

# PAYING FOR DANIEL WEBSTER: LEGAL AND ETHICAL IMPLICATIONS OF ADVANCEMENT OF LEGAL FEES IN CRIMINAL PROCEEDINGS

by

**Regina M. Robson\***

## I. INTRODUCTION

In the short story, *The Devil and Daniel Webster*,<sup>1</sup> a frustrated farmer, Jabez Stone, makes a pact with the devil in exchange for worldly success.<sup>2</sup> When the devil appears, to collect his soul, however, Jabez retains noted litigator, Daniel Webster, to plead his case before a jury of the damned.<sup>3</sup> Jabez keeps his soul, Daniel Webster goes on to greater glory, and the devil is left to pursue other souls, who hopefully lack the benefit of counsel. Like Jabez, the erstwhile defendant in Benet's short story, employees who are the subject of a criminal investigation for white collar crimes have a keen interest in securing the best counsel available. However, unlike Daniel Webster, knowledgeable defense counsel does not work gratis, and for most employees advancement of legal fees by their employers is critical to mounting an effective defense.

This paper considers the legal and ethical issues surrounding the decision by an organization<sup>4</sup> to advance legal fees to employees facing criminal investigation. It posits that the use of a contract model creates ethical and practical challenges for the organization and the target employee, and fails to consider the interest of the larger community in the fair and efficient administration of criminal justice.<sup>5</sup>

Part II provides a general overview of the jurisprudence of advancement of legal fees and the policy considerations which influence an organization's decision to advance fees.<sup>6</sup> It also describes the contract model which is currently used to determine the existence and scope of advancement.<sup>7</sup>

Part III discusses recent trends in the prosecution of organizational crime which may both impact and reinforce the contract paradigm.<sup>8</sup>

Part IV identifies the limitations of the contract model and posits that a duty paradigm may provide a more appropriate model for consideration of advancement issues.<sup>9</sup> The article suggests that the disparate outcomes of the bargaining process and the disregard of interests beyond those of the parties to the agreement, have a potentially negative impact on individual employees and on the administration of criminal justice.<sup>10</sup> It argues that the relationship between the parties, and the critical nature of the subject matter suggest that the appropriate legal framework for considering the issue of advancement is one of duty rather than bargain.<sup>11</sup>

Part V of this article concludes that a conscious shift from a contract model toward a duty model will result in a more appropriate balancing of all of the interests impacted by the decision to advance legal fees in a criminal investigation.<sup>12</sup>

## II. GENERAL OVERVIEW OF ADVANCEMENT

"Advancement" refers to the payment of legal and related expenses in defense of a matter related to or arising from an employment or agency relationship, prior to a final determination of liability.<sup>13</sup> Payment of such costs may be made directly by the employer to the provider of services, or indirectly when the employer reimburses the employee for expenses as they are incurred, or by the provision of insurance policies.<sup>14</sup>

Advancement of legal fees and other costs of litigation is a modern day corollary to the principle that business organizations have a duty to indemnify innocent agents who sustain losses by virtue of their role in an organization.<sup>15</sup> However, despite this common heritage, both the legal and policy considerations influencing advancement are distinct from that which informs indemnification.<sup>16</sup>

### A. Relationship Between Advancement and Indemnification

The relationship between indemnification of employees who are successfully vindicated of criminal liability and those advanced legal fees to secure such vindication, is juridical dimity: a complex weave of concepts which are at once intimately related and irreconcilably distinct.

Indemnification generally refers to "reimbursement by the corporation of liabilities, including judgments, amounts paid in settlement, expenses and attorneys' fees incurred by directors, officers, employees, and sometimes even agents in the course of their service to the corporation."<sup>17</sup> In addition to demonstrating that the action against the claimant arose because of the claimant's relationship to the indemnitor, common law claims for indemnification required a showing that a claimant had been "successful" in defending against the action.<sup>18</sup>

---

\* Assistant Professor of Business Law, St. Joseph's University, Philadelphia, Pennsylvania

Common law obligations of indemnification were both inconsistent and unreliable.<sup>19</sup> In 1939, *New York Dock Company v. McCollom*<sup>20</sup> created consternation among directors and officers when a New York court denied indemnification to directors who had successfully defended a derivative action.<sup>21</sup> The resulting “pothole”<sup>22</sup> energized state legislatures to codify the conditions and requirements for indemnification as part of state corporate law.<sup>23</sup>

Today, many states<sup>24</sup> follow the model of Delaware corporation law<sup>25</sup> which provides for both mandatory indemnification and permissive indemnification.<sup>26</sup> Section 145 (c) of the Delaware Corporation law requires that corporations<sup>27</sup> reimburse the costs of fees and expenses where an officer or director has been successful “on the merits” or “otherwise” in defending against a claim.<sup>28</sup> Other sections of the law permit indemnification if the claimant acted in good faith and, in the context of a criminal proceeding, “had no reason to believe the person’s conduct was unlawful.”<sup>29</sup>

Delaware law permits, but does not require corporations to advance payment of fees and expenses prior to a final determination on the merits.<sup>30</sup> The right to advancement of fees has been held to be separate and distinct from the right to indemnification.<sup>31</sup> Even where a statute requires indemnification, it has not been deemed to invest a claimant with a right to advancement of costs in the period prior to a final determination of liability.<sup>32</sup> Conversely, entitlement to indemnification is not statutorily required as a precondition to advancement.<sup>33</sup> In contrast to indemnification provisions which are triggered upon a determination of liability, claims for advancement in a criminal matter arise well “upstream” of a final determination of liability, at the investigative stage before any charges have been brought.<sup>34</sup> Because fees and expenses are advanced prior to a final determination of guilt or innocence, expenses may be advanced to claimants who are ultimately found not to qualify for indemnification. A decision to advance fees is not a decision – or even a prediction of a decision – on a claimant’s eligibility for indemnification.<sup>35</sup>

### **B. Statutory Framework of Advancement of Fees**

While most states require indemnification of employees in certain defined circumstances,<sup>36</sup> statutes treating payment of fees prior to a final adjudication are permissive, not mandatory.<sup>37</sup> All fifty states explicitly permit corporations to advance attorneys’ fees, pending a finding of liability.<sup>38</sup> Neither the Delaware law<sup>39</sup> nor the Model Business Corporation Act (“MBCA”)<sup>40</sup> distinguishes between advancement of costs incurred in defending against criminal or civil liability: advancement is permitted in both cases. Section 145(e) of the Delaware law provides that a corporation may advance expenses to officers and directors “upon receipt of an undertaking by or on behalf of such director or officer to repay such amount if it shall ultimately be determined that such person is not entitled to be indemnified....”<sup>41</sup> The statute does not require a promise of repayment from recipients who are neither directors or officers; such decisions are left to the discretion of the board.<sup>42</sup>

Even where there is a promise to repay advances, such undertakings may be little more than cosmetic.<sup>43</sup> Since the obligation to advance fees is frequently pre-authorized in a by-law<sup>44</sup> or in an explicit agreement,<sup>45</sup> assessment of the conditions usually considered in advancing credit is shallow at best. The undertaking is frequently only a naked promise of repayment, unaccompanied by an assessment of credit worthiness or secured by collateral.<sup>46</sup> In the context of a criminal case, obligations of repayment are especially hollow: recipients who are vindicated qualify for indemnification while those who are unsuccessful on the merits frequently face punitive fines or incarceration with few assets available for repayment.

### **C. The Legal Framework for Advancement of Legal Fees**

Advancement of fees is typically governed by state corporation law.<sup>47</sup> The Delaware model of permissive advancement provides organizations with enormous discretion as to whether and under what circumstances they will advance legal fees to agents facing criminal liability.<sup>48</sup> The extent to which organizations offer advancement may vary based on the form of organization,<sup>49</sup> the cost and availability of liability insurance,<sup>50</sup> and the expanding scope of white collar crime.<sup>51</sup> Nonetheless, some commonalities exist both in policies supporting advancement of fees and the legal framework used to facilitate advancement.

A frequent justification for advancement of legal fees is the unexamined,<sup>52</sup> but often repeated observation, that such action is a necessary inducement to encourage capable men and women to serve in positions of responsibility,<sup>53</sup> and to encourage prudent risk taking.<sup>54</sup>

For the most part, in upholding claims for advancement, courts generally have refrained from sweeping pronouncements of public policy<sup>55</sup> and focused instead on the mundane task of recruiting corporate talent.<sup>56</sup> Yet, while advancement of fees may have an incidental benefit in recruiting or retaining talent, the vicarious nature of organizational criminal liability<sup>57</sup> provides a far more compelling justification for corporate advancement. The same misconduct which is sufficient to support individual charges can give rise to organizational criminal liability as well.<sup>58</sup> Consequently the legal strategy of an individual defendant can have an enormous influence on the litigation facing the corporation.<sup>59</sup> For example, if a targeted employee proceeds to trial and is found guilty, her conviction may foreclose certain organizational defense strategies in a companion civil case and may provide potential plaintiffs with valuable information for use in a civil trial.<sup>60</sup> In other instances, a targeted employee might accept an offer of immunity in exchange for information against other executives.<sup>61</sup> Far more than the need

to attract top-level talent, or altruistic notions of right to counsel, the decision by organizations to advance fees has been prompted by a desire to create a first line of defense against charges of organizational criminal liability.

The determination of whether an organization will advance fees is still determined within the framework of contract law. Contracts requiring advancement of legal fees generally fall into three categories: (i) provisions negotiated as part of an employment or consulting agreement, or a specific agreement executed at the initiation of an investigation;<sup>62</sup> (ii) commitments contained in organizational documents, such as bylaws or board resolutions, or written policies;<sup>63</sup> or (iii) implied-in-fact agreements based on an organization's course of dealing with other employees.<sup>64</sup>

Specific provisions concerning indemnification and advancement of legal fees, as well as the scope of coverage provided by directors and officers liability insurance are frequently included in executive level employment agreements. Such provisions frequently require no further authorization beyond what may be required by rules on officers and directors compensation.<sup>65</sup> Since they are private agreements, the specific provisions of such arrangements are not readily accessible, and unless disclosed in subsequent litigation, are not subject to shareholder review.<sup>66</sup>

The framework for interpreting contracts providing for advancement was set forth in the influential case of *Citadel Holding Corporation v. Roven*.<sup>67</sup> At issue was an indemnity agreement between Citadel Holding, and its director, Albert Roven, which required advancement of attorneys' fees and expenses incurred in defending "any action, suit, proceeding or investigation."<sup>68</sup> The agreement specifically excluded indemnification for any liability or expense related to a "violation of Section 16(b) of the Securities Act of 1934."<sup>69</sup> Roven sued Citadel when Citadel refused to advance expenses incurred in Roven's defense of a Section 16(b) claim brought against him by Citadel.<sup>70</sup> In upholding the decision of the Superior Court to compel advancement, the Delaware Supreme Court found that the exclusion of Section 16(b) liability from the requirements of indemnification had no effect on Roven's right to advancement of funds for defense of such a claim.<sup>71</sup>

*Citadel* set forth two general principles which are critical in the interpretation of contracts and by-laws providing for advancement. It effectively "decoupled" advancement from indemnification;<sup>72</sup> organizations were free to enter into contracts to advance fees for defense of claims which would not be entitled to indemnification. Moreover, while not explicit, the decision effectively positioned advancement of fees as a matter appropriate for contract - a private undertaking between the parties, which could significantly expand the rights of individual employees beyond the protections offered by the Articles and By-laws.<sup>73</sup>

While negotiated contracts explicitly treating advancement of fees are not uncommon, particularly for officers and directors, many organizations have adopted explicit By-laws requiring advancement in specified circumstances. By-law provisions have been interpreted as a matter of contract.<sup>74</sup> Where the words of the bylaw are unambiguous, courts are reluctant to look beyond the four corners of document.<sup>75</sup> Although bylaws are customarily drafted by the organizations, the interpretation of bylaw provisions has overwhelmingly favored the claimant. Courts have construed the language of by-laws to require advancement despite allegations that the claimant's action was motivated by personal greed;<sup>76</sup> that claimant fraudulently induced the organization to enter into the advancement agreement;<sup>77</sup> despite allegation that payment of advancement might result in financial hardship to the organization;<sup>78</sup> and after a claimant admitted under oath to deliberate falsification of financial statements.<sup>79</sup> Courts appear to be unwilling to rescue sinners who "find religion":<sup>80</sup> organizations who, regretting of past transgressions, implore the courts to adopt "rigorous interpretation of loosely written bylaws."<sup>81</sup> In refusing to look outside of the specific language of the bylaw, courts effectively reaffirm that the organization itself must strike the "proper balance between seeking able bodied persons to serve as directors and officers and safeguarding the expenses advanced by the company...."<sup>82</sup> Strikingly absent from such decisions is any reference to other corporate stakeholders or to the community at large.

