

## EPHEMERAL LETTERS OF TRANSIT<sup>1</sup>: RESPONDING TO GOVERNMENT REQUESTS FOR ELECTRONICALLY STORED INFORMATION

~Jim Belanger and Joe Orzano\*

*The obstruction of justice and witness tampering convictions of former Credit Suisse First Boston tech investment banker Frank Quattrone were overturned by the Second Circuit in an extensive opinion. The prosecution of Quattrone revolved around his forwarding an e-mail urging colleagues in his department to “catch up on file cleanup” when he knew that there were pending grand jury and SEC investigations of the IPO practices of the firm. Quattrone included a message forwarding the “cleanup” e-mail stating “[I] strongly advise you to follow these procedures” related to CSFB’s document retention policy. Quattrone had been in touch with the firm’s legal department*

*about the pending investigations, although his defense at trial was that he did not know that documents from the tech group he headed were involved in the investigations. The government charged Quattrone with violations of 18 U.S.C. Secs. 1503 and 1505, obstruction of grand jury and agency investigations, and witness tampering under 18 U.S.C. Sec. 1512.<sup>2</sup>*

### Introduction

This is not an article about Frank Quattrone, although what happened to Frank Quattrone is important to the subject we are going to discuss. This,

rather, is an article about figuring out how to effectively deal with government requests and demands for information in the already upon us era of electronically stored information (“ESI”). There are a couple of old bromides that are most appealing to the Luddites<sup>3</sup> among us. You know them – “Ignorance is bliss” and “What you don’t know can’t hurt you.” Those bromides no longer apply, if they ever did, at least in the context of ESI. Now, it is important to be conversant in the language and concepts of ESI – how it works, how it is stored, how it is produced, and so on. In this era, this knowledge is critical. It can save you time, money, and

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## STOCK OPTIONS BACKDATING: THE NEW FOCUS

~Michael A. Collora and William J. Lovett\*

Almost daily since the Wall Street Journal first broke the story of the stock options backdating scandal, another public traded company is added to the list of companies under investigation for backdating abuses.<sup>1</sup> The Journal, which publishes an “Options Scorecard” that lists companies hit by the backdating scandal, now reports that over 50 companies have received federal grand jury subpoenas and are under criminal investigation by the Department of Justice.<sup>2</sup> As a result of the scandal, companies have restated past earnings, directors and high level management including several general counsel, have left their positions, and in a few extreme cases, there have been criminal prosecutions. As government investigators from the SEC and Department of Justice turn

their attention to the backdating scandal, new stock options abuses are being uncovered that may expose officers and directors to criminal liability. Because prosecutors must prove that a defendant possessed a specific intent to defraud, a necessary element of any mail or wire fraud offense, the Department of Justice criminal prosecutions will likely be limited to those cases where the government can gather strong evidence of such intent, such as altered corporate books and records. Nevertheless, the specter of criminal prosecution remains real for the executives of the companies whose stock option practices are currently under investigation by the Department of

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**MESSAGE FROM THE CO-CHAIRS**

~ *Kristin Graham Koehler & Ronald Machen.*



Happy New Year from the Criminal Litigation Committee. Christmas came early this year for many criminal defense lawyers as Deputy Attorney General Paul J. McNulty made revisions to the Thompson Memorandum on December 12, 2006. The Thompson Memorandum, issued in 2003 by then-Deputy Attorney General Larry Thompson, provides useful guidance that federal prosecutors should consider when deciding whether to charge a corporation with criminal offenses. Among the more notable factors that have come under scrutiny during the last year are demands by prosecutors for corporations to waive the attorney-client privilege and produce the results of their internal investigations to the government and expectations that cooperating corporations will deny advancement of attorney's fees to employees under investigation.

These provisions have been widely criticized by the American Bar Association, the US Chamber of Commerce, the American Civil Liberties Union (ACLU) and former high-ranking Department of Justice officials. In addition, in two widely reported published opinions in *United States v. Stein* (criminal prosecution involving former executives of the accounting firm KPMG), U.S. District Court Judge Lewis A. Kaplan found unconstitutional portions of the Thompson Memorandum which led government prosecutors to pressure KPMG not to advance the legal fees for various former KPMG employees.

In the wake of this controversy, Senate Judiciary Chairman Arlen Specter, on December 7, 2006, proposed the Attorney-Client Privilege Protection Act of 2006. This proposed bill would seek to bar federal attorneys from demanding or requesting that a corporation waive the attorney-client privilege and from pressuring companies not to advance legal fees for individual employees. On the heels of the Specter legislation, Deputy Attorney General Paul McNulty issued his own memorandum which scaled back the more egregious aspects of the Thompson Memorandum. In particular, the McNulty Memorandum now requires prosecutors to obtain prior senior supervisory approval -- starting at the U.S. Attorney and rising to the Deputy Attorney General -- before making a waiver demand.

The Memorandum does not outlaw waiver demands, but requires that prosecutors must first establish a legitimate need for privileged information, and that they must then seek approval before they can request it. More specifically, line prosecutors are now required to follow a two-step process before requesting that a corporation produce privileged information. First, in order for an Assistant U.S. Attorney (AUSA) to request from a corporation purely factual information, such as facts uncovered in a company's internal investigation for corporate misconduct [*i.e.*, Category I information], the AUSA must obtain prior written authorization from the local United States Attorney, who must in turn consult with the Assistant Attorney General for the Criminal Division before approving the request. Second, in "rare circumstances" and only if the Category I information "provides an incomplete basis to conduct a thorough investigation," the local United States Attorney can request that a corporation produce "attorney-client communications or non-factual attorney work product" [*i.e.*, Category II information] but only after receiving prior written approval from the Deputy Attorney General. If a corporation chooses not to provide attorney-client communications after the government makes the request, prosecutors should not consider this fact in their charging decisions. However, they can take into account the corporation's response to a Category I information request, and they can continue to make waiver demands in situations where corporations agree to plead guilty and cooperate with the government.

The McNulty Memorandum also effectively adopts the position of Judge Kaplan in *Stein* by instructing prosecutors that they cannot consider a corporation's advancement of attorney's fees when making charging decisions. Pursuant to the McNulty Memorandum, such payments, which are typically required by state law and incorporated into the bylaws of most corporations, will "generally not be taken into account" as evidence of a lack of cooperation. In extremely rare cases, the advancement of attorneys fees may be taken into account when the totality of the circumstances demonstrates that the advancement was intended to impede a criminal investigation. However, in those rare circumstances, the prosecutors must first obtain prior approval from the Deputy Attorney General before considering the advancement of attorneys fees.

The effects of the McNulty Memorandum will be seen in the upcoming year, but it is clear that new challenges have been placed in the path of line prosecutors intent on making, either explicit or implicit, waiver and advancement demands. Obtaining prior supervisory approval, particularly from Main Justice, is often a difficult and time-consuming process, and this check should provide a meaningful balance to local prosecutorial discretion.

We will continue to watch this issue closely over the upcoming year and keep you apprised of any new developments. We hope that our Newsletter is useful and informative. It is our pleasure to serve as your Co-Chairs and, as always, we welcome your input concerning any topics of interest to our Committee. Please do not hesitate to contact us if you have suggestions on how we can continue to improve our Newsletter and our Committee.

*All the best for a successful and productive 2007.*

Kristin Koehler  
Ronald Machen

## MESSAGE FROM THE EDITOR



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Any attorney who wishes to contribute an article to the Criminal Litigation Newsletter is encouraged to do so. The next submission deadline is May 15, 2007.

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We hope that you find this Newsletter a helpful resource.

~Tom Gilson

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## SOMETHING FUNNY HAPPENED ON THE WAY TO DISCRETIONARY SENTENCING: WHY A PRESUMPTION OF REASONABLENESS VIOLATES THE HOLDING OF BOOKER

~Mark Rankin and Laura Whitmore Paquin\*

Tremors were felt throughout the world of federal criminal practice when, in June 2004, the United States Supreme Court struck down Washington State's guideline sentencing scheme as unconstitutional.<sup>1</sup> Those tremors gave way to tectonic shifts in January 2005 when the Supreme Court in *United States v. Booker*<sup>2</sup> declared the United States Sentencing Guidelines to be unconstitutional. In *Booker*, the Court held that the then-mandatory Federal Guidelines violated the defendant's Sixth Amendment right to a jury trial. Rather than strike down the entire federal sentencing system, the Court fashioned a remedy by which the Guidelines are "advisory only," and sentencing must also be based upon other factors set forth by statute.<sup>3</sup> The Court further held that appellate review of federal sentences would thereafter be for "reasonableness."

Most expected major changes in federal sentencing after *Booker*, but that simply has not occurred. Since *Booker*, district judges have largely continued to follow the Guidelines, imposing a variance<sup>4</sup> in only about 8% of cases.<sup>5</sup> In turn, the federal appeals courts have encouraged, even enforced, strict Guideline sentencing in two ways. First, the circuit courts have generally reversed downward variances while affirming upward variances.<sup>6</sup> Second, a majority of the circuits has created a "presumption of reasonableness" for sentences within the Guidelines range. As such, one commentator's post-*Booker* analysis now seems almost prophetic: "The Federal Sentencing Guidelines are dead. Long live the Federal Sentencing Guidelines."<sup>7</sup>

This article outlines the present circuit split regarding the proper weight that should be placed on the Sentencing Guidelines in determining reasonableness on appellate review. The article also describes the cases of *Rita* and *Claiborne*, in which the Supreme Court will consider these issues during this term. Finally, we propose a deferential standard of review that will establish a framework of sentencing that respects the continuing importance of the Sentencing Guidelines while still honoring *Booker* and the new-found sentencing discretion of the district courts.

### **Are the Federal Sentencing Guidelines "Presumptively Reasonable?"**

In *Booker*, the Supreme Court established a "reasonableness" standard of review for federal sentencing appeals. Despite that seemingly simple directive, "[a]chieving agreement between the circuit courts ... on post-*Booker* issues has, unfortunately, been like trying to herd bullfrogs into a wheelbarrow."<sup>8</sup> The disagreements greatly pertain to the question of how to apply the reasonableness standard of review established by *Booker*, and the inextricably intertwined question of what deference, if any, should be given to a sentence that falls within the Guidelines range. Every federal appeals court has taken a position on the matter, as detailed below.

### **The Majority View: The Guidelines Are Presumptively Reasonable**

A majority of the federal circuits has held that a sentence within the Guidelines

range enjoys a rebuttable presumption of reasonableness. The Fourth, Fifth, Sixth, Seventh, Eighth, Tenth, and D.C. Circuits have each established this standard of review for post-*Booker* sentences.<sup>9</sup> A defendant who appeals a Guideline sentence in these circuits faces an uphill battle to rebut this presumption that a Guideline sentence is reasonable. To date, only one defendant has successfully mounted an appellate attack on the reasonableness of a Guideline sentence.<sup>10</sup>

Going one step further, some circuits have taken to evaluating the *extent* of the variance, applying what amounts to a continuum theory of reasonableness. Such courts hold that the

**To date, only one defendant has successfully mounted an appellate attack on the reasonableness of a Guideline sentence.**

more distance between the sentence imposed and the Guideline range, the more compelling the evidence justifying the variance must be.<sup>11</sup> The Seventh Circuit best summed up this theory of review in *United States v. Dean*, stating: “The further the judge’s sentence departs from the guidelines sentence (in either direction – that of greater severity, or that of greater lenity), the more compelling the justification based on factors in section 3553(a) that the judge must offer.”<sup>12</sup> This standard further demonstrates the extent to which the Guidelines anchor the majority of appellate courts’ reasonableness review.

The true reasoning behind the establishment of a presumption of reasonableness is at best unclear. Most courts have justified the presumption as necessary to achieve the Congressional goal of uniformity in federal sentencing.<sup>13</sup> Many others have adopted this view of post-*Booker* appellate review without any explanation at all.<sup>14</sup> Meanwhile, not one of the circuits adopting the presumption has cited any passage in *Booker* that places the Guidelines range on a pedestal above the other section 3553(a) factors. Nor have any of these courts completely explained how *Booker*’s directive to “consider” the Guidelines amounts to an instruction to

follow them except in the exceptional case.

### **The Minority View: The Guidelines Are Not Presumptively Reasonable**

The remaining federal appellate courts, the First, Second, Third, Ninth, and Eleventh Circuits, have not followed their sister courts in creating a rebuttable presumption of reasonableness on appellate review.<sup>15</sup> Note, however, that the Ninth Circuit’s decision (or non-decision) leaves the question open in that jurisdiction. That court’s original opinion in *Guerrero-*

*Velasquez* stated in a footnote: “We also note that, on appellate review, a sentence suggested by the guidelines is presumptively reasonable.”<sup>16</sup> Without explanation, that footnote simply disappeared from an amended opinion.<sup>17</sup>

Appellate courts rejecting the presumption have largely grounded their decisions upon the danger that “presumptive” or *per se* reasonable Guidelines come dangerously close to unconstitutionally *de facto* mandatory guidelines.<sup>18</sup> The development of *de facto* mandatory guidelines is a real danger about which Justice Scalia has expressly warned, stating in *Booker* that “any system which held it *per se* unreasonable ... for a sentencing judge to reject the Guidelines is indistinguishable from the mandatory Guidelines system that the Court today holds unconstitutional.”<sup>19</sup>

Don’t be fooled. Even those circuits formally rejecting a rebuttable presumption still enforce what can only be described as a *de facto* presumption of reasonableness on appeal. For instance, in *United States v. Talley*,<sup>20</sup> the Eleventh Circuit

ostensibly declined to adopt a presumption of reasonableness, yet noted that “the use of the Guidelines remains central to the sentencing process,” and that “when the district court imposes a sentence within the advisory Guidelines range,

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we ordinarily will expect the choice to be a reasonable one.” Similarly, in *United States v. Lloyd*,<sup>21</sup> the Third Circuit made clear where it stands, presumption or not, stating that “it is less likely that a within-guidelines sentence, as opposed to an outside-guidelines sentence, will be unreasonable.” Nor has the First Circuit made any secret of its Guidelines-centric theory of reasonableness, noting that “a defendant who attempts to brand a within-the-range sentence as unreasonable must carry a heavy burden.”<sup>22</sup> These decisions leave no doubt that the United States Sentencing Guidelines remain the focus of appellate inquiry, whether they enjoy a presumption of reasonableness or not.

