

# **Protecting Employee Rights and Prosecuting Corporate Crime: A Proposal for Criminal *Cumis* Counsel**

by  
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*To address multi-dimensional conflict of interest problems in directors and officers (D&O) indemnification cases, we propose a solution that was originally developed for civil insurance cases in California, but that has an even more powerful and appropriate application in the context of criminal employee defendants.*

*Corporate crime costs the United States a staggering \$600 billion a year. By contrast, the total cost of all non-corporate crime in 2001 from robbery, burglary, larceny-theft, and motor vehicle theft combined was \$17.2 billion; less than one-third of what fraudulent activities at the single company of Enron cost investors, pensioners, and employees in the same year. Given these statistics, it is understandable why the U.S. Department of Justice (the DOJ) put pressure on corporations not to pay employees' legal fees and judgments in its efforts to fight corporate crime and to hold individual employees responsible for their criminal acts.*

*But the DOJ's approach missed at least two essential pieces of the problem. The DOJ overlooked individual employee defendants as potential allies in the fight against corporate crime. Most importantly, however, the DOJ failed to recognize that its objections to corporate indemnification ultimately rest on the conflict of interest for employee's counsel when counsel is being controlled by the corporation—a violation in the criminal context of the individual employee defendant's Sixth Amendment rights.*

*Adopting criminal *Cumis* counsel would address this violation of individual employee defendant's rights. In addition, adopting criminal *Cumis* counsel would ultimately operate to the benefit of the DOJ, corporations, and individual employee defendants, as well as serve larger social objectives in reducing corporate crime and encouraging the more effective management of companies.*

I. Introduction .....	4
A. The Fundamental Conflict of Interest Problem Inherent in Corporate Control of Employee’s Counsel.....	4
B. Article Argument and Organization.....	7
II. The Tradition of D&O Indemnification: An Employee’s Right .....	7
A. Current Standards for Indemnification of Employees and their Actions.....	7
1. Which Employees May Be Indemnified.....	8
2. What Employee Actions May Be Indemnified .....	8
3. Indemnification of Criminal Conduct.....	10
B. Why and How Corporations Provide Indemnification.....	10
1. Practical Methods of Indemnification.....	11
2. The Function of D&O Insurance .....	11
3. Benefits of D&O Insurance Coverage for Employees.....	12
4. Larger Social Benefits of D&O Insurance Coverage.....	13
III. The Standoff between the DOJ and Corporations over D&O Indemnification .....	13
A. The DOJ’s Opening Salvo .....	13
1. The Holder Memorandum .....	14
2. The Thompson and McCallum Memoranda .....	15
3. The DOJ’s Three Main Policy Concerns Distilled .....	16
4. The DOJ’s Arguments as Rooted in Conflict of Interest Concerns under the Sixth Amendment .....	18
B. Attacks on the DOJ’s Initiative.....	19
1. The <i>Stein</i> Case .....	19
2. The ABA’s Resolution 302B .....	19
3. Proposed Anti-DOJ Legislation.....	21
C. The DOJ Retreats from its Initiative.....	21
1. The McNulty Memorandum .....	21
2. The Filip Memorandum.....	22
3. The Current U.S. Attorney’s Manual.....	23
IV. A Solution to Multi-Dimensional Conflicts of Interest: <i>Cumis</i> Counsel in California.....	23
A. The <i>Cumis</i> Decision.....	24
B. The California <i>Cumis</i> Statute.....	26
C. The Use of <i>Cumis</i> Counsel in California .....	28
V. Arguing for a Better Way: Adopting Criminal <i>Cumis</i> Counsel in DOJ Prosecutions .....	29
A. Corporations Should Not Control Employee’s Counsel .....	29
1. The Conflict of Interest at Issue.....	29
2. The Restatement and the Sixth Amendment.....	29
3. The Law is Moving in this Direction, and Insurance Companies are Already Anticipating the Spread of a <i>Cumis</i> Counsel Requirement.....	31
4. Criminal <i>Cumis</i> Counsel Should be Adopted Regardless of Whether the Corporation or the Insurance Company Pays for Employee’s Counsel.....	31
B. Right to Counsel Under the Sixth Amendment.....	32

