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THE U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON THE JUDICIARY
SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

"*DEFERRED PROSECUTION: SHOULD CORPORATE SETTLEMENT AGREEMENTS BE WITHOUT GUIDELINES*?"

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TESTIMONY OF BRANDON L. GARRETT
ASSOCIATE PROFESSOR OF LAW
UNIVERSITY OF VIRGINIA SCHOOL OF LAW

Chairwoman Sánchez, Ranking Member Cannon and Members of the Subcommittee,

Thank you for the opportunity to testify before you today. I am an associate professor of law at the University of Virginia School of Law. My scholarship focuses on criminal law and procedure. In 2007, I published an article in the Virginia Law Review exploring remedies in deferred and non-prosecution agreements as embodying a "structural reform" approach, because these agreements call for ongoing organizational change.[1] Since 2003, dozens of leading corporations have entered into demanding settlements with federal prosecutors, including AIG, American Online, Boeing, Bristol-Myers Squibb Co., Computer Associates, HealthSouth, KPMG, MCI, Merrill Lynch & Co., Monsanto, and Pfizer, Inc.

To provide an example of such an agreement, in 2004, after a lengthy investigation, the IRS referred a criminal tax case involving KPMG International to the U.S. Attorney's Office for the Southern District of New York. In 2005, prosecutors announced that they had reached a deferred prosecution agreement with KPMG. The settlement stated that if at the end of fourteen months, prosecutors were satisfied that KPMG had complied with the agreement terms they would move to have the case dismissed.[2] In the agreement itself, KPMG International provided detailed admissions of wrongdoing. KPMG paid $456 million in fines, disgorgement, and restitution. KPMG agreed to shut down its entire private tax practice and to cooperate fully in the investigation of former employees. KPMG also agreed to retain an independent monitor for three years, in order to implement an elaborate compliance program. The monitor was paid by KPMG and invested with power to recommend policy changes, obtain access to documents, interview employees, and employ

[1] *See* Brandon L. Garrett, *Structural Reform Prosecution*, 93 Va. L. Rev. 853 (2007), at http://www.virginialawreview.org/content/pdfs/93/853.pdf. A companion essay further developed several proposals for reform. *See* Brandon L. Garrett, *United States v. Goliath*, 93 Va. L. Rev. In Brief 91 (2007), at http://www.virginialawreview.org/inbrief/2007/06/18/garrett.pdf. Both articles have been submitted for the record.

[2] *See* Letter from David N. Kelley, U.S. Attorney, S. Dist. of N.Y., to Robert S. Bennett, Attorney for KPMG (Aug. 26, 2005), http://www.usdoj.gov/usao/nys/pressreleases/August05/kpmgdpagmt.pdf.

personnel. The district judge approved the deferred prosecution agreement. At the end of the fourteen months, the prosecutors moved to dismiss the case, stating that the agreement had been effective. None of the monitor's reports or actions were made public. After dismissal of the criminal case, the IRS continued to supervise compliance at KPMG for two more years. Further, prosecutions of certain individual KPMG employees are ongoing.

Federal prosecutors should be applauded for these efforts to pursue corporate crime and for adopting a creative approach designed to avoid the potentially dire consequences of an indictment, when it is appropriate to do so. However, a careful review of these complex pre-indictment agreements is warranted because of the national importance of these cases and because these remedies are new and untested. I will describe the data that I have collected from these agreements and then discuss two recommendations: (1) the adoption of prosecution guidelines concerning their content; and (2) judicial oversight over the approval, implementation and termination of these agreements.

I. Available Data From Deferred and Non-Prosecution Agreements

Though much remains outside the public eye, the terms of the agreements themselves provide one source for information. I have gathered data from the text of these agreements, with some difficulty, where the text of several agreements was not available. Given the public importance of these agreements, their complete text, including Appendices, should be promptly and routinely made available online on the DOJ Corporate Crime Task Force website. At least 39 agreements were entered in the four years after the Thompson Memo was issued in January 2003. These agreements involved leading corporations and a few public entities. They were entered by 19 U.S. Attorney's Offices as well as the main DOJ office, typically in conjunction with regulatory agencies, such as the SEC, IRS and U.S. Postal Inspection Services.