### **Rita And Claiborne: The Supreme Court’s First Post-Booker Review Of Reasonableness**

Later this term, the Supreme Court will consider the Eighth Circuit’s decision in *United States v. Claiborne*<sup>23</sup> and the Fourth Circuit’s unpublished, *per curiam* decision in *United States v. Rita*.<sup>24</sup> These two decisions present variations of the problem associated with the “presumption of reasonableness,” but both ultimately question whether concluding that a Guidelines sentence is presumptively reasonable necessarily involves a *de facto* application of the mandatory Sentencing Guidelines dispensed of in *Booker*.

### **Claiborne – A Below-Guidelines Sentence**

In *Claiborne*, the Supreme Court granted cert to decide whether a sentence imposed by a district court that falls *below* the Federal Sentencing Guidelines is reasonable and whether a showing of extraordinary circumstances is needed to justify the sentence’s significant downward variance from the Guidelines. Simply put, the question is whether *Claiborne*’s below-Guidelines sentence was *unreasonable* absent a showing of extraordinary circumstances.

Mario Claiborne pleaded guilty to two counts of possessing and distributing cocaine base. The amounts of cocaine base involved were relatively small—0.23 grams and 5.03 grams. Initial rulings by the district court resulted in a Guidelines sentencing range of 37 to 46 months in prison.

Following the Supreme Court's decision in *Booker* that the Guidelines are to be "advisory" and considered in conjunction with the other section 3553(a) factors, the district court varied downward from the Guidelines and imposed a sentence of fifteen months imprisonment. This sentence was based on the district court's findings that the 37-month low end of the range was "excessive" given Claiborne's lack of criminal history, youth, and the small amount of drugs involved.

The government challenged the reasonableness of the sentence on appeal and the Eighth Circuit Court of Appeals reversed the 15-month sentence as "unreasonable." The Eighth Circuit's analysis was founded on the presumption that sentences within the Guidelines range are reasonable, and that sentences outside the Guidelines range are reasonable only where there is a showing of proper justifications for the variance. According to the Court, "[h]ow compelling that justification must be is proportional to the extent of the difference between the advisory range and the sentence imposed."<sup>25</sup> Moreover, any "extraordinary reduction must be supported by extraordinary circumstances."<sup>26</sup>

The Eighth Circuit concluded that the sixty-percent downward variance imposed on Claiborne was not supported by extraordinary circumstances. The Court further concluded that Claiborne's lack of criminal history and the small amount of drugs were already adequately considered in initial sentencing rulings on the safety valve and Guidelines range. The Court also stated that "[r]educing the resulting guidelines range sentence based upon drug quantity is unreasonable because it is a fair inference that Claiborne distributed additional quantities of cocaine during the sixth months between the two occasions interdicted by the police."<sup>27</sup>

Accordingly, the Eighth Circuit reversed and remanded the case for resentencing. The questions arising from this case that will be addressed by the Supreme Court are: (1) whether the District Court's imposition of a below-Guidelines sentence was reasonable; and (2) In determining a sentence's reasonableness, is it consistent with *Booker* to require a showing of extraordinary circumstances to justify a sentence that constitutes a substantial variance?<sup>28</sup>

### **Rita - A Within-Guidelines Sentence**

*Rita* presents the converse problem: whether a sentence *within* the Guidelines is "presumptively reasonable" and whether the district court erred by imposing that sentence without expressly analyzing other factors that would justify a lesser sentence.

Victor Rita was convicted of perjury, obstruction of justice, and making false statements. Despite offering a lesser sentence, Rita was sentenced within the applicable Guidelines range to thirty-three months imprisonment. Rita appealed his sentence to the Fourth Circuit Court of Appeals.

The Fourth Circuit stated that a sentence within the Guidelines is presumptively reasonable. Although the district court had not engaged in an explicit analysis of the other section 3553(a) factors, the Fourth Circuit approved of the district court's truncated analysis and consideration of the Guidelines and held that Rita's sentence was reasonable.

The questions before the Supreme Court in *Rita* are threefold: (1) Was the district court's imposition of a within-Guidelines sentence reasonable? (2) In determining whether the sentence was reasonable, is it consistent with *Booker* to accord a presumption of reasonableness to within-Guidelines sentences? (3) If the answer to (2) is "yes," can that presumption of reasonableness justify a sentence imposed

without an explicit analysis by the district court of the 18 U.S.C. § 3553(a) factors and any other relevant factors that might justify a lesser sentence?<sup>29</sup>

### **The Presumption of Reasonableness Violates *Booker***

*Booker* directs the district courts to "consult" and "take into account" the Sentencing Guidelines, but to do so without jeopardizing the "flexibility sufficient to individualize sentences where necessary."<sup>30</sup> Nowhere did the *Booker* Court place the Guidelines range above any of the co-existent section 3553(a) factors. Justice Scalia's dissenting opinion noted that section 3553(a) "places no

order of priority among all those factors"; the majority, however, failed to respond to this point.<sup>31</sup> As such, the central flaw in a presumption of reasonableness is that it unjustifiably places the Sentencing Guidelines above the other factors set forth at section 3553(a).

Those courts placing the Guidelines upon this pedestal make the faulty assumption that the Guidelines themselves take into account the section 3553(a) factors,<sup>32</sup> a theory advanced (not surprisingly) by the Commission itself.<sup>33</sup> At least two courts *not* adopting the rebuttable presumption have even embraced this flawed line of thinking.<sup>34</sup>

To the contrary, the Guidelines consist of gross generalizations that are quite often at odds with the section 3553(a) factors.<sup>35</sup> For example, in *United States v. Lloyd*,<sup>36</sup> the district court refused to grant a downward variance based upon the defendant's significant post-sentencing rehabilitation. Citing the Guidelines provision that forbids a *departure* on that basis,<sup>37</sup> and giving lip-service to the idea that a variance could be imposed on that ground in an unusual case, the Third Circuit affirmed.<sup>38</sup> The reasoning of the *Lloyd* court demonstrates the problem with equating the Guidelines with the section 3553(a) factors. For while the Guidelines expressly *forbid* a departure based upon post-sentencing rehabilita-

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tion, such a factor would undoubtedly color the “history and characteristics of the defendant.” The Guidelines elsewhere clearly and almost innumerable conflict with the section 3553(a) factors, such that one cannot reasonably argue that the former subsumes the latter.<sup>39</sup> In a common example, the Sentencing Guidelines only permit a sentencing court to reduce a defendant’s sentence as a reward for his cooperation with law enforcement where the Government files a motion for such relief.<sup>40</sup> Under section 3553(a), such cooperative behavior by a defendant would certainly factor into the defendant’s personal characteristics or the need for punishment, regardless of whether the Government filed a motion.

### The Appropriate Standard of Reasonableness Review

The appellate standard of review of “reasonableness” set forth in *Booker* gives little guidance as to how the reasonableness of a sentence should be determined by appellate courts. Equally unclear is what amount of deference the district court judges are entitled to when sentencing a defendant. As detailed herein, the circuit courts thus far have been unable to establish a workable standard of reasonableness. That said, *Booker* made one point very clear: “Section 3553(a) remains in effect, and sets forth numerous factors that guide sentencing. Those factors in turn will guide appellate courts ... in determining whether a sentence is unreasonable.”<sup>41</sup> As previously noted, section 3553(a) provides no order of priority among its listed factors, the Guidelines thus being but one among equals.

In circuits where the presumption has been adopted, the review for reasonableness has deviated from the standard that *Booker* sought to impose. Instead of reviewing a sentence from a neutral standpoint, after considering the applicable Guidelines range and the other section 3553(a) factors on equal terms, courts have expressly or impliedly begun with

the presumption that a Guidelines sentence is reasonable and essentially forced defendants to justify any variance. This not only attributes more significance to the Guidelines than to the other section 3553(a) factors, but it frames the analysis in a dangerous posture where the implication can be drawn that extra-Guidelines sentences are presumptively *unreasonable*. This consequence of applying the presumption expressly conflicts with the intent in *Booker* that equal consideration be given to the Guidelines and the other section 3553(a) factors and that the Guidelines’ role be only advisory.

Adopting a presumption of reasonableness in favor of the Guidelines also puts district courts in a difficult position. In some situations, the courts may face a struggle between exercising the discretion that they are entitled to, but witnessing the deference they should be given go by the wayside as sentences outside the Guidelines get reversed with far greater frequency than sentences within the Guidelines.<sup>42</sup> Naturally, this lack of deference discourages district courts from imposing sentences outside of the Guidelines, regardless of what the other relevant factors might actually warrant. This atmosphere may also breed a sense of complacency in the district courts with regard to sentencing within the Guidelines. If a district court assumes a within-Guidelines sentence will be upheld, it may lose the incentive to actually review the other section 3553(a) factors in some situations, or curtail the review in others.

The lack of consensus regarding the real role and significance of the Guidelines has, at a minimum, created the appearance of inconsistency and unfairness. Accordingly, the Supreme Court should take this opportunity to provide a workable definition of “reasonableness” so that all of the circuit courts can fall in line with the appropriate standard of review. Ultimately, in crafting a definition

of “reasonableness,” it will likely be difficult, if not impossible, for the Supreme Court to reconcile the presumption of reasonableness accorded the Guidelines by some courts with the intent and express language of *Booker*. The consequences of adopting a presumption of reasonableness

in favor of the Guidelines counteract the Supreme Court’s intent and justifications for dispensing with mandatory application of the Guidelines in the first place.

Indeed, to comport with *Booker*,

a “reasonable” sentence needs to be supported by a clear articulation and explanation from the district court regarding any and all relevant section 3553(a) factors, including the Guidelines, it has considered when imposing a sentence, *and* a showing that all factors have been given *equal* significance. The Guidelines may serve as a reasonable starting point, so long as they are not accorded greater weight or considered to the exclusion of other factors. Thus, a “reasonable” sentence becomes one where all relevant factors have been expressly considered and have been given equal weight. If the district court is required to articulate the specific factors it has relied on when sentencing, it will be less likely to impose a sentence that is either unduly harsh or lenient. This, in turn, should result in increased sentence consistency.

Furthermore, if this requirement is satisfied, more meaningful, yet deferential, appellate review will follow. If district judges do a better job of articulating all section 3553(a) factors considered when imposing a sentence, the record on appeal should contain sufficient evidence to jus-

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tify the district court's decision. In light of the deference accorded the trial court's vantage point, the appellate courts should then be limited to examining the record and reversing only where the court has failed to equally and expressly consider all relevant factors.

In this regard, a "reasonableness" review will accord considerable deference to and uphold a court's sentence that is the result of equal and express consideration of the Guidelines and the other section 3553(a) factors. Only those sentences that are found to be the result of an unbalanced analysis or improperly considered factors should be reversed.

### Conclusion

In light of the law and spirit of *United States v. Booker*, it is unlawful and unconstitutional for appellate courts to presume that the United States Sentencing Guidelines are "reasonable." No matter whether within or outside the Guidelines range, a sentence that reflects a district court's express consideration of the section 3553(a) factors in equal measure should generally be reasonable under *Booker* and be given significant defer-

ence. With a clear understanding of how a reasonable sentence is determined, the district courts will once again feel free to exercise their new-found (and mandated) sentencing discretion. There will be no more "presumption of reasonableness" in favor of the Guidelines. All section 3553(a) factors will be given equal consideration, and the intent of *Booker* will be achieved. Giving both the district courts and circuit courts clear definitions of their roles and obligations will promote sentencing that is both fair and consistent.

Justice Scalia complained that "[t]he worst feature of the [*Booker*] scheme is that no one knows ... how advisory Guidelines and 'unreasonableness' review will function in practice."<sup>43</sup> Nearly two years after *Booker*, we still don't know. How the Supreme Court will actually settle the matter, however, is anyone's guess. Two of the justices from the *Booker* majority, Justice O'Connor and the late Chief Justice Rehnquist, are no longer on the Court. How their replacements, Justice Samuel Alito and Chief Justice John Roberts, will influence this decision, and, in turn, federal sentencing in the years to come, will become more clear once *Rita* and *Claiborne* are decided. ☞



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## The Young Lawyer's Corner: Your First Sentencing

~Gloria Tan\*

Despite your best efforts, the jury finds your client guilty at trial. Or maybe your client decides to plead guilty or make an admission before trial. In either case, you are now faced with making a sentencing argument for your client. What do you say? How do you get the best disposition for your client?

### Early preparation.

In many instances, you will know early in the case whether it will result in a guilty plea. You should immediately start gathering information about your client to help your sentencing argument. Obtain as much mitigating information about

your client as you can. Ask your client to sign a release of information, and request records as soon as possible because record keepers may take some time to provide information.