C.	Benefits of Adopting Criminal <i>Cumis</i> Counsel for the DOJ.....	33
1.	Stonewalling .....	33
2.	Insincere Offers of Corporate Cooperation.....	33
3.	Corporations Throwing Employees ‘Under the Bus’ .....	34
D.	Benefits of Adopting Criminal <i>Cumis</i> Counsel for Corporations.....	35
1.	Easier Perception of Cooperation with Government Investigations .....	35
2.	Easier Attraction and Retention of Talented Employees .....	36
3.	Relief from Political Pressures during Litigation .....	36
4.	More Positive Public Perception of Corporations’ Compliance with General Legal Standards.....	36
E.	Benefits of Adopting Criminal <i>Cumis</i> Counsel for Individual Employee Defendants .....	37
1.	More Secure Right to Conflict-Free Counsel under the Sixth Amendment .....	37
2.	More Secure Protection of Individual Employee’s Interests against Co-Defendants .....	38
F.	Benefits of Adopting Criminal <i>Cumis</i> Counsel for Multiple Parties and for Society .....	39
1.	Use of a Well-Tailored Tool to Protect Interests in the New Environment of D&O Insurance .....	39
2.	All Parties Benefit from Longer and More Productive Careers for Employees.....	40
3.	Larger Economic Benefits of Adopting Criminal <i>Cumis</i> Counsel .....	40
G.	Additional Challenges to, and Arguments for, Adopting Criminal <i>Cumis</i> Counsel.....	40
VI.	Conclusion.....	42

## I. INTRODUCTION

The United States Department of Justice (the DOJ) has wrestled for a long time with a significant practical issue: the DOJ, like other law enforcement agencies, wants to prosecute business crime and to force the employees of business associations to internalize the social costs of their malfeasance.<sup>i</sup> But business associations (hereinafter generally “corporations” because that is the standard term that has been used in the debate)<sup>ii</sup> typically indemnify their directors and officers with insurance for the costs of defending lawsuits and for satisfying legal judgments, as long as employees could reasonably have been acting on the corporation’s behalf.

Although the costs of corporate crime are hard to compute, the Association of Certified Fraud Examiners estimates that the cost of occupational fraud and abuse in the United States in the year 2002 was \$600 billion.<sup>iii</sup> By contrast, in a 2001 report, the FBI estimated that the nation’s total loss that year from non-corporate crime, such as robbery, burglary, larceny-theft, and motor vehicle theft was \$17.2 billion.<sup>iv</sup> That total loss from non-corporate crime is less than a third of what the fraudulent activities at the single company of Enron cost investors, pensioners, and employees in the same year.<sup>v</sup> In 1979, the DOJ’s first and last survey of corporations and their violations of law found that approximately two-thirds of large corporations had violated the law, some of them many times over the two-year period from 1975 to 1976.<sup>vi</sup> Between 1999 and 2010, the number of “organizations” sentenced by U.S. courts in DOJ cases ranged from a low of 20 to a high of 198 each year.<sup>vii</sup>

Since at least 1999, the DOJ, corporations, defense counsel, in-house counsel, civil rights groups, and other interested parties have engaged in a slow-motion war of policy announcements, political push-back, and retractions to establish a proper balance between the need to hold individual corporate employees financially responsible for malfeasance and corporations’ practical need to be able to hire and to retain employees concerned about being sued. Both the government and corporations have legitimate and socially valuable interests in the debate. There is, additionally, a third important party involved in the indemnification of employees in business prosecutions that is overlooked in most discussions of the issue.<sup>viii</sup> Employees themselves have civil rights interests in being represented by counsel who can efficiently negotiate on the employee’s behalf and who can help make deals with the government when appropriate.

What none of these three parties, nor the academic community,<sup>ix</sup> has considered is adopting a new form of independent counsel in indemnification situations similar to a form first pioneered in civil suits in California. *Cumis* counsel, so named after the California Court of Appeals case in which the court ruled that such special counsel was necessary,<sup>x</sup> are paid for by insurance companies, but must represent the individual employee’s interest when the employee’s interest conflicts with the interest of the insurance company—or, in the case of a corporate business prosecution—with the interest of the potentially co-insured corporation that is the holder of the indemnification policy.