A notable exception to this trend was the case of *Fidelity Federal Savings and Loan Association v. Felicetti*.<sup>83</sup> The claimants in *Felicetti* sought advancement of fees for defense of a criminal matter under the provision of the corporate by-laws which provided for mandatory advancement.<sup>84</sup> The directors rejected the claim, based on language in the bylaws that required the directors act in the best interests of the company.<sup>85</sup> In upholding the directors' decision, the court observed that the *Felicetti* directors, having determined that advancement of fees was not in the best interest of the company, had a fiduciary duty to reject advancement.<sup>86</sup> In effect, the *Felicetti* court recognized a duty which superseded the contract provisions of the by-law. However, *Felicetti* stands alone; other courts have either distinguished the case on its facts<sup>87</sup> or effectively rejected its reasoning outright,<sup>88</sup> effectively insulating agreements from the interests of third parties.

Whatever strictures the courts are willing to impose on By-law provisions which require advancement appear to be grounded in equitable principles.<sup>89</sup> However, as a practical matter, organizations relying on the doctrine of "unclean hands" to defeat a provision requiring advancement have had little success. In *Homestore, Inc. v. Tafeen*,<sup>90</sup> for example, although the court found that intentionally sheltering assets to defeat and organization's ability to recoup advances would amount the "unclean hands,"<sup>91</sup> in a subsequent ruling<sup>92</sup> the court found that the claimant's extravagant lifestyle and purchase of an expensive home in a state with strong homestead protection,<sup>93</sup> was insufficient to establish unclean hands and bar advancement.<sup>94</sup>

Absent an arms length agreement, a by-law provision or an authorization from the board, claimants seeking advancement of fees must establish an implied-in-fact contract to advance fees.<sup>95</sup> Implied-in-fact contracts have the same legal effect as express agreements;<sup>96</sup> however, the determination of whether an implied-in-fact contract exists requires inquiry into the behavior of the parties, and an assessment of whether such conduct infers mutual consent.<sup>97</sup> Such was the situation in the case

of *United States v. Stein*<sup>98</sup> in which a number of employees alleged that their employer, KPMG, had succumbed to prosecutorial pressure and breached their obligation to advance fees to employees facing indictment.<sup>99</sup> While some employees had the benefit of explicit contracts which obligated KPMG to advance fees,<sup>100</sup> other employees relied on an implied-in-fact contract based on KPMG's "uniform past practice" of advancing fees to employee targets.<sup>101</sup> In rejecting the district court's exercise of ancillary jurisdiction over the advancement claims,<sup>102</sup> the United States Court of Appeals for the Second Circuit identified some of the difficulties in establishing an implied-in-fact agreement for advancement when it noted that "it would require scrutinizing decades of ... conduct, determining the states of minds of hundreds of individuals [and] applying the findings from those inquiries to the particular circumstances of each appellee...."<sup>103</sup>

### III. Changing the Landscape: Current Influences on the Advancement of Legal Fees

For all of the twentieth century, organizations had virtually no reason to limit advancement of fees to employees who were under criminal investigation.<sup>104</sup> However, changes in the manner of investigating and prosecuting white collar crime in the prompted a reconsideration of organizational policies on advancement which has significant implications for individuals facing criminal liability.

#### A. Changing the Equation: the Thompson Memorandum

The confluence of individual and organizational interests in the face of a criminal investigation posed significant challenges for prosecutors. Without corporate cooperation to focus and guide an investigation, prosecutors could potentially squander limited resources on activities unlikely to result in a conviction.<sup>105</sup> In 2003, Deputy Attorney General Larry Thompson issued a policy directive (the "*Thompson Memorandum*")<sup>106</sup> designed to encourage organizational cooperation in a criminal investigation of white collar crime. In effect, the *Thompson Memorandum* permitted corporations to trade cooperation for a prosecutor's agreement to indefinitely defer prosecution.<sup>107</sup>

The *Thompson Memorandum* identified the factors the United States Attorney's Office would consider in evaluating corporate cooperation,<sup>108</sup> including "[a] corporation's promise of support for culpable<sup>109</sup> employees and agents ... through the advancing of attorneys' fees...."<sup>110</sup>

The canny application of the *Thompson Memorandum* by prosecutors created a fissure between an organization and its employees.<sup>111</sup> Capping or terminating legal fees, or conditioning fees on employee waivers of constitutional protection was a signal flare sent to a prosecutor that an organization was "cooperating" in an effort to "catch the crooks."<sup>112</sup>

The *Thompson Memorandum* was the subject of extensive criticism<sup>113</sup> which culminated in the case of *United States v. Stein*.<sup>114</sup> In a carefully crafted opinion, the court held that the policies of the *Thompson Memorandum* and the actions of the prosecutor had resulted in actions which violated the Sixth Amendment right to counsel,<sup>115</sup> and the Fifth Amendment right to due process.<sup>116</sup>

In an effort to respond to *Stein* and to forestall legislative action,<sup>117</sup> the Department of Justice issued a series of memoranda intended to clarify and limit the factors considered in evaluating organizational cooperation in charging decisions.<sup>118</sup> The most recent directive, popularly called the "*Filip Memorandum*,"<sup>119</sup> bars prosecutors from considering an organization's advancement of legal fees in evaluating organizational cooperation,<sup>120</sup> and prohibits prosecutors from requesting that an organization terminate such actions.<sup>121</sup> However, the *Filip Memorandum* does not bar "routine questions" regarding legal representation, including payment arrangements,<sup>122</sup> and it specifically considers advancement of fees where such action is part of an effort at obstruction.<sup>123</sup> In addition, the *Filip Memorandum* does not prohibit prosecutors from considering an organization's advancement of fees when deciding whether to enter into a plea bargain.<sup>124</sup>

#### B. Advancement of Legal Fees after *Stein*

Despite the relatively brief duration of the *Thompson Memorandum*,<sup>125</sup> the lingering effect has been to put the advancement of legal fees "in play" in the context of organizational criminal liability. The *Thompson Memorandum* was neither an innovative nor solitary policy. Rather, it was one example of what has been termed the government's "regulation" of criminal defense counsel – a subtle intrusion of government into the purview of criminal defense.<sup>126</sup> While the *Stein* cases and the *Filip Memorandum* may have restrained prosecutors from pressuring organizations to restrict advancement of legal fees, it did not limit an organization's power to voluntarily restrict or reduce advancement, or to structure advancement to curry prosecutorial favor. Moreover, an organization's posture on indemnification and advancement may also be considered in the penalty phase of a proceeding in determining sentencing under the federal Sentencing Guidelines for Organizations.<sup>127</sup> Proposed changes to the Organizational Sentencing Guidelines<sup>128</sup> suggest that corporate treatment of "wrongdoers" may continue to garner scrutiny as an indication of whether the organization is fostering an ethical work climate.<sup>129</sup> As Professor Coffee observed, "A funny dance will occur.... Corporations will remain under pressure to do anything the government wants even though the government can't officially ask for it."<sup>130</sup> Prescient organization may well choose to keep their options open with regard to advancement, retaining sufficient flexibility to ensure that advancement is used to further the organization's own interests, however such interests are best served.

Whatever its constitutional failings, the *Thompson Memorandum* implicitly reaffirmed the principle that advancement of legal fees is a private matter between organizations and their employees. Even when operating under the *Thompson Memorandum*, the government did not demand that an organization breach its contractual obligations.<sup>131</sup> This fact has led one commentator to suggest that explicit contracts requiring advancement is the best defense against even the most aggressive prosecutor.<sup>132</sup>

If the creation of explicit, well crafted language on advancement provides some protection against prosecutorial pressure, such provisions can also extend the influence already enjoyed by organizations whose employees face criminal investigation.<sup>133</sup>

The existence of an organizational “benefactor” – an organization which pays for counsel both for itself and the target employee,<sup>134</sup> invests an organization with subtle influence on employees benefiting from the advancement<sup>135</sup> – an influence which is compounded by the use of joint defense agreements.<sup>136</sup> Whatever ethical dilemmas are raised by the organization’s benefactor status appears to be laid solely at the feet of counsel,<sup>137</sup> not at the organization advancing fees.<sup>138</sup> While the Code of Professional Conduct requires counsel to exercise his independent professional judgment in advising clients,<sup>139</sup> there appears to be no prohibition on an organization recommending counsel who, in the words of KPMG’s counsel “understands that cooperation is the best way to go in this type of case.”<sup>140</sup>

Organizational influence on selection of counsel need not be subtle; there appears to be few impediments<sup>141</sup> to organizations’ negotiating or imposing whatever restrictions or conditions on advancement they deem advisable.<sup>142</sup> Clearly drafted conditions or restrictions on advancement, including selection of counsel provisions, will be upheld and enforced by the courts. In *Tafeen I*, for example, the court noted without comment that the claimant agreed as a condition to advancement, that the corporation would have the right to approve the identity and rates of counsel and staff retained by the claimant; that claimant’s counsel could not undertake any extensive research project without prior approval of the corporation; that on-line research was to be limited to \$1000.00/month; and that the only one attorney could attend interviews and legal proceedings, unless prior approval was given in advance by the corporation.<sup>143</sup> The court suggests that such provisions would be defeated only in cases where the restrictions are so severe as to virtually deny meaningful access to counsel.<sup>144</sup>

The new realities of post-*Stein* prosecution have put organizations firmly in control of the advancement decision. Any organization served by knowledgeable counsel can deduce that advancement of fees remains a significant bargaining chip in the event of a criminal investigation. If they deem it advisable to cooperate, organizations can use advancement conditions to encourage employees to waive constitutional protections and make statements. If they deem it advisable to mount a unified defense, selection of counsel provisions and other conditions may encourage greater alignment of organizational and individual legal strategies. While in the short term the realities of renegotiating contracts or amending bylaws suggest that advancement will proceed in much the same way as pre-*Stein*, in the long term, savvy organizations may place greater reliance on explicit contracts to leverage advancement of fees in their own best interests.<sup>145</sup>

#### **IV. Examination of the contract Paradigm and Proposal for a Duty Paradigm**

A review of the legal landscape suggests that the jurisprudence of advancement of legal fees is firmly rooted in contract law,<sup>146</sup> a private arrangement between interested parties intent in protecting their own interests. Moreover, *Stein* and its legislative progeny<sup>147</sup> suggest that any scrutiny of this arrangement by ham-handed prosecutors will be rebuffed. In light of this, it seems appropriate to reconsider the contractual underpinnings of advancement to determine whether such a framework operates in the best interests of all the constituencies affected by the advancement of legal fees.

##### **A. Limitations of Contractual Model as a Basis for Advancement of Legal Fees**

In its simplest form, a contract is an exchange of promises created obligations which are legally enforceable.<sup>148</sup> Influenced by the seminal work of Ronald Coase,<sup>149</sup> courts have used the construct of a contract as the legal infrastructure for consideration of numerous relationships.<sup>150</sup> Coasean theory suggests that the ability of the parties to bargain over property rights and reallocate such rights in accordance with their own best interests will result in the most efficient treatment of external costs.<sup>151</sup> In Coasean “jurisprudence,” the optimal role of the law is to “get out of the way” of the parties agreement so that the rights can be efficiently transferred.<sup>152</sup> In effect, there is no right which cannot be bargained, sold, purchased or traded.