Your client's counseling, medical, employment and school records can provide a wealth of helpful information. For example, your client may suffer from a mental illness and receive medical treatment or counseling. While you may argue to the court that your client suffers from a mental illness, you strengthen your argument and credibility by presenting supporting documentation. Giving the court a more complete picture of your client can help persuade the judge that he should receive

the sentence you are seeking.

### Investigate the case.

Even if your client does not want to plead guilty, you should still investigate the case. Speak to the witnesses, visit the scene, and review the evidence. You may discover details that differ from the government's version of events and which will help you in your sentencing argument. For example, you may learn that the complaining witness does not want your client go to jail, a fact you can then convey to the court. In some cases, you will have more contact with the witnesses than the government will.

***What does your client want?***

While you may believe that your client would benefit from being placed on probation requiring random drug screens or entering a substance abuse program, your client may not agree to such a condition. Do not propose sentencing terms that your client does not want or will find difficult to follow. Have an honest discussion with your client about the proposed terms. Imposing too many conditions can set some clients up to fail on probation. In some cases, your client may actually prefer a short period of incarceration over probation because your client believes that probation will be more difficult to complete. Remember that you must zealously advocate for what your client wants, not what you believe will be best for your client.

**Familiarize yourself with the sentencing judge's practices. Find out as much as you can about the judge's reputation by asking other attorneys and court personnel who are familiar with the judge.**

***Lobby the prosecutor***

Approach the prosecutor as soon as you suspect that your client might change his plea, and find out what the prosecutor will be recommending. Gather and present mitigating information to the prosecutor in advance of the sentencing date, especially if the prosecutor's recommendation is more severe than yours. In some cases, ask the prosecutor to reduce a charge to a less serious offense or even dismiss a charge, if appropriate. Getting the prosecutor to agree with your proposed disposition is ideal so that you can present the judge with an agreed recommendation, but narrowing the disparity between your sentencing recommendations will also help.

***Lobby probation.***

Depending on the jurisdiction and type of case, the probation department may prepare a presentence report to aid the court in sentencing. If probation intends to issue a presentence report in your case,

you should provide the probation department with as much helpful information as possible. While you may not be able to persuade the probation officer to adopt your recommendation, you can at least provide the department with information that it may not have or correct any misinformation. You should obtain a copy of the presentence report in advance and review it for any inaccuracies. Reading the report before the sentencing hearing will also allow you to anticipate what information the judge will receive and help you shape your sentencing argument.

***Know the judge.***

You could give the most well-reasoned, articulate sentencing argument, but the judge will make the final call on what sentence your client actually receives. Some judges may have certain idiosyncrasies. For example, a particular judge may be sympathetic to clients who suffer from drug addiction and be willing to sentence

them to probation with drug treatment rather than to jail. Another judge may find certain crimes particularly offensive and tend to sentence defendants convicted of those offenses more harshly. Familiarize yourself with the sentencing judge's practices. Find out as much as you can about the judge's reputation by asking other attorneys and court personnel who are familiar with the judge. You can then shape your sentencing recommendation and argument based on what you know about the judge. Or you may decide that it would be not be in your client's best interest to enter a guilty plea in front of a particular judge.

***Get details of your client's prior offenses.***

If your client has a criminal record, find out the details of all the prior cases. The judge and prosecutor will consider the client's record, and you may be able to

provide mitigating information about previous cases. For example, a prior assault and battery charge could turn out to be much less serious than it sounds on paper.

***Find alternatives to incarceration.***

Assuming that your client does not want to go to jail, you should find alternatives to incarceration. Be creative. Presenting the court with an alternative could mean the difference between incarceration and probation. If the judge believes there are options other than incarceration, the judge will be more likely to adopt your recommendation. Argue that your proposed alternative will more effectively address your client's needs and prevent your client from reoffending than will a prison or jail sentence. For example, if your client is charged with drug possession or another crime that is the result of a drug addiction and is amenable to treatment, find an appropriate treatment program. If your client is not in custody pending the disposition of the case, get your client services right away. Such programs often have long waiting lists so you should start looking immediately. Demonstrating to the court that your client is committed to treatment and rehabilitation will help support your argument that your proposed alternative will make him less likely to reoffend. If your client suffers from a mental illness, you may argue to the court that your client needs mental health services and will be better served through the local department of mental health rather than

**You must show the court that your client is more than the "defendant" portrayed in the police report, indictment, or presentence report.**

incarcerated in prison.

***Humanize your client.***

The prosecutor and/or probation officer will portray your client in a limited way – they will likely focus on the crime and emphasize any criminal history he may have. You must show the court that your client is more than the "defendant" portrayed in the police report, indictment, or presentence report. No one else in

the courtroom will present information about your client in a sympathetic way. Your responsibility is to convince the judge to adopt your proposed sentence by persuading the court that your client deserves it. You can do this by telling the court about your client's life history, obstacles your client has faced, the circumstances that may have led to your client's involvement in the criminal justice system, and how the sentence you are requesting is the most appropriate. Speak to your client's family, friends, teachers, employers, case workers, and others in the community who know your client well. Ask them to come to court to support your client. Depending on the case, you can ask them to testify or address the court on your client's behalf. If they are unable to appear in court, ask them to write letters or statements supporting your client. Showing such community support for your client can strengthen your sentencing argument. In some cases, having your client apologize to the victim may be a good idea. If you plan to do this, work with your client on what to say. Some clients may be more eloquent than others, and you want to make sure that the apology will sound sincere.

### ***Be aware of collateral consequences.***

All too often, clients receive sentences that have collateral consequences. It is imperative that you inform your client of any collateral consequences of his guilty plea. Some convictions may result in immigration consequences such as deportation or exclusion from reentry. Other dispositions may require sex offender or DNA registration, loss of a driver's license, eviction from public housing, or suspension or expulsion from school. Some convictions render your client ineligible for federal education grants, or expose him to future career offender charges. To avoid collateral consequences, you can negotiate with the prosecutor to amend the charges or change the length of the probationary term.

### ***Know the sentencing guidelines.***

If your jurisdiction has sentencing guidelines, you should familiarize yourself with them.

### ***Post-conviction advocacy***

If your client was detained before the imposition of the sentence, make sure

that the court awards the appropriate jail credit if a sentence of incarceration is imposed.

### ***Good luck!***

Remember that zealous advocacy of your client does not end after a guilty plea is entered. Early, extensive preparation and creative advocacy can help convince the court to adopt your sentencing recommendation. ☞



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## **NEITHER A WHITEWASH NOR A WITCH-HUNT BE: RECLAIMING THE INDEPENDENCE OF INTERNAL INVESTIGATIONS**

*~By Michael N. Levy, Michael L. Spafford, Amy K. Carpenter-Holmes, and Lothlórien S. Redmond\**

What is the purpose of an internal investigation? An observer who has been listening to recent discussions of the practical requirements of internal investigations in today's regulatory climate might conclude that the sole purposes of an internal investigation are (1) to demonstrate absolute and uncompromised cooperation with the government and (2) to uncover "the fraud." Unfortunately, somewhere between the government's rush to punish perceived rampant corporate wrongdoing and corporate America's understandable desire to avoid becoming another Arthur Andersen, the very simple purpose of an

internal investigation – to investigate with true independence – has been lost.

The ultimate purpose of an internal investigation is to uncover the facts, whatever they may be. To realize this objective, a neutral investigator must conduct a thorough, thoughtful inquiry, considering all relevant factors and following all valid leads, to come to an independent assessment. Fraud must be identified without hesitation even when it reaches to the highest levels of a company. On the other hand, if accusations of wrongdoing are not well-founded, they must be

rejected no matter how much pressure to find wrongdoing may exist.

The current enforcement environment should not be allowed to distort the fundamental purpose and independence of an internal investigation. An experienced investigator, however, also will recognize that, now more than ever, internal investigations are not one-size-fits-all. Internal investigations must be carefully tailored to the unique circumstances of each matter, and internal investigators must remain flexible enough to respond to changes in those circumstances. When all is said

and done, law firms conducting internal investigations must be committed to wading through all the increasing pressures and competing interests in order to come to a truly independent assessment of the facts at issue.

### On Fraud, Culprits, and Cooperation

In the wake of an internal investigation at Enron in August and September of 2001 that many viewed as overly narrow, prosecutors throughout the country became increasingly skeptical not only of narrowly constrained internal investigations performed by lawyers too closely aligned with the matters being investigated, but also of any investigation – whether truly independent or not – that did not root out purported wrongdoing. Responding to Enron's collapse, the President of the United States proclaimed a pandemic of fraud in corporate America and swiftly committed significant resources to the eradication of corporate corruption, creating the Corporate Fraud Task Force ("Task Force").<sup>1</sup> The Task Force "aggressively responded to the President's call to action" by charging more than 150 defendants with civil or criminal wrongdoing in its first three months of existence.<sup>2</sup>

On January 20, 2003, in the midst of this declared war on corporate corruption, Deputy Attorney General Larry D. Thompson issued his "Principles of Federal Prosecution of Business Organizations" (the "Thompson Memorandum") setting forth the factors federal prosecutors must weigh when deciding whether to seek an indictment against a company. "The main focus of [the principles set forth in the memorandum] is increased emphasis on and scru-

tiny of the authenticity of a corporation's cooperation" with prosecutors.<sup>3</sup> The Thompson Memorandum generated controversy because, among other things, it identified as considerations in assessing the "authenticity" of a company's cooperation the entity's willingness to reject previously standard corporate practices such as advancement of employees' legal fees and preservation of the company's attorney-client privilege.<sup>4</sup>

On December 12, 2006, responding to concerns from a broad spectrum of business and legal groups that the Thompson Memorandum insufficiently protected the rights of corporations and their employees, current Deputy Attorney General Paul J. McNulty revised the Thompson Memorandum.<sup>5</sup> Notwithstanding the fanfare with which the new McNulty Memorandum was announced, however, this memorandum did not change the fundamental principles in the Thompson Memorandum, including the emphasis on a corporation's cooperation with prosecutors and the favorable treatment to be accorded corporations who waive the attorney-client privilege. Thus, in practice, the McNulty Memorandum is unlikely to produce dramatic changes in the manner in which internal investigations are conducted in the current era.

Although discussed less often than the Thompson and McNulty Memoranda's provisions regarding both the attorney-client privilege and the advancement of legal fees, but in many respects even more significant, is the fact that the Thompson and McNulty

Memoranda both presume fraud. The Thompson Memorandum reflected this presumption in, among other things, its numerous references to "the culprits" and its reminder that a corporation's willingness to "support culpable employees and agents" by paying their attorney's fees, retaining them as employees, or entering into joint defense agreements with them, weighed against receiving credit for cooperation. Although the McNulty Memorandum suggests a less aggressive posture with respect to attorney's fees, it still refers to "culprits" and maintains that the retention of employees and the use of joint defense agreements are facts that may be considered "in weighing the extent and value of a corporation's cooperation." Thus, notwithstanding the fact that companies cannot function if their employees are too intimidated to focus on their jobs, the Department of Justice ("DOJ") provides a powerful incentive for a company at the outset to treat any employee involved in an internal investigation just as the Thompson and McNulty Memoranda do – as a "culprit."

The impact of this aggressive posture has been dramatic and widespread, and the impact on internal investigations has been particularly noticeable. Once fraud by "culpable" employees is presumed, any cooperation by the company that does not result in uncovering that

Neither a desire to deliver a clean bill of health to a profitable, long-time law firm client nor the desire of regulators to find fraud should drive an internal investigation.

fraud and identifying those guilty parties becomes suspect. The *pressure to uncover fraud becomes almost unavoidable*. When meeting the government's expectations of cooperation becomes paramount to

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the survival of the company, satisfying the government can easily threaten to take precedence over the fundamental independence of the investigation.

### Identifying an Investigatory Approach

The essential goal of an internal investigation is to evaluate allegations of corporate wrongdoing effectively, efficiently, and independently. Returning to this purpose does not ignore the reality of the current regulatory environment or diminish the importance of reasonable cooperation with the government; it simply shifts the focus back to the task at hand. Neither a desire to deliver a clean bill of health to a profitable, long-time law firm client nor the desire of regulators to find fraud should drive an internal investigation. Regulatory pressures and the current environment are but two factors amid the multiple considerations that must go into appropriately staffing, structuring, and conducting an internal investigation.

An investigation should provide the information necessary for the company to make well-informed judgments and, when appropriate, engage criminal or regulatory authorities with a complete, objective view of the facts. This starts, of course, with determining what happened and why and, depending on the nature and scope of the investigation, may further include determining whether, in the opinion of the independent investigator, any laws, regulations, or internal corporate policies were violated. If there

were violations, the internal investigator almost certainly will want to address who is responsible and how similar issues can be prevented in the future, including, when appropriate, making recommendations for changes in corporate governance, controls, and the compliance function.

Achieving these goals will require an independent investigator to consider at the outset a number of issues, including:

#### 1. *Who Should Serve As Counsel For the Investigation and Who Is the Client?*

One of the first decisions in conducting an internal investigation is whether the investigation should be handled by in-house attorneys or outside counsel. While truly self-regulatory investigations traditionally can be and have been handled by in-house counsel, in the current environment it is generally the wisest course of action to engage outside counsel for any investigation that has even the potential to garner interest from government enforcement agencies. If outside counsel is desired, the question becomes whether to rely on a company's regular outside counsel or a law firm unrelated to the activities at issue. Using counsel familiar with the company's structure and the matters at hand allows the investigation to move more quickly and economically because the investigator does not need to spend time getting up to speed. This may be particularly tempting when the subject of the investigation is highly technical or specialized.