### A. *The Fundamental Conflict of Interest Problem Inherent in Corporate*

### *Control of Employee's Counsel*

Although the U.S. Supreme Court in case of *Wood v. Georgia*<sup>xi</sup> identified the inherent conflict of interest that exists when an employer controls its employee's counsel, until now, no uniform solution has existed to protect employee's rights in these situations. As the Supreme Court has written in the criminal context:

It is inherently wrong to represent both the employer and the employee if the employee's interest may, and the public interest will, be advanced by the employee's disclosure of his employer's criminal conduct. For the same reasons, it is also inherently wrong for an attorney who represents only the employee to accept a promise to pay from one whose criminal liability may turn on the employee's testimony.<sup>xii</sup>

Currently, a single attorney,<sup>xiii</sup> as in *Wood* above, may often represent both the corporation and the corporation's employees. Under agency law, the cost of the lawsuit and potential judgment is incurred on behalf of the principal, so only the interests of the principal are at stake.<sup>xiv</sup> Agency law provides for the principal to control the employee's defense because the principal will ultimately be liable for payments to a third party on the agent's behalf.<sup>xv</sup>

This interpretation of the principal's interest under agency law creates conflict of interest problems for attorneys. In criminal cases, agency law intrudes onto Sixth Amendment protections for individual employee defendants. The Sixth Amendment to the U.S. Constitution provides that "[i]n all criminal prosecutions, the accused shall enjoy the right to . . . have the Assistance of Counsel for his defence."<sup>xvi</sup> The U.S. Supreme Court has interpreted the Sixth Amendment to require effective assistance of counsel,<sup>xvii</sup> including the "correlative right to representation that is free from conflicts of interest"<sup>xviii</sup> for the defendant.

As the Court explains, "[n]ot only the interest of a criminal defendant but the institutional interest in the rendition of just verdicts in criminal cases may be jeopardized by unregulated multiple representation."<sup>xix</sup> The Court's broad concern is that:

[j]oint representation of conflicting interests is suspect because of what it tends to prevent the attorney from doing. . . . [A] conflict may. . . prevent an attorney from challenging the admission of evidence prejudicial to one client but perhaps favorable to another, or from arguing at the sentencing hearing the relative involvement and culpability of his clients in order to minimize the culpability of one by emphasizing that of another.<sup>xx</sup>

In the case of an employee criminal defendant, the problem is not who *pays* for the attorney's services,<sup>xxi</sup> but whether the attorney's actions will be controlled by the corporation or by the individual employee defendant whose Sixth Amendment rights are at stake.

An attorney's duty of loyalty should not be divided between the corporation and the individual employee. As the American Bar Association's (hereinafter

the “ABA”) Model Rules of Professional Conduct state, “a lawyer shall not represent a client if the representation involves a concurrent conflict of interest.”<sup>xxii</sup> According to Rule 1.7,

A concurrent conflict of interest exists if: (1) the representation of one client will be directly adverse to another client; or (2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer’s responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.<sup>xxiii</sup>

But many attorneys waive even these direct conflicts of interest.<sup>xxiv</sup> Under the ABA Model Rules of Professional Conduct, an attorney may waive his or her conflict of interest when “(1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;” when “(2) the representation is not prohibited by law;” when “(3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal;” and when “(4) each affected client gives informed consent, confirmed in writing.”<sup>xxv</sup> Currently, outside of California and other jurisdictions that have adopted *Cumis* counsel provisions, joint representation of the corporation and individual employees is not commonly prohibited by law. Agency law’s provision that the interest at stake in the representation is the corporation’s, and not the individual employee’s, has permitted attorneys to retain both the corporation and its employees as clients.<sup>xxvi</sup>

As will be discussed in this Article, very little academic debate has focused on the real problem: joint representation of corporations and their individual employees is rife with conflicts of interest for attorneys and, most certainly in criminal cases, threatens employee defendants’ Sixth Amendment rights. In some civil suits, such conflicts of interest may be minor enough to permit joint representation. But, even in civil suits, courts already distinguish between derivative suits and direct suits against corporations. In derivative suits, courts are now starting to require that a corporation and the suit’s real defendants be represented by separate counsel on the theory that, although “it is the corporation’s cause of action that is asserted in the derivate suit, [and] it is well understood that the corporation is a necessary party in the action,” the corporation’s interests will be “adverse to those of the suit’s real defendants.”<sup>xxvii</sup> In direct civil suits, the *Cumis* court was one of the few courts to find that the conflicts of interest required separate counsel, and the *Cumis* case was decided within the special circumstances of insurance claims.

