alleged that World Health transferred any property to Licastro in entering into the Indemnification Agreement.

The Trustee also cites *In re Enivid,* where he says the court found that "plaintiff trustee's cause of action asserting that certain *payments made* under a director's indemnification agreement were fraudulent transfers or preferential transfers pursuant to section 547 and 548 of the Bankruptcy Code survived a motion to dismiss." (Doc. # 104, p. 29) (emphasis added.) In the matter before me, the Trustee does not allege that any payments were made by World Health to Licastro pursuant to the Indemnification Agreement.

[21] With respect to the 10 money transfers from World Health to Licastro, which occurred between March 11, 2005 and November 18, 2005, other than noting that these transfers did not involve "payroll and stock issuance" the Complaint does not state why the transfers were effected. (Doc. # 113, ¶ 247.) However, one cannot infer from this fact that these were gratuitous transfers with no consideration running from Licastro to World Health. Indeed, 7 of the 10 items are so small and in amounts down to cents that one may reasonably conclude that they represent reimbursement for business expenses incurred by Licastro. In any event, there is nothing in the Complaint alleging that these transfers to Licastro were made in the absence of any transfer of value from Licastro to World Health. Thus, these three counts of fraudulent transfers will be dismissed without prejudice.

(f) Equitable Subordination Claim (Count XII)

[22] The next count is equitable subordination (Count XII). This count will be dismissed without prejudice because the Complaint does not allege that Licastro has filed a claim in this case. It asserts that "certain of the Defendants—including Hayden and Jackson—have filed proofs of claim in these cases." (Doc. # 113, ¶ 247.) The next paragraph then goes on to allege that "[o]ther Defendants are listed as having either priority unsecured, or general unsecured claims on the Debtors' Schedules." (Doc. # 113, ¶ 248.) Note that it does not say that all the other Defendants are listed in the schedules as having claims. It would not be difficult for the Trustee to examine the claims register and the schedules to determine whether Licastro has a claim against the estate. The allegations under this count are too imprecise to conclude that Licastro has a claim. If he has, then the Trustee can easily file a further amended complaint to address this issue.

(g) Professional Negligence Claim (Count XIII)

[23, 24] The final count the Trustee raises is professional negligence (Count

XIII). Under Pennsylvania law, which parties agree is the applicable law, the elements for a professional negligence claim are: "(1) the employment of the attorney or other basis for his duty to act as an attorney; (2) the failure of the attorney to exercise ordinary skill and knowledge; and (3) that such negligence was the proximate cause of damage to the plaintiff." *Ibn–Sadiika v. Riester,* 380 Pa.Super. 397, 551 A.2d 1112, 1115 (1988); *Veneri v. Pappano,* 424 Pa.Super. 394, 622 A.2d 977, 978–79 (1993). In addition, pursuant to Pennsylvania Rule of Civil Procedure 1042.3(a), a plaintiff asserting a professional negligence claim must file a Certificate of Merit within 60 days of filing the complaint.

Licastro argues that this count should be dismissed because he never was or acted as an attorney for World Health, and even if he had, *arguendo,* the Complaint does not allege any violation of his duty. I disagree. The Complaint states that "Licastro was employed by and served the Company as in-house General Counsel on a de facto and/or formal basis, and had a duty to provide legal services to the Company consistent with the applicable standard of care." (Doc. # 113, ¶ 255.) In light of the fact that I must take this assertion as true, Licastro owed a certain standard of care to World Health.

[25] An attorney must "act[ ] with a proper degree of skill, and with reasonable care and to the best of his knowledge." *Savings Bank v. Ward,* 100 U.S. 195, 198, 25 L.Ed. 621 (1880). The Complaint alleges "Licastro breached the applicable standard of care, for example, by not providing oversight and failing to provide advice that would have prevented the Company from submitting SEC filings that included material misrepresentation." (Doc. # 113, ¶ 255.) Moreover, "Members of the Company's management including . . . Licastro became aware or should have been aware of the malfeasance and misdealing and discrepancies in the Company's revenue; however, no actions were taken consistent with their fiduciary duties to remedy or ameliorate the discrepancies until after McDonald's resignation." (Doc. # 113, ¶ 151.) And, as a result of Licastro's alleged professional negligence, World Health suffered damages. (Doc. # 113, ¶ 257.) I believe the Trustee has alleged sufficient facts for a cause of action and the motion should be denied as to this count.

With regard to Pennsylvania Rule of Civil Procedure 1042.3(a)'s requirement for Certificate of Merits, the Complaint is silent. In the Trustee's answering brief, he states that he would file it within the requisite time. Given that this is a motion to dismiss, I will assume that the Trustee has met the requirement for the purpose of this motion.

CONCLUSION

For the reasons discussed above Licastro's motion to dismiss (Doc. # 98) is denied with respect to Counts I, II, III, IV, V, VII, and XIII, and granted without prejudice with respect to Counts IX, X, XI, and XII, provided that the Trustee shall have 30 days to file an amended complaint if he can correct the deficiencies noted in this Memorandum Opinion as to Counts IX, X, XI, and XII.

ORDER

For the reasons set forth in the Court's memorandum opinion of this date, the motion (Doc. # 98) of defendant Brian T. Licastro to dismiss the complaint is **denied** with respect to Counts I, II, III, IV, V, VII, and XIII, and **granted** without prejudice with respect to Counts IX, X, XI, and XII, provided that the Trustee shall have 30 days to file an amended complaint if he can correct the deficiencies noted in the memorandum opinion as to Counts IX, X, XI, and XII.

In re Ali JOOBEEN, Debtor.

Ali Joobeen, Appellant,

Michael Tsokas, Creditor; Ceil Joobeen, Interested Party; Orang Joobeen, Interested Party; Kelly Clark, Interested Party; William C. Miller, Trustee; and United States Trustee, Trustee, Appellees

and

In re Jian Joobeen, a Minor, by Ali Joobeen, his guardian & trustee, Debtor.

Kelly Clark, Intervenor, Appellant,

Jeffrey T. Grossman, Interested Party; Aaron Pogach, Interested Party; William C. Miller, Trustee; and Frederick Baker, Trustee, Appellees

and

In re Jian Joobeen, a Minor, by Ali Joobeen, his guardian & trustee, Debtor.

Jian Jobeen, Appellant,

Jeffrey T. Grossman, Interested Party; Aaron Pogach, Interested Party; William C. Miller, Trustee; and Frederick Baker, Trustee, Appellees.

Civil Action Nos. 07–CV–2736 to 07–CV–2738.
Bankruptcy Nos. 06–15749–dws, 06–15752–dws.

United States District Court,
E.D. Pennsylvania.

March 27, 2008.

Background: Creditor moved to dismiss Chapter 13 case filed by debtor-father, and for automatic stay relief in both case of debtor-father and Chapter 13 case filed by debtor-father as guardian and trustee for his seven-year-old son. Chapter 13 standing trustee moved to dismiss son's case. The United States Bankruptcy Court for the Eastern District of Pennsylvania, Diane Weiss Sigmund, Chief Judge, 2007 WL 1521230, dismissed both cases as having been filed in bad faith. Debtor-father, debtor-son, and mother appealed, and appeals were consolidated.

Holdings: The District Court, James Knoll Gardner, J., held that:

(1) remand to clarify for how long relief from automatic stay was being granted to creditors was warranted;

(2) determination that bankruptcy cases were filed in bad faith was not clearly erroneous;

(3) remand was warranted for clarification as to whether debtor-father's bad faith should be imputed to debtor-son and mother;

(4) lack of findings regarding propriety of filing made on debtor-son's behalf warranted remand;

(5) decision to remove debtor-father from witness stand and to preclude him from offering further testimony during hearing was fair and appropriate sanction for his disruptive and contumacious conduct;

(6) disqualification of Chapter 13 standing trustee, or of his representatives, was not warranted on grounds of bias; and

(7) bankruptcy judge's disqualification was not warranted on grounds of bias or partiality.

Affirmed in part and remanded in part.

1. Bankruptcy ⇔3782

Legal determinations of a bankruptcy court are reviewed de novo.

SEC. 307. RULES OF PROFESSIONAL RESPONSIBILITY FOR ATTORNEYS.

Not later than 180 days after the date of enactment of this Act, the Commission shall issue rules, in the public interest and for the protection of investors, setting forth minimum standards of professional conduct for attorneys appearing and practicing before the Commission in any way in the representation of issuers, including a rule -

(1) requiring an attorney to report evidence of a material violation of securities law or breach of fiduciary duty or similar violation by the company or any agent thereof, to the chief legal counsel or the chief executive officer of the company (or the equivalent thereof); and

(2) if the counsel or officer does not appropriately respond to the evidence (adopting, as necessary, appropriate remedial measures or sanctions with respect to the violation), requiring the attorney to report the evidence to the audit committee of the board of directors of the issuer or to another committee of the board of directors comprised solely of directors not employed directly or indirectly by the issuer, or to the board of directors.

Rule 1.6: Confidentiality of Information

(a) A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation or the disclosure is permitted by paragraph (b).

(b) A lawyer may reveal information relating to the representation of a client to the extent the lawyer reasonably believes necessary:

(1) to prevent reasonably certain death or substantial bodily harm;

(2) to prevent the client from committing a crime or fraud that is reasonably certain to result in substantial injury to the financial interests or property of another and in furtherance of which the client has used or is using the lawyer's services;

(3) to prevent, mitigate or rectify substantial injury to the financial interests or property of another that is reasonably certain to result or has resulted from the client's commission of a crime or fraud in furtherance of which the client has used the lawyer's services;

(4) to secure legal advice about the lawyer's compliance with these Rules;

(5) to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client, to establish a defense to a criminal charge or civil claim against the lawyer based upon conduct in which the client was involved, or to respond to allegations in any proceeding concerning the lawyer's representation of the client; or

(6) to comply with other law or a court order.

Rule 1.13 Organization as Client

(a) A lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents.
(b) If a lawyer for an organization knows that an officer, employee or other person associated with the organization is engaged in action, intends to act or refuses to act in a matter related to the representation that is a violation of a legal obligation to the organization, or a violation of law that reasonably might be imputed to the organization, and that is likely to result in substantial injury to the organization, then the lawyer shall proceed as is reasonably necessary in the best interest of the organization. Unless the lawyer reasonably believes that it is not necessary in the best interest of the organization to do so, the lawyer shall refer the matter to higher authority in the organization, including, if warranted by the circumstances to the highest authority that can act on behalf of the organization as determined by applicable law.
(c) Except as provided in paragraph (d), if

(1) despite the lawyer's efforts in accordance with paragraph (b) the highest authority that can act on behalf of the organization insists upon or fails to address in a timely and appropriate manner an action, or a refusal to act, that is clearly a violation of law, and
(2) the lawyer reasonably believes that the violation is reasonably certain to result in substantial injury to the organization, then the lawyer may reveal information relating to the representation whether or not Rule 1.6 permits such disclosure, but only if and to the extent the lawyer reasonably believes necessary to prevent substantial injury to the organization.

(d) Paragraph (c) shall not apply with respect to information relating to a lawyer's representation of an organization to investigate an alleged violation of law, or to defend the organization or an officer, employee or other constituent associated with the organization against a claim arising out of an alleged violation of law.
(e) A lawyer who reasonably believes that he or she has been discharged because of the lawyer's actions taken pursuant to paragraphs (b) or (c), or who withdraws under circumstances that require or permit the lawyer to take action under either of those paragraphs, shall proceed as the lawyer reasonably believes necessary to assure that the organization's highest authority is informed of the lawyer's discharge or withdrawal.
(f) In dealing with an organization's directors, officers, employees, members, shareholders or other constituents, a lawyer shall explain the identity of the client when the lawyer knows or reasonably should know that the organization's interests are adverse to those of the constituents with whom the lawyer is dealing.
(g) A lawyer representing an organization may also represent any of its directors, officers, employees, members, shareholders or other constituents, subject to the provisions of Rule 1.7. If the organization's consent to the dual representation is required by Rule 1.7, the consent shall be given by an appropriate official of the organization other than the individual who is to be represented, or by the shareholders.

Rule 1.16 Declining or Terminating Representation

(a) Except as stated in paragraph (c), a lawyer shall not represent a client or, where representation has commenced, shall withdraw from the representation of a client if:

(1) the representation will result in violation of the Rules of Professional Conduct or other law;
(2) the lawyer's physical or mental condition materially impairs the lawyer's ability to represent the client; or
(3) the lawyer is discharged.

(b) except as stated in paragraph (c), a lawyer may withdraw from representing a client if:

(1) withdrawal can be accomplished without material adverse effect on the interests of the client;
(2) the client persists in a course of action involving the lawyer's services that the lawyer reasonably believes is criminal or fraudulent;
(3) the client has used the lawyer's services to perpetrate a crime or fraud;
(4) the client insists upon taking action that the lawyer considers repugnant or with which the lawyer has a fundamental disagreement;
(5) the client fails substantially to fulfill an obligation to the lawyer regarding the lawyer's services and has been given reasonable warning that the lawyer will withdraw unless the obligation is fulfilled;
(6) the representation will result in an unreasonable financial burden on the lawyer or has been rendered unreasonably difficult by the client; or
(7) other good cause for withdrawal exists.

(c) A lawyer must comply with applicable law requiring notice to or permission of a tribunal when terminating a representation. When ordered to do so by a tribunal, a lawyer shall continue representation notwithstanding good cause for terminating the representation.
(d) Upon termination of representation, a lawyer shall take steps to the extent reasonably practicable to protect a client's interests, such as giving reasonable notice to the client, allowing time for employment of other counsel, surrendering papers and property to which the client is entitled and refunding any advance payment of fee or expense that has not been earned or incurred. The lawyer may retain papers relating to the client to the extent permitted by other law.

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disqualified from voting, whether or not he or they constitute a quorum, may unanimously appoint another director to act at the meeting in the place of the absent or disqualified member.

(b) TERM. — Each committee of the board shall serve at the pleasure of the board.

(c) STATUS OF COMMITTEE ACTION. — The term "board of directors" or "board," when used in any provision of this subpart relating to the organization or procedures of or the manner of taking action by the board of directors, shall be construed to include and refer to any executive or other committee of the board. Any provision of this subpart relating or referring to action to be taken by the board of directors or the procedure required therefor shall be satisfied by the taking of corresponding action by a committee of the board of directors to the extent authority to take the action has been delegated to the committee pursuant to this section.

HISTORY: Act 1992-169 (S.B. 1083), § 3, approved Dec. 18, 1992, eff. in 60 days; Act 2001-34 (S.B. 215), § 2, approved June 22, 2001, eff. in 60 days.

§ 1732. Officers

(a) GENERAL RULE. — Every business corporation shall have a president, a secretary and a treasurer, or persons who shall act as such, regardless of the name or title by which they may be designated, elected or appointed and may have such other officers and assistant officers as it may authorize from time to time. The bylaws may prescribe special qualifications for the officers. The president and secretary shall be natural persons of full age. The treasurer may be a corporation, but if a natural person shall be of full age. Unless otherwise restricted in the bylaws, it shall not be necessary for the officers to be directors. Any number of offices may be held by the same person. The officers and assistant officers shall be elected or appointed at such time, in such manner and for such terms as may be fixed by or pursuant to the bylaws. Unless otherwise provided by or pursuant to the bylaws, each officer shall hold office for a term of one year and until his successor has been selected and qualified or until his earlier death, resignation or removal. Any officer may resign at any time upon written notice to the corporation. The resignation shall be effective upon receipt thereof by the corporation or at such subsequent time as may be specified in the notice of resignation. The corporation may secure the fidelity of any or all of the officers by bond or otherwise.