Considerations of expense and efficiency may prevail when the company is confident that the scope of the investigation is unlikely to expand to areas of interest to government enforcement agencies. In the current enforcement environment, however, choosing an outside law firm with no prior involvement with the transactions or matters at issue is almost always the preferred course of action

for any investigation involving an area of potential governmental scrutiny. The need for truly objective, unaffiliated, independent investigators is particularly strong for investigations involving significant financial concerns or the actions of senior management.

The investigator, whether in-house counsel or outside

counsel, then must understand who the client is. Because in most circumstances any investigation involving potential legal or regulatory violations should be independent of company management, the client generally should be an independent committee of the board of directors, a role often fulfilled by the audit committee of the board. Of course, if the allegations are significant or have the potential to implicate the audit committee or the board, the company would be well advised to establish a special committee of the board consisting solely of newly-appointed independent directors who can act without any suggestion of a conflict of interest.

#### 2. *What Is the Nature and Scope of the Investigation?*

It is critical that the scope of the investigation be determined by neither a client nor an investigator who was involved in any way with the subject matter of the investigation. Rather, an independent investigator and an autonomous client must consider the nature of the allegations and work together to establish the initial scope of the investigation. Are the allegations of a self-regulatory nature or do they indicate potential fraud or violation of some other law or government regulation? The nature and subject matter of the allegations usually will define the scope of the investigation, as well as who the investigator will interview and what documents the investigator will review first. While it is essential to define the scope of any internal investigation at the outset, any independent investigator must be encouraged to seek expansion of that

**The need for truly objective, unaffiliated, independent investigators is particularly strong for investigations involving significant financial concerns or the actions of senior management.**

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scope whenever he deems it necessary – particularly in matters involving potential fraud or other legal or regulatory violations.

### 3. *How Can Counsel Best Obtain the Facts?*

An investigator gets facts from two primary sources: documents and employees. In order to review and analyze all relevant documents, an investigator first needs to freeze the company's document retention program and communicate this change to all relevant employees. An investigator then needs to establish a protocol for the collection and review of documents, as well as decide whether it is necessary to hire outside experts, such as forensic accountants, to help analyze these materials. With the explosion of electronic mail and other electronic records, the task of gathering all relevant materials, and then reviewing and analyzing them, requires significant technological and organizational skills in addition to the traditional skills of legal analysis and judgment.

Even if an investigator has easy access to all relevant documents, however, a complete investigation is only possible when employees are candid and forthcoming with information. The challenge for the investigator is how best to encourage such cooperation. An investigator needs to communicate forthrightly with employees regarding the investigation, including how it will impact their work,

what is expected from them, and whether and how the company plans to provide counsel for its employees.<sup>6</sup>

### 4. *Should the Company Pay for Counsel for Employees?*

An investigator's access to employees will be influenced materially by the company's decision whether to provide counsel to its employees at the company's expense. In making this decision, the company will necessarily face a number of considerations including the company's own bylaws, indemnification agreements it has with its employees, and any applicable laws – all of which may require the company to indemnify and advance the payment of employees' attorneys' fees.<sup>7</sup>

The McNulty Memorandum explicitly recognizes the other considerations that companies face in deciding whether to advance legal fees to employees, stating that "a corporation's compliance with governing state law

and its contractual obligations cannot be considered a failure to cooperate."<sup>8</sup> By noting expressly that a decision to advance employees' legal fees will be a consideration in the DOJ's assessment of whether to charge a corporation only in "extremely rare cases," the McNulty Memorandum has adapted a noticeably less hostile posture towards the advancement of legal fees than the Thompson Memorandum.<sup>9</sup> The McNulty Memorandum, however, also states that a prosecutor may ask questions about how and by whom attorney's fees are paid to

determine whether there is a conflict of interest or other such issues.

Even in the absence of any legal or contractual requirement to do so, it may still be in the best interests of the corporation to advance the payment of legal fees for counsel to represent certain employees. The decision whether to advance employees' legal fees depends on many factors, including the nature of the allegations, the likelihood of government interest in the matter, and, if the government is already involved, whether the company reasonably expects that it will waive its privilege and provide information gathered from interviews of company employees directly to the government. Contrary to what some might assume, providing counsel for employees usually increases the efficiency and completeness of an investigation. An internal investigation is a stressful and anxious time for employees. Talking to an investigator can seem intimidating, and even the most well-intentioned employees do not always know how to be most helpful. Providing counsel to represent the interests of employees often makes employees more comfortable speaking with investigators and allows them to focus on their work while their lawyers focus on the investigation. Providing counsel also may be an important incentive for employees to stay with the company during a critical time.

### 5. *What, If Anything, Should the Company Disclose and When?*

Once the investigator has made a truly independent assessment of the facts, the company may face difficult decisions surrounding disclosure. Of course, these decisions may have been pre-empted if

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the government already knows of the investigation and real-time disclosure is the price of the government delaying the commencement of a full-scale government investigation. Assuming the government is not yet involved, however, disclosure decisions can be made only after the investigator has had a full and fair opportunity to assess the facts and advise the client about their implications. Furthermore, the company must reassess disclosure decisions as additional facts are learned. It is important for the company to disclose to its regulator what it knows as soon as practicable, but only if there is actually something to disclose. The company, advised by its counsel, must engage in a very delicate balancing act between disclosing as early as possible and taking the time necessary to learn what really happened. Even once a decision to disclose has been made, the company must consider the thorny questions of how to communicate the disclosure and whether it is possible to disclose without waiving the attorney-client privilege or attorney work product immunity.<sup>10</sup>

In response to concerns expressed about the Thompson Memorandum, the McNulty Memorandum provides certain steps that a federal prosecutor must take before formally asking a corporation for privileged information. Nonetheless, the McNulty Memorandum also makes it clear, however, that a corporation is always free to voluntarily provide privileged

information to the government even in the absence of a formal request and that such a voluntary waiver can be considered favorably in a prosecutor's decision not to indict the corporation.<sup>11</sup> Because corporation will continue to seek to avoid indictments at almost any cost, it is highly likely that, in practice, the issuance of the McNulty Memorandum will not change the factors that a corporation will consider with regard to disclosure issues.

### Conclusion

Every internal investigation is different. Each poses unique challenges. An experienced investigator will recognize that not all begin the same way or progress the same way. Nor should every internal investigation – even in today's environment of cooperation – be expected to come to any one particular conclusion.

The last four years have seen dramatic changes in how the government addresses alleged corporate fraud. Yet the fundamental purpose of an internal investigation cannot be sublimated to any external factors, whether they be a desire to placate an important law firm client or a desire to satisfy the DOJ by starting an investigation with the McNulty Memorandum's presumption of fraud.

The purpose of an internal investigation is best served if the facts are uncovered and the process respected, no matter what the conclusion. It is the independence and thoroughness of an internal investigation that will allow a company to be confident it has uncovered and addressed fraud when it exists and, likewise, to set aside baseless complaints when fraud does not exist.

To accomplish that end, an independent investigator must conduct a thorough, well-planned investigation that is sensitive to, and respectful of, the needs and limitations of the company as well as any expected demands from regulators. It is incumbent upon the law firms conducting internal investigations to balance these pressures and competing interests in order to conduct a thorough, thoughtful,

efficient, and, most importantly, independent investigation. An investigation must be committed to finding the facts, and internal investigators must jealously guard their independence. An internal investigation best serves the interests of the company, its employees, its shareholders, and the government when it neither presumes fraud nor gullibly declares inno-

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## EPHEMERAL LETTERS OF TRANSIT: RESPONDING TO GOVERNMENT REQUESTS FOR ELECTRONICALLY STORED INFORMATION (CONT'D)

manpower. In some instances, it can save your liberty or that of your employees.

The quantum proliferation of ESI has significantly impacted all types of litigation and document production, including that with the federal government. Extensive and intrusive interaction with and by the federal government is sometimes necessary and oftentimes unavoidable. In fact, responding to the claims, inquiries and investigations of the federal government and its agencies is very likely an accepted price of operating a business in a regulated industry. Much of this forced interaction deals with the production and exchange of copious amounts of information. As such, operating a business in a highly regulated area requires an understanding of the processes of ESI generally as well as how the December 2006 amendments to the Federal Rules of Civil Procedure ("FRCP") impact and shape the discovery and production process for all of us and for years to come. Equally important is understanding how the December 2006 amendments fit within the existing framework of statutory and regulatory requirements for information reporting and "document" retention, as well as the potential consequences for non-compliance. Such awareness can be the difference between avoiding costly litigation and potential civil or even criminal liability.

This article provides an overview of some key factors and concepts to consider when faced with a production of information to the federal government.

### ***A Starting Point - Relevant Agency Policies and Procedures***

By now does it go without saying that counsel for an organization in a highly regulated industry must be familiar with any relevant government policies and

procedures governing information retention, storage and production? Would you think of being counsel to a health care client without being intimate with HHS safe harbors? Working familiarity with an agency's policies is critical to responding to government requests for information and avoiding litigation. While some agency ESI policies are in a very primitive state, others are significantly more developed. All of these policies can provide a

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useful reference point, not only in responding to a specific agency's request for information, but also in formulating a response to an agency that has less well-developed policies.<sup>4</sup>

### *Anti-trust: The Merger Approval Process*

The anti-trust merger approval process is an example where extensive policy documentation is available. The Federal Trade Commission ("FTC") and the U.S. Department of Justice ("DOJ") have responsibility for enforcing the anti-trust laws of the United States.<sup>5</sup> Generally, parties to a prospective merger or acquisition above a certain threshold size must notify the FTC and DOJ for review prior to completing the transaction.<sup>6</sup> The initial notification process is relatively straightforward. However, a small proportion of reported transactions, historically less than 5%, receive a "second request" for further review.<sup>7</sup> Responding to a second request is extremely costly and time-consuming for parties, and is only becoming more so. Recently, the FTC reported nine productions of over one million documents in response to second requests in a single fiscal year. Not surprisingly, the FTC attributes the growth in production demands, at least in part, to an increase in electronic documents retained by regulated entities. For those entities subject to a second request,

the process does not move forward until the party has "substantially complied" with the agency's request.<sup>8</sup> According to agency interpretation, however, substantial compliance means full compliance with the information request.<sup>9</sup> So how does an entity comply? FTC and DOJ policy provide some guidance.

The seminal policy document governing compliance with second requests is the Model Request for Additional Information and Documentary Material (the "Model Second Request"), produced in 1995 jointly by the FTC and DOJ.<sup>10</sup> Key provisions of the Model Second Request and its updates include:

- *Type of producible material* – "Documents" requested are defined to include, e.g., computer files, electronic correspondence, electronic mail messages.
- *Format of producible material* – At this time, electronic production of materials and its format appears a case-by-case negotiation. The Model Second Request provides for electronic production in "machine-readable" format, *if* FTC staff determine the format would permit FTC review.<sup>11</sup> The FTC's February 2006 policy revision provides little formal guidance, but states that the agency is working on its ability to accept and review documents in electronic format. The policy revision also states that the agency is working to identify acceptable formats and platforms.
  - The FTC did, however, amend its policy to require consultation with the agency before using de-duplication or near-de-duplication software.
- *Number of custodians* – The FTC will presume that the files of no more than thirty-five employees will be searched, *if* certain conditions are met. Note, however, that the policy provides for a larger search group where it is "reasonably likely" to

be necessary to analyze the transaction.<sup>12</sup> Further, the FTC may still request centrally stored company files in addition to the 35 employees' files.

- *Time period searched* – The FTC's February 2006 policy revision reduced the searchable time period from three years to two. Note, however, that this time period is inapplicable to data requests from the FTC. Moreover, the FTC may require the party to search beyond a two-year period if "reasonably likely" to be necessary to analyze the transaction.<sup>13</sup>
- *Empirical Data Coordination* – FTC policy states that agency staff will inform the party of the types of empirical analysis and data under consideration; in turn, FTC policy encourages parties to provide the agency with information to facilitate the data analysis.
- *Backup Tape Preservation* – The FTC modified its Model Request policy to establish the presumption that a party may preserve backup tapes for two days; moreover, the FTC will only require production of "documents" on backup tapes as a secondary option to other, more accessible methods.
- *Privilege Logs* – FTC policy was revised to permit provision of a partial privilege log for some record custodians, if certain conditions are met. The partial privilege log need only include the custodian's name and the number of documents of that custodian withheld due to privilege.

As the foregoing indicates, relatively extensive policies exist in the pre-merger review process. It is critical for counsel to be aware of the specific conditions and limits of these provisions, but at the same time understand the general topics in which the government has an interest – form of production, custodians, preservation, claims of privilege, etc.