In the criminal context, the argument against not only physical joint representation, but more specifically, the corporation’s *control* of employee’s counsel, more easily rises to the level of a violation of the individual employee’s Sixth Amendment rights. This is a fast-moving area of the law, and the Authors will describe how legal practice is already starting to change around it. There has been no discussion in the literature, however, of the root issues that should be driving reforms in this area, nor of how widespread reforms should be designed to remedy the core conflict of interest that affects an employee’s representation. Although, as the Authors note, there may be

broader applications of this Article’s argument in the area of civil litigation, this Article targets the narrow area of criminal prosecutions of individual employee defendants in which the Sixth Amendment applies, and which presents the strongest area for adoption of systemic reform.

### *B. Article Argument and Organization*

An excellent model already exists for solving multi-dimensional conflict of interest problems among employees, corporations, and counsel; righting what the U.S. Supreme Court, among other institutions, has identified as wrongs. Applying the *Cumis* counsel model developed to address conflicts of interest in insurance cases to the criminal context is a simple step that adopts a tested model to address similar, and even more compelling, circumstances.

To set the stage for adopting *Cumis* counsel in criminal cases, this Article will make an argument in five parts. Part One of this Article is an introduction to the issue. Part Two of this Article will briefly discuss traditional directors’ and officers’ indemnification (hereinafter “D&O indemnification”) and the transformative growth of D&O insurance. Part Three will outline the history of the recent standoff between the DOJ and corporations over D&O indemnification. Part Four will describe California’s *Cumis* counsel model. Part Five will conclude with arguments for adopting criminal *Cumis* counsel in federal criminal prosecutions of employees, although the Article’s recommendations apply equally well to criminal prosecutions at the state level. Ultimately, as this Article will illustrate, instituting criminal *Cumis* counsel in DOJ criminal business prosecutions paradoxically works to the advantage of corporations, their employees, DOJ prosecutions, and society as a whole.

## II. THE TRADITION OF D&O INDEMNIFICATION: AN EMPLOYEE’S RIGHT

Traditionally, one of the basic duties that a principal owes to its agents under agency law is to indemnify them when agents incur costs on the principal’s behalf.<sup>xxviii</sup> A corporation has an obligation to indemnify the employees who act on its behalf. That indemnification includes reimbursement of costs to the employees from lawsuits that they incur while serving the corporation.<sup>xxix</sup> The indemnification of employees, most commonly D&O indemnification, has an important place in the business culture of the United States. It is an employee’s right. But, in a series of memoranda promulgating its policies to put pressure on corporations not to indemnify their D&Os, the DOJ failed to honor this basic right of employees.

This Part of the Article will briefly discuss the roots and function of D&O indemnification to illustrate how it works and the place that it has in U.S. business culture. The beauty of instituting criminal *Cumis* counsel is that society could maintain the benefits of D&O indemnification while addressing both the employee’s Sixth Amendment protection problem and the DOJ’s concerns about its ability to prosecute corporate crime.

### *A. Current Standards for Indemnification of Employees and their Actions*

D&O indemnification is very common. Most states, including New York,<sup>xxx</sup> Delaware,<sup>xxxi</sup> and California,<sup>xxxii</sup> have enacted statutes that generously permit corporations to indemnify employees who act on the corporations’

behalf. In the many states<sup>xxxiii</sup> that follow the Revised Model Business Corporation Act (the “RMBCA”), corporate indemnification of employees is required in broad circumstances.<sup>xxxiv</sup> Additionally, when appropriate, the RMBCA provides for directors of corporations affirmatively to request that courts order both indemnification and advance expenses for directors to defend themselves from suit.<sup>xxxv</sup>