Whatever economic efficiencies are gained by a Coasean approach, there are two salient features of a contract which make its application to the advancement of legal fees ethically problematic: the first is the nature of a contract as a bargained-for exchange; the second is the character of contract as “private” laws.

Not all “contracts” for advancement stand in pari passu. As a practical matter, explicit provisions contained in arms length agreements are expansive; there appears to be no outer limit on the generosity or scope of advancement.<sup>153</sup> The contours of advancement are left to the bargaining power of the parties themselves who are free to pursue their own best interests. This structure results in inherent inequities among employees within the same organization<sup>154</sup> and potentially among individuals employed by different types of organizations.<sup>155</sup> Moreover, the very employees who are likely to have

negotiated the most expansive provisions for advancement of fees are frequently the ones most likely to influence corporate policies on advancement.<sup>156</sup> The result is an inverted model of individual responsibility where those vested with the greatest power to deter misconduct also have the greatest insulation against misconduct.<sup>157</sup>

Mid-level and lower level employees who have not negotiated explicit agreements must rely on organizational bylaws or an implied-in-fact agreement to secure advancement of fees in a criminal matter. Yet, even a generous interpretation of the contractual form of an implied contract is strained when it is applied to advancement of legal fees. An implied contract is one in which the circumstances suggest that the parties have reached an agreement, even though the agreement is not express.<sup>158</sup> The idea that middle and lower level managers have reached any “agreement” with their employer on the issue of advancement of fees strains credulity. Candidates for employment seldom inquire as to an organization’s policies or past behavior on advancement of fees. Moreover, there may be psychological and sociological barriers to even making an inquiry, particularly as it relates to a criminal action. The reality of the contract for advancement is a far cry from the contract model of “two alert individuals, mindful of their self-interest, hammering out an agreement by a process of hard bargaining.”<sup>159</sup>

Sidestepping these realities, courts adopt a pragmatic approach. Courts effectively treat organizational by-laws and past practices of the firm as part of an agreement that an employee effectively accepts upon employment – despite the fact that an employee may not even have inquired about the existence or the terms of such an arrangement until faced with a criminal investigation. In practice, however, the arrangement is not really a *contract*, but *something like a contract*. Because the arrangement is not negotiated – or even reviewed – prior to an employee’s acceptance of employment, there are few “checks” on the organization’s power to structure advancement of fees as it sees fit, with little risk of paying a penalty in terms of lost talent.<sup>160</sup> While the implied covenant of good faith and fair dealing<sup>161</sup> provides some limit on how an organization utilizes its discretion in interpreting this “contract,”<sup>162</sup> there are limits to the application of such concepts. The obligation to act in good faith comes into play only *after* the parties have entered into an agreement;<sup>163</sup> it does not adjust for disparities in bargaining power nor does it contravene specific terms of the agreement.<sup>164</sup> Moreover, the use of such equitable considerations are effectively a last resort; they do little to mitigate the *in terrorem* effect that a potential termination of advancement would have on an employee embroiled in a criminal investigation. The result is potentially a two tiered system, with explicit contracts providing expansive advancement and indemnification for top executive talent, and potentially less protective provisions for all other managers.<sup>165</sup>

A second characteristic of contract law which renders it inadequate as a theoretical basis for advancement of fees is its character as a “private law” - that part of the law relating to the rights and relationships of individuals as opposed to their dealings with the state.<sup>166</sup> In providing a method for legal enforcement of such private laws, the state can be seen as delegating power to its citizens in the interests of allowing them to regulate their own affairs.<sup>167</sup> In practice, private laws are left to the negotiation of private parties who are generally at liberty to negotiate to protect their own interests, without regard to the larger good. While the ability of parties to exercise absolute and complete autonomy in the subject of their contract has been circumscribed by principles of equity and public policy,<sup>168</sup> such considerations, however, have rarely been used to void either advancement or indemnification agreements.<sup>169</sup>

Utilizing the private law structure of contracts effectively insulates the decision to advance legal fees from the concerns of other constituencies who are not parties to the contract.<sup>170</sup> As one scholar observed: “If the contract... is “knowingly” and “feely” made by the parties, then ... its performance makes each of the parties better off and creates a larger pie for society....”<sup>171</sup>

The insularity of contractual provisions results in a misallocation of resources, with negative implications for the administration of criminal justice. An optimal system of criminal justice would provide for sufficient resources to protect fundamental rights of fairness without frustrating the system by frivolous maneuvers.<sup>172</sup> As one commentator noted succinctly, “[D]efense resources should be scant when they hurt accuracy [of a criminal verdict] and ample when they aid it.”<sup>173</sup> There is nothing to suggest that private contracts providing for advancement come close to achieving this objective. A contractual model risks channeling excessive resources to those with the greatest bargaining power,<sup>174</sup> and minimal resources to employees who are deemed expendable.<sup>175</sup> Individual defendants have a keen interest in maximizing the funds available for their defense;<sup>176</sup> organizations, while generally sharing in this objective, have an interest in using advances as a “carrot” to secure behavior which benefits their own legal strategy.<sup>177</sup> At the hypothetical bargaining table, where organizations and their employees “agree” on advancement provisions, there is no place set for the prosecutor or the community at large.

## **B. Toward a Duty Model of Advancement**

The term “duty” is an umbrella term, covering a myriad of relations and obligations, both legal<sup>178</sup> and ethical.<sup>179</sup> While legal duties are created by contract,<sup>180</sup> they also may also be found at common law<sup>181</sup> or prescribed by statute. While arguably contractual duties are voluntarily and knowingly undertaken by the parties,<sup>182</sup> statutory or common law duties are imposed, without the explicit assent of the parties. In many instances, statutory or common law duties are rooted in ethical duties;<sup>183</sup> in other instances, they reflect a community decision on risk allocation.<sup>184</sup>

Perhaps the most significant distinction between contractual duties and other legal and ethical duties is the consideration of interests beyond those of the immediate parties to the contract. In construing a contract, a court is almost exclusively

concerned with the interests and positions of the parties themselves; it need not look beyond the metaphorical bargaining table. In contrast, in those instances where the court discerns a duty outside of the context of a specific contract, judicial considerations are broader. In such circumstances, the court strikes a balance, not only between the rights and obligations of the immediate parties, but all similarly situated parties, without regard to their effective bargaining power.<sup>185</sup>

It is difficult to predict when the courts will discern a duty of one party to another. Like Justice Stewart's pithy observation on obscenity, "I know it when I see it,"<sup>186</sup> it is frequently much easier to recognize a duty in a particular context than to generalize when the imposition of a duty is appropriate. The traditional definition of "duty" – a "legal obligation that is owed to another"<sup>187</sup> – is not particularly illuminating. While there appears to be consensus that the duty arises because of a "relationship" between the parties,<sup>188</sup> the determination of which relationships give rise to a duty and the scope of such duty is one of "shifting sands."<sup>189</sup> A court which did attempt to articulate a standard observed that the imposition of a duty turns on "...whether the imposition of such a duty satisfies an abiding sense of basic fairness under all of the circumstances in light of the considerations of public policy."<sup>190</sup> Dean Prosser offered a somewhat cynical but pragmatic approach when he noted, "There is a duty if the court says there is a duty."<sup>191</sup>

Not surprisingly, the theoretical basis for discernment of a duty has been most fully developed in the context of fiduciary duties.<sup>192</sup> Scholars suggest that a fiduciary relationship comes into existence when one party holds property which belongs to another, when one party is relying on the other to protect her interests, when there is a disparity of information or bargaining power or unilateral and unfettered discretion.<sup>193</sup> Courts and commentators have also noted a connection between the imposition of a legal duty and "moral rhetoric."<sup>194</sup> Cases imposing fiduciary duties refer to "standards of common decency"<sup>195</sup> and "the punctilio of an honor the most sensitive is ... the standard"<sup>196</sup> to describe the obligations owed by a fiduciary. In a general sense, the imposition of a duty occurs when the contract paradigm is somehow inadequate, either because of the relationship of the parties or the nature of the subject matter makes the use of a contract model inappropriate.<sup>197</sup>

There are two conditions which support use of a duty model for analyzing advancement of legal fees: the nature of the relationship between an organization and an employee facing criminal liability; and the critical nature of advancement in the context of criminal liability.

The relationship between employees and the organizations that employ them is generally symbiotic: each is dependant upon the other and receives reinforcement from the other.<sup>198</sup> Although the ability of an organization to avoid criminal misconduct is dependant upon the knowledge and good will of its employees,<sup>199</sup> employees may not fully comprehend the implications of a criminal investigation<sup>200</sup> and they may depend on the organization for guidance as to what constitutes compliant behavior.<sup>201</sup> The asymmetric knowledge and dependency which characterize this relationship make it virtually impossible for most employees to discuss – much less negotiate – contractual provisions providing for advancement.

It would appear to be a self-evident proposition that except perhaps at the highest levels within an organization, there are few instances in which the organization's policy on advancement of attorneys' fees is a topic of inquiry during the employment process. It is a confident candidate who can inquire of a putative employer: "And, in the event of a criminal investigation, can you assure me that the company will advance fees for my representation?" Most employees neither know nor inquire about an organization's policy on advancement of fees.

Except where the employee candidate is an attorney knowledgeable in organizational criminal prosecution, it may also be assumed that most employees have little appreciation for the potential conflicts which arise when both an individual and an organization are facing a criminal investigation.<sup>202</sup> It is reasonable for employees to assume that the interests of the employee and the corporation facing indictment are congruent and that the organization will have ample incentive to advance legal fees.<sup>203</sup> In contrast, sophisticated organizations regularly served by counsel have some appreciation of the potential conflicts which arise when both individuals and organizations face criminal charges.<sup>204</sup> While disparities in knowledge and differential valuing of risk frequently characterize contract negotiations, in the context of advancement, candidates for employment may be ignorant, not only of the subject matter of their hypothetical bargain, but of the fact that they are making a bargain at all. The asymmetric knowledge of the parties and the naiveté or ignorance with which most employees approach the issue suggests that advancement of fees in a criminal matter is not appropriate subject matter for a contract.

While the asymmetric knowledge of employees and the organization which employs them frequently prevents any meaningful pre-employment agreement on the issue of advancement, once an agent has accepted employment, other factors appear which further support a duty analysis of advancement. The decision to accept employment with an organization is a decision to join a tribe, to participate in a culture, and to abide by the norms of that group.<sup>205</sup> The impact of the organization in shaping individual behavior has been a fertile area of study.<sup>206</sup> Whether consciously or not, individuals entering into an employment relationship relinquish a degree of autonomy at the office cubicle.<sup>207</sup>

The influence of organizational culture is particularly pronounced in attitudes toward unethical and unlawful behavior.<sup>208</sup> An organization's "ethical climate" will influence which ethical issues are even identified and, once identified, how such conflicts are resolved.<sup>209</sup> Moreover, in the context of white collar crime, employees may lack the expertise or sophistication to recognize the impropriety of their actions or that of the organization. Unlike street crime, the link between white collar crime and the patently immoral or violent behavior which have been the traditional concern of criminal liability can be attenuated.<sup>210</sup> Criminalization of what some view as legitimate, albeit aggressive business practices,<sup>211</sup> coupled with diminished *mens rea* requirements<sup>212</sup> can effectively impose liability for "being a bad manager."<sup>213</sup> While some employees

may be recruited precisely because of their familiarity with the legal environment, or for the purpose of ensuring organizational compliance, for other employees such knowledge is tangential to their core competencies.<sup>214</sup> In such situations, employees are dependant on the organization to provide practical, industry specific guidance on the legal obligations and organizational support for compliant behavior.<sup>215</sup>

In those instances where an employee's conduct makes her the subject of a criminal investigation, it can be impossible to determine whether such behavior stems from inadequate training, a crimogenic culture or the employee's intentional disregard of corporate policies. In such circumstances, it is not unreasonable to discern an obligation to advance fees and expenses— even if organizational self-interest might suggest it is time to “throw the employee under the bus.” While there remain important questions as to the extent and duration of such advancement,<sup>216</sup> the difficulty of defining the contours of the duty should not obscure the existence of the duty itself.