As is intended by the amendments to the FRCP in the context of civil litigation, these policies may well turn out to be

a starting point for negotiation regarding the scope, breadth and form of the production. For example, the FTC makes clear that their reforms to the Model Second Request "are not intended to preclude or discourage staff or parties from negotiating additional modifications to second requests, or entering into other forms of agreements."<sup>14</sup> The DOJ is even less committal – "[t]he Second Request Model will serve simply as an example" and "[t]he objective of the merger review process initiative is to empower and encourage Division staff to actively tailor investigative plans and strategies according to each proposed transaction, *in lieu of reliance on standardized procedures or models.*"<sup>15</sup> Familiarity with these policies and with your own ESI architecture and personnel – as now required under FRCP 26(f) – can enable an entity to develop a more informed and effective negotiating strategy.<sup>16</sup>

#### *Securities Regulation: The Public Company Accounting Oversight Board*

The Sarbanes-Oxley Act of 2002 ("SOX") created a new organization and process for oversight of firms engaged in the audit of public companies. SOX created the Public Company Accounting Oversight Board (the "Board") and granted the organization extensive document inspection and investigation powers, under the supervision of the Securities and Exchange Commission (the "SEC"). The Board conducts inspections to enforce compliance with SOX, Board rules, SEC rules and professional accounting standards.

As of late October 2006, the Board reported over 1,700 accounting firms registered to engage in audits of public companies. The potential reach of the Board, however, goes beyond these registered firms; the Board may also issue a request for documents "to any person . . . for the production of any document that

is relevant or material to an investigation . . ."<sup>17</sup> Accordingly, any public company or individual involved in the audit of a public company is potentially subject to a Board document request. The PCOAB has developed some limited document production policies, which include the following:

*Type of information producible* – for purposes of production rules, the Board defines "document" by reference to the Rules of Civil Procedure, Rule 34(a). Rule 34(a) defines "documents" to include "writings, drawings, graphs, charts, photographs, phonorecords, and other data compilations from which information can be obtained, translated, if necessary, by the respondent through detection devices into reasonably usable form . . ."<sup>18</sup> The Board rules further specify that documents include "electronic or computerized data compilations," any draft or non-identical copy to an original, and includes more than mere audit workpapers.<sup>19</sup>

*Format of producible material* – The default is to provide copies of original documents in electronic format where the document exists electronically.

**Familiarity with agency policies can serve as a useful starting point in dealing with agencies exerting oversight responsibilities and ultimately avoiding litigation.**

*Privilege logs* – According to Board rules, any claim of privilege must include the nature of the privilege and corresponding rule invoked, type of document, general subject matter of the document, date of the document, and any other information required

for the SEC to issue a subpoena for the document.

While the Board's policies are not nearly as comprehensive as those available in the pre-merger review process, note the commitment to receipt of documents in electronic form as well as the permitted production of copies, with conditions. Again, familiarity with such policies can serve as a useful starting point in dealing with agencies exerting oversight responsibilities and ultimately avoiding litigation.

### Environmental Regulation

The Environmental Protection Agency (“EPA”) has substantial authority to gather and access information of regulated entities under the various regulatory regimes. The EPA has promulgated rules providing for, but not requiring, electronic reporting under many of its regulatory programs.

It is also important to note the prevalence of EPA administrative enforcement actions, as compared to the number of civil and criminal enforcement actions taken by EPA.<sup>20</sup> Between 2002 and 2004, for example, administrative actions increased roughly fifty percent, while the EPA’s civil and criminal actions showed little change.<sup>21</sup> Accordingly, parties subject to EPA regulation need to be familiar with the EPA’s Consolidated Rules of Practice (“CROP”), which govern discovery in such administrative actions.<sup>22</sup>

The CROP are based on the FRCP and court decisions interpreting the FRCP are often persuasive to interpretations of CROP.<sup>23</sup> However, while the FRCP and CROP are similar, they differ considerably in the discovery area.<sup>24</sup> Under CROP, discovery is limited. Discovery centers around a pre-hearing information exchange where parties exchange “[c]opies of all documents and exhibits which it intends to introduce into evidence at the hearing.”<sup>25</sup> However, the rule does not provide guidance as to the manner or method of document production. Here, given the general lack of formal policy governing the CROP discovery process, counsel has an opportunity to be pro-active in negotiating cost-effective methods of production, particularly where substantial documentation is required at an administrative enforcement hearing. Familiarity with the rules and objectives of the amendments to the FRCP and of

other government ESI policies should prove very helpful in attaining the desired result.

### The FRCP as a Gap-filler

Obviously, there is no substitute for familiarity with an agency’s specific policies on the production of ESI. But when dealing with agencies with less developed polices, or even when negotiating within the confines of well-defined policies, such as the FTC, the norms and objectives that the amendments to the FRCP are intended to accomplish will be relevant. For example, consider for a moment whether the following admonitions and practices would facilitate production to the government and whether a court might deem these to be reasonable:

#### Fed. R. Civ. P. 26(f) Conference

- o Requires parties to sit down together before discovery begins to agree on discovery protocol
- o Creates a record of good faith and cooperation to avoid spoliation sanctions
- o Formulate a cost-effective, yet fair scope of discovery
- o Maximize cost-shifting opportunities

#### Rule 26(f) Conference Checklist

- o Agree on steps each party will take to segregate and preserve electronic data
- o Agree on protocol for deleted information
- o Agree on protocol for back-up and archival data
- o Agree on file types and locations to be searched
- o Agree on number of relevant custodians
- o Agree on search terms for processing data
- o Agree on accessible and inaccessible electronic data
- o Agree on format of data production
- o Agree on whether to produce duplicate or near duplicate

documents

- o Agree on time periods for processing and production
- o Agree on common vendor, if possible
- o Negotiate Clawback Agreement

The answer to the question of whether the directives and practices suggested by the amendments to the FRCP would be effective as gap-fillers and appropriate topics for negotiation appears to be self-evident.<sup>26</sup>

### The Importance of Statutory Document Retention Requirements

*“[I]t [is not] necessarily corrupt for an attorney to ‘persuad[e]’ a client ‘with intent to ... cause’ that client to ‘withhold’ documents from the Government. In *Upjohn Co. v. United States*, 449 U.S. 383 (1981), for example, we held that *Upjohn* was justified in withholding documents that were covered by the attorney-client privilege from the Internal Revenue Service (IRS). See *id.*, at 395. No one would suggest that an attorney who ‘persuade[d]’ *Upjohn* to take that step acted wrongfully, even though he surely intended that his client keep those documents out of the IRS’ hands. ... It is, [likewise], not wrongful for a manager to instruct his employees to comply with a valid document retention policy under ordinary circumstances.”<sup>27</sup>*

When litigating with or responding to requests for information by the government, it is critical that organizations recognize their document retention responsibilities beyond the requirements of the FRCP. Perhaps most notably, SEC regulations require auditors of public companies to retain audit records for a period of seven years.<sup>28</sup> This broad requirement includes electronic records and not only those workpapers that formed the basis of the audit opinion but also, for example, memoranda, correspondence, communications that were created, sent or received in connection with the audit and contain any analysis. Criminal liability may be imposed for knowing and willful non-compliance.<sup>29</sup>

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Affected parties need to remain very aware of their statutory document retention obligations. Under the FRCP amendments, a party need not provide – absent good cause – electronically stored information that is not reasonably accessible.<sup>30</sup> One of the concerns during the drafting stage was that parties would deliberately make certain data sources “not reasonably accessible” to gain an advantage in litigation.<sup>31</sup> The Notes make clear, however, that “[a] party’s identification of sources of electronically stored information as not reasonably accessible does not relieve the party of its common-law or statutory duties to preserve evidence.”<sup>32</sup> Compliance with statutory duties therefore remains critical.

Moreover, amended Rule 37(f), referred to as the “safe harbor” provision, prohibits – “absent exceptional circumstances” – a court from imposing sanctions on a party for failure to provide electronically stored information if lost due to routine, good faith operation of the party’s electronic information system.<sup>33</sup> However, the rule only prohibits imposing sanctions “under these rules;” this provision will provide no safe harbor from penalties to abide by statutory document retention requirements.<sup>34</sup> Accordingly, an organization’s sound document management policy will account for these statutory requirements, while ensuring other electronic information is not unnecessarily maintained.

### *The Specter of Criminal Liability*

In any government investigation, there is the additional implication of increasingly broad obstruction of justice statutes. Litigants in a private dispute who commit violations of discovery rules face possible spoliation sections, such as adverse inference instructions or

default judgments. Those in a dispute with the government can face these sanctions, but also potential individual criminal liability for obstruction – which, post-SOX, can carry a 20 year prison term – or organizational criminal liability as in the Arthur Andersen case.

SOX made considerable changes to the obstruction statutory landscape by supplementing and clarifying what had previously been a somewhat confusing area of the law. Previously obstruction statutes did not *expressly* deal with the destruction of documents and other recorded information.<sup>35</sup> The scienter requirements were convoluted and there was confusion regarding the requirement that an official proceeding be pending.<sup>36</sup> SOX added obstruction provisions to specifically deal with document destruction, and include punishment of the individual actually destroying the documents “with the intent to impair the object’s integrity or *availability for use in an official proceeding.*”<sup>37</sup>


SOX also added provisions specifically criminalizing document related obstruction relating to “the investigation or proper administration of *any matter within the jurisdiction of any department or agency of the United States . . . , or in relation to or contemplation of such matter or case, . . .*”<sup>38</sup> This provision is key for its seeming breadth

and apparent rejection of evolving judicial interpretations of other obstruction statutes. The legislative history evidences an intent to at least reduce, if not eliminate, the constraints placed on prosecutors by the pending proceeding requirements.<sup>39</sup> Indeed, “the timing of the act in relation to the beginning of the matter or investigation is . . . not a bar to prosecution.”<sup>40</sup>

It remains to be seen how the courts will interpret this statute given the legislative history. However, the provision seems a likely choice by prosecutors for pursuing document-related obstruction.

In short, SOX has obviously expanded the net of liability and makes judgments regarding litigation holds and whether document destruction policies must be suspended all the more critical.<sup>41</sup>

### *Conclusion*

The December 2006 amendments to the FRCP are ushering in a new era of ESI discovery. Familiarity with these rule changes is critical. But any regulated entity must view the FRCP changes not only as they apply in civil litigation, but also as a tool to be considered and used in the context of agency policy, regulations, statutory document retention requirements and anti-obstruction statutes. Consideration of all of this information as a whole should inform an entity’s management regarding the orderly, efficient, and economic production of ESI to the government. 

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**In any government investigation, there is the additional implication of increasingly broad obstruction of justice statutes.**

## STOCK OPTIONS BACKDATING: THE NEW FOCUS (CONT'D)

~Michael A. Collora and William J. Lovett\*

Justice.<sup>3</sup> The purpose of this article is to explore some of the theories advanced by the government in criminal prosecutions brought to date and explore new theories that may arise as new stock option abuses come to light.

### Backdating Stock Options

A stock option gives the recipient the right to buy company stock at a price set at the time the option is granted (the exercise or strike price) at some predetermined point in the future. The use of stock options in executive compensation strives to give the recipient an additional incentive that is tied to the company's stock price. If the stock increases in value, the value of the option rises accordingly. In an effort to tie the option to long-term performance, the right to purchase the stock traditionally vests over a period of time, typically a year or more, and is dependent on an increase in the employer's stock price.

Stock options abuses may occur in a variety of ways that expose companies and their officers and directors to criminal liability. The most common abuse involves the back dating of stock option grant dates. For tax and financial reporting purposes, stock options are generally granted "at the money" where the strike price is equal to the price at which the stock is trading on the grant date. Problems arise, however, when stock options grants are backdated to correspond with a stock's quarterly low point. In this scenario, the corporate books and records make it appear that the options were granted "at the money" when, in fact, the options were "in the money," where the strike price is less than the price at which the stock was trading on the grant date. A corporation that backdates stock option grant dates runs

the risk of losing favorable tax treatment and misstating its financial results.

From a financial statement perspective, the backdating of stock options may lead to an understatement of expenses, overstatement of income and materially misstated financial statements. From a tax perspective, the backdating of stock option grant dates may result in companies filing false tax returns. Likewise, the officers and directors who receive backdated stock options may file false tax returns because options that are "in the money" when received should be considered income that likely was not reported on the individual's tax returns.

**Stock options abuses may occur in a variety of ways that expose companies and their officers and directors to criminal liability.**

A variation on this theme is the practice of backdating a stock option's exercise date or the date the recipient purportedly decides to purchase the shares. Corporations and executives engage in this practice to avoid (or evade) the payment of a tax liability that arises when stock options are exercised. Generally, the difference between the options exercise or strike price and the price at which the option is exercised is taxed as ordinary income by the IRS. By backdating an exercise date to a point where the stock is trading at a lower price, the recipient pays less tax than they would if the stock were trading at the actual higher price. In addition, because the recipient pays tax at the lower capital gains rate on the spread between the exercise price and the eventual sale price of the stock, the amount of income taxed at the lower rate is maximized when the stock is eventually sold. On the flip side, because a corporation is entitled to an expense deduction equal to the income earned by the individual exercising the option, backdating an exercise date has an adverse impact on a corporation's taxable income.

As discussed more fully below, backdating

option grant dates and exercise dates has exposed officers and directors to criminal liability in the past and will continue to be the focus of investigators in the future.

### Tax Issues

#### Backdating Exercise Dates

Beginning in 2004 with the Symbol Technologies prosecution, the Department of Justice has been investigating and prosecuting stock option abuses. In June of that year, the government unsealed a twenty-five count indictment charging Symbol executives with wide-ranging corporate fraud designed to inflate corporate earnings. Buried in that indictment was the allegation that Symbol executives committed tax fraud by engaging in the practice of backdating stock option exercise dates. (*United States v. Razmilouie*, (Case No. 2:04-CR-00519-LDW, E.D. N.Y.))