### *1. Which Employees May Be Indemnified*

State laws differ significantly on the types of employees who may be indemnified by corporations. California, Delaware, and New York all have expansive statutes on which types of employees may be indemnified. California allows corporations to indemnify “any person who is or was a director, officer, employee or other agent of the corporation,” as an agent of the corporation.<sup>xxxvi</sup> Delaware’s statute permits corporations to indemnify “any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding” if that “person is or was a director, officer, employee or agent of the corporation,”<sup>xxxvii</sup> and even if the person served at the request of the corporation for another business entity that was not the corporation.<sup>xxxviii</sup> New York’s indemnification statute includes any person “made, or threatened to be made, a party to an action or proceeding” whether that person, “his testator or intestate” served as a “director or officer of the corporation,” or served another corporation at the request of the corporation, “in any capacity.”<sup>xxxix</sup>

The RMBCA limits corporate indemnification to directors and officers. Under the RMBCA, a “director” or “officer” is an individual “who is or was a director or officer, respectively, of a corporation” or who, while serving as a director or officer of that corporation, served at the corporation’s request as a “director, officer, partner, trustee, employee, or agent of another domestic or foreign corporation, partnership, joint venture, trust, employee benefit plan, or other entity.”<sup>xl</sup>

### *2. What Employee Actions May Be Indemnified*

In addition, state laws differ as to what actions by employees the corporation may indemnify. Almost all states require that the employee must have been reasonably acting on behalf of the corporation’s interest. But how states define a corporation’s interest vary widely.

Delaware has perhaps the broadest terms for defining when corporations may indemnify employees. Corporations may indemnify their employees “[t]o the extent that a present or former director or officer of a corporation has been successful on the merits or otherwise in defense of any action, suit or proceeding referred to in subsections (a) and (b) of this section [regarding which employees may be indemnified], or in defense of any claim, issue or matter therein, such person shall be indemnified expenses (including attorneys’ fees) actually and reasonably incurred by such person in connections therewith.”<sup>xli</sup> In criminal cases, Delaware courts have held that any result other than conviction must be considered “successful on the merits.”<sup>xlii</sup> Employees are entitled to partial indemnification if successful on one count of an indictment, even if the employee is unsuccessful on a related count of the same



indictment.<sup>xliii</sup>

New York has a slightly less expansive set of conditions for when corporations may indemnify their employees. The employee must have acted “in good faith, for a purpose which he reasonably believed to be in, . . . [or] not opposed to, the best interests of the corporation and, in criminal actions or proceedings, in addition, had no reasonable cause to believe that his conduct was unlawful.”<sup>xliiv</sup> In contrast with Delaware law, legal conviction alone does not determine whether the employee fails the New York standard. New York law provides that:

[t]he termination of any such civil or criminal action or proceeding by judgment, settlement, conviction or upon a plea of nolo contendere, or its equivalent, shall not in itself create a presumption that any such director or officer did not act, in good faith, for a purpose which he reasonably believed to be in, . . . [or] not opposed to, the best interests of the corporation or that he had reasonable cause to believe that his conduct was unlawful.<sup>xlv</sup>

California’s statute utilizes the same test as New York for the circumstances in which corporations may indemnify their employees,<sup>xlvi</sup> but it vastly broadens the situations in which corporate indemnification is mandatory instead of permissive. California mandates indemnification of an employee “for all necessary expenditures or losses incurred by the employee in direct consequence of the discharge of his or her duties, or of his or her obedience to the directions of the employer, even though unlawful, unless the employee, at the time of obeying the directions, believed them to be unlawful.”<sup>xlvii</sup>

The RMBCA differentiates indemnification circumstances according to whether the employee is a director or an officer. Regarding directors, articles of incorporation may include provisions in the criminal context that either permit or mandate, indemnification for any liability “except liability for. . . an intentional violation of criminal law.”<sup>xlviii</sup> An “intentional” violation, as opposed to a negligent or unintentional violation of criminal law, is very limited and, to establish this required state of mind, a significant amount must be proven for the director to be found guilty.<sup>xlix</sup>

Additionally, regarding directors, the RMBCA provides as a limitation on permissible indemnification that:

- (iii) in the case of any criminal proceeding, he had no reasonable cause to believe his conduct was unlawful; or
- (2) he engaged in conduct for which broader indemnification has been made permissible or obligatory under a provision of the articles of incorporation (as authorized by section 2.02(b)(5) [the section on articles of incorporation provisions quoted above]).<sup>1</sup>