While both asymmetric knowledge and dependency undercut the autonomy and self-interest which is the fundamental assumption of contract law, such factors are not universally applicable. High level executives may be well counseled on the risks of criminal prosecution and may have both the responsibility and the opportunity to be a shaper of organizational culture. Yet, even where knowledge is not asymmetric, and even where an agent has significant influence over organizational culture, the critical influence of advancement in the context of white collar crime make it an inappropriate subject for a private bargain.

The difficulty and complexity of investigating and prosecuting white collar crime makes timely access to counsel essential to an effective defense. White collar investigations are characterized by what has been termed, “procedural overbreadth”<sup>217</sup> - a situation where criminal procedure applies even *before* it is determined whether a crime has been committed.<sup>218</sup> Moreover, the panoply of “secondary offenses”<sup>219</sup> such as obstruction of justice or lying to the prosecutor raise the real possibility that an employee may be convicted of a crime which is committed *after* the investigation has begun.<sup>220</sup> Without early access to knowledgeable counsel,<sup>221</sup> an individual may do irreparable damage to her own defense.<sup>222</sup>

In addition to impact on targeted employees, decisions on advancement have significant implications for the administration of criminal justice. Together with indemnification provisions, advancement of legal fees is a significant mechanism for allocating the risk of liability for white collar crime.<sup>223</sup> Historically, advancement and indemnification provisions shifted some of the risk of pursuing aggressive or innovative business strategies from the individual to the organization which he served.<sup>224</sup> In the era of the Thompson Memorandum, organizations discovered that the terms of advancement could be used to shift risk *from* the organization and *back* to the individual actor,<sup>225</sup> resulting in what one commentator called “inverted entity liability” - a situation in which individuals are indicted while charges against the organization are deferred.<sup>226</sup> Whether the fulcrum is positioned to assist the government in making its case<sup>227</sup> or the individual defendant in defending against personal liability, under the current contract paradigm, the decision on advancement is being made without regard to the interest of the larger community in the fair and efficient administration of criminal justice.<sup>228</sup>

The contract paradigm of advancement decisions presents challenges even for the most well intentioned organizations intent on considering the ethical implications of their actions. The recent prosecutorial climate suggests that organizations must triangulate between ethical obligations to targeted employees and to shareholders and other constituencies.<sup>229</sup> Even assuming that corporations are capable of acting ethically,<sup>230</sup> balancing multifaceted obligations to targeted employees and other internal constituencies can overwhelm whatever ethical model organizations have in place. Faced with such complexities, which are frequently played out against the backdrop of a potentially fatal indictment of the organization, can organizations be blamed if they fail to get it “right”?

Advancement of legal fees is far too important to be analyzed against a contractual infrastructure. Use of a contract model allocates “too much” counsel to those with significant bargaining power, and “too little” counsel to those who lack knowledge and are most dependent on the organization. Contractual treatment of advancement of fees distorts the criminal justice system by encouraging an inefficient allocation of resources, without a corresponding increase in accuracy.<sup>231</sup> While determination of the optimal deployment of resources is neither simple nor uniform,<sup>232</sup> a model which excludes consideration of the interests of a key constituency is bound to be inadequate.

Defining a duty which balances the legitimate needs of defendants and obligations to organizational stakeholders and the criminal justice system is bound to be imprecise, with myriad arguments as to where to strike a balance. The courts, certainly no strangers to the identification and imposition of duties, have failed, for the most part,<sup>233</sup> failed to consider the interests of other stakeholders because of the strictures of the contract paradigm. While acknowledging that treatment of advancement provisions has an “admittedly maddening aspect,”<sup>234</sup> courts have nonetheless laid the responsibility for balancing the needs of targeted employees and other stakeholders on the board of directors. The likelihood of the courts reversing a hundred year old contract model of advancement is small. Any change if it is to occur at all, is likely to be legislative.

Current laws regarding advancement are “strikingly lax,”<sup>235</sup> essentially abdicating responsibility to the parties themselves.<sup>236</sup> The Attorney Client Privilege Protection Act,<sup>237</sup> which *inter alia* purports to guard against consideration of advancement policies as evidence of organizational cooperation,<sup>238</sup> misses an opportunity to sketch the contour of a duty to advance fees, by neither delineating a minimum level of advancement nor identifying when advancement becomes so excessive as to undermine the interests of other stakeholders.

The MBCA<sup>239</sup> which has been adopted in a number of states,<sup>240</sup> suggests some minimum criteria which should be a prerequisite to advancing of fees,<sup>241</sup> but leaves undisturbed the structure of permissive advancement.

The most thoughtful consideration of the implications of advancement policies and the most expansive in terms of defining a duty of advancement are contained in the Minnesota business corporation law.<sup>242</sup> The Minnesota statute provides for mandatory advancement unless the organization “opts out” of the statutory requirement through an explicit provision of its articles or by-laws.<sup>243</sup> The statute is unique in that any “opt out” must apply equally “to all persons within a given class,”<sup>244</sup> although the statute does not prohibit disparate treatment for different classes of agents.<sup>245</sup> The Minnesota Act also suggests a bias toward “reimbursement” and against “overcompensation.”<sup>246</sup> While no silver bullet solution, the Minnesota statute represents a first step in a conscious and public consideration of advancement of legal fees and represents a concerted effort to strike a viable balance in satisfying the legitimate needs of various constituencies.

## V. Conclusion

The issue of advancement is too important to be treated to be left to the vagaries of totally private negotiation between parties with disparate bargaining power and sophistication. Such a model serves neither the larger interests of the community in administering criminal justice, nor, in many instances, the interests of the parties themselves.<sup>247</sup>

A conscious repudiation of the contract model is the first step toward balancing the legitimate needs of the affected parties. Whether such consideration occurs in the courts or the legislature, the transparency of the process – freed from back-room negotiation of private parties or heavy handed attempts at influence by the prosecutor – will be an improvement over the current system

The shift to a duty paradigm ensures consideration of other factors not normally considered in the contract context. Without a duty based paradigm in determining advancement, the situation is not unlike the one faced by a modern-day Jabez Stone: it will be left to the corporation to decide whether the devil or Daniel Webster wins the case.

## Footnotes

---

<sup>1</sup> Stephen Vincent Benet, *The Devil and Daniel Webster*, in 2 SELECTED WORKS OF STEPHEN VINCENT BENET 32-46, (1942).

<sup>2</sup> *Id.* at 33-34. It is interesting to note that Jabez deceives his family about the identity of the devil by telling them that the devil is “a lawyer, come to see him.” *Id.* at 33.

<sup>3</sup> *Id.* at 39-41.

<sup>4</sup> Unless the context requires otherwise, as used in this article, the term “organization” refer to any form of business enterprise, including corporations, limited liability entities and partnerships.

<sup>5</sup> See *infra* notes 146-232 and accompanying text.

<sup>6</sup> See *infra* notes 13-103 and accompanying text.

<sup>7</sup> See *infra* notes 62-103 and accompanying text.

<sup>8</sup> See *infra* notes 104-145 and accompanying text.

<sup>9</sup> See *infra* notes 146-246 and accompanying text.

<sup>10</sup> See *infra* notes 148-177 and accompanying text.

<sup>11</sup> See *infra* notes 178-232 and accompanying text.

<sup>12</sup> See *infra* note 247 and accompanying text.

<sup>13</sup> *Homestore, Inc. v. Tafeen*, 888 A.2d 205, 211 (Del. 2005) (advancement provides corporate officials with immediate relief from burden of expenses related to legal proceedings).

<sup>14</sup> While historically the purchase of insurance for the purpose of advancement and indemnification was deemed *ultra vires*, today purchase of insurance for such purposes is specifically authorized by state corporation law. Edward Paul Mattar, III & John Francis Hilson, 46 J. RISK & INSURANCE, 411, 422(1977). See *e.g.* DEL. CODE ANN. tit.8 §145 (g) (2009).

<sup>15</sup> *Homestore*, 888 A.2d at 211.

<sup>16</sup> See *infra* notes 17-35 and accompanying text.

<sup>17</sup> Stephen A. Radin, “Sinners Who Find Religion:” *Advancement of Litigation Expenses To Corporate Officials Accused of Wrongdoing*, 25 REV. LITIG. 251, 257-58(2006).

<sup>18</sup> Chester F. Relyea, *Indemnification of Management for Litigation Expenses*, 52 MICH. L. REV. 1023, 1028 (1954).

<sup>19</sup> Joseph W. Bishop, Jr., *Current Status of Corporate Directors’ Right to Indemnification*, 69 HARV. L. REV. 1057, 1068-69 (1956) (common law grounds for director’s right to indemnification is a “welter of confusion”); Edward Brodsky & M. Patricia Adamski, LAW OF CORPORATE OFFICERS AND DIRECTORS §19:1 (2009) (common law right to reimbursement was uncertain). *But see* Relyea, *supra* note 18, at 1025-28 (courts tend to award indemnification for costs incurred in successful defense of an action, even in the absence of a specific statute).

<sup>20</sup> 173 Misc. 106 (Sup.1939).

<sup>21</sup> *Id.* at 109. The *New York Dock* court held that a director’s position was “sui generis” and that principles of agency which might require indemnification were a “rule of guidance rather than a rule of law.” *Id.*

---

<sup>22</sup> At least one commentator suggests that the consternation of corporate directors and officers was fed in part by “propaganda of underwriters pushing insurance.” Joseph W. Bishop, Jr., *Sitting Ducks and Decoy Ducks: New Trends in the Indemnification of Corporate Directors and Officers*, 77 YALE L. J. 1078, 1078 (1968).

<sup>23</sup> Reylea, *supra* note 18, at 1029-1030 (*New York Dock* prompted adoption of statutes and by-laws requiring indemnification); Pamela H. Bucy, *Indemnification of Corporate Executives Who Have been Convicted of Crimes: An Assessment and Proposal*, 24 IND. L. REV. 279, 283 (1991) (*New York Dock* sparked a “new generation” of statutes with expansive coverage).

<sup>24</sup> All fifty states have enacted legislation treating indemnification. 2 William E. Knepper & Dan A. Bailey, LIABILITY OF CORPORATE OFFICERS AND DIRECTORS §22.02 (2d ed. 2002).

<sup>25</sup> *Id.* (Delaware indemnification law has served as a pattern in many states). See also Bucy, *supra* note 23, at 287-326 for a description of the basic patterns followed by state laws.

<sup>26</sup> DEL. CODE ANN. tit. 8 §145 et seq. (2009).

<sup>27</sup> The provisions of Section 145 are expansive and are applicable not only to existing corporations, but also to their constituent entities. *Id.* §145(g) However, there can be significant variation with respect to indemnification with regard to rights of other entities. See e.g. *Delphi Easter Partners Ltd. P’ship v. Spectacular Partners, Inc.*, Civ. A. No. 12409, 1993 LEXIS 159, at \*22 (Del. Ch. Aug. 6, 1993) (corporate indemnification statutes are significantly more restrictive than the Delaware Revised Uniform Limited Partnership Act).

<sup>28</sup> DEL. CODE ANN. tit. 8 §145(c) (2009)(*emphasis added*).

<sup>29</sup> *Id.* §145(a).

<sup>30</sup> *Id.* §145(e). See also *Kaung v. Cole. Nat. Corp.*, 884 A.2d 500, 509 (Del. 2005) (advancement fills the gap prior to a determination of mandatory indemnification).

<sup>31</sup> *Citadel Holding Corp. v. Roven*, 603 A. 2d 818, 822 (Del. 1990).