The indictment charged Symbol's general counsel, Leonard Goldner, and its Chief Financial Officer, Kenneth Jaeggi, with tax evasion (26 U.S.C. § 7201), filing false tax returns (26 U.S.C. § 7206(1)) and conspiracy to impede and impair the lawful functions of the IRS (18 U.S.C. § 371).<sup>4</sup> The allegations involved a fraudulent "look-back" scheme that allowed certain Symbol executives, including Goldner and Jaeggi, to "look back" up to 30 days and retroactively choose the lowest price at which to exercise their stock options regardless of whether they had actually satisfied the conditions required to exercise the options. Because the difference between the exercise price and cost of the option (the stock price on the date the option is granted) is taxed at an ordinary income rate, the "look back" scheme allowed Goldner and Jaeggi to substantially understate their income related to the exercise of options reported on their individual returns. Moreover, Symbol was deprived of the full expense deduction that it would have otherwise

received had the exercise date not been backdated.

In October, 2004, Goldner admitted that he engaged in a *Klein* conspiracy to impede the Internal Revenue Service (18 U.S.C. § 371) related to the “look back scheme” and is awaiting sentencing. Jaeggi’s trial ended in a mistrial earlier this year and he is awaiting a retrial.

Other executives have also come under scrutiny for backdating exercise dates. The former Chief of Comverse Technology, Inc. who fled to Namibia steps ahead of a criminal indictment, also reportedly engaged in the practice of backdating exercise dates.<sup>5</sup> A report commissioned by a special committee of Comverse Directors concluded that Alexander reduced his ordinary income by \$8.72 million or 60% by backdating options exercise dates in 1998.<sup>6</sup> Mercury Interactive, a software testing company, has also acknowledged that its executives engaged in backdating of exercise dates. And if past performance is indicative of future results, more disclosures and criminal prosecutions are sure to follow.

Using criminal tax statutes allows the Department of Justice to reach back six years from the date of the filing of the false tax returns or the last affirmative act of evasion committed by the defendant, allowing the government to focus on grants issued as far back as the 2000 tax year.<sup>7</sup>

### Backdating Grant Dates

Backdating stock option grant dates likewise may expose corporations and their officers and directors to criminal tax liability. At a recent Senate Finance Committee hearing, Chairman Grassley stated that executives who manipulated stock option grants should be prosecuted and he is willing to make changes in the tax laws to make it happen.<sup>8</sup> At the hearing, Assistant Attorney General Eileen O’Connor, head of the Department of Justice Tax Division, stated that the government is looking into the “highly suspicious practice” of awarding stock options to executives at the stock’s low point.<sup>9</sup>

Backdating of stock options causes tax problems because stock options are tied to an increase in a company’s stock price, they are considered performance based compensation. For this reason, companies may fully deduct the expenses associated with the options’ issuance. However, because I.R.C. § 162(m) limits the deduction a corporation may take for non-performance based compensation, companies risk losing all or a portion of the compensation expense deduction if the options grants are deemed to be non-performance based. Backdated stock option grants issued “in the money” are arguably non-performance based compensation subject to the limits of I.R.C. § 162(m). At least one recent shareholder’s derivative lawsuit filed against Maxim Integrated Products, Inc. alleges that the practice of back dating stock option grants resulted in improper tax deductions on the backdated stock options, in violation of Section 162(m) or the Internal Revenue Code.<sup>10</sup>

The practice may also result in a tax liability for individuals who receive the options because they may have to recognize income on their tax returns to the extent the options were “in the money.” When stock options are issued “in the money,” the recipient arguably receives income on the grant date because of the immediate gain. He or she may be required to report the income resulting from the option being “in the money” and failure to do so may expose individuals to criminal tax liability.

Although there have yet to be any criminal tax prosecutions brought based on the back dating of stock option grants, Senator Grassley’s and Assistant Attorney General O’Connor’s comments indicate the IRS is poised to aggressively pursue companies and individuals that have engaged in this practice. In the more serious cases, where the government uncovers evidence to support intent to evade taxes, (a willful violation of a known legal duty) corporations and individuals could be charged

with tax evasion (26 U.S.C. § 7201), filing false tax returns (26 U.S.C. § 7206(1) & (2)) or conspiracy to impede or impair the IRS (18 U.S.C. § 371).

### Securities Violations

In addition to criminal tax liability, backdating may also expose corporations and their officers and directors to criminal liability in the area of securities law. From a financial statement perspective, if a corporation grants options “in the money,” the difference between the fair market value of the stock on the measurement date and the exercise price should be accounted for as a compensation expense. When the options are backdated, however, corporations make it appear as if the stock option was issued “at the money” with no expense recognition required. If the stock option is actually granted in the money because of backdating, the corporation may fail to properly recognize the appropriate expense thereby overstating its income. Accordingly, the backdating of stock options may lead to understatement of expenses, overstatement of income, materially misstated financial statements and may conflict with proxy statements regarding stock option grants filed with the SEC.

In cases where the government can muster evidence to prove that the backdating was done with an intent to defraud criminal prosecutions are more likely to follow. This point is best illustrated by

**When stock options are issued “in the money,” the recipient arguably receives income on the grant date because of the immediate gain.**

securities fraud charges contained in indictments returned against Brocade and Comverse executives. In the Comverse case, CEO Jacob “Kobi” Alexander was charged with conspiracy (18 U.S.C. § 371), securities fraud (15 U.S.C. § 78j(b) and 78ff), making false SEC filings (15 U.S.C. § 78m(a) and 78ff), mail fraud, conspiracy to commit securities fraud (15 U.S.C. § 1349 and 3551), conspiracy to commit securities fraud (18 U.S.C. § 1341), wire fraud (18 U.S.C. § 1343), money laundering (18 U.S.C. §

1956(a)(1)(B)(i) and a (2) B (i)), engaging in unlawful monetary transactions (18 U.S.C. § 1957(a), 1957(b)), obstruction of criminal investigation (18 U.S.C. § 1510(a)), and obstruction of official proceedings (18 U.S.C. § 1512(b)(1)).<sup>11</sup>

The Comverse indictment is replete with intent evidence, a necessary element of any white collar criminal case. For example, the indictment alleges that Alexander and others created slush funds under the name "I.M. Fanton" and "Fargo" where the parked backdated options. In order to conceal these funds and the backdated options, the indictment alleges that Alexander caused documents to be falsified, made false statements in the company's proxy statements and quarterly and annual financial statements filed with the SEC and offered a cohort \$5 million to take sole responsibility for the fraud scheme. Alexander's co-defendants, David Kreinberg, the Comverse CFO, and William Sorin, the Comverse General Counsel, have both waived indictment and pled guilty to a conspiracy to commit securities fraud, wire fraud and mail fraud charge relating to the Comverse backdating scheme. Kreinberg also pled guilty to one count of securities fraud. Both are reportedly cooperating with prosecutors and have implicated Alexander in the scheme.<sup>12</sup>

Similarly, in Brocade, the Chief Executive Officer and Vice President of Human Resources were charged with securities fraud, mail fraud and falsifying corporate books and records.<sup>13</sup> As with Comverse, the Brocade indictment paints a picture of intent to defraud as evidenced by the false corporate documents, manufactured meetings and false statements to the company's auditor.

### *Cases In The Pipeline*

While Symbol, Comverse and Brocade backdating schemes are the only cases to date resulting in criminal charges, a review of the conduct alleged in SEC filings, third parties complaints and companies own disclosures provide clues as to the cases where future criminal charges may arise.

### **McAfee**

Kent Roberts, the former general counsel for software giant McAfee is reportedly the target of a federal grand jury investigating his role in fabricating dates on option grants.<sup>14</sup> Roberts, who was fired from McAfee in May, 2006 shortly after the stock options scandal broke, purportedly engaged in at least one instance of backdating option grants that the company admits was improper.<sup>15</sup> A shareholder's derivative suit filed in the Northern District of California may provide some insight as to the focus of the grand jury's investigation.<sup>16</sup> The suit alleges that Roberts received approximately \$6.8 million representing the unlawful profits from the exercise of backdated or misdated stock options.<sup>17</sup> Roberts, who had previously signed a consent decree with the SEC in January, 2006 relating to a scheme to inflate the company's revenue and earning through "channel stuffing", was responsible for signing McAfee's proxy statements filed with SEC containing information on the company's stock option plan. The proxy statements represented that all options were granted at an exercise price equal to the fair market value on the date of the grant. In fact, many of the stock options granted to executives, including Roberts, were granted at or near the low price for the year. The government will certainly look to establish evidence that Roberts knew the proxy statements were false because he himself was backdating to option grant dates.

### **UnitedHealth Group, Inc.**

While no formal charges have been brought against the Minnetonka, MN based health insurer, storm clouds are on the horizon. The Wall Street Journal reports that the company acknowledged problems with its stock option grants and warned that it may have to restate financial results, lose tax deductions and "take charges that could reduce the past three years' net earnings by \$286 million."<sup>18</sup> The company also acknowledged that it received a federal grand jury subpoena, an informal letter of inquiry from the SEC and a request for documents by the

IRS. Minnesota Attorney General Mike Hatch also publicly stated that he plans on investigating UnitedHealth's stock option plan.

UnitedHealth's problems reportedly relate to stock option grants made to its CEO William McGuire. In 1999, McGuire received the first of two 250,000 share grants of United stock at the low price for the year. McGuire received similar grants at the stock's low price in 1997 and 2000. Apparently, McGuire could chose the option date and orally inform the compensation committee as to his decision. At least ten others at UnitedHealth, including the General Counsel, received similar grants at the low price of the year.

McGuire has been forced out as UnitedHealth's CEO and has been named as a defendant in a class action complaint filed in federal district court in Minnesota. In that suit, investors sued McGuire and the Board alleging violations of Section 14 of the Exchange Act regarding proxy statements and common law violations of breach of fiduciary duty and unjust enrichment; and the investors are seeking the return of excess profits for 1996.<sup>19</sup> Recently, the judge overseeing the litigation ordered that McGuire's unexercised options worth an estimated \$1.6 billion be frozen pending the outcome of the litigation.<sup>20</sup>

### **Brooks Automation**

Brooks Automation, a Chelmsford, Massachusetts based hi-tech company, is also under investigation by the Department of Justice. Apparently CEO Robert Therrien received a stock option grant on May 31, 2000 with a strike price of \$39.75, the low price for that day. The next day, the stock price increased 30%, a fact that was not disclosed to the SEC until August, 2000 according to the Wall Street Journal. Therrien received a similar stock option grant at a favorable strike price in October, 2001 as did two other compensation committee members. One of these members, Amin L. Khoury, subsequently left Brooks for B/E Aerospace in Wellington, Florida where the practice

may have repeated itself.<sup>21</sup> Brooks has admitted that two former directors and its former CEO signed a false document permitting the CEO to exercise expired options allowing Therrien to reap millions in profits. A shareholders derivative lawsuit was also recently filed against Brooks and its Board members alleging breach of fiduciary duty and unjust enrichment related to the backdating practices.<sup>22</sup>

### Sycamore Networks

Sycamore Networks, a company that develops and markets optical networking products, has likewise announced that it is under investigation by the U.S. Attorney's Office for the District of Massachusetts. Sycamore has already restated its financial statements for the years 2000 and 2004 as a result of backdating problems. The focus of the investigation is likely found in the details of a civil complaint filed by Sycamore's former Human Resource director who alleges that he was forced out of the company after he objected to the practice of backdating new employee start dates for the purpose of making new employees eligible for stock options that had been granted before the employees' actual start date.<sup>23</sup> Attached to the complaint is the proverbial "smoking gun," an internal memorandum listing employees who may have had their start dates altered.<sup>24</sup>

Sycamore recently announced that it could not comply with the federal grand jury subpoena because a former employee who managed the stock option program is refusing to return documents that are responsive to the subpoena.<sup>25</sup> In an unusual maneuver, Sycamore, which maintains that the documents are confidential and should have been returned when the employee left the company, has filed suit in state trial court asking a judge to order the former employee to return the documents.<sup>26</sup>

### Apple Computer

Apple Computer's stock option practices have likewise drawn the unwanted attention of federal prosecutors. In October, Apple publicly disclosed that 15 stock

options grants had grant dates that preceded formal approval.<sup>27</sup> The results of the internal investigation, which raised questions about the actions of two Apple executives in connection with stock option grants, were reportedly presented to federal prosecutors at the U.S. Attorneys Office in San Francisco.<sup>28</sup> The focus of the Apple investigation is likely the falsification of documents to conceal the back dating of stock options grants.

These documents include the creation of the documents purportedly showing that Apple's full board met and authorized \$7.5 million in stock options to Apple CEO Steve Jobs in 2001.<sup>29</sup> According to Apple's filings with the SEC, Job's stock option grant dated October 19, 2001 was originally approved at a Board meeting on August 29, 2001.<sup>30</sup> The grant was dated October 19, 2001, with an exercise price of \$18.30. The terms of the grant, however, were not finalized until December 18, 2001 when Apple's stock was trading at \$21.01. The approval for the grant was improperly recorded as occurring at a special Board meeting on October 19, 2001, a meeting that did not occur. Apple's backdating practices will lead to an \$84 million restatement stemming from Apple's recognition of compensation based expenses dating back to 1999.

### Defenses

If misstated options were granted, and exercised more than five years ago, the criminal prosecutors may face a five year criminal statute of limitations, see 18 U.S.C. § 3282, or six years for a tax violation. See 26 U.S.C. § 6531. However, if an option were granted in 1997 (and the strike price misdated) but not exercised until 2002, prosecutors could argue that the crime constituted a continuing offense and only ended when the money

was realized and the statutes of limitation had not yet tolled. Civilly, an injunction and disgorgement could still be brought.