Having “no reasonable cause to believe his conduct was unlawful” is a somewhat narrow limitation for directors to be permissively indemnified, but this formulation still entitles those directors to significant protection under a wide range of circumstances. Moreover, a director is entitled to mandatory indemnification when “wholly successful, on the merits or otherwise, in the

defense of any proceeding to which he was a party because he was a director of the corporation against expenses incurred by him in connection with the proceeding.”<sup>li</sup>

Under the RMBCA, officers of a corporation may be indemnified, and officers may have their expenses advanced by the corporation, either “to the same extent as a director,”<sup>lii</sup> or on the very forgiving condition that the officer has not committed “an intentional violation of criminal law.”<sup>liii</sup>

The American Law Institute’s Principles of Corporate Governance exclude from indemnification conduct “[i]nvolv[ing] a knowing and culpable violation of law by the director or officer.”<sup>liv</sup> As one commentator famously noted, this formulation of the ALI Principles “permit[s] companies to exculpate their directors for liability. . . even for knowing and intentional violations of the law, so long as these are not also ‘culpable’ violations.”<sup>lv</sup> The ALI commentary defines as ‘culpable’ “conduct that is morally reprehensible under generally prevailing standards.”<sup>lvi</sup> By this definition of culpability, a significant amount of criminal behavior may be permitted without barring indemnification.<sup>lvii</sup>

### 3. *Indemnification of Criminal Conduct*

Accordingly, an employee being criminally prosecuted for behavior carried out in the interest of his or her employer can, and sometimes must be, indemnified by the corporation as a matter of the employee’s right. As documented in one recent report published for the benefit of directors of non-profit organizations,<sup>lviii</sup> the many laws that directors may be held liable for violating include everything from the Securities Exchange Act,<sup>lix</sup> the Internal Revenue Code,<sup>lx</sup> the Employee Retirement Income Security Act,<sup>lxi</sup> the Occupational Safety and Health Act,<sup>lxii</sup> environmental protection laws, to failure to withhold or to pay social security taxes, as well as additional issues at the federal, state, and local levels.<sup>lxiii</sup> The Sarbanes-Oxley Act,<sup>lxiv</sup> the Dodd-Frank Wall Street Reform and Consumer Protection Act,<sup>lxv</sup> the Racketeer Influenced and Corrupt Organizations Act,<sup>lxvi</sup> and other statutes are criminalizing more and more employee behavior performed on behalf of corporations.<sup>lxvii</sup>

#### *B. Why and How Corporations Provide Indemnification*

Given the scope of potential liability for lawsuits against the employees of corporations, it is understandable why many directors and officers will not serve a corporation that chooses not to indemnify them. Courts have recognized that “[i]ndemnification encourages corporate service by capable individuals by protecting their personal financial resources from depletion by the expenses they incur during an investigation or litigation that results by reason of that service.”<sup>lxviii</sup> As one report flatly announced to a library executive board in a predominantly rural area, “Quality directors will not serve without D&O coverage.”<sup>lxix</sup>

Thus, both because indemnification may be required by law and because it may serve as a recruiting and retention tool, corporations typically indemnify their top employees, and courts protect employees’ right to indemnification.<sup>lxx</sup>

## 1. *Practical Methods of Indemnification*

In practice, the mechanism that a corporation uses to indemnify employees may vary.<sup>lxxi</sup> Indemnification refers to the repayment post-hoc of actual costs incurred by the employee on behalf of the corporation. But corporations utilize other methods to pay employees for these costs as well.

First, there is a distinction in time between indemnification, which is repayment of the costs incurred by the employee after the employee has already paid out-of-pocket, and the advancement of fees to cover the employee's costs,<sup>lxxii</sup> which is a form even more attractive to employees.<sup>lxxiii</sup> As courts have described, “[a]dvancement provides corporate officials with immediate interim relief from the personal out-of-pocket financial burden of paying the significant on-going expenses inevitably involved with investigations and legal proceedings.”<sup>lxxiv</sup> Recently, explicit contractual provisions for the mandatory advancement of fees have become increasingly common.<sup>lxxv</sup> There are differences among jurisdictions as to when an employee is entitled to one mechanism or the other.<sup>lxxvi</sup>