(b) AUTHORITY. — Unless otherwise provided in the bylaws, all officers of the corporation, as between themselves and the corporation, shall have such authority and perform such duties in the management of the corporation as may be provided by or pursuant to the bylaws or, in the absence of controlling provisions in the bylaws, as may be determined by or pursuant to resolutions or orders of the board of directors.

(c) CROSS REFERENCES. — See sections 1110 (relating to annual report information), 1712(c) (relating to officers) and 3132 (relating to officers).

HISTORY: Act 1990-198 (S.B. 1761), § 102, approved Dec. 19, 1990, eff. immediately.

CASE NOTES

1. Corporation was liable for fraudulent misrepresentation when its chief operating officer induced a prospective employee to join the company by showing him erroneous reports on the company's financial health; under former 15 P.S. § 1406 (now 15 Pa.C.S. § 1732), a corporate officer's scope of authority to act for the corporation is established by the corporation's by-laws or, in their absence, by resolution of the board of directors. Lokay v. Lehigh Valley Cooperative Farmers, Inc., 342 Pa. Super. 89, 492 A.2d 405, 1985 Pa. Super. LEXIS 7255 (1985).

2. Insurer was not liable after an employee of the corporation resigned and fraudulently removed 3,000 application cards belonging to the corporation because the policy precluded loss for dishonest, fraudulent, or criminal acts by an officer; the employee who removed the applications had been made a vice president by a unanimous written resolution, and under former 15 P.S. §§ 3102, 402, 408 (see now 15 Pa.C.S. § 1721 et seq.), a "vice-president" was clearly an "officer" of a corporation. Gruber Personnel Service, Inc. v. Indemnity Ins. Co., 212 Pa. Super. 120, 239 A.2d 880, 1968 Pa. Super. LEXIS 1075 (1968).

§ 1733. Removal of officers and agents

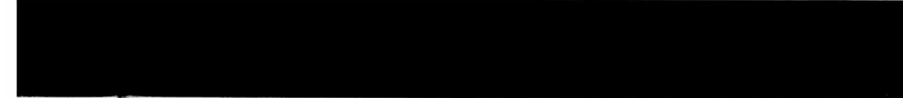
Any officer or agent of a business corporation may be removed by the board of directors with or without cause. The removal shall be without prejudice to the contract rights, if any, of any person so removed. Election or appointment of an officer or agent shall not of itself create contract rights.

SUBCHAPTER D. INDEMNIFICATION

Sec.
§ 1741. Third-party actions
§ 1742. Derivative and corporate actions
§ 1743. Mandatory indemnification
§ 1744. Procedure for effecting indemnification
§ 1745. Advancing expenses
§ 1746. Supplementary coverage
§ 1747. Power to purchase insurance
§ 1748. Application to surviving or new corporations
§ 1749. Application to employee benefit plans
§ 1750. Duration and extent of coverage

§ 1741. Third-party actions

Unless otherwise restricted in its bylaws, a business corporation shall have power to indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action or proceeding, whether civil, criminal, administrative or investigative (other than an action by or in the right of the corporation), by reason of the fact that he is or was a representative of the corporation, or is or was serving at the request of the corporation as a representative of another domestic or foreign corporation for profit or not-for-profit, partnership, joint venture, trust or other enterprise, against expenses (including attorneys' fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by him in connection with the action or proceeding if he acted in good faith and in a manner he reasonably believed to be in, or not opposed to, the best interests of the corporation and, with respect to any criminal proceeding, had no reasonable cause to believe his conduct was unlawful. The termination of any action or proceeding by judgment, order, settlement or conviction or upon a plea of nolo contendere or its equivalent shall not of itself create a presumption that the person did not act in good faith and in a manner that he reasonably believed to be in, or not opposed to, the best interests of the corporation and, with respect to any criminal proceeding, had reasonable cause to believe that his conduct was unlawful.



§ 1742. Derivative and corporate actions

Unless otherwise restricted in its bylaws, a business corporation shall have power to indemnify any person who was or is a party, or is threatened to be made a party, to any threatened, pending or completed action by or in the right of the corporation to procure a judgment in its favor by reason of the fact that he is or was a representative of the corporation or is or was serving at the request of the corporation as a representative of another domestic or foreign corporation for profit or not-for-profit, partnership, joint venture, trust or other enterprise, against expenses (including attorneys' fees) actually and reasonably incurred by him in connection with the defense or settlement of the action if he acted in good faith and in a manner he reasonably believed to be in, or not opposed to, the best interests of the corporation. Indemnification shall not be made under this section in respect of any claim, issue or matter as to which the person has been adjudged to be liable to the corporation unless and only to the extent that the court of common pleas of the judicial district embracing the county in which the registered office of the corporation is located or the court in which the action was brought determines upon application that, despite the adjudication of liability but in view of all the circumstances of the case, the person is fairly and reasonably entitled to indemnity for the expenses that the court of common pleas or other court deems proper.

HISTORY: Act 1992-169 (S.B. 1083), § 3, approved Dec. 18, 1992, eff. in 60 days.

§ 1743. Mandatory indemnification

To the extent that a representative of a business corporation has been successful on the merits or otherwise in defense of any action or proceeding referred to in section 1741 (relating to third-party actions) or 1742 (relating to derivative and corporate actions) or in defense of any claim, issue or matter therein, he shall be indemnified against expenses (including attorney fees) actually and reasonably incurred by him in connection therewith.

HISTORY: Act 1992-169 (S.B. 1083), § 3, approved Dec. 18, 1992, eff. in 60 days.

§ 1744. Procedure for effecting indemnification

Unless ordered by a court, any indemnification under section 1741 (relating to third-party actions) or 1742 (relating to derivative and corporate actions) shall be made by the business corporation only as authorized in the specific case upon a determination that indemnification of the representative is proper in the circumstances because he has met the applicable standard of conduct set forth in those sections. The determination shall be made:

(1) by the board of directors by a majority vote of a quorum consisting of directors who were not parties to the action or proceeding;

(2) if such a quorum is not obtainable or if obtainable and a majority vote of a quorum of disinterested directors so directs, by independent legal counsel in a written opinion; or

(3) by the shareholders.

HISTORY: Act 1992-169 (S.B. 1083), § 3, approved Dec. 18, 1992, eff. in 60 days.

§ 1745. Advancing expenses

Expenses (including attorneys' fees) incurred in defending any action or proceeding referred to in this subchapter may be paid by a business corporation in advance of the final disposition of the action or proceeding upon receipt of an undertaking by or on behalf of the representative to repay the amount if it is ultimately determined that he is not entitled to be indemnified by the corporation as authorized in this subchapter or otherwise. Except as otherwise provided in the bylaws, advancement of expenses shall be authorized by the board of directors. Sections 1728 (relating to interested directors or officers; quorum) and 2538 (relating to approval of transactions with interested shareholders) shall not be applicable to the advancement of expenses under this section.

HISTORY: Act 2001-34 (S.B. 215), § 2, approved June 22, 2001, eff. in 60 days.

§ 1746. Supplementary coverage

(a) GENERAL RULE. — The indemnification and advancement of expenses provided by, or granted pursuant to, the other sections of this subchapter shall not be deemed exclusive of any other rights to which a person seeking indemnification or advancement of expenses may be entitled under any bylaw, agreement, vote of shareholders or disinterested directors or otherwise, both as to action in his official capacity and as to action in another capacity while holding that office. Section 1728 (relating to interested directors or officers; quorum) and, in the case of a registered corporation, section 2538 (relating to approval of transactions with interested shareholders) shall be applicable to any bylaw, contract or transaction authorized by the directors under this section. A corporation may create a fund of any nature, which may, but need not be, under the control of a trustee, or otherwise

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secure or insure in any manner its indemnification obligations, whether arising under or pursuant to this section or otherwise.

(b) WHEN INDEMNIFICATION IS NOT TO BE MADE. — Indemnification pursuant to subsection (a) shall not be made in any case where the act or failure to act giving rise to the claim for indemnification is determined by a court to have constituted willful misconduct or recklessness. The articles may not provide for indemnification in the case of willful misconduct or recklessness.

(c) GROUNDS. — Indemnification pursuant to subsection (a) under any bylaw, agreement, vote of shareholders or directors or otherwise may be granted for any action taken and may be made whether or not the corporation would have the power to indemnify the person under any other provision of law except as provided in this section and whether or not the indemnified liability arises or arose from any threatened, pending or completed action by or in the right of the corporation. Such indemnification is declared to be consistent with the public policy of this Commonwealth.

HISTORY: Act 1990-198 (S.B. 1761), § 102, approved Dec. 19, 1990, eff. immediately.

§ 1747. Power to purchase insurance

Unless otherwise restricted in its bylaws, a business corporation shall have power to purchase and maintain insurance on behalf of any person who is or was a representative of the corporation or is or was serving at the request of the corporation as a representative of another domestic or foreign corporation for profit or not-for-profit, partnership, joint venture, trust or other enterprise against any liability asserted against him and incurred by him in any such capacity, or arising out of his status as such, whether or not the corporation would have the power to indemnify him against that liability under the provisions of this subchapter. Such insurance is declared to be consistent with the public policy of this Commonwealth.

HISTORY: Act 1990-198 (S.B. 1761), § 102, approved Dec. 19, 1990, eff. immediately.

§ 1748. Application to surviving or new corporations

(a) GENERAL RULE. — Except as provided in subsection (b), for the purposes of this subchapter, references to "the corporation" include all constituent corporations absorbed in a consolidation, merger or division, as well as the surviving or new corporations surviving or resulting therefrom, so that any person who is or was a representative of the constituent, surviving or new corporation, or is or was serving at the request of the constituent, surviving or new corporation as a representative of another domestic or foreign corporation for profit or not-for-profit, partnership, joint venture, trust or other enterprise, shall stand in the same position under the provisions of this subchapter with respect to the surviving or new corporation as he would if he had served the surviving or new corporation in the same capacity.

(b) DIVISIONS. — Notwithstanding subsection (a), the obligations of a dividing corporation to indemnify and advance expenses to its representatives, whether arising under this subchapter or otherwise, may be allocated in a division in the same manner and with the same effect as any other liability of the dividing corporation.

HISTORY: Act 2001-34 (S.B. 215), § 2, approved June 22, 2001, eff. in 60 days.

§ 1749. Application to employee benefit plans

For purposes of this subchapter:

(1) References to "other enterprises" shall include employee benefit plans and references to "serving at the request of the corporation" shall include any service as a representative of the business corporation that imposes duties on, or involves services by, the representative with respect to an employee benefit plan, its participants or beneficiaries.

(2) Excise taxes assessed on a person with respect to an employee benefit plan pursuant to applicable law shall be deemed "fines."

(3) Action with respect to an employee benefit plan taken or omitted in good faith by a representative of the corporation in a manner he reasonably believed to be in the interest of the participants and beneficiaries of the plan shall be deemed to be action in a manner that is not opposed to the best interests of the corporation.

§ 1750. Duration and extent of coverage

The indemnification and advancement of expenses provided by, or granted pursuant to, this subchapter shall, unless otherwise provided when authorized or ratified, continue as to a person who has ceased to be a representative of the corporation and shall inure to the benefit of the heirs and personal representative of that person.

SUBCHAPTER E.
SHAREHOLDERS

Sec.
§ 1755. Time of holding meetings of shareholders
§ 1756. Quorum
§ 1757. Action by shareholders
§ 1758. Voting rights of shareholders
§ 1759. Voting and other action by proxy
§ 1760. Voting by fiduciaries and pledgees
§ 1761. Voting by joint holders of shares
§ 1762. Voting by corporations
§ 1763. Determination of shareholders of record
§ 1764. Voting lists
§ 1765. Judges of election
§ 1766. Consent of shareholders in lieu of meeting
§ 1767. Appointment of custodian of corporation on deadlock or other cause

§ 1768. § 1769. § 1770.

§ 1755

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U.S. Department of Justice

Office of the Deputy Attorney General

The Deputy Attorney General — *Washington, D.C. 20530*

MEMORANDUM

TO: Heads of Department Components
United States Attorneys

FROM: Paul J. McNulty
Deputy Attorney General

SUBJECT: Principles of Federal Prosecution of Business Organizations

The Department experienced unprecedented success in prosecuting corporate fraud during the last four years. We have aggressively rooted out corruption in financial markets and corporate board rooms across the country. Federal prosecutors should be justifiably proud that the information used by our nation's financial markets is more reliable, our retirement plans are more secure, and the investing public is better protected as a result of our efforts. The most significant result of this enforcement initiative is that corporations increasingly recognize the need for self-policing, self-reporting, and cooperation with law enforcement. Through their self-regulation efforts, fraud undoubtedly is being prevented, sparing shareholders from the financial harm accompanying corporate corruption. The Department must continue to encourage these efforts.

Though much has been accomplished, the work of protecting the integrity of the marketplace continues. As we press forward in our enforcement duties, it is appropriate that we consider carefully proposals which could make our efforts more effective. I remain convinced that the fundamental principles that have guided our enforcement practices are sound. In particular, our corporate charging principles are not only familiar, but they are welcomed by most corporations in our country because good corporate leadership shares many of our goals. Like federal prosecutors, corporate leaders must take action to protect shareholders, preserve corporate value, and promote honesty and fair dealing with the investing public.

We have heard from responsible corporate officials recently about the challenges they face in discharging their duties to the corporation while responding in a meaningful way to a government investigation. Many of those associated with the corporate legal community have expressed concern that our practices may be discouraging full and candid communications between corporate employees and legal counsel. To the extent this is happening, it was never the intention of the Department for our corporate charging principles to cause such a result.

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Therefore, I have decided to adjust certain aspects of our policy in ways that will further promote public confidence in the Department, encourage corporate fraud prevention efforts, and clarify our goals without sacrificing our ability to prosecute these important cases effectively. The new language expands upon the Department's long-standing policies concerning how we evaluate the authenticity of a corporation's cooperation with a government investigation.

This memorandum supersedes and replaces guidance contained in the Memorandum from Deputy Attorney General Larry D. Thompson entitled Principles of Federal Prosecution of Business Organizations (January 20, 2003) (the "Thompson Memorandum") and the Memorandum from the Acting Deputy Attorney General Robert D. McCallum, Jr. entitled Waiver of Corporate Attorney-Client and Work Product Protections (October 21, 2005)(the "McCallum Memorandum").

U.S. Department of Justice

Office of the Deputy Attorney General

The Deputy Attorney General

Washington, D.C. 20530

MEMORANDUM

TO: Heads of Department Components
United States Attorneys

FROM: Paul J. McNulty
Deputy Attorney General

SUBJECT: Principles of Federal Prosecution of Business Organizations

Federal Prosecution of Business Organizations[1]

I. Duties of the Federal Prosecutor; Duties of Corporate Leaders

The prosecution of corporate crime is a high priority for the Department of Justice. By investigating wrongdoing and bringing charges for criminal conduct, the Department plays an important role in protecting investors and ensuring public confidence in business entities and in the investment markets in which those entities participate. In this respect, federal prosecutors and corporate leaders share a common goal. Directors and officers owe a fiduciary duty to a corporation's shareholders, the corporation's true owners, and they owe duties of honest dealing to the investing public in connection with the corporation's regulatory filings and public statements. The faithful execution of these duties by corporate leadership serves the same values in promoting public trust and confidence that our criminal prosecutions are designed to serve.