<sup>32</sup> *Advanced Mining Systems, Inc. v. Fricke*, 623 A.2d 82, 84 (Del. Ch. 1992) (mandatory indemnification does not impose obligation to advance fees prior to termination of case); *Homestore*, 888 A.2d at 212 (Delaware law on permits advancement of expenses but does not require it).

<sup>33</sup> *Ridder v. Cityfed Financial Corp.*, 47 F.3d 85, 87 (3d Cir. 1995), *citing* *Citadel Corp. v. Roven*, 603 A.2d 818, 822 (Del. 1992) (further citations omitted). See also Bucy, *supra* note 23, at 316-17 (numerous states require no assessment of eligibility for indemnification as a condition to advancement).

<sup>34</sup> Access to knowledgeable counsel early in an investigation has significant influence on many aspects of a criminal investigation including waiver of rights, plea bargaining and pressure to withstand prosecutorial pressure to accede to unsupportable charges. Darryl K. Brown, *Executive Branch Regulation of Criminal Defense Counsel and the Private Contract Limit on Prosecutor Bargaining*, 57 DEPAUL L. REV. 365, 385-86(2008). See also Nishchay H. Maskay, *The Constitutional of Federal Restrictions on the Indemnification of Attorneys’ Fees*, 156 U. PA. L. REV. 491, 544-45 (2007) (limited resources can pressure employees to accede to prosecutor demands even though no charges have been filed).

<sup>35</sup> *Ridder*, 47 F.3d at 87.

<sup>36</sup> Bucy, *supra* note 23, at 287. The Model Business Corporation Act, a variant of which has been adopted in many states provides for indemnification if the claimant met certain identified standards of conduct, primarily that he have acted in good faith. MODEL BUS. CORP. ACT §§8.50-8.58, (2007).

<sup>37</sup> Bucy, *supra* note 23, at 316.

<sup>38</sup> As of 1991, forty-nine states authorized corporations to advance attorneys’ fees and other expenses. Bucy *supra* note 23, at 316. The sole exception, Vermont, adopted provisions authorizing permissive advancement in 1994. VT. STAT. ANN. tit.11A §§8.53, 8.56 (2009).

<sup>39</sup> DEL. CODE ANN. tit.8 §145(e) (2009).

<sup>40</sup> MODEL BUS. CORP. ACT §8.53(2007). Section 8.53(a) permits advancement on a case by case basis, upon approval of disinterested directors or the shareholder. It conditions advancement to a director upon a written affirmation of the director’s good faith belief that she is entitled to advancement and a generally obligation to repay any advances if it is ultimately determined that the director does not qualify for indemnification. *Id.* Section 8.58 provides authority for inclusion of advancement provisions in corporate articles and by-laws, *id.* at §8.58(a), and confirms that advancement can be extended to employees and agents. *Id.* at 8.58(e).

<sup>41</sup> DEL. CODE ANN. tit.8 §145(e) (2009).

<sup>42</sup> *Fricke*, 623 A.2d at 83 (the decision to advance fees is a decision to advance credit).

<sup>43</sup> See Bucy, *supra* note 23, at 316 (statutes provide no requirement or mechanism for repayment and problem is compounded because of lack of transparency of the transaction and the “friendly relationship” which may exist between the debtor and colleagues who must seek repayment).

<sup>44</sup> See *infra* notes 74-94 and accompanying text.

<sup>45</sup> See *infra* notes 65-73 and accompanying text.

<sup>46</sup> In *Tafeen v. Homestore, Inc. (Tafeen I)*, No. Civ. A. 0-23-N, 2004 WL556733 (Del. Ch. March 22, 2004), the court did note that the bylaws providing for advancement would not limit the organizations ability to require equitable on a theory of

---

“unclean hands” if it could prove that an officer had deliberately attempted to shelter assets with the intention of defeating the undertaking given as a condition to advancement. *Id.* at \*7.

<sup>47</sup> While the vast majority of such provisions are contained in state corporation law, California provides for mandatory indemnification of all employees, including officers under the provisions of its employment statute. Cal. Lab. Code §2802 (2009).

<sup>48</sup> A few states provide for mandatory advancement of fees in certain limited circumstances. Minnesota provides for mandatory advancement of fees unless the corporation has opted out of the statutory scheme. *See e.g.* MINN. STAT. §302A.521 (2008). *See also* Barry v. Barry, 824 F. Supp. 178, 183 (D. Minn. 1993), judgment aff’d, 28 F.3d 848 (8<sup>th</sup> Cir. 1994) (advancement of fees required unless organization has prohibited it). The MBCA also provides that courts may order advancement if it determines that advancement is “fair and reasonable.” MODEL BUS. CORP. ACT §8.54(a) (3) (ii) (2007).

<sup>49</sup> *See supra* n. 27. For example, the Delaware Limited Liability Company Act, DEL. CODE ANN. tit. 6 *et seq.*, unlike the Delaware General Corporation statutes, DEL. CODE ANN. tit. 8 *et seq.*, is silent about the terms of advancement and does not require a promise of repayment in any instance. *Compare* DEL. CODE ANN. tit. 6. §18-108 with DEL. CODE ANN. tit. 8 §145(e). Members of limited liability companies would appear to enjoy even greater autonomy than corporations when structuring contracts for advancement. *See e.g.* PGA Senior Tour Players 207 Management Company LLC v. Golftown 207 Holding Company LLC, 853 A. 2d 124, 129 (Del. Ch. 2004) (right of parties to determine their respective rights via contract is critical to operation of LLC).

<sup>50</sup> Bucy, *supra* note 23, at 327 (D&O insurance may pay reimburse employees directly for eligible expenses or may reimburse organization).

<sup>51</sup> Bucy *supra* note 23, at 303-04 (expanding prosecution of crimes with reduced mens rea requirements encourages expansion of indemnification and advancement by organizations to targeted executives); John Hasnas, *Ethics and the Problem of White Collar Crime*, 54 AM. U. L. REV. 579, 602-03 (2005). *See also* John C. Coffee, Jr., *Does “Unlawful” Mean “Criminal”?: Reflection on the Disappearing Tort/Crime Distinction in American Law*, 71 B. U. L. REV. 193, 193 (1991) (the most significant development in substantive criminal law has been the blurring of civil and criminal liability).

<sup>52</sup> Such information which is available has been compiled by the insurance industry. One study, which considered the effect of the existence of D&O insurance on attracting Board room talent, found that 25% of the companies who had not obtained D&O insurance had lost some board members. Bucy *supra* note 23 at 330-31 *citing* THE 1987 WYATT DIRECTORS AND OFFICERS AND FIDUCIARY LIABILITY SURVEY 161 (1987). However, recent data shows a decline in the number of inquiries by directors about D& O insurance. TOWERS PERRIN DIRECTORS & OFFICERS LIABILITY 2008 SURVEY OF INSURANCE PURCHASING TRENDS 26. Despite the decline in inquiries, 2008 witnessed an increase in the number of companies purchasing fiduciary insurance, with forty-five percent purchasing coverage in 2008. *Id.* at 24.

<sup>53</sup> Mooney v. Willis-Overland Motors, Inc., 204 F.2d 888,898 (3d Cir. 1953) (promise of reimbursement is necessary to secure capable individuals); *Homestore*, 888 A.2d at 211 (advancement attracts capable individuals into corporate service); *Fasciana v. Elec. Data Sys. Corp.*, 829 A.2d 160, 170 (Del. Ch. 2003) (advancement provisions necessary to encourage talented people to serve in corporations).

<sup>54</sup> *Kaung*, 884 A.2d at 509 (Delaware advancement provisions are part of a policy to manage risk/reward balance for organizations); *Fasciana*, 829 A.2d at 170 (advancement encourages officers and directors to undertake risk in exchange for lucrative return).

<sup>55</sup> Public policy concerns are cited as the basis of decisions involving denial of advancement by insurance carriers. *See e.g.* Little v. MGIC Indemnity Corp. 649 F. Supp. 1460, 1461 (W.D. Pa. 1986), aff’d., 836 F.2d 789 (3d Cir. 1987) (requiring the employee to pay their expenses as incurred would be “unconscionable”); *Flintkote Co. v. Lloyd’s Underwriters*, 1976 WL 16591 (N.Y. Sup. July 27, 1976) at \*4 *aff’d* 56 A.D.2d 743 (1977) (public policy was served by having executive properly represented, despite conviction on antitrust charges).

<sup>56</sup> *See supra* note 54 and cases cited therein.

<sup>57</sup> Samuel W. Buell, *Criminal Procedure Within The Firm*, 59 STAN. L. REV. 1613, 1662 (2007) (enterprise liability is vicarious liability).

<sup>58</sup> For a general description on the evolution of organizational criminal liability, *see* 1 KATHLEEN F. BRICKEY, CORPORATE CRIMINAL LIABILITY: A TREATISE ON THE CRIMINAL LIABILITY OF CORPORATIONS, THEIR OFFICERS AND AGENTS, §§2.06-2.09 (1984); James R. Elkins, *Corporations and the Criminal Law: An Uneasy Alliance*, 65 KY. L.J. 73, 88-99 (1976).

<sup>59</sup> Bucy, *supra* note 23, at 346 (strategy in criminal case may impact subsequent civil suits). *See also* Simon v. Socony-Vacuum Oil Co., 38 N.Y.S. 2d 270, 275 (N.Y. Sup. Ct. 1942) *aff’d*, 47 N.Y.S. 2d 589 (1944) (executive’s plea of *nolo contendere* benefited the corporation since the plea could not be used as evidence against the company).

<sup>60</sup> Bucy, *supra* note 23, at 346 (potential collateral estoppel effect of criminal action may be the reason that corporations advance fees).

<sup>61</sup> Buell, *supra* note 57, at 1647 (proffer of immunity may induce targeted employees to make statements).

<sup>62</sup> *See infra* notes 65-72 and accompanying text.

<sup>63</sup> *See infra* notes 74-94 and accompanying text.

<sup>64</sup> *See infra* notes 95-103 and accompanying text.

<sup>65</sup> Dale A. Oesterle, *Limits on a Corporation's Protection of Its Directors and Officers From Personal Liability*, 1983 Wis. L. REV. 513, 543-44 (1983)(authorization to advance funds has no specific disclosure requirements other than what might be required by rules on directors and officers compensation). Neither Delaware law nor the MBCA have specific requirements regarding disclosure of agreements to advance fees which are contained in arms length contracts. *But see* MINN. STAT. ANN. §302A.521, subd.(8)(2008)(requiring disclosure to shareholders of advancement of expenses).

<sup>66</sup> One commentator speculates that the disclosure of generous terms of indemnification would “chill” likelihood of shareholder approval. Bucy, *supra* note 23, at 321.

<sup>67</sup> 603A.2d 818 (Del. 1992).

<sup>68</sup> *Id.* at 820.

<sup>69</sup> *Id.*

<sup>70</sup> *Id.* at 821

<sup>71</sup> *Id.* at 822.

<sup>72</sup> *Id.* at 826.

<sup>73</sup> *Id.* at 823.

<sup>74</sup> Neal v. Neumann Medical Center 667 A.2d 479, 480 (Pa. Commw. Ct. 1995) (bylaw providing for indemnification is treated as contract right). *See also* Hibbert v. Hollywood Park, Inc. 457 A.2d 339, 342-43 (Del. 1983)(rules used in interpreting contracts are used in interpreting bylaws).

<sup>75</sup> *Hibbert*, 457 A.2d at 343. (if bylaw is unambiguous, court will not search of the parties’ intention).

<sup>76</sup> Perconti v. Thornton Oil Co., Civ. A 18630-NC, 2002 WL 982419, at \*4 (Del. Ch. May 3, 2002 )

<sup>77</sup> *Tafeen I*, No. Civ. A. 0-23-N, 2004 WL 556773, at \* 4 (Del. Ch. March 22, 2004).

<sup>78</sup> Dunlap v. Sunbeam Corp., Civ. No. 17048, 1999 LEXIS 126, at \*17 (Del. Ch. June 23, 1999); *Tafeen I*, No. Civ. A. 023-N, 2004 WL 556733, at \*10 (Del. Ch. March 22, 2004).