Second, because corporations may have exposure to suits from employees for either the advancement of fees or indemnification, corporate purchase of insurance to cover such costs has become common practice. U.S. corporations are not required to disclose the purchase of D&O insurance, but a survey in 2004 reported that over ninety percent, and possibly a figure as high as ninety-nine percent, of public companies carried D&O insurance.<sup>lxxvii</sup> All states currently permit corporate purchase of D&O insurance by statute.<sup>lxxviii</sup> Furthermore, most state statutes permit D&O insurance policies to cover behavior beyond the terms that the corporation itself could offer in the advancement of fees or the indemnification of its employees.<sup>lxxix</sup>

## 2. *The Function of D&O Insurance*

D&O insurance comes in two basic versions<sup>lxxx</sup> and three basic types.<sup>lxxxi</sup> These versions and types may be mixed, matched, combined, and altered in countless different ways to suit the needs of any corporation. As one insurance broker informs its clients, “[t]here is no standard D&O insurance policy.”<sup>lxxxii</sup>

Insurance companies advertise that D&O insurance covers “[c]riminal, administrative, civil, and regulatory proceedings based on actual or alleged acts, errors, omission, misstatements, neglect, or breach of duty committed or allegedly committed by a director or officer.”<sup>lxxxiii</sup> The technical wrinkle in this language is that, although D&O insurance may pay for the cost of defending proceedings against D&Os,<sup>lxxxiv</sup> it often cannot pay for the cost of judgments against them in those proceedings.<sup>lxxxv</sup> Commonly, this restriction on the payment of insurance premiums in certain D&O cases is a matter of public policy, similar to limits on indemnification, as codified in statutory law.<sup>lxxxvi</sup> Additionally, the insurance company may seek to recover its outlay of funds in D&O defense proceedings if the D&Os are found guilty of behavior that the insurance company could not indemnify—or that the insurance company claims is a violation of the terms of the policy, which may be more limited by contract than the terms upon which the company itself could have indemnified its D&Os.<sup>lxxxvii</sup> The typical forms of D&O insurance policies provide exclusions for “fraud, dishonesty, and illegal profit or advantage—so-called

‘conduct’ exclusions.”<sup>lxxxviii</sup>

Importantly, an insurance company “will typically reserve its rights to deny coverage under the policy” to protect itself in situations in which the company must defend a case, but in which it may have reservations about whether the employee or the company’s actions exceed the terms of the policy’s coverage.<sup>lxxxix</sup> A reservation of rights letter informs the insured that the insurance company will begin to defend the suit against the insured, but, if it receives information that the insured’s behavior exceeded the terms of the policy’s coverage, the insurance company will stop defending the insured, and it will seek reimbursement from the insured for the expenses that the company has already incurred in the suit.

In contrast with general liability insurance claims, an insurance company defending a D&O suit almost always issues a reservation of rights letter.<sup>xc</sup> Whereas most general liability claims easily cover the range of allegations regarding negligence made in general liability suits, D&O insurance coverage is highly dependent on findings about the insured’s behavior, as determined by the litigation itself.<sup>xc<sup>i</sup></sup> D&O insurance cases, for example, often turn on issues such as allegations of fraud that would violate the policy’s conduct exclusions: allegations to which the insured is unlikely to plead at the beginning of litigation, precisely for fear of jeopardizing his or her insurance coverage.<sup>xc<sup>ii</sup></sup>

Nonetheless, an insurance company will usually defend D&O insurance suits, even when it is not convinced that the insured’s behavior will ultimately be covered under the terms of its policy. In fact, in a majority of states, an insurer may be penalized if it does not defend a suit that arguably could have been covered under the terms of its policy because courts imply a covenant of good faith and fair dealing when evaluating insurance coverage.<sup>xc<sup>iii</sup></sup> If the insured can establish a breach of the duty of good faith and fair dealing in the insurance company’s handling of his or her claim, he or she “could recover not just [his or her] economic losses—the policy amount and consequential economic damages—but mental anguish and, upon proper proof, punitive damages.”<sup>xc<sup>iv</sup></sup>