A prosecutor's duty to enforce the law requires the investigation and prosecution of criminal wrongdoing if it is discovered. In carrying out this mission with the diligence and resolve necessary to vindicate the important public interests discussed above, prosecutors should be mindful of the common cause we share with responsible corporate leaders. Prosecutors should also be mindful that confidence in the Department is affected both by the results we achieve and by the real and perceived ways in which we achieve them. Thus, the manner in

[1] While these guidelines refer to corporations, they apply to the consideration of the prosecution of all types of business organizations, including partnerships, sole proprietorships, government entities, and unincorporated associations.

which we do our job as prosecutors – the professionalism we demonstrate, our resourcefulness in seeking information, and our willingness to secure the facts in a manner that encourages corporate compliance and self-regulation – impacts public perception of our mission. Federal prosecutors recognize that they must maintain public confidence in the way in which they exercise their charging discretion, and that professionalism and civility have always played an important part in putting these principles into action.

II. Charging a Corporation: General Principles

A. General Principle: Corporations should not be treated leniently because of their artificial nature nor should they be subject to harsher treatment. Vigorous enforcement of the criminal laws against corporate wrongdoers, where appropriate, results in great benefits for law enforcement and the public, particularly in the area of white collar crime. Indicting corporations for wrongdoing enables the government to address and be a force for positive change of corporate culture, alter corporate behavior, and prevent, discover, and punish white collar crime.

B. Comment: In all cases involving corporate wrongdoing, prosecutors should consider the factors discussed herein. First and foremost, prosecutors should be aware of the important public benefits that may flow from indicting a corporation in appropriate cases. For instance, corporations are likely to take immediate remedial steps when one is indicted for criminal conduct that is pervasive throughout a particular industry, and thus an indictment often provides a unique opportunity for deterrence on a massive scale. In addition, a corporate indictment may result in specific deterrence by changing the culture of the indicted corporation and the behavior of its employees. Finally, certain crimes that carry with them a substantial risk of great public harm, e.g., environmental crimes or financial frauds, are by their nature most likely to be committed by businesses, and there may, therefore, be a substantial federal interest in indicting the corporation.

Charging a corporation, however, does not mean that individual directors, officers, employees, or shareholders should not also be charged. Prosecution of a corporation is not a substitute for the prosecution of criminally culpable individuals within or without the corporation. Because a corporation can act only through individuals, imposition of individual criminal liability may provide the strongest deterrent against future corporate wrongdoing. Only rarely should provable individual culpability not be pursued, even in the face of an offer of a corporate guilty plea or some other disposition of the charges against the corporation.

Corporations are "legal persons," capable of suing and being sued, and capable of committing crimes. Under the doctrine of *respondeat superior*, a corporation may be held criminally liable for the illegal acts of its directors, officers, employees, and agents. To hold a corporation liable for these actions, the government must establish that the corporate agent's actions (I) were within the scope of his duties and (ii) were intended, at least in part, to benefit the corporation. In all cases involving wrongdoing by corporate agents, prosecutors should consider the corporation, as well as the responsible individuals, as potential criminal targets.

Agents, however, may act for mixed reasons -- both for self-aggrandizement (both direct and indirect) and for the benefit of the corporation, and a corporation may be held liable as long as one motivation of its agent is to benefit the corporation. *See United States v. Potter*, 463 F.3d 9, 25 (1st Cir. 2006) (stating that the test to determine whether an agent is acting within the scope of employment is whether the agent is performing acts of the kind which he is authorized to perform, and those acts are motivated--at least in part--by an intent to benefit the corporation). In *United States v. Automated Medical Laboratories*, 770 F.2d 399 (4th Cir. 1985), the Fourth Circuit affirmed a corporation's conviction for the actions of a subsidiary's employee despite its claim that the employee was acting for his own benefit, namely his "ambitious nature and his desire to ascend the corporate ladder." The court stated, "*Partucci* was clearly acting in part to benefit AML since his advancement within the corporation depended on AML's well-being and its lack of difficulties with the FDA." Furthermore, in *United States v. Sun-Diamond Growers of California*, 138 F.3d 961, 969-70 (D.C. Cir. 1998), *aff'd on other grounds*, 526 U.S. 398 (1999), the D.C. Circuit rejected a corporation's argument that it should not be held criminally liable for the actions of its vice-president since the vice-president's "scheme was designed to -- and did in fact -- defraud [the corporation], not benefit it." According to the court, the fact that the vice-president deceived the corporation and used its money to contribute illegally to a congressional campaign did not preclude a valid finding that he acted to benefit the corporation. Part of the vice-president's job was to cultivate the corporation's relationship with the congressional candidate's brother, the Secretary of Agriculture. Therefore, the court held, the jury was entitled to conclude that the vice-president had acted with an intent, "however befuddled," to further the interests of his employer. *See also United States v. Cincotta*, 689 F.2d 238, 241-42 (1st Cir. 1982) (upholding a corporation's conviction, notwithstanding the substantial personal benefit reaped by its miscreant agents, because the fraudulent scheme required money to pass through the corporation's treasury and the fraudulently obtained goods were resold to the corporation's customers in the corporation's name).

Moreover, the corporation need not even necessarily profit from its agent's actions for it to be held liable. In *Automated Medical Laboratories*, the Fourth Circuit stated:

> [B]enefit is not a "touchstone of criminal corporate liability; benefit at best is an evidential, not an operative, fact." Thus, whether the agent's actions ultimately redounded to the benefit of the corporation is less significant than whether the agent acted with the intent to benefit the corporation. The basic purpose of requiring that an agent have acted with the intent to benefit the corporation, however, is to insulate the corporation from criminal liability for actions of its agents which may be inimical to the interests of the corporation or which may have been undertaken solely to advance the interests of that agent or of a party other than the corporation.

770 F.2d at 407 (emphasis added; *quoting Old Monastery Co. v. United States*, 147 F.2d 905, 908 (4th Cir.), *cert. denied*, 326 U.S. 734 (1945)).

III. Charging a Corporation: Factors to Be Considered

A. General Principle: Generally, prosecutors apply the same factors in determining whether to charge a corporation as they do with respect to individuals. *See* USAM § 9-27.220, *et seq*. Thus, the prosecutor must weigh all of the factors normally considered in the sound exercise of prosecutorial judgment: the sufficiency of the evidence; the likelihood of success at trial; the probable deterrent, rehabilitative, and other consequences of conviction; and the adequacy of noncriminal approaches. *See id.* However, due to the nature of the corporate "person," some additional factors are present. In conducting an investigation, determining whether to bring charges, and negotiating plea agreements, prosecutors must consider the following factors in reaching a decision as to the proper treatment of a corporate target:

1. the nature and seriousness of the offense, including the risk of harm to the public, and applicable policies and priorities, if any, governing the prosecution of corporations for particular categories of crime (see section IV, *infra*);

2. the pervasiveness of wrongdoing within the corporation, including the complicity in, or condonation of, the wrongdoing by corporate management (see section V, *infra)*;

3. the corporation's history of similar conduct, including prior criminal, civil, and regulatory enforcement actions against it (see section VI, *infra*);

4. the corporation's timely and voluntary disclosure of wrongdoing and its willingness to cooperate in the investigation of its agents (see section VII, *infra*);

5. the existence and adequacy of the corporation's pre-existing compliance program (see section VIII, *infra*);

6. the corporation's remedial actions, including any efforts to implement an effective corporate compliance program or to improve an existing one, to replace responsible management, to discipline or terminate wrongdoers, to pay restitution, and to cooperate with the relevant government agencies (see section IX, *infra*);

7. collateral consequences, including disproportionate harm to shareholders, pension holders and employees not proven personally culpable and impact on the public arising from the prosecution (see section X, *infra*);

8. the adequacy of the prosecution of individuals responsible for the corporation's malfeasance; and

9. the adequacy of remedies such as civil or regulatory enforcement actions (see section XI, *infra).*

B. Comment: In determining whether to charge a corporation, the foregoing factors must be considered. The factors listed in this section are intended to be illustrative of those that should be considered and not a complete or exhaustive list. Some or all of these factors may or may not apply to specific cases, and in some cases one factor may override all others. For example, the nature and seriousness of the offense may be such as to warrant prosecution regardless of the other factors. In most cases, however, no single factor will be dispositive. Further, national law enforcement policies in various enforcement areas may require that more or less weight be given to certain of these factors than to others. Of course, prosecutors must exercise their judgment in applying and balancing these factors and this process does not mandate a particular result.

In making a decision to charge a corporation, the prosecutor generally has wide latitude in determining when, whom, how, and even whether to prosecute for violations of federal criminal law. In exercising that discretion, prosecutors should consider the following general statements of principles that summarize appropriate considerations to be weighed and desirable practices to be followed in discharging their prosecutorial responsibilities. In doing so, prosecutors should ensure that the general purposes of the criminal law -- assurance of warranted punishment, deterrence of further criminal conduct, protection of the public from dangerous and fraudulent conduct, rehabilitation of offenders, and restitution for victims and affected communities -- are adequately met, taking into account the special nature of the corporate "person."

IV. Charging a Corporation: Special Policy Concerns

A. General Principle: The nature and seriousness of the crime, including the risk of harm to the public from the criminal conduct, are obviously primary factors in determining whether to charge a corporation. In addition, corporate conduct, particularly that of national and multi-national corporations, necessarily intersects with federal economic, taxation, and criminal law enforcement policies. In applying these principles, prosecutors must consider the practices and policies of the appropriate Division of the Department, and must comply with those policies to the extent required.

B. Comment: In determining whether to charge a corporation, prosecutors should take into account federal law enforcement priorities as discussed above. *See* USAM § 9-27-230. In addition, however, prosecutors must be aware of the specific policy goals and incentive programs established by the respective Divisions and regulatory agencies. Thus, whereas natural persons may be given incremental degrees of credit (ranging from immunity to lesser charges to sentencing considerations) for turning themselves in, making statements against their penal interest, and cooperating in the government's investigation of their own and others' wrongdoing, the same approach may not be appropriate in all circumstances with respect to corporations. As an example, it is entirely proper in many investigations for a prosecutor to consider the corporation's pre-indictment conduct, *e.g.*,voluntary disclosure, cooperation, remediation or restitution, in determining whether to seek an indictment. However, this would not necessarily be appropriate in an antitrust investigation, in which antitrust violations, by definition, go to the

heart of the corporation's business and for which the Antitrust Division has therefore established a firm policy, understood in the business community, that credit should not be given at the charging stage for a compliance program and that amnesty is available only to the first corporation to make full disclosure to the government. As another example, the Tax Division has a strong preference for prosecuting responsible individuals, rather than entities, for corporate tax offenses. Thus, in determining whether or not to charge a corporation, prosecutors must consult with the Criminal, Antitrust, Tax, and Environmental and Natural Resources Divisions, if appropriate or required.

V. Charging a Corporation: Pervasiveness of Wrongdoing Within the Corporation

A. General Principle: A corporation can only act through natural persons, and it is therefore held responsible for the acts of such persons fairly attributable to it. Charging a corporation for even minor misconduct may be appropriate where the wrongdoing was pervasive and was undertaken by a large number of employees or by all the employees in a particular role within the corporation, *e.g.*, salesmen or procurement officers, or was condoned by upper management. On the other hand, in certain limited circumstances, it may not be appropriate to impose liability upon a corporation, particularly one with a compliance program in place, under a strict *respondeat superior* theory for the single isolated act of a rogue employee. There is, of course, a wide spectrum between these two extremes, and a prosecutor should exercise sound discretion in evaluating the pervasiveness of wrongdoing within a corporation.

B. Comment: Of these factors, the most important is the role of management. Although acts of even low-level employees may result in criminal liability, a corporation is directed by its management and management is responsible for a corporate culture in which criminal conduct is either discouraged or tacitly encouraged. As stated in commentary to the Sentencing Guidelines:

> Pervasiveness [is] case specific and [will] depend on the number, and degree of responsibility, of individuals [with] substantial authority ... who participated in, condoned, or were willfully ignorant of the offense. Fewer individuals need to be involved for a finding of pervasiveness if those individuals exercised a relatively high degree of authority. Pervasiveness can occur either within an organization as a whole or within a unit of an organization. *See* USSG §8C2.5, comment. (n. 4).

VI. Charging a Corporation: The Corporation's Past History

A. General Principle: Prosecutors may consider a corporation's history of similar conduct, including prior criminal, civil, and regulatory enforcement actions against it, in determining whether to bring criminal charges.

B. Comment: A corporation, like a natural person, is expected to learn from its mistakes. A history of similar conduct may be probative of a corporate culture that encouraged, or at least condoned, such conduct, regardless of any compliance programs. Criminal prosecution of a

corporation may be particularly appropriate where the corporation previously had been subject to non-criminal guidance, warnings, or sanctions, or previous criminal charges, and it either had not taken adequate action to prevent future unlawful conduct or had continued to engage in the conduct in spite of the warnings or enforcement actions taken against it. In making this determination, the corporate structure itself, *e.g.*, subsidiaries or operating divisions, should be ignored, and enforcement actions taken against the corporation or any of its divisions, subsidiaries, and affiliates should be considered. *See* USSG § 8C2.5(c) & comment.(n. 6).

VII. Charging a Corporation: The Value of Cooperation

A. General Principle: In determining whether to charge a corporation, that corporation's timely and voluntary disclosure of wrongdoing and its cooperation with the government's investigation may be relevant factors. In gauging the extent of the corporation's cooperation, the prosecutor may consider, among other things, whether the corporation made a voluntary and timely disclosure, and the corporation's willingness to provide relevant evidence and to identify the culprits within the corporation, including senior executives.

B. Comment: In investigating wrongdoing by or within a corporation, a prosecutor is likely to encounter several obstacles resulting from the nature of the corporation itself. It will often be difficult to determine which individual took which action on behalf of the corporation. Lines of authority and responsibility may be shared among operating divisions or departments, and records and personnel may be spread throughout the United States or even among several countries. Where the criminal conduct continued over an extended period of time, the culpable or knowledgeable personnel may have been promoted, transferred, or fired, or they may have quit or retired. Accordingly, a corporation's cooperation may be critical in identifying the culprits and locating relevant evidence. Relevant considerations in determining whether a corporation has cooperated are set forth below.

1. Qualifying for Immunity, Amnesty or Pretrial Diversion

In some circumstances, granting a corporation immunity or amnesty or pretrial diversion may be considered in the course of the government's investigation. In such circumstances, prosecutors should refer to the principles governing non-prosecution agreements generally. *See* USAM § 9-27.600-650. These principles permit a non-prosecution agreement in exchange for cooperation when a corporation's "timely cooperation appears to be necessary to the public interest and other means of obtaining the desired cooperation are unavailable or would not be effective." Prosecutors should note that in the case of national or multi-national corporations, multi-district or global agreements may be necessary. Such agreements may only be entered into with the approval of each affected district or the appropriate Department official. *See* USAM §9-27.641.

In addition, the Department, in conjunction with regulatory agencies and other executive branch departments, encourages corporations, as part of their compliance programs, to conduct internal investigations and to disclose their findings to the appropriate authorities. Some agencies, such as the Securities and Exchange Commission and the Environmental Protection Agency, as well as the Department's Environmental and Natural Resources Division, have formal voluntary disclosure programs in which self-reporting, coupled with remediation and additional criteria, may qualify the corporation for amnesty or reduced sanctions. Even in the absence of a formal program, prosecutors may consider a corporation's timely and voluntary disclosure in evaluating the adequacy of the corporation's compliance program and its management's commitment to the compliance program. However, prosecution and economic policies specific to the industry or statute may require prosecution notwithstanding a corporation's willingness to cooperate. For example, the Antitrust Division offers amnesty only to the first corporation to agree to cooperate. This creates a strong incentive for corporations participating in anti-competitive conduct to be the first to cooperate. In addition, amnesty, immunity, or reduced sanctions may not be appropriate where the corporation's business is permeated with fraud or other crimes.