<sup>79</sup> Bergonzi v. Rite Aid Corp., Civ. A. 20453-NC, 2003 WL 22407303, at \*2 (Del. Ch. Oct. 20, 2003).

<sup>80</sup> *Tafeen I*, No. Civ. A. 023-N, 2004 WL 556733, at \*1 (Del. Ch., March 22, 2004).

<sup>81</sup> *Id.*

<sup>82</sup> *Id.* at \*3 n.71 (*emphasis in the original*).

<sup>83</sup> 830 F. Supp. 262, 268 (E.D. Pa. 1993)

<sup>84</sup> Although *Felicetti* applied Pennsylvania law, the court noted that the Pennsylvania act was modeled on the Delaware statutes and MBCA. *Id.* at 268.

<sup>85</sup> *Id.* at 270. Specifically, the board found that the value of the undertaking to repay the advance was “illusory” and it was not in the overall best interests of the company to advance fees. *Id.* at 264-65.

<sup>86</sup> *Id.* at 260.

<sup>87</sup> *Neal*, 667 A.2d at 482 (1995) (court distinguished *Felicetti*, noting that the instant case presented no conflict between the by-law provision and fiduciary duty of directors); *Ridder*, 47 F.3d at 87(*Felicetti* construes Pennsylvania law and should not be applied in a case involving Delaware law). *But see Felicetti*, 830 F. Supp. at 270 (although not obligated for follow Delaware law, the court distinguished Delaware case law by noting that in prior cases bylaw had not conflicted with fiduciary duties of the directors).

<sup>88</sup> *Ridder*, 47 F.3d at 87(*Felicetti* is unpersuasive in that it is rare that directors could breach a fiduciary duty by complying with a duly approved by-law).

<sup>89</sup> In *Tafeen I*, for example, the court noted that although the corporation raised the issue of “unclean hands” in an effort to defeat a claimant’s claim for advancement, the same actions might constitute the contract defense of a breach of the implied warranty of good faith and fair dealing. *Tafeen I*, No. Civ. A. 023-N, 2004 WL 556733, at \*6 n.32 (Del. Ch. March 22, 2004).

<sup>90</sup> *Tafeen I*, No. Civ. A. 023-N, 2004 WL 556733 (Del. Ch. March 22, 2004)(court found that intentionally sheltering assets to defeat organization’s ability to recoup advances if claimant not entitled to indemnification would amount to “unclean hands”)

<sup>91</sup> *Id.* at \*7.

<sup>92</sup> *Tafeen v. Homestore, Inc. (Tafeen II)*, No. Civ. A. 023-N, 2004 WL 3053129 (Del. Ch. Oct. 27, 2004).

<sup>93</sup> *Id.* at \*3. Claimant’s behavior ranged from use of private jets, expensive trips, and excessive personal expenditures such as a \$50,000 fish tank. *Id.*

<sup>94</sup> *Id.* at \*2.

<sup>95</sup> Despite a willingness to analyze advancement in terms of an implied-in-fact agreement, courts have eschewed consideration of advancement as contracts which are “implied-in-law” – obligations which are imposed by law, without regard to the assent of the parties. Restatement (Second) of Contracts §4 cmt. b (1981).

<sup>96</sup> *Id.* §4.

<sup>97</sup> *Id.* §4 cmt. a (promise may be inferred from course of dealing, course of performance or trade usage).

<sup>98</sup> 435 F. Supp.2d 330 (S.D.N.Y. 2006), *aff’d*, 541 F.3d 130 (2d Cir. 2008).

<sup>99</sup> *Id.* at 353.

<sup>100</sup> *Stein*, 435 F. Supp.2d at 356 n.119.

<sup>101</sup> *Id.*

<sup>102</sup> *Stein v. KPMG*, 486 F.3d 753, 763-64 (2d Cir. 2007). Although the federal district court recognized that the determination of the existence of an implied-in-fact contract was a matter of state law, the district court asserted ancillary jurisdiction over the claims. *Stein*, 435 F. Supp. 2d at 378.

<sup>103</sup> *KPMG*, 486 F.3d 753, 762-63 (2d Cir. 2007).

<sup>104</sup> See *supra* notes 57-61 and accompanying text.

<sup>105</sup> Hasnas, *supra* note 51, at 594 (since evidence of organizational wrongdoing is in the hands of the organization, organizational cooperation is very valuable to the prosecutor).

<sup>106</sup> Larry D. Thompson, *Principles of Federal Prosecution of Business Organizations* [www.usdoj.gov/dag/cftf/corporate\\_guidelines.htm](http://www.usdoj.gov/dag/cftf/corporate_guidelines.htm). (last visited Jan. 5, 2010).

<sup>107</sup> A deferred prosecution agreement (“DPA”) is a contractual arrangement in which the government agrees to forego any prosecution of an organizational defendant in exchange for the latter’s cooperation and payment of a fine. Lisa Kern Griffin, *Compelled Corporation and the New Corporate Criminal Procedure*, 82 N.Y.U.L.Rev. 311, 321-22 (2007). The DPA typically requires an organization to accept criminal responsibility so that failure to abide by the terms of a DPA is likely to result in a summary conviction. *Id.* at 322.

<sup>108</sup> *Thompson Memorandum* at VI (A).

<sup>109</sup> The *Thompson Memorandum* contains no guidance on determining which employees are “culpable.”

<sup>110</sup> *Thompson Memorandum* at VI (B). (footnote omitted). An exception was made in those instances where advancement of attorneys’ fees was required by law. *Id.*

<sup>111</sup> Hasnas, *supra* note 51, at 627 (the *Thompson Memorandum* made organizations auxiliary prosecutors).

<sup>112</sup> Interview with United States Attorney James B. Comey Regarding Department of Justice’s Policy on Requesting Corporations Under Criminal Investigation to Waive the Attorney Client Privilege and Work Product protections, 51 U.S. ATTY’S BULL. 1 (2003) available on line at [http://www.justice.gov/usao/eousa/foia\\_reading\\_room/usab5106.pdf](http://www.justice.gov/usao/eousa/foia_reading_room/usab5106.pdf) (last visited 1/10/2010).

<sup>113</sup> See e.g. Conference Report on the ABA Annual Meeting, 74 U.S. L.WEEK, 2091, 2092 (Aug.16, 2005) (*Thompson Memorandum* is an impingement on corporate constitutional protections); Earl J. Silbert & Demme Doufekias Joannou, *Under Pressure to Catch the Crooks: The Impact of Corporate Privilege Waivers on the Adversarial System*, 43 AM. CRIM. L. REV. 1225, 1226-27 (2006) (a trampling of constitutional rights of individuals); George Ellard, *Making the Silent Speak and the Informed Wary: False Statements to Impede Government Investigations*, 42 AM. CRIM. L. REV. 985, 990 (2005) (a seismic shift from an accusatorial to an inquisitional systems of justice); Lisa Kern Griffin, *supra* note 107, at 334. (*Thompson Memorandum* encourages false and unreliable statements).

<sup>114</sup> 435 F. Supp.2d 330 (S.D.N.Y. 2006), *aff’d*, 541 F.3d 130 (2d Cir. 2008),

<sup>115</sup> *Id.* at 367.

<sup>116</sup> *Id.* at 362.

<sup>117</sup> Within days of the *Stein* decision, the Attorney - Client Privilege Protection Act of 2006 was introduced in the Senate to ensure *inter alia* that advancement of fees to target employees, as well as joint defense agreements and information sharing would not be considered by prosecutors in evaluating organizational cooperation. Attorney-Client Privilege Protection Act, S.30, 109<sup>th</sup> Cong. (12/8/06)§§3(b)(2)(b)-(d). Although the 2006 Act was not reported out of Committee, revised versions were introduced in 2007, 2008 and 2009 to address the issues first raised in *Stein* and in reaction to perceived inadequacies in the revised guideline issued by the Department of Justice. Attorney-Client Privilege Protection Act of 2007, S. 186 110<sup>th</sup> Cong. (1/4/07); Attorney-Client Privilege Protection Act of 2007 H.R. 3013 110<sup>th</sup> Cong. (7/12/07); Attorney -Client Privilege Protection Act, of 2008 S 3217, 110<sup>th</sup> Cong. (6/26/08); Attorney-Client Privilege Protection Act of 2009, S 445 111<sup>th</sup> Cong. (2/13/09); Attorney -Client Privilege Protection Act, of 2009, H.R. 4326 111<sup>th</sup> Cong. (12/16/09).

<sup>118</sup> In response to the criticism sparked by the *Thompson Memorandum* and perhaps in anticipation of the court’s rulings in the *Stein* cases themselves, Acting Deputy Attorney General, Robert McCallum, Jr. issued a directive (the “*McCallum Memorandum*”) requiring each district to formulate a written policy designed to make the process of requesting a waiver more transparent. Robert D. McCallum, Jr., *Waiver of Corporate Attorney Client and Work Product Protection*, [https://www.usdoj.gov/usao/eousa/foia\\_reading\\_room/usam/title9/crim00163](https://www.usdoj.gov/usao/eousa/foia_reading_room/usam/title9/crim00163) last visited 11/13/06. The *McCallum Memorandum* did not establish any standards for granting or seeking a waiver and was superseded by the *McNulty Memorandum* on December 12, 2006. See Paul J. McNulty, *Principles of Federal Prosecution of Business Organizations*, [http://www.usdoj.gov/dag/speech/2006/mcnulty\\_memo.pdf](http://www.usdoj.gov/dag/speech/2006/mcnulty_memo.pdf) (hereinafter the “*McNulty Memorandum*”).

<sup>119</sup> *Principles of Federal Prosecution of Business Organizations*, available at <http://www.justice.gov/opa/documents/corp-charging-guidelines.pdf> (last visited January 12, 2010).

<sup>120</sup> *Id.* at §9-28.730.

<sup>121</sup> *Id.*

<sup>122</sup> *Id.*

<sup>123</sup> *Id.* at §9-28.730.

<sup>124</sup> One commentator suggests that *Thompson Memorandum* “tactics” may not be impermissible in the context of a plea bargain. Brown, *supra* note 34, at 385.

<sup>125</sup> The Thompson Memorandum was promulgated in 2003 and was superseded by the *McNulty Memorandum* in 2006. See *supra* notes 106, 119.

<sup>126</sup> Brown, *supra* note 34, at 367-68. Such de facto regulation includes the establishment of funding levels which circumscribe the efforts of appointed counsel and the scope of their investigatory capability (*id.* at 370 n.34); broad use of forfeiture statutes which may adversely influence a defendant’s choice of counsel (*id.* at 372); eavesdropping on communications between lawyer and clients (*id.* at 370-72); and objecting to the use of a single attorney representing joint defendants (*id.* at 379 n.63).

<sup>127</sup> William S. Lafler, *Corporate Liability, Risk Shifting and the Paradox of Compliance*, 52 VANDR. L. R. 1343, 1391 (1999) (indemnification poses multiple risks in calculating organizational sentence including perception of organizational irresponsibility; suggestion of conspiracy; reduced mitigation score; and increased likelihood of derivative suits).

<sup>128</sup> Proposed Amendments to Sentencing Guidelines, 75 Fed. Reg. 2010-970 (proposed Jan. 21, 2010).

<sup>129</sup> *Id.* §8B2.1(b)(7) (after criminal conduct is detected, organization shall “respond appropriately”).

<sup>130</sup> Joseph Goldstein, *DOJ Introduces New Guidelines Curbing Prosecutors*, THE NEW YORK SUN, Aug. 28, 2008 available at <http://www.nysun.com/national/doj-introduces-new-guidelines-curbing-prosecutors/> 84845 (last visited 9/11/2008).

<sup>131</sup> *United States v. Stein (Stein III)*, 495 F. Supp. 2d 390, 402 (S.D. N. Y. 2007).

<sup>132</sup> Brown, *supra* note 34, at 388-89.