Because scienter must be established in criminal securities cases and specific intent must be proved in criminal tax cases, criminal exposure will depend on the flagrancy of the backdating, its frequency, the knowledge or approval by the Board, the amount of money involved and the position of the recipient. Good lawyering may reduce the penalty or avoid a criminal reference, but much is unknown at this point. ☞

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**EPIHEMERAL LETTERS OF TRANSIT:  
RESPONDING TO GOVERNMENT  
REQUESTS FOR ELECTRONICALLY STORED  
INFORMATION**

- 1 *Casablanca* (Warner Brothers 1942)(In *Casablanca*, the Letters of Transit were much sought after by many people, including the German government, yet they were not produced until the very end of the movie).
- 2 Peter J. Henning, White Collar Crime Prof Blog, March 20, 2006 ([http://lawprofessors.typepad.com/whitecollarcrime\\_blog/obstruction/index.html](http://lawprofessors.typepad.com/whitecollarcrime_blog/obstruction/index.html))
- 3 The term Luddite has taken on a much broader meaning than its origin might suggest. Now it generally refers to people who intentionally choose ignorance over technological advancement. Originally, however, the Luddite movement was a form of labor protest, stemming from some early 19<sup>th</sup> century Leicestershire workmen destroying labor-saving machinery as a form of protest and, more to the point, to preserve their livelihoods.
- 4 We are of the opinion that much is to be gleaned about government tendencies and expectations by reading the government's policies and protocols not only in case specific circumstances, but also in analogous contexts, and not just regarding ESI. These lessons, coupled with the experience and reputation of a good lawyer, can then be applied to the specific situation in which you find yourself. See Belanger, *A Practical Guide to Remediation, Disclosure and Cooperation in the Context of Corporate Misconduct*, ABA Corporate Counsel Newsletter, Fall 2005 ([www.lewisandroca.com/article\\_detail.asp?ArticleID=155](http://www.lewisandroca.com/article_detail.asp?ArticleID=155)).
- 5 15 U.S.C. §§ 25 and 53(b).
- 6 15 USC § 18a(a); 16 CFR §§ 801-803.
- 7 REFORMS TO THE MERGER REVIEW PROCESS, Deborah Platt Majoras, Chairman, Federal Trade Commission (Feb. 16, 2006), at 4, available at <http://www.ftc.gov/os/2006/02/mergereviewprocess.pdf>.
- 8 15 USC § 18a(e); 16 CFR 803.20(c).
- 9 See Bailey, Matthew S., *The Hart-Scott-Rodino Act: Needing a Second Opinion About Second Requests*, 67 OHIO ST. L.J. 433, 443 (2006).
- 10 Federal Trade Commission & US Department of Justice, Model Second Request for Additional Information and Documentary Material, Hart-Scott-Rodino Premerger Program Improvements (mar. 23, 1995) [hereinafter MODEL SECOND REQUEST], available at <http://www.ftc.gov/modelguide.htm>
- 11 MODEL SECOND REQUEST, at Definitions and Instructions, C.
- 12 Deborah Platt Majoras, *Reforms to the Merger Review Process* (Feb. 16, 2006) at 11.
- 13 *Id.* at 19.
- 14 *Id.* at 29.
- 15 U.S. Department of Justice, *Merger Review Process Initiative* (Aug. 4, 2004), available at <http://www.usdoj.gov/atr/public/204895.htm> (emphasis supplied).
- 16 Any experienced white collar defense lawyer will be very familiar with the process of negotiating the parameters of a government subpoena or request for information. The government will likewise be familiar with this type of negotiation and will often welcome them, particularly where refining the request and manner of production will make the government's job easier.
- 17 Public Company Accounting Oversight Board Rule 5105(b) [hereinafter Board Rule].
- 18 FED. R. CIV. PRO. 34(a).
- 19 Board Rule 1001(d)(ii).
- 20 See generally, Joseph J. Lisa, *EPA Administrative Enforcement Actions: An Introduction to the Consolidated Rules of Practice*, 24 TEMP. J. SCI. TECH. & ENVTL. L. 1 (Spring 2005).
- 21 *Id.* at 1 (citation omitted).
- 22 *Id.* at 2.
- 23 *Id.* at 3.

- 24 *Id.* at 23.
- 25 40 C.F.R. § 22.19(a)(2)(ii); *Id.* at 24.
- 26 By and large, the Department of Justice was very supportive of the amendments to the FRCP and the negotiated resolution of various ESI production issues the amendments were intended to facilitate. Comments of the U.S. Department of Justice on the Proposed Amendments to the Federal Rules of Civil Procedure, transmitted by Peter D. Keisler, February 15, 2005.
- 27 *Arthur Andersen LLP v. United States*, 544 U.S. 696 (2005).
- 28 18 U.S.C. § 1520; SEC Rule § 210.2-06.
- 29 See 18 U.S.C. § 1501 *et seq.*
- 30 Fed. R. Civ. P. 26(b)(2)(B).
- 31 Excerpt of the Report of the Advisory Committee on Civil Rules (July 2005) at 36, available at [http://www.uscourts.gov/rules/supct1105/Excerpt\\_CV\\_Report.pdf](http://www.uscourts.gov/rules/supct1105/Excerpt_CV_Report.pdf).
- 32 *E-Discovery Amendments and Committee Notes*, Rule 26(b) comm. n, available at [http://www.uscourts.gov/rules/EDiscovery\\_w\\_Notes.pdf](http://www.uscourts.gov/rules/EDiscovery_w_Notes.pdf).
- 33 Fed. R. Civ. P. 37(f).
- 34 *Id.*
- 35 Chase, *To Shred Or Not To Shred: Document Retention Policies and Federal Obstruction Of Justice Statutes*, Forham Journal of Corporate and Financial Law, 2003 ([http://findarticles.com/p/articles/mi\\_qa4048/is\\_200301/ai\\_n9217310/print](http://findarticles.com/p/articles/mi_qa4048/is_200301/ai_n9217310/print))
- 36 *Id.*
- 37 18 U.S.C. §§ 1512(c)(emphasis added)(Query how far liability extends under this statute?).
- 38 18 U.S.C. § 1519 (emphasis supplied)(Again, just how far does criminal liability extend).
- 39 148 Cong. Rec. S7419 (July 26, 2002) ("This statute [section 1519] is specifically meant not to include any technical requirement, which some courts have read into other obstruction of justice statutes, to tie the obstructive conduct to a pending or imminent proceeding or matter by intent or otherwise.").
- 40 *Id.*
- 41 A well designed, neutrally implemented and consistently applied document retention policy should not violate federal obstruction of justice statutes nor should it give rise to an inference of wrongdoing. Create the policy and implement it at a time when no investigation or proceeding is pending or threatened, suspend it as necessary, in whole or in part, when reasonable indicia of an investigation comes to light, reinstate the policy when the need for the suspension dissipates, and do all of this in as consistent and objective a fashion as possible. See Chase, footnote 59 above.

**STOCK OPTIONS BACKDATING: THE NEW  
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- 1 A Perfect Payday, *Wall Street Journal*, March 18, 2006.
- 2 *Wall Street Journal Online*, Perfect Payday - Options Scorecard, [www.wsj.com/public/resources/documents/info-optionsscore06-fill.html](http://www.wsj.com/public/resources/documents/info-optionsscore06-fill.html).
- 3 *Id.*
- 4 *Id.*
- 5 Comverse Ex-CEO May Have Fudged Option Exercise Dates, Not Just Grant Dates, *Wall Street Journal*, December 6, 2006.
- 6 *Id.*
- 7 26 U.S.C. § 6531.
- 8 Senate Chairman Asks Prosecutors To Act On Options, *Bloomberg.com*, June 13, 2006.
- 9 *Id.*
- 10 Horkay, Jr. v. Maxim Integrated Products, Inc., (Case No. C06-339, N.D. CA).
- 11 *United States v. Jacob Alexander*, Case No. 06-628 (S-1) (NGG), E.D. N.Y.
- 12 Kobi Gets April Hearing, *Long Island Business News*, November 16, 2006.

- 13 *United States v. Reyes*, Case No. CR-06-0556-CRB N.D. CA.
- 14 Former McAfee GC May Face Charges Over Backdating, *Lau.Com*, December 15, 2006.
- 15 *Id.*
- 16 *In re McAfee, Inc. Derivative Litigation*, Case No. 5:06-cv-03484-JF, N.D. CA.
- 17 *Id.*
- 18 *Wall Street Journal Online*, Perfect Payday - Options Scorecard, [www.wsj.com/public/resources/documents/info-optionsscore06-fill.html](http://www.wsj.com/public/resources/documents/info-optionsscore06-fill.html).
- 19 Public Employee Retirement System of Ohio, et al., v. McGuire, et al., (CV 06-2094 D. Minn.).
- 20 McGuire's Stock Option, Pension Suspended During Review, *Bizjournals.com*, November 30, 2006.
- 21 The Perfect Payday, *The Wall Street Journal*, (March 18, 2006).
- 22 *Mark Collins, et al. v. Robert J. Therrien, et al.*, (Case No. 06CA10943RWZ, D. Mass.).
- 23 *Stephen Landry v. Sycamore Networks, Inc.*, Case No. 06-2333 Middlesex Superior Court.
- 24 *Id.*
- 25 *Sycamore: Ex-exec Thwarts Options Probe*, Boston Business Journal, December 8-14, 2006, Vol 26, No. 45.
- 26 *Sycamore Networks, Inc. v. Galli*, (Case No. 2006-04856 Suffolk Superior Court, Suffolk County Massachusetts).
- 27 Apple Presents Stock Option Findings To Feds, *Lau.Com*, October 5, 2006.
- 28 *Id.*
- 29 Apple "Falsified" Files on Jobs Options, *Financial Times*, December 28, 2006.
- 30 Apple Computer, Inc. Securities and Exchange Commission Form 10-Q for the Quarterly Period Ending July 1, 2006.

**SOMETHING FUNNY HAPPENED ON THE  
WAY TO DISCRETIONARY SENTENCING:  
WHY A PRESUMPTION OF REASONABLENESS  
VIOLATES THE HOLDING OF BOOKER**

- 1 See *Blakely v. Washington*, 542 U.S. 296 (2004).
- 2 543 U.S. 220 (2005).
- 3 The statutory factors are set forth at 18 U.S.C. § 3553(a), and include the nature of the offense, the history and characteristics of the defendant, and the need for punishment, deterrence, and incapacitation.
- 4 This article uses the term "variance" to signify a sentence either above or below the properly-calculated sentencing range according to the U.S. Sentencing Guidelines. A variance is justified by the factors set forth at 18 U.S.C. § 3553(a), as opposed to a departure, which is justified by Chapter 5 of the Sentencing Guidelines. Several federal appeals courts have adopted that terminology. See, e.g., *United States v. Sitting Bear*, 436 F.3d 929 (8th Cir. 2006); *United States v. Vampire Nation*, 451 F.3d 189, 196-98 (3d Cir.), cert. denied sub. nom., *Banks v. United States*, 127 S. Ct. 424 (2006)
- 5 See U.S. Sentencing Commission Preliminary Quarterly Data Report (Dec. 6, 2006), at p. 1, available at <http://www.uscc.gov/Blakely/QuarterReport4Qrt06.pdf>
- 6 See, e.g., *United States v. Meyer*, 452 F.3d 998, 1000 (8th Cir.) (noting that 8th Circuit has a 92.3% rate of affirming upward variances, but a 15.8% rate of affirming downward variances), *reh'g and reh'g en banc denied* (2006).
- 7 Edward Lazarus, "The Supreme Court's Sentencing Guidelines Decision: Its Logic, and its Surprisingly Limited Practical Effect," Jan. 21, 2005, available at <http://writ.news.findlaw.com/lazarus/20050121.html>.
- 8 *United States v. McBride*, 434 F.3d 470, 474 (6th Cir. 2006).
- 9 See *United States v. Dorely*, 454 F.3d 366, 376 (D.C. Cir.), cert. denied, 127 S. Ct. 691 (2006); *United*

*States v. Kristl*, 437 F.3d 1050, 1053-54 (10th Cir. 2006); *United States v. Williams*, 436 F.3d 706, 708 (6th Cir. 2006), cert. denied, No. 06-5275 (July 11, 2006); *United States v. Green*, 436 F.3d 449, 455-57 (4th Cir.), cert. denied, 126 S. Ct. 2309 (2006); *United States v. Alonzo*, 435 F.3d 551, 554 (5th Cir. 2006); *United States v. Mykytiuk*, 415 F.3d 606, 607-08 (7th Cir. 2005); *United States v. Lincoln*, 413 F.3d 716, 717 (8th Cir. 2005).

10 See *United States v. Lazenby*, 439 F.3d 928, 933-34 (8th Cir. 2006).

11 See, e.g., *United States v. Moreland*, 437 F.3d 424, 433-34 (4th Cir. 2006) (reversing variance of two-thirds the guideline range and noting that appeals court must consider reasonableness of both the variance and the "extent of the variance"); *United States v. McMannus*, 436 F.3d 871, 874-75 (8th Cir. 2006) ("the farther the district court varies from the presumptively reasonable guidelines range, the more compelling the justification based on the § 3553(a) factors must be"); *United States v. Castro-Juarez*, 425 F.3d 430, 432-34 (7th Cir. 2005) (reversing and remanding for re-sentencing where record did not support upward variance of more than double the guideline range).