2. Waiving Attorney-Client and Work Product Protections[2]

The attorney-client and work product protections serve an extremely important function in the U.S. legal system. The attorney-client privilege is one of the oldest and most sacrosanct privileges under U.S. law. *See Upjohn v. United States*, 449 U.S. 383, 389 (1976). As the Supreme Court has stated "its purpose is to encourage full and frank communication between attorneys and their clients and thereby promote broader public interests in the observance of law and administration of justice." *Id.* The work product doctrine also serves similarly important interests.

Waiver of attorney-client and work product protections is not a prerequisite to a finding that a company has cooperated in the government's investigation. However, a company's disclosure of privileged information may permit the government to expedite its investigation. In addition, the disclosure of privileged information may be critical in enabling the government to evaluate the accuracy and completeness of the company's voluntary disclosure.

Prosecutors may only request waiver of attorney-client or work product protections when there is a legitimate need for the privileged information to fulfill their law enforcement obligations. A legitimate need for the information is not established by concluding it is merely

[2] The Sentencing Guidelines reward voluntary disclosure and cooperation with a reduction in the corporation's offense level. *See* USSG §8C2.5(g). The reference to consideration of a corporation's waiver of attorney-client and work product protections in reducing a corporation's culpability score in Application Note 12, was deleted effective November 1, 2006. *See* USSG §8C2.5(g), comment. (n.12).

desirable or convenient to obtain privileged information. The test requires a careful balancing of important policy considerations underlying the attorney-client privilege and work product doctrine and the law enforcement needs of the government's investigation.

Whether there is a legitimate need depends upon:

(1) the likelihood and degree to which the privileged information will benefit the government's investigation;

(2) whether the information sought can be obtained in a timely and complete fashion by using alternative means that do not require waiver;

(3) the completeness of the voluntary disclosure already provided; and

(4) the collateral consequences to a corporation of a waiver.

If a legitimate need exists, prosecutors should seek the least intrusive waiver necessary to conduct a complete and thorough investigation, and should follow a step-by-step approach to requesting information. Prosecutors should first request purely factual information, which may or may not be privileged, relating to the underlying misconduct ("Category I"). Examples of Category I information could include, without limitation, copies of key documents, witness statements, or purely factual interview memoranda regarding the underlying misconduct, organization charts created by company counsel, factual chronologies, factual summaries, or reports (or portions thereof) containing investigative facts documented by counsel.

Before requesting that a corporation waive the attorney-client or work product protections for Category I information, prosecutors must obtain written authorization from the United States Attorney who must provide a copy of the request to, and consult with, the Assistant Attorney General for the Criminal Division before granting or denying the request. A prosecutor's request to the United States Attorney for authorization to seek a waiver must set forth law enforcement's legitimate need for the information and identify the scope of the waiver sought. A copy of each waiver request and authorization for Category I information must be maintained in the files of the United States Attorney. If the request is authorized, the United States Attorney must communicate the request in writing to the corporation.

A corporation's response to the government's request for waiver of privilege for Category I information may be considered in determining whether a corporation has cooperated in the government's investigation.

Only if the purely factual information provides an incomplete basis to conduct a thorough investigation should prosecutors then request that the corporation provide attorney-client communications or non-factual attorney work product ("Category II"). This information includes legal advice given to the corporation before, during, and after the underlying misconduct occurred.

This category of privileged information might include the production of attorney notes, memoranda or reports (or portions thereof) containing counsel's mental impressions and conclusions, legal determinations reached as a result of an internal investigation, or legal advice given to the corporation.

Prosecutors are cautioned that Category II information should only be sought in rare circumstances.

Before requesting that a corporation waive the attorney-client or work product protections for Category II information, the United States Attorney must obtain written authorization from the Deputy Attorney General. A United States Attorney's request for authorization to seek a waiver must set forth law enforcement's legitimate need for the information and identify the scope of the waiver sought. A copy of each waiver request and authorization for Category II information must be maintained in the files of the Deputy Attorney General. If the request is authorized, the United States Attorney must communicate the request in writing to the corporation.

If a corporation declines to provide a waiver for Category II information after a written request from the United States Attorney, prosecutors must not consider this declination against the corporation in making a charging decision. Prosecutors may always favorably consider a corporation's acquiescence to the government's waiver request in determining whether a corporation has cooperated in the government's investigation.

Requests for Category II information requiring the approval of the Deputy Attorney General do not include:

(1) legal advice contemporaneous to the underlying misconduct when the corporation or one of its employees is relying upon an advice-of-counsel defense; and

(2) legal advice or communications in furtherance of a crime or fraud, coming within the crime-fraud exception to the attorney-client privilege.

In these two instances, prosecutors should follow the authorization process established for requesting waiver for Category I information.

For federal prosecutors in litigating Divisions within Main Justice, waiver requests for Category I information must be submitted for approval to the Assistant Attorney General of the Division and waiver requests for Category II information must be submitted by the Assistant Attorney General for approval to the Deputy Attorney General. If the request is authorized, the Assistant Attorney General must communicate the request in writing to the corporation.

Federal prosecutors are not required to obtain authorization if the corporation voluntarily offers privileged documents without a request by the government. However, voluntary waivers must be reported to the United States Attorney or the Assistant Attorney General in the Division where the case originated. A record of these reports must be maintained in the files of that office.

3. Shielding Culpable Employees and Agents

Another factor to be weighed by the prosecutor is whether the corporation appears to be protecting its culpable employees and agents. Thus, while cases will differ depending on the circumstances, a corporation's promise of support to culpable employees and agents, *e.g.*, through retaining the employees without sanction for their misconduct or through providing information to the employees about the government's investigation pursuant to a joint defense agreement, may be considered by the prosecutor in weighing the extent and value of a corporation's cooperation.

Prosecutors generally should not take into account whether a corporation is advancing attorneys' fees to employees or agents under investigation and indictment. Many state indemnification statutes grant corporations the power to advance the legal fees of officers under investigation prior to a formal determination of guilt. As a consequence, many corporations enter into contractual obligations to advance attorneys' fees through provisions contained in their corporate charters, bylaws or employment agreements. Therefore, a corporation's compliance with governing state law and its contractual obligations cannot be considered a failure to cooperate.[3] This prohibition is not meant to prevent a prosecutor from asking questions about an

[3] In extremely rare cases, the advancement of attorneys' fees may be taken into account when the totality of the circumstances show that it was intended to impede a criminal investigation. In these cases, fee advancement is considered with many other telling facts to make a determination that the corporation is acting improperly to shield itself and its culpable employees from government scrutiny. *See discussion in* Brief of Appellant-United States, *United States v. Smith and Watson*, No. 06-3999-cr (2d Cir. Nov. 6, 2006). Where these circumstances exist, approval must be obtained from the Deputy Attorney General before prosecutors may consider this factor in their charging decisions. Prosecutors should follow the authorization process established for waiver requests of Category II information (see section VII-2, *infra*).

attorney's representation of a corporation or its employees.[4]

4. Obstructing the Investigation

Another factor to be weighed by the prosecutor is whether the corporation, while purporting to cooperate, has engaged in conduct intended to impede the investigation (whether or not rising to the level of criminal obstruction). Examples of such conduct include: overly broad assertions of corporate representation of employees or former employees; overly broad or frivolous assertions of privilege to withhold the disclosure of relevant, non-privileged documents; inappropriate directions to employees or their counsel, such as directions not to cooperate openly and fully with the investigation including, for example, the direction to decline to be interviewed; making presentations or submissions that contain misleading assertions or omissions; incomplete or delayed production of records; and failure to promptly disclose illegal conduct known to the corporation.

5. Offering Cooperation: No Entitlement to Immunity

Finally, a corporation's offer of cooperation does not automatically entitle it to immunity from prosecution. A corporation should not be able to escape liability merely by offering up its directors, officers, employees, or agents as in lieu of its own prosecution. Thus, a corporation's willingness to cooperate is merely one relevant factor, that needs to be considered in conjunction with the other factors, particularly those relating to the corporation's past history and the role of management in the wrongdoing.

VIII. Charging a Corporation: Corporate Compliance Programs

A. General Principle: Compliance programs are established by corporate management to prevent and to detect misconduct and to ensure that corporate activities are conducted in accordance with all applicable criminal and civil laws, regulations, and rules. The Department encourages such corporate self-policing, including voluntary disclosures to the government of any problems that a corporation discovers on its own. However, the existence of a compliance program is not sufficient, in and of itself, to justify not charging a corporation for criminal conduct undertaken by its officers, directors, employees, or agents. Indeed, the commission of such crimes in the face of a compliance program may suggest that the corporate management is

[4] Routine questions regarding the representation status of a corporation and its employees, including how and by whom attorneys' fees are paid, frequently arise in the course of an investigation. They may be necessary to assess other issues, such as conflict-of-interest. Such questions are appropriate and this guidance is not intended to prohibit such inquiry.

not adequately enforcing its program. In addition, the nature of some crimes, *e.g.*, antitrust violations, may be such that national law enforcement policies mandate prosecutions of corporations notwithstanding the existence of a compliance program.

B. Comment: A corporate compliance program, even one specifically prohibiting the very conduct in question, does not absolve the corporation from criminal liability under the doctrine of *respondeat superior*. *See United States v. Basic Construction Co.*, 711 F.2d 570 (4th Cir. 1983) ("[A] corporation may be held criminally responsible for antitrust violations committed by its employees if they were acting within the scope of their authority, or apparent authority, and for the benefit of the corporation, even if... such acts were against corporate policy or express instructions."). In *United States v. Potter*, 463 F.3d 9, 25-26 (1st Cir. According to the court, a corporation cannot "avoid liability by adopting abstract rules" that forbid its agents from engaging in illegal acts; "even a specific directive to an agent or employee or honest efforts to police such rules do not automatically free the company for the wrongful acts of agents." Similarly, in *United States v. Hilton Hotels Corp.*, 467 F.2d 1000 (9th Cir. 1972), *cert. denied*, 409 U.S. 1125 (1973), the Ninth Circuit affirmed antitrust liability based upon a purchasing agent for a single hotel threatening a single supplier with a boycott unless it paid dues to a local marketing association, even though the agent's actions were contrary to corporate policy and directly against express instructions from his superiors. The court reasoned that Congress, in enacting the Sherman Antitrust Act, "intended to impose liability upon business entities for the acts of those to whom they choose to delegate the conduct of their affairs, thus stimulating a maximum effort by owners and managers to assure adherence by such agents to the requirements of the Act.[5] It concluded that "general policy statements" and even direct instructions from the agent's superiors were not sufficient; "Appellant could not gain exculpation by issuing general instructions without undertaking to enforce those instructions by means commensurate with the obvious risks." *See also United States v. Beusch*, 596 F.2d 871, 878 (9th Cir. 1979) ("[A] corporation may be liable for the acts of its employees done contrary to express instructions and policies, but ... the existence of such instructions and policies may be considered in determining whether the employee in fact acted to benefit the corporation."); *United States v. American Radiator & Standard Sanitary Corp.*, 433 F.2d 174 (3rd Cir. 1970) (affirming conviction of corporation based upon its officer's participation in price-fixing scheme, despite corporation's defense that officer's conduct violated its "rigid anti-fraternization policy" against any socialization (and exchange of price information) with its competitors; "When the act of the agent is within the scope of his employment or his apparent authority, the corporation is held

[5] Although this case and *Basic Construction* are both antitrust cases, their reasoning applies to other criminal violations. In the *Hilton* case, for instance, the Ninth Circuit noted that Sherman Act violations are commercial offenses "usually motivated by a desire to enhance profits," thus, bringing the case within the normal rule that a "purpose to benefit the corporation is necessary to bring the agent's acts within the scope of his employment." 467 F.2d at 1006 & n4. In addition, in *United States v. Automated Medical Laboratories*, 770 F.2d 399, 406 n.5 (4th Cir. 1985), the Fourth Circuit stated "that Basic Construction states a generally applicable rule on corporate criminal liability despite the fact that it addresses violations of the antitrust laws."

legally responsible for it, although what he did may be contrary to his actual instructions and may be unlawful.").

While the Department recognizes that no compliance program can ever prevent all criminal activity by a corporation's employees, the critical factors in evaluating any program are whether the program is adequately designed for maximum effectiveness in preventing and detecting wrongdoing by employees and whether corporate management is enforcing the program or is tacitly encouraging or pressuring employees to engage in misconduct to achieve business objectives. The Department has no formal guidelines for corporate compliance programs. The fundamental questions any prosecutor should ask are: "Is the corporation's compliance program well designed?" and "Does the corporation's compliance program work?" In answering these questions, the prosecutor should consider the comprehensiveness of the compliance program; the extent and pervasiveness of the criminal conduct; the number and level of the corporate employees involved; the seriousness, duration, and frequency of the misconduct; and any remedial actions taken by the corporation, including restitution, disciplinary action, and revisions to corporate compliance programs.[6] Prosecutors should also consider the promptness of any disclosure of wrongdoing to the government and the corporation's cooperation in the government's investigation. In evaluating compliance programs, prosecutors may consider whether the corporation has established corporate governance mechanisms that can effectively detect and prevent misconduct. For example, do the corporation's directors exercise independent review over proposed corporate actions rather than unquestioningly ratifying officers' recommendations; are the directors provided with information sufficient to enable the exercise of independent judgment, are internal audit functions conducted at a level sufficient to ensure their independence and accuracy and have the directors established an information and reporting system in the organization reasonably designed to provide management and the board of directors with timely and accurate information sufficient to allow them to reach an informed decision regarding the organization's compliance with the law. *In re: Caremark*, 698 A.2d 959 (Del. Ct. Chan. 1996).

Prosecutors should therefore attempt to determine whether a corporation's compliance program is merely a "paper program" or whether it was designed and implemented in an effective manner. In addition, prosecutors should determine whether the corporation has provided for a staff sufficient to audit, document, analyze, and utilize the results of the corporation's compliance efforts. In addition, prosecutors should determine whether the corporation's employees are adequately informed about the compliance program and are convinced of the corporation's commitment to it. This will enable the prosecutor to make an informed decision as to whether the corporation has adopted and implemented a truly effective compliance program that, when consistent with other federal law enforcement policies, may result in a decision to charge only the corporation's employees and agents.

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[6] For a detailed review of these and other factors concerning corporate compliance programs, *see* USSG §8B2.1.

Compliance programs should be designed to detect the particular types of misconduct most likely to occur in a particular corporation's line of business. Many corporations operate in complex regulatory environments outside the normal experience of criminal prosecutors. Accordingly, prosecutors should consult with relevant federal and state agencies with the expertise to evaluate the adequacy of a program's design and implementation. For instance, state and federal banking, insurance, and medical boards, the Department of Defense, the Department of Health and Human Services, the Environmental Protection Agency, and the Securities and Exchange Commission have considerable experience with compliance programs and can be very helpful to a prosecutor in evaluating such programs. In addition, the Fraud Section of the Criminal Division, the Commercial Litigation Branch of the Civil Division, and the Environmental Crimes Section of the Environment and Natural Resources Division can assist U.S. Attorneys' Offices in finding the appropriate agency office and in providing copies of compliance programs that were developed in previous cases.

IX. Charging a Corporation: Restitution and Remediation

A. General Principle: Although neither a corporation nor an individual target may avoid prosecution merely by paying a sum of money, a prosecutor may consider the corporation's willingness to make restitution and steps already taken to do so. A prosecutor may also consider other remedial actions, such as implementing an effective corporate compliance program, improving an existing compliance program, and disciplining wrongdoers, in determining whether to charge the corporation.