<sup>133</sup> White collar defendants have often experienced what has been termed, “relational representation” - an ongoing association, between the employee and in-house counsel or outside counsel who customarily works for the organization. Brown, *supra* note 34, at 378. Such counsel frequently influence the attitude which target employees have toward the organization and their perception that their own interests are aligned with that of the organization. As one commentator noted, “[T]here are times when any individual will find it difficult to hear a warning, no matter what is said.... There are also times when simple actions, or the manner in which cautionary statements are delivered, can impact how an employee responds far more than the words themselves.” Sarah Helene Duggin, *The McNulty Memorandum, the KPMG Decision and Corporate Corporation: Individual Rights and Legal Ethics*, 21 GEO. J. LEGAL ETHICS 341, 405 (2008). See also Buell, *supra* note 57, at 1632 (while employees understand that employers may punish misconduct, they may not understand the interest the employer may have in helping the criminal law system impose sanctions).

<sup>134</sup> Brown, *supra* note 34, at 380.

<sup>135</sup> *Id.*

<sup>136</sup> Buell, *supra* note 57, at 1633 (although given the opportunity to choose their own lawyers and eschewing joint defense arrangements, employees seldom do).

<sup>137</sup> Duggin, *supra* note 133, at 348 (corporate cooperation controversy must be solved within the system of legal ethics).

<sup>138</sup> The legal rules of professional responsibility implicitly acknowledge that problem, noting that organizations who furnish lawyers to others can exert strong pressure on such lawyers in order to advance their own objectives. Model Code of Prof’l Responsibility EC 5-23.

<sup>139</sup> Model Rule of Prof’l Conduct R. 1.8(f) )

<sup>140</sup> *U.S. v. Stein (Stein II)*, 440 F. Supp. 2d 315, 320 (S.D. N.Y. 2006).

<sup>141</sup> See e.g. Maskay, *supra* note 34, at 493 (suggesting that Fifth and Sixth Amendments may not provide timely protection in the investigative stage).

<sup>142</sup> While the Rules of Professional Responsibility have no effect on organizational employers who presumably may freely restrict their choice of counsel or limit the amount of advancement available to targeted employees. Duggin, *supra* note 133, at 403 (an employees *a priori* agreement to cooperate with prosecutors in order to assure continuation of advancement does not violate Canon of Ethics because the condition is placed on the client rather than counsel).

<sup>143</sup> *Tafeen I*, No. Civ. A. 023-N, 2004 WL 556733, at \*3 (Del. Ch. March 22, 2004).

<sup>144</sup> Cf. *Chaimson v. Healthtrust Inc.*, 735 A. 2d 912, 922 (Del. Ch. 1999) (organization had discretion when structuring indemnification provision to approve counsel but cannot abuse that discretion by foisting inferior counsel on claimant).

<sup>145</sup> See Brown, *supra* note 34, at 388-89 (suggesting that existence of a contract explicitly requiring advancement will both deter government attempts to curtail advancement and provide courts with a bright line test for evaluating prosecutorial misconduct).

<sup>146</sup> See *supra* notes 62-103 and accompanying text. .

<sup>147</sup> See *supra* notes 106-130 and accompanying text.

<sup>148</sup> BLACK’S LAW DICTIONARY 365 (9<sup>th</sup> ed. 2009).

<sup>149</sup> For an accessible description and criticism of the theories of Ronald Coase and their application to law, see A. W. Brian Simpson, *Coase v. Pigou Reexamined*, 25 J. LEGAL STUD.53, 58-62 (1996).

<sup>150</sup> Frank H. Easterbrook & Daniel R. Fischel, *Contract and Fiduciary Duty*, 36 J. LAW & ECONOMICS, 425. 427(1993) (fiduciary “duties” which have been recognized in are really a variant of contract law in which courts supply the terms that the parties would have negotiated with respect to the subject).

- <sup>151</sup> R. H. Coase, *The Problem of Social Cost*, 3 J. LAW & ECONOMICS 1, 15-16 (1960)(pricing system which would permit a reallocation of legal rights through market mechanisms would lead to economic efficiency).
- <sup>152</sup> Coasean theory suggests that market forces will circumvent legally imposed duties which shift costs to achieve economic efficiency. See Mark Kelman, *Consumption Theory, Production Theory, and Ideology in the Coase Theorem*, 52 S. CAL. L. REV. 669, 675 (1979) (like an “untameable river” market will burst through obstacles to economic efficiency) (criticizing this theory).
- <sup>153</sup> *Tafeen I*, No. Civ. A. 023-N, 2004 WL 556733, at \*10 n.71 (Del. Ch. March 22, 2004) (statutory standards on indemnification and advancement are strikingly lax).
- <sup>154</sup> For example, in the *Stein* case, only Jeffrey Stein had an explicit agreement providing for advancement. The other defendants based their claims on implied-in-fact agreements which they hoped to demonstrate by a course of dealing. 435 F. Supp. 2d at 356 n. 119.
- <sup>155</sup> See *supra* n.27 for an example of differential treatment of advancement among different entities.
- <sup>156</sup> Bucy, *supra* note 23, at 286 (bylaws and corporate resolutions tend to favor corporate executives); Buell, *supra* note 57, at 1656 (indemnification and advancement most likely to be used by agents in are most likely to influence policies on indemnification). See also *In re Adelpia Communications Corp.*, 323 B.R. 345, 364 (Bankr. S.D.N.Y 2003) (disallowing claim of directors for advancement because of deficiencies in the meetings at which the accused directors authorized advancement for themselves).
- <sup>157</sup> Reinier Kraakman, *Corporate Liability Strategies and the Cost of Legal Controls*, 93 YALE L. J. 857,859 (1984) (contractual provision are most effective at deflecting personal risks at highest echelons of the corporation)
- <sup>158</sup> Restatement (Second) of Contracts §4 cmt. a(1981).
- <sup>159</sup> Arthur A. Leff, *Contract as Thing*, 19 AM. U. L. REV. 131, 143 (1970).
- <sup>160</sup> Buell, *supra* note 57, at 1656 (agents probably have limited ability to bargain for contractual guarantees against criminal liability).
- <sup>161</sup> Easterbrook & Fischel, *supra* note 150, at 438 (good faith means “honesty in fact” and the duty to refrain from taking undue advantage) (footnotes omitted).
- <sup>162</sup> *Chaimson*, 735 A.2d at 920 (citations omitted) (obligation of good faith and fair dealing implied in every contract).
- <sup>163</sup> Deborah A. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 DUKE L.J. 879, 898(1988)
- <sup>164</sup> See *Cincinnati SMSA Ltd. P’ship v. Cincinnati Bell Cellular Sys. Co.*, 708 A.2d 989, 992 (Del. 1998) (while contracts terms may be implied to accord with the intent of the parties, such occasions should be rare and involving issues of “compelling fairness”).
- <sup>165</sup> See *supra* notes 153-157.
- <sup>166</sup> BLACK’S LAW DICTIONARY 1613 (9<sup>th</sup> ed. 2009).
- <sup>167</sup> John D. Calamari & Joseph M. Perillo, THE LAW OF CONTRACTS §1-3(c) (3d ed. 1987).
- <sup>168</sup> *Id.* (trend is toward the limitation of unrestricted freedom of contract).
- <sup>169</sup> Bucy, *supra* note 23, at 314 (courts have ignored public policy considerations in analyzing indemnification and advancement).
- <sup>170</sup> See, e.g., *Reddy v. Electronic Data Systems Corporation*, No. Civ. A. 19467, 2002 WL 1358761, at \*5 (Del. Ch. June 18, 2002) (organization compelled to advance fees to officers whose engagement in criminal activities caused him to be perceived as a “faithless fiduciary”). See also Victor Brudney, *Corporate Governance, Agency Costs, and the Rhetoric of Contract*, 85 COLUM. L. REV. 1403, 1409 (1985) (emphasis on freedom of contract suggests lessened concern for non-party stakeholders). *But see* Felicetti, 830 F. Supp. at 269 (Board’s duty to the shareholder overrides its contractual obligations to claimants seeking advancement).
- <sup>171</sup> Brudney, *supra* note 170, at 1404.
- <sup>172</sup> Brown, *supra* note 34, at 373.
- <sup>173</sup> *Id.* at 374.
- <sup>174</sup> *Id.* at 373-74 (wealthy defendants can overlitigate cases resulting in unmerited acquittals). For example, in both *Citadel Holding Corp. v. Roven*, 603 A. 2d 818, (Del. 1992), and *Dunlap*, Civ. No. 17048, 1999 LEXIS 126, (Del. Ch. June 23, 1999), plaintiffs, who had negotiated generous advancement contracts, were directors or high level officers who presumably had the authority and opportunity to discourage misconduct within the firm.
- <sup>175</sup> See *supra* notes 153-57 and accompanying text
- <sup>176</sup> One commentator has termed such motivation as the “agency cost problem” – the tendency to spend organizational resources on a defense without regard to efficacy or efficiency. Buell, *supra* note 57, at 1655.
- <sup>177</sup> See *supra* notes 57-61 and accompanying text.
- <sup>178</sup> BLACK’S LAW DICTIONARY 580 (9<sup>th</sup> ed. 2009)
- <sup>179</sup> Edward Soule, *Trust and Managerial Responsibility*, 8 BUS. ETHICS Q. 249,268(1995) (Employers who actively encourage employees to trust them create moral obligations toward such employees); Hasnas, *supra* note 51, at 648 (fostering trust requires assumption of a duty by the trusted actor to protect the interests of the vulnerable party).
- <sup>180</sup> BLACK’S LAW DICTIONARY 365 (9<sup>th</sup> ed. 2009) (“a duty rising under a particular contract”).

<sup>181</sup> The most well known common law duty is the obligation to exercise “reasonable care” to avoid subjecting others to an unreasonable risk of harm. *Restatement (Third) of Torts § 6* cmt. a (Discussion Draft 1999).

<sup>182</sup> *But see* Restatement (Second) of Contracts §4 cmt. b (1981) (a contract implied in law does not require assent of the parties).

<sup>183</sup> For example, the common law duty to attempt to rescue where an actor has caused the peril reflects a widespread belief of a moral obligation to aid those in peril. PROSSER AND KEETON ON THE LAW OF TORTS § at page 375 (W. Page Keeton, et al. eds., 5<sup>th</sup> ed.1984).

<sup>184</sup> William L. Prosser, *Palsgraf Revisited*, 52 MICH. L. REV.1, 15 (1953) (discernment of a duty is based in part on ideas as to where a loss should fall).

<sup>185</sup> As one commentator noted on the discernment of a duty: “[E]ach duty itself defines the types of relationship to which it applies . . . . [E]ach duty exacts its own standard of acceptable conduct from the fiduciary to whom it applies.” DeMott, *supra* note 163, at 915 n.160 quoting P. Finn, FIDUCIARY OBLIGATIONS 4 (1977).

<sup>186</sup> *Jacobellis v. Ohio*, 378 U.S. 184, 197 (1964) (Stewart, J., concurring).

<sup>187</sup> BLACK’S LAW DICTIONARY 580 (9<sup>th</sup> ed. 2009).

<sup>188</sup> Prosser, *supra* note 184, at 13.(consensus of opinion is that duty arises out of a “relation” between parties)

<sup>189</sup> *Id.* at 14.

<sup>190</sup> *Hopkins v. Fox & Lazo Realtors*, 625 A.2d 1110, 1116 (N.J. 1993)

<sup>191</sup> Prosser, *supra* note 184, at 15. DeMott, *supra* note 163, at 915 (“[T]he fiduciary obligation is a device that enables the law to respond to a range of situations in which, for a variety of reasons, one person’s discretion ought to be controlled because of characteristics of that person’s relationship with another”).

<sup>192</sup> DeMott, *supra* note 163, at 879. (law of fiduciary obligation applies to wide range of situations and has developed in the context of specific cases). *See also* Austin W. Scott, *The Fiduciary Principle*, 37 CAL. L. REV. 539, 540-41 (1949) (discussing general principles of fiduciary law).