Most agreements ordered that independent monitors be retained. These monitors possessed sweeping powers to gather information, promulgate policies, and oversee compliance. However, as will be discussed further, the terms of their retention, the precise scope of the duties they owe, to whom they owe duties, the reports they generate, and the actions that they take, have all remained non-public. Most agreements also required the adoption of compliance programs, often with detailed provisions for revisions of policy, training, establishment of compliance committee, and creation of compliance officer positions within the firm. Some agreements included additional injunctions, such as permanent restrictions on conduct. Most agreements were entered in conjunction with regulatory agencies. The agreements remained in force for an average of two years. The agreements also obliged firms to cooperate with the investigation and prosecution of individual employees, typically for an indefinite period of time. Finally, most of those Thompson Memo agreements included privilege waivers.[3]

In preparation for this hearing, I compiled updated data reflecting 43 agreements entered in the one year and two months after the McNulty Memo was issued in Dec. 12, 2006, through January 2008.[4] In just slightly more than a year, more agreements were entered than had been entered during the almost four years the Thompson Memo was in effect. That represents a remarkable acceleration in the use of pre-indictment agreements with organizations. In several respects, these post-McNulty Memo agreements differ from their predecessors. Seventeen of these post-McNulty Memo agreements called for

[3]This data is developed in greater detail in Garrett, *Structural Reform Prosecution*, *supra,* at Part II.B, which provides an empirical analysis of the terms of Thompson Memo agreements. However, that article analyses 35 agreements. Since that article was published, four additional agreements have been located with the invaluable assistance of UVA Law School reference librarian Jon Ashley. Those agreements are included in an updated chart that has been submitted for the record.

[4]A chart reflecting that preliminary data has been submitted for the record. I note that the complete text of all agreements during this time period have not yet been obtained, where two agreements identified have not yet been made public.

independent monitors and 29 required compliance programs. However, in a departure from the prior pattern that may be accounted for by the McNulty Memo's altered policies, only six of these agreements required a privilege waiver. Also of interest and perhaps of concern, nine included no fines or restitution at all.

All of these McNulty Memo agreements, like almost all of the Thompson Memo agreements, stated that prosecutors may terminate the agreement and prosecute the firm should they, in their discretion, unilaterally find the agreement to have been breached. The agreements typically state that having been found to have breached the agreement, the firm may not object to the introduction of the firm's admissions of wrongdoing that were included in the agreement. A conviction would then be highly likely to follow, where the prosecutor can make full use of the firm's own admissions.

These data provide a sense of the scope of ambitious organizational prosecution agreements, the issues they raise, and a sense of how the remedies have shifted over time. I turn now to several of the reform proposals advanced in the articles that I have written, and most recently in legislation drafted by Rep. Pallone and in a statement of principles authored by Rep. Pascrell.

II. Prosecution Guidelines Concerning Organizational Remedies

First, while the McNulty Memo provides useful guidance on whether a firm should be charged, as well as when pre-trial diversion is appropriate, no guidance exists regarding either the structure of the remedies included in the agreements themselves or the implementation of those remedies. These agreements are the product of negotiations and can raise case-specific facts. However, these remedies appear to have evolved in an ad hoc fashion. Defense counsel, prosecutors and judges would be substantially assisted

by a document describing the range of considerations relevant when drafting – and implementing – an organizational prosecution agreement.

Several areas are particularly ripe for such guidance. The agreements vary widely in their provisions for the selection of independent monitors. Since 2003 when the Thompson Memo was signed, at least 39 agreements included the retention of monitors. Of those, only one advertised an open position to solicit candidates. In 17 agreements, prosecutors named the monitor, typically after consulting with the target firm. Yet in 13 agreements the firm selected the candidate. In still others, some combination of the firm, regulators and prosecutors selects the monitor. In only three did a court play any role in approving the monitor.

Given the central importance of monitors in supervising compliance and the sweeping powers they are provided, a fair process for selection of monitors involving public notice and judicial approval is appropriate. For example, the firm, the prosecutor, and regulators could each nominate several candidates after the position is announced and candidates apply. A court could then review submissions regarding the merits of the finalists and choose the monitor from among those names. Such a process would help to prevent any perception of cronyism in the selection of monitors.

Many other questions remain. Why do some agreements not require a monitor? Perhaps for smaller firms independent monitoring was thought to be unnecessary to secure compliance. Yet some agreements lacking monitors involve large firms.