B. Comment: In determining whether or not a corporation should be prosecuted, a prosecutor may consider whether meaningful remedial measures have been taken, including employee discipline and full restitution. A corporation's response to misconduct says much about its willingness to ensure that such misconduct does not recur. Thus, corporations that fully recognize the seriousness of their misconduct and accept responsibility for it should be taking steps to implement the personnel, operational, and organizational changes necessary to establish an awareness among employees that criminal conduct will not be tolerated. Among the factors prosecutors should consider and weigh are whether the corporation appropriately disciplined the wrongdoers and disclosed information concerning their illegal conduct to the government.

Employee discipline is a difficult task for many corporations because of the human element involved and sometimes because of the seniority of the employees concerned. While corporations need to be fair to their employees, they must also be unequivocally committed, at all levels of the corporation, to the highest standards of legal and ethical behavior. Effective internal discipline can be a powerful deterrent against improper behavior by a corporation's employees. In evaluating a corporation's response to wrongdoing, prosecutors may evaluate the willingness of the corporation to discipline culpable employees of all ranks and the adequacy of the discipline imposed. The prosecutor should be satisfied that the corporation's focus is on the integrity and credibility of its remedial and disciplinary measures rather than on the protection of the wrongdoers.

In addition to employee discipline, two other factors used in evaluating a corporation's remedial efforts are restitution and reform. As with natural persons, the decision whether or not to prosecute should not depend upon the target's ability to pay restitution. A corporation's efforts to pay restitution even in advance of any court order is, however, evidence of its "acceptance of responsibility" and, consistent with the practices and policies of the appropriate Division of the Department entrusted with enforcing specific criminal laws, may be considered in determining whether to bring criminal charges. Similarly, although the inadequacy of a corporate compliance program is a factor to consider when deciding whether to charge a corporation, that corporation's quick recognition of the flaws in the program and its efforts to improve the program are also factors to consider.

X. Charging a Corporation: Collateral Consequences

A. General Principle: Prosecutors may consider the collateral consequences of a corporate criminal conviction in determining whether to charge the corporation with a criminal offense.

B. Comment: One of the factors in determining whether to charge a natural person or a corporation is whether the likely punishment is appropriate given the nature and seriousness of the crime. In the corporate context, prosecutors may take into account the possibly substantial consequences to a corporation's officers, directors, employees, and shareholders, many of whom may, depending on the size and nature (*e.g.*, publicly vs. closely held) of the corporation and their role in its operations, have played no role in the criminal conduct, have been completely unaware of it, or have been wholly unable to prevent it. Prosecutors should also be aware of non-penal sanctions that may accompany a criminal charge, such as potential suspension or debarment from eligibility for government contracts or federal funded programs such as health care. Whether or not such non-penal sanctions are appropriate or required in a particular case is the responsibility of the relevant agency, a decision that will be made based on the applicable statutes, regulations, and policies.

Virtually every conviction of a corporation, like virtually every conviction of an individual, will have an impact on innocent third parties, and the mere existence of such an effect is not sufficient to preclude prosecution of the corporation. Therefore, in evaluating the severity of collateral consequences, various factors already discussed, such as the pervasiveness of the criminal conduct and the adequacy of the corporation's compliance programs, should be considered in determining the weight to be given to this factor. For instance, the balance may tip in favor of prosecuting corporations in situations where the scope of the misconduct in a case is widespread and sustained within a corporate division (or spread throughout pockets of the corporate organization). In such cases, the possible unfairness of visiting punishment for the corporation's crimes upon shareholders may be of much less concern where those shareholders have substantially profited, even unknowingly, from widespread or pervasive criminal activity.

Similarly, where the top layers of the corporation's management or the shareholders of a closely-held corporation were engaged in or aware of the wrongdoing and the conduct at issue was accepted as a way of doing business for an extended period, debarment may be deemed not collateral, but a direct and entirely appropriate consequence of the corporation's wrongdoing.

The appropriateness of considering such collateral consequences and the weight to be given them may depend on the special policy concerns discussed in section III, *supra*.

XI. Charging a Corporation: Non-Criminal Alternatives

A. General Principle: Non-criminal alternatives to prosecution often exist and prosecutors may consider whether such sanctions would adequately deter, punish, and rehabilitate a corporation that has engaged in wrongful conduct. In evaluating the adequacy of non-criminal alternatives to prosecution, *e.g.*, civil or regulatory enforcement actions, the prosecutor may consider all relevant factors, including:

1. the sanctions available under the alternative means of disposition;

2. the likelihood that an effective sanction will be imposed; and

3. the effect of non-criminal disposition on federal law enforcement interests.

B. Comment: The primary goals of criminal law are deterrence, punishment, and rehabilitation. Non-criminal sanctions may not be an appropriate response to an egregious violation, a pattern of wrongdoing, or a history of non-criminal sanctions without proper remediation. In other cases, however, these goals may be satisfied without the necessity of instituting criminal proceedings. In determining whether federal criminal charges are appropriate, the prosecutor should consider the same factors (modified appropriately for the regulatory context) considered when determining whether to leave prosecution of a natural person to another jurisdiction or to seek non-criminal alternatives to prosecution. These factors include: the strength of the regulatory authority's interest; the regulatory authority's ability and willingness to take effective enforcement action; the probable sanction if the regulatory authority's enforcement action is upheld; and the effect of a non-criminal disposition on federal law enforcement interests. *See* USAM §§ 9-27.240, 9-27.250.

XII. Charging a Corporation: Selecting Charges

A. General Principle: Once a prosecutor has decided to charge a corporation, the prosecutor should charge, or should recommend that the grand jury charge, the most serious offense that is consistent with the nature of the defendant's conduct and that is likely to result in a sustainable conviction.

B. Comment: Once the decision to charge is made, the same rules as govern charging natural persons apply. These rules require "a faithful and honest application of the Sentencing Guidelines" and an "individualized assessment of the extent to which particular charges fit the specific circumstances of the case, are consistent with the purposes of the federal criminal code, and maximize the impact of federal resources on crime." *See* USAM § 9-27.300. In making this determination, "it is appropriate that the attorney for the government consider, inter alia, such factors as the sentencing guideline range yielded by the charge, whether the penalty yielded by such sentencing range ... is proportional to the seriousness of the defendant's conduct, and whether the charge achieves such purposes of the criminal law as punishment, protection of the public, specific and general deterrence, and rehabilitation." *See* Attorney General's Memorandum, dated October 12, 1993.

XIII. Plea Agreements with Corporations

A. General Principle: In negotiating plea agreements with corporations, prosecutors should seek a plea to the most serious, readily provable offense charged. In addition, the terms of the plea agreement should contain appropriate provisions to ensure punishment, deterrence, rehabilitation, and compliance with the plea agreement in the corporate context. Although special circumstances may mandate a different conclusion, prosecutors generally should not agree to accept a corporate guilty plea in exchange for non-prosecution or dismissal of charges against individual officers and employees.

B. Comment: Prosecutors may enter into plea agreements with corporations for the same reasons and under the same constraints as apply to plea agreements with natural persons. *See* USAM §§ 9-27.400-500. This means, *inter alia*, that the corporation should be required to plead guilty to the most serious, readily provable offense charged. As is the case with individuals, the attorney making this determination should do so "on the basis of an individualized assessment of the extent to which particular charges fit the specific circumstances of the case, are consistent with the purposes of the federal criminal code, and maximize the impact of federal resources on crime. In making this determination, the attorney for the government considers, *inter alia*, such factors as the sentencing guideline range yielded by the charge, whether the penalty yielded by such sentencing range ... is proportional to the seriousness of the defendant's conduct, and whether the charge achieves such purposes of the criminal law as punishment, protection of the public, specific and general deterrence, and rehabilitation." *See* Attorney General's Memorandum, dated October 12, 1993. In addition, any negotiated departures from the Sentencing Guidelines must be justifiable under the Guidelines and must be disclosed to the sentencing court. A corporation should be made to realize that pleading guilty to criminal charges constitutes an admission of guilt and not merely a resolution of an inconvenient distraction from its business. As with natural persons, pleas should be structured so that the corporation may not later "proclaim lack of culpability or even complete innocence." *See* USAM §§ 9-27.420(b)(4), 9-27.440, 9-27.500. Thus, for instance, there should be placed upon the record a sufficient factual basis for the plea to prevent later corporate assertions of innocence.

A corporate plea agreement should also contain provisions that recognize the nature of the corporate "person" and ensure that the principles of punishment, deterrence, and rehabilitation are met. In the corporate context, punishment and deterrence are generally accomplished by substantial fines, mandatory restitution, and institution of appropriate compliance measures, including, if necessary, continued judicial oversight or the use of special masters. *See* USSG §§ 8B1.1, 8C2.1, *et seq*. In addition, where the corporation is a government contractor, permanent or temporary debarment may be appropriate. Where the corporation was engaged in government contracting fraud, a prosecutor may not negotiate away an agency's right to debar or to list the corporate defendant.

In negotiating a plea agreement, prosecutors should also consider the deterrent value of prosecutions of individuals within the corporation. Therefore, one factor that a prosecutor may consider in determining whether to enter into a plea agreement is whether the corporation is seeking immunity for its employees and officers or whether the corporation is willing to cooperate in the investigation of culpable individuals. Prosecutors should rarely negotiate away individual criminal liability in a corporate plea.

Rehabilitation, of course, requires that the corporation undertake to be law-abiding in the future. It is, therefore, appropriate to require the corporation, as a condition of probation, to implement a compliance program or to reform an existing one. As discussed above, prosecutors may consult with the appropriate state and federal agencies and components of the Justice Department to ensure that a proposed compliance program is adequate and meets industry standards and best practices. See section VIII, *supra*.

In plea agreements in which the corporation agrees to cooperate, the prosecutor should ensure that the cooperation is complete and truthful. To do so, the prosecutor may request that the corporation waive attorney-client and work product protection, make employees and agents available for debriefing, disclose the results of its internal investigation, file appropriate certified financial statements, agree to governmental or third-party audits, and take whatever other steps are necessary to ensure that the full scope of the corporate wrongdoing is disclosed and that the responsible culprits are identified and, if appropriate, prosecuted. See generally section VII, *supra*.

This memorandum provides only internal Department of Justice guidance. It is not intended to, does not, and may not be relied upon to create any rights, substantive or procedural, enforceable at law by any party in any matter civil or criminal. Nor are any limitations hereby placed on otherwise lawful litigative prerogatives of the Department of Justice.

Office of the Deputy Attorney General
Washington, D.C. 20530

July 9, 2008

The Honorable Patrick J. Leahy
Chairman
Committee on the Judiciary
United States Senate
Washington, DC 20510

The Honorable Arlen Specter
Ranking Member
Committee on the Judiciary
United States Senate
Washington, DC 20510

Dear Chairman Leahy and Senator Specter:

At your request during my confirmation proceedings last year, I committed to review the Department of Justice's Principles of Federal Prosecution of Business Organizations ("Principles"), the internal policy that governs how all federal prosecutors investigate, charge, and prosecute corporate crimes. I write to update you on my review, and to provide you with a summary of certain changes to the Principles that the Department intends to make in the coming weeks to address issues you have raised and that were echoed during my review. I respectfully ask that you give us an opportunity to implement these changes and then review their operation after a reasonable amount of time before pursuing legislation in this area.

As you are aware, some have raised concerns about the effect of the Principles on the preservation of the attorney-client privilege and work product protection. Specifically and most notably, some have argued that the Department has used the threat of criminal indictment and prosecution (or the threat of withholding cooperation credit) to coerce corporations to waive privilege or work product protection against their will and to provide information to the government that otherwise would be subject to these protections. Others have argued that the perceived widespread use of privilege waivers has inhibited candid communications between corporate employees and legal counsel whose advice has been sought. Additionally, some have expressed concern that the Principles improperly permit the government to limit or refuse cooperation credit to a corporation if the corporation has advanced attorneys' fees to its employees, failed to sanction or fire allegedly culpable employees, or entered into joint defense agreements.

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Letter to Chairman Leahy and Senator Specter

In response to these and other concerns, senior attorneys in the Department and I met internally and with several organizations and former government officials who expressed an interest in this issue, including representatives of the corporate community, criminal defense attorneys, in-house counsel, and civil liberties advocates. During those meetings, we discussed the matters noted above, as well as the Department's belief that we have been judicious in our limited requests for waivers. We pointed out that in the eighteen months since the Principles were last amended, the Department has approved no requests by prosecutors to obtain from corporations core attorney-client communications or non-factual attorney work product.

Despite the obvious difference of opinion between the Department and these groups in some key areas, our meetings were extremely productive and we did find common ground, particularly in the areas of joint defense agreements, attorneys' fees, and employee sanctions. I also came away impressed by the need for the Department to address any lingering perceptions that our conduct in corporate criminal investigations is anything other than fair and respectful of the attorney-client privilege. To that end, I have carefully reviewed the Principles and expect that the Department will make the following revisions to them in the next few weeks:

- Cooperation will be measured by the extent to which a corporation discloses relevant facts and evidence, not its waiver of privileges. The government's key measure of cooperation will be the same for a corporation as for an individual: to what extent has the corporation timely disclosed the relevant facts about the misconduct? That will be the operative question – *not* whether the corporation waived attorney-client privilege or work product protection in making its disclosures.

- Federal prosecutors will not demand the disclosure of "Category II" information as a condition for cooperation credit. To be eligible for cooperation credit, a corporation need not disclose, and the government may not demand, what the McNulty Memo defines as "Category II information" – namely, non-factual attorney work product and core attorney-client privileged communications. (Of course, attorney-client communications that were made in furtherance of a crime or fraud, or that relate to an advice-of-counsel defense, are excluded from the protection of the privilege by well-settled case law and will therefore continue to fall outside these principles.)

Page 3
Letter to Chairman Leahy and Senator Specter

- Federal prosecutors will not consider whether the corporation has advanced attorneys' fees to its employees in evaluating cooperation. The advancement of attorneys' fees or provision of counsel by a corporation to its employees will not be taken into account for the purpose of evaluating cooperation.

- Federal prosecutors will not consider whether the corporation has entered into a joint defense agreement in evaluating cooperation. The mere participation in a joint defense, common interest, or similar agreement by a corporation will not be taken into account for the purpose of evaluating cooperation. The government may, of course, request that a corporation refrain from disclosing to others sensitive information about the investigation that the government provides in confidence to the corporation, and may consider whether the corporation has abided by that request.

- Federal prosecutors will not consider whether the corporation has retained or sanctioned employees in evaluating cooperation. How and whether a corporation disciplines culpable employees may bear on the quality of its remedial measures or its compliance program; it will not be taken into account for the purpose of evaluating cooperation.

During my tenure as Deputy Attorney General, I have appreciated the courtesy you have extended to me and to the Department, particularly your patience during my review of this important issue. I have come to the conclusion that the above changes to the Principles are preferable to any legislation, however well intentioned and diligently drafted, that would seek to address the same core set of issues. I think we all very much share an appreciation for the foundational role that the attorney-client privilege plays in our legal system, including our system of criminal justice. The interest that you both have shown in this matter, including your vigilance in protecting the attorney-client privilege, certainly has motivated the Department to pursue the changes I have outlined above.

I remain available to discuss this matter with you further at your convenience. Thank you again for considering our views.