<sup>193</sup> Easterbrook & Fischel, *supra* note 150, at 435-36 (identifying and criticizing criteria for imposition of a fiduciary duty).

<sup>194</sup> *See, e.g.*, Scott, *supra* note 190, at 539 (quoting the parable of the servant who wastes his master’s goods); Robert Charles Clark, *Agency Costs Versus Fiduciary Duties* in PRINCIPALS AND AGENTS: THE STRUCTURE OF BUSINESS 71-76 (John W. Pratt & Richard Zeckhauser, eds. 1985).

<sup>195</sup> *Pepper v. Litton*, 308 U.S. 295, 311 (1939).

<sup>196</sup> *Meinhard v. Salmon*, 249 N.Y. 458, 464 (1928).

<sup>197</sup> Demott, *supra* note 163, at 915.

<sup>198</sup> Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247 (1999) (the relationship between an organization and its agents may be so ambiguous that it is difficult to determine who is the agent and who is the principal).

<sup>199</sup> V. S. Khanna, *Corporate Criminal Liability: What Purpose Does It Serve?*, 109 HARV. L. REV. 1477, 1487 (1996) (finding of organizational criminal liability is based on respondeat superior). Organizations have been held criminally liable even when the action of their employee contravened company policy. *United States v. Hilton Hotel Corp.*, 467 F.2d 1000, 1008 (9<sup>th</sup> Cir. 1972), *cert. denied* 409 U. S. 1125 (1973).

<sup>200</sup> *See infra* notes 208-215 and accompanying text.

<sup>201</sup> Bart Victor & John B. Cullen, *The Organizational Bases of Ethical Work Climates*, 33 ADM. SCI. Q. 101, 101 (1988)(growing body of literature suggesting that organizations are responsible for the ethical or unethical behavior of employees)(citations omitted).

<sup>202</sup> Jennifer Arlen & Reinier Kraakman, *Controlling Corporate Misconduct: An Analysis of Corporate Liability Regimes*, 72 N.Y.L.U. REV. 687 696(1997) (employees committing white collar crime may be “neither savvy nor rationale” with little appreciation of penalties).

<sup>203</sup> For most of the twentieth century, this was the case. *See supra* notes 57-61 and accompanying text.

<sup>204</sup> *See e.g.* 495 F. Supp. 2d at 398 quoting Robert S. Bennett, chief counsel for KPMG (“where . . . it appears that criminal conduct occurred, it generally is advisable not to advance fees) (footnote omitted); Brown, *supra* note 34, at 386 (despite *Stein*, there is little doctrinal basis to restrict prosecutors from bargaining for organizational cooperation or considering advancement in context of plea bargains). Even the *Stein* court acknowledged that advancement of fees to employees may be considered in the context of obstruction charges. *Stein*, 435 F. Supp.2d 330, 363 (payment of legal fees may be evidence of obstruction). Further, the Attorney-Client Privilege Protection Act of 2009 (S.445) §3041(f) also permits a prosecutor to continue advancement of fees and entering into a joint defense agreement in the context of plea bargains or obstruction charges. Attorney-Client Privilege Protection Act of 2009, S 445 111<sup>th</sup> Cong. (2/13/09)

<sup>205</sup> Samuel W. Buell, *The Blaming Function of Entity Criminal Liability*, 81 IND. L.J. 473, 495 (2006) (group membership is a critical factor in deciding how to behave and whether to override personal values); John Darley, *The Cognitive and Social Psychology of Contagious Organizational Corruption*, 70 BROOK. L. REV. 1177, 1191(2005) (individuals may adopt moral values of the group in order to contribute to group success).

- 
- <sup>206</sup> See generally Steven H. Appelbaum, Kyle J. Deguire & Mathieu Lay, *The Relationship of Ethical Climate to Deviant Workplace Behavior*, 5 CORP. GOVERNANCE 43 (2005) (presenting literature review of empirical studies on organizational deviance); MARSHALL B. CLINARD & PETER C. YEAGER, *CORPORATE CRIME* 25 (1980) (discussing influences on white collar crime); TONY G. POVEDA, *RETHINKING WHITE-COLLAR CRIME* 86-98 (1994) (describing early theories exploring theories of white collar crime).
- <sup>207</sup> Buell, *supra* note 205, at 495 (effective group leaders engage in an “entrepreneurship of identity” which structures and manages group norms and expectations) (citations omitted).
- <sup>208</sup> Appelbaum, Deguire & Lay, *supra* note 206, at 45-44. Buell, *supra* note 205, at 493. (“institutions do produce wrongdoing”); John M. Darley, *How Organizations Socialize Individuals into Evildoing*, in *Codes of Conduct: Behavioral Research* in BUSINESS ETHICS 13, 13-14 (David M. Messick & Ann E. Tenbrunsel eds. 1996) (corporate culture may encourage misconduct).
- <sup>209</sup> Victor & Cullen, *supra* note 201, at 105.
- <sup>210</sup> Regina A. Robson, *Crime and Punishment: Rehabilitating Retribution as a Justification for Organizational Criminal Liability*, 47 AM. BUS. L. J., 109 140 (2010) (moral content, frequently absent from white collar crimes, serves a notice function that conduct may be prohibited).
- <sup>211</sup> *Id.* at 139-41.
- <sup>212</sup> *Id.* at 134.
- <sup>213</sup> Arguably this is what happened in *United States v. Park*, 421 U.S. 658 (1975). In *Park*, an executive was held criminally liable under a strict liability statute because he stood in a “responsible relationship” to the prohibited conduct. *Id.* at 673-74. In fact, the executive had delegated responsibility for responding to FDA concerns to a lower level manager and had failed to follow up to ensure that the citations were remedied. *Id.* at 677. His was a failure of management as much as a crime.
- <sup>214</sup> *But see*, George J. Seidel, *Six Forces and the Legal Environment of Business: The Relative Value of Business Law Among Business School Courses*, 72 AM. BUS. L. J. 717, 728-29 (2000) (suggesting that the value placed on an understanding of the law increased as managers moved to more senior positions).
- <sup>215</sup> A survey of small businesses found that almost half were unaware of regulations on the disposal of hazardous waste. Kraakman, *supra* note 157, at 865 (citation omitted).
- <sup>216</sup> See *infra* notes 234-246 and accompanying text.
- <sup>217</sup> Buell, *supra* note 57, at 1628.
- <sup>218</sup> *Id.* at 1628-29. (“machinery” of criminal justice is activated well in advance of charges being filed).
- <sup>219</sup> Secondary offenses consist of conduct which makes it more difficult for the government to prove other substantive offenses. Hasnas, *supra* note 51, at n.43.
- <sup>220</sup> In *Computer Associates International*, for example, an executive pleaded guilty to a charge of obstruction based upon false statements allegedly made to auditors and outside counsel that the executive had retained to conduct an internal investigation. Indictment, ¶¶ 51-59, 75-79, *United States v. Kumar*, Cr. No. 04 Cr. 0846 (E.D. N.Y. filed Sept. 20, 2004). See also Alex Berenson, *Software Chief Admits to Guilty in Fraud Case*, N. Y. TIMES, Apr. 25, 2006 at A1.
- <sup>221</sup> Brown, *supra* note 34, at 370 (while the Supreme Court has defined the constitutional entitlement to counsel in certain cases, the “benefit level” of this right – what kind of counsel and how much – has not been constitutionally defined by the Court).
- <sup>222</sup> *Id.* at 386-87 (defendants may waive rights even in the face of specious charges).
- <sup>223</sup> Kraakman, *supra* note 157, at 859 (indemnification provisions in combination with other factors ensure that culpable actors have little personal risk); Christopher D. Stone, *The Place of Enterprise Liability in the Control of Corporate Conduct*, 90 YALE L. REV. 1, 46 (1980) (organization and its agents are continuing shifting risks back and forth); Laufler, *supra* note 127, at 1350 (organizations frequently purchase only the amount of compliance which is necessary to shift liability away from the firm); Peter Margulies, *Legal Hazard: Corporate Crime, Advancement of Executives’ Defense Costs, and the Federal Courts (Part I)*, 7. U. C. DAVIS BUS. L.J. 2, (2006) (advancement of fees creates conflicts of interest which jeopardize the interests of the organization).
- <sup>224</sup> See *supra* notes 52-54 and accompanying text.
- <sup>225</sup> See *supra* notes 107-112 and accompanying text.
- <sup>226</sup> Lisa Kern Griffin, *supra* note 107, at 332-33.
- <sup>227</sup> In one respect, the *Thompson Memorandum* can be seen as an effort by prosecutors to encourage organizations to leverage their “benefactor status” to compel employee cooperation. Brown, *supra* note 34, at 380.
- <sup>228</sup> See *supra* notes 172-177 and accompanying text.
- <sup>229</sup> Hasnas, *supra* note 51, at 631-32 (system of white collar crime presents ethical dilemmas for organizations).
- <sup>230</sup> Organizational “ethics” are frequently categorized as either compliant or ethical. See e.g. Lynn Sharp Paine, *Managing for Organizational Integrity*, 72 HARV. BUS. REV. 106, 106-07 (1994) (describing organizational approaches to ethics). A compliant strategy seeks conformity with laws in order to avoid prosecution and other adverse consequences. *Id.* at 109-110. An ethical model is one in which actions are guided by ethical norms and managers are empowered to make ethical decisions. *Id.* at 111-12.

---

<sup>231</sup> See *supra* notes 172-175 and accompanying text.

<sup>232</sup> In the context of court appointed counsel, courts and legislatures indirectly make such determination in setting funding levels for counsel and expert assistance. Brown, *supra* note 34, at 370-71.

<sup>233</sup> But see *supra* notes 83-86 and accompanying text.

<sup>234</sup> Reddy v. Electronic Data Systems Corporation, No. Civ. A. 19467, 2002 WL 1358761, at \*5 (Del. Ch. June 18, 2002).

<sup>235</sup> *Tafeen I*, No. Civ. A. 0-23-N, 2004 WL 556733, at \*10 n.71 (Del. Ch. March 22, 2004).

<sup>236</sup> In Delaware, the single legislative intrusion into the contract forged between the parties is the provision which requires that high – level executives to execute an undertaking of repayment. CITE

<sup>237</sup> See *supra* note 117 and accompanying text.

<sup>238</sup> The most recent version of the bill provides that neither the provision of counsel nor the contribution of legal fees to a targeted employee shall be considered in a charging decision. Attorney-Client Privilege Protection Act of 2009, S 445 111<sup>th</sup> Cong. §3(a)(2/13/09).

<sup>239</sup> Model Bus. Corp. Act §§8.50-8.59.

<sup>240</sup> The MBCA has been adopted in whole or in part by Alabama, Colorado, Connecticut, Florida, Georgia, Indiana, Iowa, Kentucky, Maryland, Mississippi, Montana, South Carolina, Texas and Vermont. Brodsky & Adamski, *supra* note 19, §19:7 (citations omitted).

<sup>241</sup> The MBCA requires that a director receiving advancement must affirm that he or she knows of no facts which would preclude indemnification under the statute. MBCA §8.53.1.

<sup>242</sup> Minn. Stat. Ann. §302A.521 (2008).

<sup>243</sup> *Id.* at subd.(4). See also Barry v. Barry, 824 F. Supp. 178, 183 (D. Minn. 1993), *aff'd*, 28 F.3d 848 (8<sup>th</sup> Cir. 1994) (Minnesota statute makes advancement mandatory unless organization elects to prohibit or limit in bylaws). In addition to prohibiting advancement completely, the statute specifically permits organizations to cap advancements and impose other “conditions” on advancement. Minn. Stat. Ann. §302A.521, subd.(4) (2008). Presumably such other conditions would include selection of counsel provisions.

<sup>244</sup> Minn. Stat. Ann. §302A.521, subd.(4)(2008).

<sup>245</sup> *Id.* at cmt,

<sup>246</sup> *Id.* at cmt.

<sup>247</sup> See *supra* notes 146-177 and accompanying text.