12 414 F.3d 725, 729 (7th Cir. 2005).

13 See, e.g., *Kristl*, 437 F.3d at 1053-54; *Mykytiuk*, 415 F.3d at 607-08.

14 See, e.g., *Dorcely*, 454 F.3d at 376; *Williams*, 436 F.3d at 708; *Green*, 436 F.3d at 457.

15 See *United States v. Fernandez*, 443 F.3d 19, 27-28 (2d Cir. 2006); *Jimenez-Beltre*, 440 F.3d at 518-19; *United States v. Cooper*, 437 F.3d 324, 330-31 (3rd Cir. 2006); *United States v. Guerrero-Velasquez*, 434 F.3d 1193 (9th Cir. 2006) (as amended); *United States v. Talley*, 431 F.3d 784, 787-88 (11th Cir. 2005).

16 *United States v. Guerrero-Velasquez*, No. 05-30066 (9th Cir. Jan. 19, 2006), amended (Feb. 7, 2006).

17 See *Guerrero-Velasquez*, supra.

18 See, e.g., *Mykytiuk*, 415 F.3d at 607-08; *United States v. Crosby*, 397 F.3d 103, 115 (2d Cir. 2005).

19 *Booker*, 543 U.S. at 311 (Scalia, J., dissenting in part).

20 431 F.3d at 787-88.

21 2006 WL 3409169, at \*4 (quoting *Cooper*, 437 F.3d at 329-32).

22 *United States v. Pelletier*, 469 F.3d 194, 203-04 (1st Cir. 2006).

23 439 F.3d 479 (8th Cir. 2006).

24 No. 05-4674, 2006 WL 1144508 (4th Cir. May 1, 2006).

25 *Claiborne*, 439 F.3d at 481 (citing *United States v. Johnson*, 427 F.3d 423, 426-27 (7th Cir. 2005)).

26 *Id.* (citing *United States v. Dalton*, 404 F.3d 1029, 1033 (8th Cir. 2005)).

27 *Id.*

28 Order Granting Certiorari, available at <http://www.supremecourtsus.gov/orders/courtorders/110306pzzr.pdf>.

29 *Id.*

30 *Booker*, 543 U.S. at 264-65.

31 *Id.* at 304-05 (Scalia, J., dissenting in part).

32 See, e.g., *United States v. Terrell*, 445 F.3d 1261, 1265 (10th Cir. 2006) ("the Guidelines are generally an accurate application of the factors listed in § 3553(a)"); *United States v. Mares*, 402 F.3d 511, 519 (5th Cir. 2005) (finding that a judge who sentences within the Guidelines range has by definition considered the statutory sentencing factors).

33 See Prepared Testimony of Judge Ricardo H. Hinojosa, Chair, United States Sentencing Commission Before the Subcommittee on Crime, Terrorism, and Homeland Security, Committee on the Judiciary, United States House of Representatives (Feb. 10, 2005), at p.4, available at <http://www.uscc.gov/Blakely/bookertestimony.pdf> (stating that the factors used to develop the Guidelines are "virtual mirror image" of those listed at § 3553(a)); U.S. Sentencing Commission, *Final Report on the Impact of United States v. Booker on Federal Sentencing* (March 2006).

34 See *United States v. Zavala*, 443 F.3d 1165, 1168 (9th Cir.) ("the Sentencing Commission presumably considered all of [the § 3553(a) factors] when it proposed the Guideline ranges – indeed, it had to do so and its says that it did") (citing 28 U.S.C. § 994 and USSG § 1A1.1 & ed. note), *reh'g en banc granted by United States v. Carty*, 462 F.3d 1066 (2006); *United States v. Shelton*, 400 F.3d 1325, 1332 n.9 (11th Cir. 2005) ("The factors the Sentencing Commission was required to use in developing the Guidelines are a virtual mirror image of the [§ 3553(a) factors]").

35 See, e.g., *United States v. Jimenez-Beltre*, 440 F.3d 514, 526-28 (1st Cir. 2006) (Lipez, J., dissenting) (the "prohibited and discouraged factors [within the Guidelines] are in tension with the holistic, personalized view of the defendant required by § 3553(a)'s other factors."). Even circuits adopting the presumption have recognized that the Guidelines do not fully encompass the statutory factors, one stating that "the Guidelines may omit some factor to which § 3553(a) or a sound exercise of discretion gives weight." *United States v. Gama-Gonzalez*, 469 F.3d 1109, 1110-11 (7th Cir. 2006). See also *McBride*, 434 F.3d at 476 ("many of the very factors that used to be grounds for a departure under the Guidelines are now considered by the district court – with greater latitude – under section 3553(a)").

36 469 F.3d 319, 323-24 (3rd Cir. 2006).

37 USSG § 5K2.19 (2005).

38 *Lloyd*, 469 F.3d at 324.

39 For example, the Sentencing Guidelines all but forbid the district court to consider factors such as the defendant's age, education, mental and emotional condition, drug addiction, employment record, or family ties. See USSG §§ 5H1.1-1.6 (2005). Nor do the Guidelines generally permit any consideration of military service or past charitable acts. See USSG §§ 5H1.11-1.12 (2005). Yet § 3553(a)(1) expressly instructs the sentencing court to consider "the history and characteristics of the defendant."

40 See USSG § 5K1.1 (2005).

41 *Booker*, 543 U.S. at 261.

42 See United States Sentencing Commission, *Final Report on the Impact of United States v. Booker On Federal Sentencing*, at 30 (March 2006) available at <http://www.uscc.gov/booker-report/Booker-Report.pdf>

43 543 U.S. at 311 (Scalia, J., dissenting in part).

## NEITHER A WHITEWASH NOR A WITCH-HUNT BE:

### RECLAIMING THE INDEPENDENCE OF INTERNAL INVESTIGATIONS

1 Executive Order 13271 of July 9, 2002, at <http://www.usdoj.gov/dag/cftf/execorder.htm>.

2 *Fact Sheet: Corporate Fraud Conference Sponsored by President's Corporate Fraud Task Force* (Sept. 26, 2002), at <http://www.whitehouse.gov/news/releases/2002/09/20020926-2.html>.

3 Deputy Attorney General Larry D. Thompson, *Principles of Federal Prosecution of Business Organizations*, U.S. Dep't of Justice (Jan. 20, 2003), at [http://www.usdoj.gov/dag/cftf/corporate\\_guidelines.htm](http://www.usdoj.gov/dag/cftf/corporate_guidelines.htm).

4 Criticism of the policies set forth in the Thompson Memorandum, and the application of those policies, came from such diverse sources as the New York Council of Defense Lawyers, the National Association of Criminal Defense Lawyers, the Securities Industry Association, the Association of Corporate Counsel, the Bond Market Association, the United States Chamber of Commerce, the American Bar Association, and at least one prominent federal judge. See Brief of Amici Curiae of the New York Council of Defense Lawyers and the National Association of Criminal Defense Lawyers, *United States v. Stein*, No. S1 05 Crim. 888 (LAK) (S.D.N.Y. May 22, 2006); Brief for Amici Curiae the Securities

Industry Association, the Association of Corporate Counsel, the Bond Market Association, and the Chamber of Commerce of the United States of America, *United States v. Stein*, No. S1 05 Crim. 888 (LAK) (S.D.N.Y. May 22, 2006); *United States v. Stein*, 435 F. Supp. 2d 330 (S.D.N.Y. 2006); see also *ABA Urges Congress to Stem 'Culture of Waiver' of Attorney-Client Privilege in Probes of Corporations* (March 2, 2006), at <http://www.abanet.org/media/releases/news030606.html>.

5 Deputy Attorney General Paul J. McNulty, *Principles of Federal Prosecution of Business Organizations*, U.S. Dep't of Justice (Dec. 12, 2006) ("McNulty Memorandum"), at [http://www.usdoj.gov/dag/speech/2006/mcnulty\\_memo.pdf](http://www.usdoj.gov/dag/speech/2006/mcnulty_memo.pdf).

6 At the commencement of interviews with employees in an internal investigation, experienced counsel will provide the so-called *Upjohn* warnings, *Upjohn Co. v. United States*, 449 U.S. 383 (1981), informing the individual about the scope and meaning of the company's attorney-client privilege and reiterating that the investigator does not represent the individual and that the individual does not control whether the company waives its privilege and discloses the contents of the interview.

7 In *United States v. Stein*, 435 F. Supp. 2d 330 (S.D.N.Y. 2006), KPMG assessed these considerations and decided to abandon its longstanding practice of paying employees' attorneys fees in order to receive credit under the Thompson Memorandum for cooperating with the Department of Justice. The defendants, former employees of KPMG, challenged the constitutionality of the government's conduct in influencing KPMG's decision, alleging that the Thompson Memorandum pressured KPMG not to pay employees' attorneys fees and therefore violated the defendants' constitutional rights. Judge Lewis A. Kaplan of the United States District Court for the Southern District of New York held that KPMG had in fact refused to pay "because the government held the proverbial gun to its head" and that the government "let its zeal get in the way of its judgment" and "violated the Constitution it is sworn to defend." *Id.* at 336. In his opinion, Judge Kaplan emphatically rejected the argument made publicly by Deputy Attorney General Thompson that employees do not need "fancy legal representation" if they do not believe they acted with criminal intent.

The innocent need able legal representation in criminal matters perhaps even more than the guilty. In addition, defense costs in investigations and prosecutions arising out of complex business environments often are far greater than in less complex criminal matters. Counsel with the skills, business sophistication, and resources that are important to able representation in such matters often are more expensive than those in less complex criminal matters. Moreover, the need to review and analyze frequently voluminous documentary evidence increases the amount of attorney time required for, and thus the cost of, a competent defense. Thus, even the innocent need substantial resources to minimize the chance of an unjust indictment and conviction.

*Id.* at 338 n.13.

8 McNulty Memorandum at 11 n.3.

9 *Id.* at 11 n.3.

10 The issue of whether a company can disclose privileged information to the government without waiving its attorney-client privilege or attorney work product immunity is a complex, hotly-debated issue beyond the scope of this article.

11 *Id.* at 10-11.

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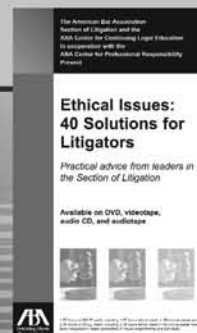
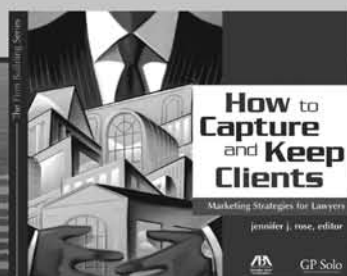
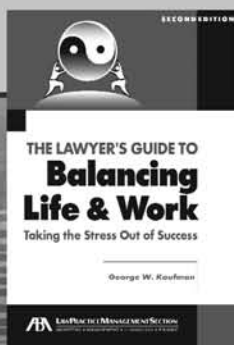
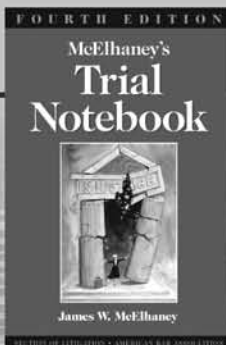
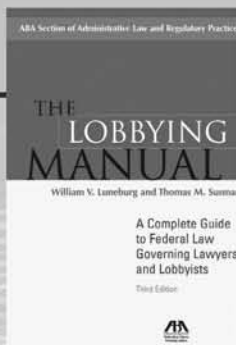
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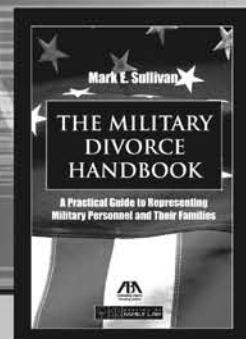
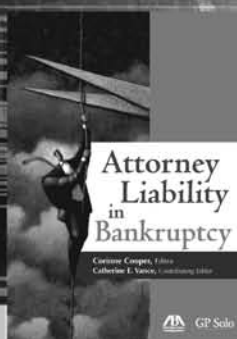
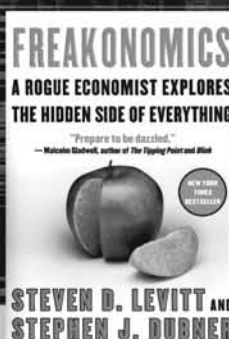
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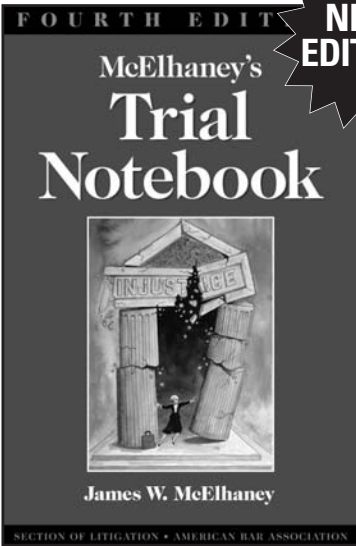
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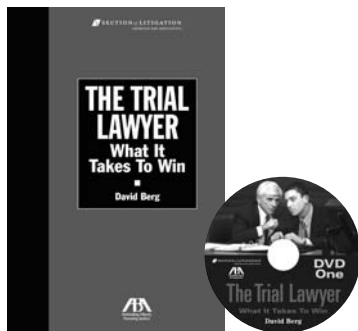
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