Sincerely,

Mark Filip
Deputy Attorney General

PATRICK J. LEAHY, VERMONT, CHAIRMAN

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United States Senate

COMMITTEE ON THE JUDICIARY
WASHINGTON, DC 20510-6275

July 10, 2008

The Honorable Mark Filip
Deputy Attorney General
Department of Justice
Washington, DC 20530

Dear Judge Filip:

Thank you for your letter of July 9, 2008 addressed to Chairman Leahy and me concerning the issue of Attorney-Client Privilege.

I begin my consideration of this issue in the context of two fundamental legal principles:

1. The constitutional right to an attorney indispensably includes the attorney-client privilege; and

2. The Government has the burden of proof to produce non-privileged evidence in order to convict.

The importance of the attorney-client privilege was stated by Justice Rehnquist in Upjohn when he wrote that the privilege's:

> "purpose is to encourage full and frank communication between attorneys and their clients and thereby promote broader public interests in the observance of law and administration of justice. The privilege recognizes that sound legal advice or advocacy serves public ends and that such advice or advocacy depends upon the lawyers being fully informed by the client."

I am concerned about the delay in enacting legislation while the Department of Justice is continuing to act under the McNulty Memorandum with individuals incurring enormous attorneys' fees including appellate litigation. The Committee's first hearing on this issue was held on September 12, 2006 and my legislation, now S.3217, was introduced on December 8, 2006. Thereafter, there was a revision of the Thompson memorandum with the McNulty memorandum on December 12, 2006 and another hearing was held on September 18, 2007.

Then on October 17, 2007, this issue was raised at the confirmation hearings of Attorney General Mukasey. As you note in the opening line of your letter, last year you committed to review the issue during your confirmation hearings which were held on December 19, 2007. When you and I discussed this matter on June 26, 2008, I pressed as to when we would have something in writing and you responded that you expected it sometime later this summer.

I note illustratively the high legal fees which have been incurred by individuals as cited in the opinion of Judge Kaplan, in *United States v. Stein*, 495 F.Supp.2d 390 (SDNY 2007), who said that the litigation costs among the individual defendants had already averaged $1.7 million. One defendant was cited as being "insolvent." The costs cited by Judge Kaplan were all before trial and appellate costs, which will be much higher. The Department of Justice conceded to Judge Kaplan that $3.3 million would be "a very conservative estimate" of the average defense costs going forward, and the defendants' lawyers cited an average expected cost of $13 million. This squares with the New York Law Journal's report last year, which said, "[r]ecent court decisions have revealed the cost of an individual's defense can reach as high as $20 million to $40 million." I would be interested to know what is happening in the other cases, besides KPMG, which involve this issue and what kind of expenditures have been required of individuals who have been subjected to the implementation of the Thompson/ McNulty memoranda.

In the context of these lengthy delays and the potential prejudice which is involved in these matters, I think it is too much to ask for the legislative process to await a written revision of McNulty and then await a review of the implementation of a new memorandum for a "reasonable amount of time" which could be very long.

While I understand that the revised memorandum you are preparing will be more explicit, the revisions set forth in your letter are unsatisfactorily vague. When you comment that cooperation will be measured by the disclosure of facts and evidence, not the waiver of privilege, such facts and evidence may have been obtained from an individual who expected the confidentiality of his disclosures of facts and evidence would be protected under the attorney-client privilege. I cite the example of the employees in the case, *In re Grand Jury Subpoena: Under Seal*, 415 F.3d 333 (4th Cir. 2005), who were confused about confidentiality because the company's counsel told them, "We can represent you as long as no conflict appears."

When you refer to "Category II" information and exclude "non-factual attorney work product," that leaves a large undefined area where factual and non-factual attorney work product may overlap.

In your statement that federal prosecutors will not consider the advance of attorneys' fees, would that standard lead the Department of Justice to abandon its appeal in the case of *United States v. Stein*? Beyond that specific case, what other cases and what cost to defendants is the Department of Justice pursuing under Thompson/McNulty because the corporation is paying defendants' attorneys fee?

On the question of federal prosecutors not considering whether the corporation has entered into a joint defense agreement, I am interested to know what relevance that factor has ever had and how often the Department of Justice opposed such joint defense agreements in the past.

Similarly, as to federal prosecutors not considering sanctions against employees, I would be interested to know what relevance that ever had and what the Department of Justice has done on that matter in past cases.

Beyond these specific issues, there are other concerns. A Department of Justice statement of Principles would not bind any other federal agencies such as the SEC and IRS. Similarly, any Department of Justice statement of Principles would be subject to modification by subsequent Attorneys-General unlike legislation. It is worth noting that former Attorneys-General Edwin Meese and Dick Thornburgh testified in strong opposition to what the Department of Justice was doing with the Thompson and McNulty memoranda.

I am making this prompt response to your letter in an effort to move this matter along. These are my initial reactions to the outline of your new proposal which I may supplement as we get more input from other interested parties.

Shortly before the July 4th recess, Chairman Leahy commented that he may schedule Judiciary Committee action on the pending legislation. My recommendation to Chairman Leahy is that we move ahead in the Judiciary Committee to either come to some accommodation with the Administration on legislation or have Congress move ahead on its own. In the interim, I would appreciate it if you would complete a more explicit statement on a "Filip memorandum" to supplement Thompson/McNulty so that we may be in a position to move ahead as promptly as possible. I would further appreciate your informing the Committee on the specific cases which are pending under Thompson/McNulty including the costs incurred by companies and individuals.

Sincerely,

Arlen Specter

DELAWARE

145 INDEMNIFICATION OF OFFICERS, DIRECTORS, EMPLOYEES AND AGENTS; INSURANCE.

(a) A corporation shall have power to indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative (other than an action by or in the right of the corporation) by reason of the fact that the person is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, against expenses (including attorneys' fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by the person in connection with such action, suit or proceeding if the person acted in good faith and in a manner the person reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to any criminal action or proceeding, had no reasonable cause to believe the person's conduct was unlawful. The termination of any action, suit or proceeding by judgment, order, settlement, conviction, or upon a plea of nolo contendere or its equivalent, shall not, of itself, create a presumption that the person did not act in good faith and in a manner which the person reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to any criminal action or proceeding, had reasonable cause to believe that the person's conduct was unlawful.

(b) A corporation shall have power to indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action or suit by or in the right of the corporation to procure a judgment in its favor by reason of the fact that the person is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against expenses (including attorneys' fees) actually and reasonably incurred by the person in connection with the defense or settlement of such action or suit if the person acted in good faith and in a manner the person reasonably believed to be in or not opposed to the best interests of the corporation and except that no indemnification shall be made in respect of any claim, issue or matter as to which such person shall have been adjudged to be liable to the corporation unless and only to the extent that the Court of Chancery or the court in which such action or suit was brought shall determine upon application that, despite the adjudication of liability but in view of all the circumstances of the case, such person is fairly and reasonably entitled to indemnity for such expenses which the Court of Chancery or such other court shall deem proper.

(c) To the extent that a present or former director 1 or officer of a corporation has been successful on the merits or otherwise in defense of any action, suit or proceeding referred to in subsections (a) and (b) of this section, or in defense of any claim, issue or matter therein, 2 such person shall be indemnified against expenses (including attorneys' fees) actually and reasonably incurred by 3 such person in connection therewith.

(d) Any indemnification under subsections (a) and (b) of this section (unless ordered by a court) shall be made by the corporation only as authorized in the specific case upon a determination that indemnification of the present or former director, officer, employee or agent is proper in the circumstances because the person has met the applicable standard of conduct set forth in subsections (a) and (b) of this section. Such determination shall be made, with respect to a person who is a director or officer at the time of such determination, (1) by a majority vote of the directors who are not parties to such action, suit or proceeding, even though less than a quorum, or (2) by a committee of such directors designated by majority vote of such directors, even though less than a quorum, or 4 (3) if there are no such directors, or if such directors so direct, by independent legal counsel in a written opinion, or 5 (4) by the stockholders.

(e) Expenses (including attorneys' fees) incurred by an officer or director in defending any civil, criminal, administrative or investigative action, suit or proceeding may be paid by the corporation in advance of the final disposition of such action, suit or proceeding upon receipt of an undertaking by or on behalf of such director or officer to repay such amount if it shall ultimately be determined that 2 such person is not entitled to be indemnified by the corporation as authorized in this section. Such expenses (including attorneys' fees) incurred by former directors and officers or other employees and agents may be so paid upon such terms and conditions, if any, as the 6 corporation deems appropriate.

(f) The indemnification and advancement of expenses provided by, or granted pursuant to, the other subsections of this section shall not be deemed exclusive of any other rights to which those seeking indemnification or advancement of expenses may be entitled under any bylaw, agreement, vote of stockholders or disinterested directors or otherwise, both as to action in 7 such person's official capacity and as to action in another capacity while holding such office.

(g) A corporation shall have power to purchase and maintain insurance on behalf of any person who is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against any liability asserted against 3 such person and incurred by 3 such person in any such capacity, or arising out of 7 such person's status as such, whether or not the corporation would have the power to indemnify 3 such person against such liability under this section.

(h) For purposes of this section, references to “the corporation” shall include, in addition to the resulting corporation, any constituent corporation (including any constituent of a constituent) absorbed in a consolidation or merger which, if its separate existence had continued, would have had power and authority to indemnify its directors, officers, and employees or agents, so that any person who is or was a director, officer, employee or agent of such constituent corporation, or is or was serving at the request of such constituent corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, shall stand in the same position under this section with respect to the resulting or surviving corporation as 2 such person would have with respect to such constituent corporation if its separate existence had continued.

(i) For purposes of this section, references to "other enterprises" shall include employee benefit plans; references to "fines" shall include any excise taxes assessed on a person with respect to any employee benefit plan; and references to "serving at the request of the corporation" shall include any service as a director, officer, employee or agent of the corporation which imposes duties on, or involves services by, such director, officer, employee, or agent with respect to an employee benefit plan, its participants or beneficiaries; and a person who acted in good faith and in a manner 2 such person reasonably believed to be in the interest of the participants and beneficiaries of an employee benefit plan shall be deemed to have acted in a manner "not opposed to the best interests of the corporation" as referred to in this section.

(j) The indemnification and advancement of expenses provided by, or granted pursuant to, this section shall, unless otherwise provided when authorized or ratified, continue as to a person who has ceased to be a director, officer, employee or agent and shall inure to the benefit of the heirs, executors and administrators of such a person.

(k) The Court of Chancery is hereby vested with exclusive jurisdiction to hear and determine all actions for advancement of expenses or indemnification brought under this section or under any bylaw, agreement, vote of stockholders or disinterested directors, or otherwise. The Court of Chancery may summarily determine a corporation's obligation to advance expenses (including attorneys' fees).

ARTICLE XII

LIMITATION OF LIABILITY,
INDEMNIFICATION AND INSURANCE

Section 1. A Director of the Club shall not be personally liable for monetary damages as such for any action taken, or any failure to take action, unless the Director has breached or failed to perform the duties of his office under Section 8363 of the Pennsylvania Directors' Liability Act, as from time to time amended, or any successor provision, and the breach or failure to perform constitutes self-dealing, willful misconduct or recklessness. This provision shall not apply to the responsibility or liability of a Director pursuant to any criminal statute or the liability of a Director for payment of taxes pursuant to local, State or Federal law. This Section 1 shall be applicable to any action taken or any failure to take any action on or after January 27, 1987.

Section 2. The Club shall indemnify any Officer, Director or member of a Regional or Advisory Board (or employee or agent designated by majority vote of the Board of Directors to the extent provided in such vote) who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceedings, whether civil, criminal, administrative or investigative (including action by or in the right of the Club) by reason of the fact that the employee is or was an Officer, Director or member of a Regional or Advisory Board (or employee or agent) of the Club or is or was serving at the request of the Club as a director or officer (or employee or agent) of another corporation, partnership, joint venture, trust employee benefit plan or other enterprise, against expenses including attorneys' fees, judgments, fines and amounts paid in settlement, actually and reasonably incurred by said employee in connection with such action, suit or proceeding. Officers and directors of subsidiaries of the Club shall be deemed to be persons acting as an officer or director of another corporation at the request of the Club. Indemnification pursuant to this Section shall not be made in any case where the act or failure to act giving rise to the claim for indemnification is determined by a court to have constituted willful misconduct or recklessness. Expenses incurred by an Officer, Director, member of a Regional or Advisory Board, employee or agent entitled to be indemnified by this Section in defending a civil or criminal action, suit or proceeding may be paid by the Club in advance of the final disposition of such action, suit or proceeding upon receipt of an undertaking by or on behalf of such person to repay such amount if it shall ultimately be determined that said employee is not entitled to be indemnified by the Club. The indemnification and advancement of expenses provided by, or granted pursuant to, this Section 2 shall continue as to a person who has ceased to be a Director, Officer, member of a Regional or Advisory Board, employee or agent of the Club and shall inure to the benefit of the heirs, executors and administrators of such person. This Section 2 shall not be effective with respect to any action, suit or proceeding commenced prior to January 27, 1987.

Section 3. The Club may purchase and maintain insurance on behalf of persons who are or were Directors, Officers, employees or agents of the Club, are or were serving

at the request of the Club as a director, officer, employee or agent of another corporation, partnership, joint venture, trust, employee benefit plan or other enterprise against any liability asserted against them and incurred by them in any such capacity, or arising out of their status as such, whether or not the Club would have the power to indemnify them against such liability under provisions of this Article. Furthermore, the Club may create a fund of any nature, which may, but need not be, under the control of a trustee, or otherwise secure or insure in any manner its indemnification obligations referred to in Section 2 hereof.

ARTICLE XII

LIMITATION OF LIABILITY,
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Section 1. A Director of the Club shall not be personally liable for monetary damages as such for any action taken, or any failure to take action, unless the Director has breached or failed to perform the duties of his office under Section 8363 of the Pennsylvania Directors' Liability Act, as from time to time amended, or any successor provision, and the breach or failure to perform constitutes self-dealing, willful misconduct or recklessness. This provision shall not apply to the responsibility or liability of a Director pursuant to any criminal statute or the liability of a Director for payment of taxes pursuant to local, State or Federal law. This Section 1 shall be applicable to any action taken or any failure to take any action on or after January 27, 1987.

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Section 3. The Club may purchase and maintain insurance on behalf of persons who are or were Directors, Officers, employees or agents of the Club, are or were serving

plaskow 8/13/08 1:25 PM
Comment: To make reimbursement to one of a loss already incurred by him.

plaskow 8/13/08 1:26 PM
Comment: Recently amended to move the parenthesis and place employees on equal footing with Officers.

plaskow 8/13/08 1:59 PM
Comment: Better than insurance? Depends on form.

plaskow 8/13/08 1:29 PM
Comment: Would this reach pro bono service on a nonprofit board with the approval of an officer? How explicit must the "request" for service be?

plaskow 8/13/08 1:42 PM
Comment: No deductible or limit on amount. Better than insurance?

plaskow 8/13/08 1:30 PM
Comment: While criminal investigations may be defended pursuant to indemnification and advanced payments, the employee may be liable for advances if found guilty.

plaskow 8/13/08 1:31 PM
Comment: Probably want to bargain for "shall"."

plaskow 8/13/08 1:38 PM
Comment: But see, *Schoon v. Troy Corporation*, 2008 WL 821666 (Del. Ch. Mar. 28, 2008, right to advancement may be revoked by amendment as not vested until litigation commences.

at the request of the Club as a director, officer, employee or agent of another corporation, partnership, joint venture, trust, employee benefit plan or other enterprise against any liability asserted against them and incurred by them in any such capacity, or arising out of their status as such, whether or not the Club would have the power to indemnify them against such liability under provisions of this Article. Furthermore, the Club may create a fund of any nature, which may, but need not be, under the control of a trustee, or otherwise secure or insure in any manner its indemnification obligations referred to in Section 2 hereof.