Why do some agreements not require the implementation of a compliance program? It is unclear why prosecutors felt that in some cases, no further compliance efforts were necessary to prevent recurrence of the criminal behavior. For some

agreements that fail to require a compliance program, the agreement does not credit the firm with already having implemented a compliance program. Related to this concern, why is it that few agreements incorporate the Organizational Sentencing Guidelines' detailed criteria for effective compliance programs? For example, while the Sentencing Guidelines call for firms to adopt means to assess the success of their compliance programs, deferred prosecution agreements typically do not. Further, the agreements do not explain how to assess whether the compliance agreements have achieved their goals.

Why do some agreements not include fines or restitution? If prosecutors are to determine in cases involving serious organizational crimes that some firms deserve no punishment at all in the form of a fine, and that no victims should be compensated in any way, then perhaps at minimum some additional explanation should be provided as to when that would be appropriate.

When are non-prosecution versus deferred prosecution agreements appropriate? The terms of non-prosecution agreements, in which no complaint is even filed with a court, often are indistinguishable from those of deferred prosecution agreements. It is not clear why some firms received a non-prosecution agreement and not a deferred prosecution agreement. In contrast to deferred prosecutions, in which a court plays a role in approving the request to defer the prosecution, non-prosecution agreements are not reviewed by a court, since no criminal information is filed with the court. Given the importance of preserving the opportunity for judicial review, as discussed next, perhaps guidelines should recommend against the use of non-prosecution agreements in organizational prosecutions.

Guidelines could help to clarify each of these questions and additional issues

regarding the implementation of these agreements discussed further in the next section.

III. Judicial Oversight Over Organizational Pre-Indictment Agreements

Judicial oversight of organizational pre-indictment agreements could provide greater legitimacy by providing a neutral decisionmaker, as well as greater transparency by making aspects of the process public. The U.S. Code currently requires judicial approval of any deferral of prosecution.[5] The statute does not separately address the unique concerns raised by the deferral of the prosecution of an organization. A court asked to approve a deferred prosecution agreement likely examines whether the agreement generally serves the purposes of the Organizational Sentencing Guidelines. Several agreements include provisions that would not withstand even that kind of fairly deferential scrutiny. Examples include agreements with side-agreements that were unrelated to the underlying crime. The court could be required to conduct an approval hearing in which the public or affected parties would have notice and an opportunity to comment, as is the case when certain agencies enter consent decrees.

Judicial supervision of the implementation of agreements could also be considered, to provide greater transparency, prevent abuses, and ensure successful completion. As it stands, the public can not tell whether agreements achieve the sought after compliance. When an agreement ends, no information is typically released except the bare fact that prosecutors were satisfied that it was successful. The court could report on the monitor's progress so that the public knows how the goals of an agreement were

[5] *See* 18 U.S.C § 3161(h)(2) (2000) (stating that the time to file an indictment is tolled during "[a]ny period of delay during which prosecution is deferred by the attorney for the Government pursuant to written agreement with the defendant, with the approval of the court, for the purpose of allowing the defendant to demonstrate his good conduct").

achieved. Courts supervise similar efforts during organizational probation following a conviction.

Further, these agreements provide prosecutors with unilateral authority to declare a breach and terminate an agreement. A firm may lack any pre-indictment remedy should a prosecutor arbitrarily declare a breach despite the firm's substantial compliance with the terms of the agreement.[6] Courts could be provided with statutory authority to adjudicate, pre-indictment, any dispute regarding a breach. Alternatively, at the approval stage, courts could be required to approve deferral of a prosecution only on the condition that the agreement provides that the court adjudicates any dispute concerning whether the agreement was breached. The court could also insist that the agreement preserve the court's authority to rule on whether the agreement was successfully implemented and should terminate.

Conclusion

The use of pre-indictment agreements represents an important shift in white collar enforcement. However, the remedies in these agreements have evolved in a haphazard fashion. Now that such agreements have become the preferred method for resolving organization prosecutions, it is time to consider ways to improve their fairness, transparency and effectiveness. Prosecution guidelines concerning remedies and increased judicial oversight are warranted to achieve those goals.

[6] *See* Stolt-Nielsen, S.A. v. United States, 442 F.3d 177, 187 (3d. Cir. 2006) (holding that where the district court found the government violated due process by arbitrarily breaching an agreement under the DOJ Antitrust Division's Corporate Leniency Program, the court lacked the power to enjoin the prosecution and could only provide relief post-indictment); *see also* Garrett, *Structural Reform Prosecution*, *supra* note 1, at Part III.B.