New York County Clerk's Indictment No. 5259/02

Court of Appeals
of the
State of New York

THE PEOPLE OF THE STATE OF NEW YORK,

Respondent,

– against –

L. DENNIS KOZLOWSKI and MARK H. SWARTZ,

Defendants-Appellants.

**BRIEF FOR AMICUS CURIAE
ASSOCIATION OF CORPORATE COUNSEL
IN SUPPORT OF RESPONDENT**

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*Requests for pro hac vice admission pending

Date of Completion: August 8, 2008

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CORPORATE DISCLOSURE STATEMENT

Pursuant to Title 22 of the New York Codes, Rules and Regulations, § 500.1(c), The Association of Corporate Counsel ("ACC") hereby states that it has a network of local chapters that are separately incorporated in the jurisdictions in which they serve members, but that share a tax status with ACC. Those chapters are listed in Appendix A to this brief. Additionally, The ACCA Foundation is a charitable arm of ACC pursuant to Internal Revenue Code Section 501(c)(3).

INTERESTS OF THE ASSOCIATION OF CORPORATE COUNSEL AND PROFESSOR GILLERS

ACC was formed in 1982 to represent the professional interests of attorneys who practice in the legal departments of corporations and other organizations in the United States and around the world. With nearly 24,000 members in 81 countries, employed in over 10,000 organizations, one of the primary missions of ACC is to provide a voice for the in-house bar on issues of universal importance to our members, such as those involved in this appeal.

Stephen Gillers, Emily Kempin Professor of Law at New York University School of Law, is a leading academician on matters of professional regulation and legal and judicial ethics, including the law of privilege in the corporate context.

The Defendants-Appellants ("Appellants") in this case, who are former corporate executives, have made an unwarranted attempt to obtain protected witness interview notes and memoranda generated by outside counsel in a corporate internal investigation. Such materials historically and under New York law are regarded as core attorney work product subject to the greatest protection, because their disclosure would necessarily reveal counsel's mental impressions and strategies. Yet the Appellants' supporting amicus would have this Court presume that corporations automatically waive work-product protection if they engage counsel to conduct an internal investigation even where there is no finding of actual waiver, and it urges the Court to adopt unprecedented rules that would effectively rewrite New York law and which would substantially degrade a corporation's ability to prevent disclosure of certain privileged and confidential material. If such rules were adopted, counsel for corporations would be deprived of the privacy necessary to provide sound legal advice and zealously represent their clients in litigation.

ACC, as the voice of the in-house bar, has an essential interest in ensuring that a corporation's right to assert the attorney-client privilege and work-product protection is preserved. ACC has been leading the fight against the ongoing erosion of the attorney-client privilege and work-product doctrine in the corporate context by, among other things, testifying before Congress and filing

amicus briefs in important cases. Through its members' collective experience, ACC is able to provide valuable insight with respect to the various policies advanced by enforcement of the attorney-client privilege and work-product doctrine in the corporate context. Accordingly, ACC, as amicus, submits this brief in support of the Respondent.

SUMMARY OF ARGUMENT

This case presents a direct challenge to the ability of a corporation to control its right to assert or waive the protections afforded to core attorney work product generated during the course of an internal investigation. A full statement of facts, which is not necessary for this brief, can be found in the Brief for the Respondent ("Resp. Br.").[1] In short, Appellants were senior executives at Tyco International Ltd. ("Tyco"). In response to allegations that the Appellants directed that improper corporate payments be made to themselves, Tyco retained the law firm of Boies, Schiller & Flexner LLP ("Boies Schiller") to conduct a thorough internal investigation. At the same time, a New York grand jury convened an investigation, and the Appellants were subsequently prosecuted in connection with these matters. During that prosecution, the Appellants directed a subpoena to Boies Schiller for, among other things, outside counsel's notes and memoranda of

[1] *See* Resp. Br. at 5-37.

interviews of corporate directors during the internal investigation. The trial court quashed the subpoena based on Tyco's assertion of work-product protection over these materials. The Appellate Division affirmed. The Appellants appeal that ruling.

The attorney-client privilege and work-product doctrine, together, are at the very foundation of the attorney-client relationship. Corporations, no less than individuals, are entitled to the benefits and protections conferred by the attorney-client privilege and work-product doctrine. Timely, candid legal advice is critical to navigate the numerous laws and regulations confronting a corporation, especially where the consequences of non-compliance can be devastating to large numbers of people. In the context of an internal investigation by outside counsel in particular – which is directly at issue in this case – the availability of the attorney-client privilege and work-product protection encourages witnesses to cooperate with counsel and enables counsel to conduct a thorough investigation, to advise the client regarding its findings, and to prepare for any investigation and litigation which may ensue.

The New York Council of Defense Lawyers ("Opposing Amicus"), invoking a general "culture of waiver" in the context of federal criminal investigations of corporations, asks the Court to rewrite New York statutes that restrict the discovery of protected work product and to substantially weaken the

right of corporations to determine whether and when to waive protection for materials created by their counsel in internal investigations. Such an unprecedented change is not warranted in this case, and would substantially erode the legal rights of corporations, not only to their detriment, but to the detriment of the adversarial process and society as a whole. Indeed, any concern about an encroaching "culture of waiver" is best addressed not by further degrading a corporation's ability to protect privileged communications and work product, but by respecting and enhancing a corporation's rights to do so.

For these reasons, ACC submits that the ruling of the trial court in this matter was correct and should be affirmed.

ARGUMENT

I. THE ATTORNEY-CLIENT PRIVILEGE AND WORK-PRODUCT DOCTRINE SERVE IMPORTANT POLICY FUNCTIONS.

A. The Attorney-Client Privilege and Work-Product Doctrine Promote Open Communications With Counsel and Effective Representation of the Client.

The attorney-client privilege, which protects communications with counsel made in confidence for the purpose of seeking legal advice or services, and the work-product doctrine, which protects materials prepared in anticipation of litigation, are at the heart of the attorney-client relationship, especially in the

corporate context, where privilege is recognized as a necessary assurance for clients who need to candidly discuss even their most sensitive concerns. *See Upjohn Co. v. United States*, 449 U.S. 383, 392 (1981).

The vital role played by the work-product doctrine in the proper functioning of our adversarial system in both criminal and civil proceedings is well-recognized, and is codified in New York and federal law. *See* N.Y. Crim. Proc. Law § 240.10(2); N.Y. C.P.L.R. 3101; Fed. R. Civ. P. 26(b)(3); Fed. R. Crim. P. 16(a)(2), (b)(2)(A); *See also Hickman v. Taylor,* 329 U.S. 495, 511 (1947); *United States v. Nobles*, 422 U.S. 225, 238 (1975).

The rationale for protecting attorney work product is famously stated by the Supreme Court in *Hickman*:

> [I]t is essential that a lawyer work with a certain degree of privacy, free from unnecessary intrusion by opposing parties and their counsel. Proper preparation of a client's case demands that he assemble information, sift what he considers to be the relevant from the irrelevant facts, prepare his legal theories and plan his strategy without undue and needless interference.

329 U.S. at 510-11.[2]

[2] The rationale for the work product doctrine articulated in *Hickman* has been adopted by courts in New York. *See, e.g., Corcoran v. Peat, Marwick, Mitchell & Co.*, 151 A.D.2d 443, 445 (1st Dept. 1989) ("It is precisely to protect the integrity and vitality of the adversarial system that the attorney-client and attorney's work product privileges have been adopted (*see, Hickman v. Taylor*, *supra*.)."); *Delta Fin. Corp. v. Morrison*, 15 Misc. 3d 308, 319 (Sup. Ct.
(cont'd)

There is no dispute that the witness interview notes and memoranda sought in this case were prepared in anticipation of litigation and are work-product entitled to some degree of protection.[3] Indeed, they are entitled to the greatest amount of protection afforded by law because they are core work product. In *Hickman*, 329 U.S. at 511-12, and *Upjohn*, 449 U.S. at 399-401, the Supreme Court specifically held that witness interview notes and memoranda were core work product, broadly protected from disclosure.

Without assurance that such materials will be protected from disclosure to the client's adversary, lawyers will be reluctant to reduce to writing the facts they have learned, as well as their theories, strategies, and impressions. As noted in *Hickman*, "[w]ere such materials open to opposing counsel on mere demand, much of what is now put down in writing would remain unwritten." 329 U.S. at 511. As a result, "[i]nefficiency, unfairness and sharp practices would inevitably develop in the giving of legal advice and in the preparation of cases for trial." *Id.* Another important policy reason for the work-product doctrine is that it

(cont'd from previous page)
Nassau Co. 2007) ("The basic New York law on the scope of work-product immunity has been guided by *Hickman v. Taylor* . . . .").

[3] *See* Brief for Appellant Mark H. Swartz at 17 (acknowledging that the materials sought were entitled to "qualified protection as material prepared in anticipation of litigation"); Brief of Opposing Amicus at 38, n.44 (adopting Appellant Swartz's argument that the items sought constituted "materials . . . prepared in anticipation of litigation.").

"prevents one party from capitalizing on another's intelligence." John S. Applegate, *Witness Preparation*, 68 Tex. L. Rev. 277, 315 (1989).

The policy reasons articulated in *Hickman* – a civil case – apply with equal vitality in the criminal context, where the "role [of the work-product doctrine] in assuring the proper functioning of the criminal justice system is even more vital." *Nobles*, 422 U.S. at 238. Accordingly, the work-product doctrine can be invoked to deny criminal defendants access to attorney work product, whether in the hands of the prosecution or a third party. *See, e.g., People v. Torres*, 251 A.D.2d 519, 520 (2d Dept. 1998); *People v. Marin*, 86 A.D.2d 40, 43-44 (2d Dept. 1982).

Although this appeal is concerned primarily with the work-product doctrine, the interviews at issue in this case were also protected by the attorney-client privilege. *See Spectrum Sys. Int'l Corp. v. Chem. Bank*, 78 N.Y.2d 371, 378 (1991) (report prepared by outside law firm relating to internal investigation of corporate client was protected by the attorney-client privilege). The attorney-client privilege "encourage[s] full and frank communication between attorneys and their clients . . . ." *Upjohn,* 449 U.S. at 389. As explained by this Court in *People v. Mitchell*, the purpose of the attorney-client privilege "is to ensure that one seeking legal advice will be able to confide fully and freely in his attorney, secure in the knowledge that his confidence will not later be revealed to the public to his

detriment or his embarrassment." 58 N.Y.2d 368, 373 (1983). By doing so, the attorney-client privilege "promote[s] broader public interests in the observance of law and administration of justice." *Upjohn*, 449 U.S. at 389.

These protections against disclosure also effectuate lawyers' ethical duty to maintain client confidences, as well as to represent their clients zealously. *See* N.Y. Lawyer's Code of Prof'l Responsibility DR 4-101(B) ("[A] lawyer shall not knowingly . . . reveal a confidence or secret of a client."); EC 6-4 (the "lawyer's obligation to the client requires adequate preparation for and appropriate attention to the legal work."); and EC 7-1 ("The duty of a lawyer, both to the client and to the legal system, is to represent the client zealously within the bounds of the law . . . .").[4]

In *Upjohn*, the Supreme Court highlighted the role of privileges in facilitating corporate counsel's fulfillment of their ethical obligations. The Supreme Court quoted the ABA Code of Professional Responsibility, which states that lawyers should "be fully informed of all the facts . . . to obtain the full advantage of our legal system." *Upjohn*, 449 U.S. at 391 (quoting ABA Model

[4] *See also*, American Bar Association ("ABA") Model Rules of Professional Conduct ("Model Rules") R. 1.6(a) ("A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent . . . ."); ABA Model Rules, Preamble ("As advocate, a lawyer zealously asserts the client's position under the rules of the adversary system.").

Code of Professional Responsibility EC 4-1). Without the protections afforded by the attorney-client privilege and work-product doctrine, a lawyer's ability to exercise the "thoroughness and preparation reasonably necessary for the representation" would be compromised, *see* ABA Model Rules R. 1.1, and lawyers would be less able to fulfill their ethical duties of competent and zealous representation.

B. In the Corporate Context, the Attorney-Client Privilege and Work-Product Doctrine are Fully Applicable and Especially Critical.

It is well-established that corporations, just as individuals, have the right to assert or waive privileges over protected communications and materials. *See Rossi v. Blue Cross & Blue Shield of Greater N.Y.,* 73 N.Y.2d 588, 591-92 (1989); *Upjohn*, 449 U.S. at 390. Because corporations act through their employees, the attorney-client privilege applies to counsel's "communications with low- and mid-level employees," and not just "control group" corporate personnel. *Niesig v. Team I*, 76 N.Y.2d 363, 371 (1990); *see also Upjohn*, 449 U.S. at 391. The protections afforded by a corporation's privileges apply equally to both in-house lawyers and outside counsel. *See Rossi,* 73 N.Y.2d at 592 (attorney-client privilege applies to communications with attorneys "whether corporate staff counsel or outside counsel"); *Lipin v. Bender*, 84 N.Y.2d 562, 570 (1994) (applying work-product doctrine to materials created by outside law firm).

Moreover, the corporation retains the right to assert privileges regardless of whether the material sought is in the physical possession of the corporation itself or in the possession of an outside law firm representing the corporation. *See Robinson v. Time Warner, Inc.*, 187 F.R.D. 144, 146 (S.D.N.Y. 1999).

The policy justifications for the attorney-client privilege and work-product doctrine take on special importance in the fast-paced and competitive corporate context, where numerous actors must comply with a "vast and complicated array of regulatory legislation," *see Upjohn*, 449 U.S. at 392, and where the actions of the corporation can have a significant impact on large segments of society. In order to promote ongoing corporate compliance, it is essential that corporations can rely on the consistent application of the attorney-client privilege and work-product doctrine and the open communications with lawyers that those privileges foster.

Encouraging candid communications between corporate employees and counsel leads to better decision-making, reduces costs to the corporation by preventing wrongdoing in the first instance, and promotes a healthy corporate culture. Confident that their communications to counsel can be kept confidential, corporations will be encouraged to take hard looks at conduct and engage in sensitive discussions that otherwise might not occur absent the attorney-client privilege and work-product doctrine. Furthermore, corporate actors will be less

likely to take an ill-advised proposed course of action if they believe that a confidential avenue for consulting counsel regarding the proposed conduct is available. The attorney-client privilege and work-product doctrine foster an environment in which such consultations are encouraged.

In particular, these protections are essential to guarantee the effectiveness of an internal investigation, which is the primary tool used to examine allegations of wrongdoing within a corporation. Through internal investigations, a corporation's lawyers are able to gather facts needed to provide informed advice, counsel the corporation about appropriate compliance actions, zealously defend against unwarranted litigation, and help identify and remove bad actors quickly, resulting in benefits for the corporation, its stakeholders (shareholders, customers, suppliers, and others), our adversarial system of justice, and society as a whole.

Undoubtedly, the dilution of the attorney-client privilege and work-product protection would reduce the frequency and effectiveness of future internal investigations. As explained by the Supreme Court in *Upjohn*, absent privileges in the internal investigation context, "the depth and quality of any investigations, to ensure compliance with the law would suffer, even were they undertaken." 449 U.S. at 393 n.2.

II. THE NEW LEGAL STANDARD PROPOSED BY OPPOSING AMICUS IS CONTRARY TO LAW AND UNWARRANTED IN THIS CASE.

Opposing Amicus has suggested that this Court should adopt a special legal standard to dilute the protections afforded to corporate internal investigation materials when they are demanded by defendants in criminal proceedings. This proposed new standard would greatly diminish a corporation's right to assert legal privileges and impermissibly usurp the role of the New York legislature by negating or effectively amending existing statutes. Additionally, the apparent justification offered by Opposing Amicus for the proposed new standard – that there is a prevailing "culture of waiver" with respect to corporate internal investigation materials – does not warrant a departure from statutory law in the absence of an actual waiver.

A. Opposing Amicus Asks the Court to Override New York Statutory Law.

The parties, the trial court, and Opposing Amicus agree that the provisions in N.Y. C.P.L.R. 3101 apply to this case.[5] In relevant part, that statute provides as follows:

[5] *See* Crim. Proc. Law § 60.10 ("Unless otherwise provided by statute or by judicially established rules of evidence applicable to criminal cases, the rules of evidence applicable to civil cases are, where appropriate, also applicable to criminal proceedings."); *People v. Radtke*, 153 Misc. 2d 554, 556 (Sup. Ct. Queens Co. 1992) ("CPLR 3101(a)(4) sets forth the operative procedure to obtain disclosure from such a nonparty witness and, since there is no

(cont'd)

(a) Generally. There shall be full disclosure of all matter material and necessary in the prosecution or defense of an action, regardless of the burden of proof, by:

(1) a party, or the officer, director, member, agent or employee of a party;

. . .

(4) any other person, upon notice stating the circumstances or reasons such disclosure is sought or required.

(b) Privileged matter. Upon objection by a person entitled to assert the privilege, privileged matter shall not be obtainable.

(c) Attorney's work product. *The work product of an attorney shall not be obtainable.*

(d) Trial preparation.

. . .

2. [M]aterials . . . otherwise discoverable under subdivision (a) of this section and prepared in anticipation of litigation or for trial by or for another party, or by or for that other party's representative (including an attorney, consultant, surety, indemnitor, insurer or agent), may be obtained only upon a showing that the party seeking discovery has substantial need of the materials in the preparation of the case and is unable without undue hardship to obtain the substantial equivalent of the materials by other means. In ordering discovery of the materials when the required showing has

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corresponding CPL provision, in terms of procedure, it is applicable to both civil actions and criminal proceedings (CPL 60.10).").

> been made, *the court shall protect against disclosure of the mental impressions, conclusions, opinions or legal theories of an attorney* or other representative of a party concerning the litigation.

Id. (emphases added).

Attorney memoranda and notes of witness interviews constitute "attorney work product" within the scope of N.Y. C.P.L.R. 3101(c). Indeed, New York courts have recognized that such materials are core work product protected from disclosure absent a knowing waiver of privilege. *See People v. Marin*, 86 A.D.2d 40, 43-44 (2d Dept. 1982) ("no question" that summaries of witness interviews "constituted attorney's work product pursuant to CPLR 3101 (subd. [c]) and [are] absolutely privileged in New York State"); *Warren v. N.Y. City Transit Auth.*, 34 A.D.2d 749, 749 (1st Dept. 1970) (it is "quite clear that statements taken from witnesses to prepare for litigation are attorney's work product and protected."); *cf. United States ex rel. Fago v. M&T Mortgage Corp.*, 238 F.R.D. 3, 7 (D.D.C. 2006) ("attorney interview notes are classic opinion work product.").

Nonetheless, Opposing Amicus has suggested the Court ignore the language of N.Y. C.P.L.R. 3101 and find that "unless work product material contains privileged attorney-client communications, which are protected under CPLR § 3101(b), it should be protected at most by the qualified privilege of §

3101(d)(2)." Opp. Am. Br. at 38-39 n.44. In support of its proposed new standard, Opposing Amicus contends that:

> [T]he work product protection over factual material must give way to a defendant's subpoena for potentially critical impeachment material – at least where, as here, there is no contention by the party asserting the work product protection that disclosure of those facts would cause any prejudice, or that the material is protected by the attorney-client privilege.

Opp. Am. Br. at 43.

This unprecedented standard would effectively rewrite New York statutory law with respect to attorney work product in several ways: (i) it would negate N.Y. C.P.L.R. 3101(c), which states that "the work product of an attorney shall not be obtainable;" (ii) it would transform the requestor's burden to show substantial need and undue hardship to obtain fact work product into the privilege holder's burden to show prejudice; and (iii) it would read out of N.Y. C.P.L.R. 3101(d)(2) the requirement that core work product be protected against discovery in any event.

Indeed, their interpretation, on its face, gives absolutely no effect to subsection (c), but instead requires all claims of work-product protection to be analyzed under either subsection (b) or subsection (d). Such interpretations, which render parts of statutes meaningless, are to be avoided because courts should "where possible . . . [give] effect and meaning . . . to the entire statute and every

part and word thereof." *Friedman v. Conn. Gen. Life Ins. Co.*, 9 N.Y.3d 105, 115 (2007) (quotation omitted).[6]

Moreover, even if one were to assume, as Opposing Amicus has proposed, that attorney work product is protected only by the qualified protection for "trial preparation" materials under N.Y. C.P.L.R. 3101(d)(2), *see* Opp. Am. Br. 39 n.44, that statutory provision requires a showing by the "party seeking discovery" of need and hardship. Opposing Amicus effectively concedes that Appellants cannot meet this burden. For this reason, it proposes a new standard that instead calls for disclosure absent a "contention *by the party asserting the work product protection* that disclosure of those facts would cause any prejudice." Opp. Am. Br. at 43 (emphasis added). In other words, not only does Opposing Amicus seek to downgrade the protection afforded to core attorney work product – which is ordinarily entitled to absolute production under N.Y. C.P.L.R. 3101(c) – to mere qualified protection under N.Y. C.P.L.R. 3101(d), Opposing Amicus further seeks to shift the burden to show hardship from the party seeking discovery to the party seeking protection from disclosure under the statute.

[6] Courts in New York have given independent effect to N.Y. C.P.L.R. 3101(c). *See, e.g., Parisi v. Leppard*, 172 Misc. 2d 951, 953-54 (Sup. Ct. Nassau Co. 1997); *cf. Ancona v. Net Realty Holding Trust Co.*, 153 Misc. 2d 946, 947 (Sup. Ct. Nassau Co. 1992) ("CPLR 3101(c) affords an attorney's work product absolute immunity from discovery; CPLR 3101(d)(2) affords a conditional immunity to materials *otherwise discoverable*, but prepared in anticipation of litigation." (emphasis added)).

In an apparent attempt to avoid the clear mandate of N.Y. C.P.L.R. 3101(c) that attorney work product is protected, Opposing Amicus has suggested that the materials sought "d[o] not extend to any 'core' work product material reflecting the thoughts, opinions, or observations of [counsel]," and that the request is "limited to the pure factual summary of the witness statements." Opp. Am. Br. at 38. In practice, of course, as is well-recognized, this distinction is largely illusory with respect to attorney memoranda and notes of interviews. Disclosure of such memoranda and notes "is particularly disfavored because it tends to reveal the attorney's mental processes." *Upjohn*, 449 U.S. at 399. Attorney memoranda and notes relating to witness statements reveal "counsel's mental impressions and litigation strategy because they reveal who counsel thought important to interview, what questions counsel thought important to ask, and what information counsel thought important to memorialize." *Fago*, 238 F.R.D. at 7; *see also Hickman,* 329 U.S. at 513 (disclosure of interview memoranda and notes reveal "what [the attorney] saw fit to write down regarding witnesses' remarks."). Moreover, even if a lawyer's "recollection were perfect," the attorney's written record of the interview "would be [the attorney's] language permeated with the [the attorney's] inferences." *Hickman,* 329 U.S. at 516-17 (Jackson, J., concurring).

Aside from negating the protections in N.Y. C.P.L.R. 3101, the proposed new standard would, in effect, expand substantially the scope of the

statute codifying the rule articulated by this Court in *People v. Rosario*, 9 N.Y.2d 286, 290-91 (1961). Specifically, in a criminal case, the prosecution must provide to a criminal defendant "any written or recorded statement . . . made by a person whom the prosecutor intends to call as a witness at trial, and which relates to the subject matter of the witness's testimony." N.Y. Crim. Proc. Law § 240.45(1)(a). This Court has held repeatedly that the *Rosario* obligation is limited to materials in the "possession or control" of the prosecution. For example, in *People v. Flynn*, 79 N.Y.2d 879, 882 (1992), a criminal defendant sought to vacate his conviction on the grounds that the trial court erred by refusing to order the prosecution to produce an accident report filed with the Department of Motor Vehicles. *Id.* The defendant claimed that the prosecution was obligated to produce the material pursuant to *Rosario* because the report represented the statement of a trial witness. *Id.* The court rejected the defendant's claim, holding that the report was not within the possession or control of the prosecution and, as a result, there was no obligation for the prosecution to produce the report to the defendant. *Id.*; *see also People v. Kelly*, 88 N.Y.2d 248, 251-52 (1996) (noting that the *Rosario* statutory disclosure obligation is "limited to circumstances when the trial prosecutor actually has *possession or control* of [the] requested materials" (emphasis added)).

Another instructive case is *People v. Marin*, 86 A.D.2d 40 (2d Dept. 1982). In *Marin*, during the course of an arson investigation, outside counsel for a hotel attended interviews of the hotel's employees conducted by the district attorney's office and took notes of the interviews which were later incorporated into interview memoranda. *Id.* at 41. Defendant Marin was indicted in connection with the arson and issued trial subpoenas to the law firm seeking "copies of . . . interviews" of certain hotel employees. *Id.* The trial court ordered the production of the summaries, but the Appellate Division reversed. The Appellate Division held that the interview summaries were not *Rosario* material and that the summaries "clearly constituted attorney's work product pursuant to CPLR 3101(c) and [are] absolutely privileged in New York State . . . ." *Id.* at 43-44.[7]

Nothing in the record suggests that the government ever possessed the memoranda and notes of the materials sought in this case, as Opposing Amicus seems to acknowledge. *See* Opp. Am. Br. at 17 n.30 (noting that the prosecution "refrained from requesting the witness statements" and that the trial court held "there was no evidence that Boies Schiller 'provided work product directly or

[7] In *Marin*, the Appellate Division also analogized to a case from the New Jersey Supreme Court, *Matter of Farber*, 78 N.J. 259 (1978), where a criminal defendant had issued a discovery subpoena for materials protected by a statutory reporter's privilege. The Appellate Division concluded that Marin had not satisfied the threshold showings articulated in *Farber* for enforcement of a criminal discovery subpoena. 86 A.D.2d 40, 47-49.

indirectly to the People.'"). Instead, Opposing Amicus, in effect, seeks to impose the prosecution's *Rosario* disclosure obligation on corporations that conduct internal investigations, even when the materials sought are protected by the attorney work-product doctrine and have never been in the possession of the prosecutor. It is the sole prerogative of the New York legislature – not Opposing Amicus – to rewrite New York statutory law in this manner, and thus the proposed rules advanced by Opposing Amicus should be rejected.

B. There is No Reason to Depart From the Existing Law.

To justify their proposed departure from the ordinary rules governing work product, Opposing Amicus cites heavily to the "culture of waiver" of corporate privileges in federal criminal investigations. *See* Opp. Am. Br. at 7-10, 16, 19. This argument badly misses the mark. To the extent that there is undue pressure on corporations to waive the attorney-client and work-product privileges, the appropriate response should not be to further weaken the corporation's ability to assert privileges, as the new standard proposed by Opposing Amicus would do. Rather, to the extent that undue governmental pressure for corporations to waive the attorney-client privilege and work-product protection is a concern, such pressure would support strengthening – not weakening – a corporation's ability to assert privileges. Indeed, amicus Association of Corporate Counsel has been in the forefront of those pushing back against the federal government's policies and

practices, which have created a "culture of waiver." The phrase "culture of waiver" was first coined in the Coalition to Protect the Attorney-Client Privilege's testimony and written submissions to Congress.[8] To the extent that there is a problem with coerced waivers, Opposing Amicus' suggestion to *weaken* a corporation's privileges, rather than strengthen them, is precisely the wrong answer.

[8] *See* Association of Corporate Counsel *et al.*, The Decline of the Attorney-Client Privilege in the Corporate Context: Survey Results, http://www.acca.com/Surveys/attyclient2.pdf; Coalition to Preserve the Attorney-Client Privilege, Submission to the U.S. House of Representatives Judiciary Subcommittee on Crime, Terrorism and Homeland Security Regarding the Subcommittee's Hearings on "White Collar Enforcement (Part 1): Attorney-Client Privilege and Corporate Waivers," March 7, 2006, http://www.acca.com/public/accapolicy/coalitionstatement030706.pdf; Coalition to Preserve the Attorney-Client Privilege, Submission to the U.S. Senate Judiciary Committee Regarding Hearings on Coerced Waiver of the Attorney-Client Privilege: The Negative Impact for Clients, Corporate Compliance, and the American Legal System, September 12, 2006, http://www.acc.com/public /attyclientpriv/coalitionsenjudtestimony.pdf; Association of Corporate Counsel, Statement of Richard T. White Chairman of the Board of Directors of the Association of Corporate Counsel (ACC) before the Subcommittee on Crime, Terrorism, and Homeland Security of the Committee on Judiciary of the United States House of Representatives concerning "The McNulty Memorandum's Effect on the Right to Counsel in Corporate Investigations," March 8, 2007, http://www.acc.com/public /policy/attyclient/richardwhitemcnultytestimony.pdf; Coalition to Preserve the Attorney-Client Privilege, Submitted before the Senate Judiciary Committee Hearing on: "Examining Approaches to Corporate Fraud Prosecutions and the Attorney-Client Privilege Under the McNulty Memorandum," September 18, 2007, http://acc.com/public/coalition-statement.pdf.

CONCLUSION

The attorney-client privilege and work-product doctrine serve valuable public policies, such as enhancing the quality of legal advice, facilitating vigorous defense of litigation, and improving corporate compliance. The assertion of entitlement to core attorney work product based solely on a general "culture of waiver" would threaten the availability of those legal protections and contravene existing law. Accordingly, ACC respectfully submits that the lower court be affirmed in this matter.

Respectfully submitted,

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Appendix A – Association of Corporate Counsel Local Chapters

ACC Europe chapter
ACCA-SoCal (Southern California) chapter
Alabama chapter
Arizona chapter
Austin chapter
Baltimore chapter
Central & Western NY chapter
Central Florida chapter
Central Ohio chapter
Central Pennsylvania chapter
Charlotte chapter
Chicago chapter
Colorado chapter
Connecticut chapter
Dallas-Fort Worth chapter
DELVACCA (Delaware Valley/and adjacent parts of Pennsylvania/New Jersey) chapter
Georgia chapter
Greater New York chapter
Houston chapter
Indiana chapter
Iowa chapter
Israel chapter
Louisiana chapter
Michigan chapter
Mid-America chapter
Minnesota chapter
Montreal chapter (certification pending)
Mountain West chapter
Nevada chapter
New Jersey chapter
Northeast chapter
Northeast Ohio chapter
Ontario chapter
Oregon chapter
Research Triangle Area chapter
Sacramento chapter

San Diego chapter
San Francisco Bay chapter
South Florida chapter
South/Central Texas chapter
Southwest Ohio chapter
St. Louis chapter
Tennessee chapter
Toronto chapter
Washington chapter
WESFACCA (Westchester/Fairfield Connecticut) chapter
West Central Florida chapter
Western Pennsylvania chapter
Wisconsin chapter
WMACCA (Washington Metropolitan Area Corporate Counsel Association)