### *3. Benefits of D&O Insurance Coverage for Employees*

Moreover, in at least three situations, D&O insurance, despite its other limitations, often provides more coverage for employees than direct corporate indemnification might. The first, and most commonly discussed, situation arises when employees seek to draw on D&O insurance after the insolvency of the corporation. In practical terms, as one long-term observer noted, employees are particularly concerned about insolvency protection given that “insolvency is the time when the risk of lawsuits against directors and officers is the highest because the plaintiffs do not have much chance of recovering losses from the corporation.”<sup>xc<sup>v</sup></sup> In addition, for directors and officers who served an insolvent corporation, “[w]hat good is an indemnification from an insolvent indemnitor?”<sup>xc<sup>vi</sup></sup>

Second, the presence of D&O insurance, rather than merely corporate indemnification, becomes important in a key situation that the DOJ, as will be discussed later in this Article, has focused on in corporate prosecutions: the problem of corporations throwing employees ‘under the bus’ to curry false favor with the government and/or to curtail the scope of a government

prosecution. When a corporation wants to settle a suit quickly, it may cut off payments for its employees' legal fees, triggering a suit from the employees to enforce their right to indemnification, but immediately leaving the employees compromised in their ability to defend themselves against the government. If the corporation has D&O insurance, the insurance company may continue to pay the employees' attorneys' fees even when the corporation would sacrifice its employees because D&O insurance is not subject to the same immediate political pressures as the corporation's decisions on indemnification.<sup>xcvii</sup>

Third, in some types of securities fraud cases in which corporations have been prohibited by law from indemnifying their employees, courts have permitted employees to be compensated through D&O insurance instead.<sup>xcviii</sup> This area of the law is still in flux, but such rulings make the point that D&O insurance contracts may be more fluid and permissive than traditional indemnification coverage in protecting employees' ability to defend themselves in litigation.

#### *4. Larger Social Benefits of D&O Insurance Coverage*

Finally, and perhaps surprisingly, the increasing utilization of D&O insurance by corporations to protect their employees may provide a measurable benefit to society as a whole. It has long been established that corporations' purchase of D&O insurance has a significantly favorable effect on the wealth of shareholders,<sup>xcix</sup> presumably because the insurance companies have an incentive to encourage better decision-making on the part of top employees.<sup>c</sup> In addition, research has found that "investors consider managers' liability protection through D&O insurance to be more important than cash for indemnification."<sup>ci</sup> Generally the availability of indemnification appears to improve the willingness of the directors and officers of corporations to be forthcoming in the quantity and the quality of a corporation's voluntary disclosures.<sup>cii</sup> In addition, specifically, among Canadian firms for which data were available,<sup>ciii</sup> when corporations provided D&O insurance, "the higher the coverage [of D&O insurance], the more frequent the voluntary disclosures, especially for firms that are cross-listed in the U.S."<sup>civ</sup> Accordingly, when considering the data on indemnification and insurance as a whole, social scientists have concluded that the very existence of "liability coverage may be a determinant of the credibility of voluntary disclosures."<sup>cv</sup>

### III. THE STANDOFF BETWEEN THE DOJ AND CORPORATIONS OVER D&O INDEMNIFICATION

The U.S. Department of Justice recently conducted a very public fight with corporations, defense counsel, and other interested parties over D&O indemnification. As the DOJ announced in 1999, "More and more often, federal prosecutors are faced with criminal conduct committed by or on behalf of corporations. The Department is committed to prosecuting both the culpable individuals and, when appropriate, the corporation on whose behalf they acted."<sup>cvi</sup>

#### *A. The DOJ's Opening Salvo*

The DOJ's new initiative to prosecute corporate crime provided, among

other things, that the DOJ would not grant credits for cooperation to corporations that indemnified their D&Os in the course of prosecutions because the DOJ considered such indemnification to be an impediment to its ability to prosecute crimes. Taking apart the DOJ's arguments against D&O indemnification reveals three main perceived threats to the ability of the DOJ successfully to prosecute corporate crime, all three of which contain a core element of legitimate threat not only to the DOJ, but also to the ability of the corporation's employees to defend themselves independent of the corporation. Despite the merit of its concerns regarding these D&O indemnification issues, the DOJ ultimately retreated from its initiative due to backlash from the overreach of its approach.

### *1. The Holder Memorandum*

In its 1999 Memorandum entitled "Bringing Charges Against Corporations,"<sup>cvii</sup> commonly known as the Holder Memorandum after the then-Deputy Attorney General, the DOJ conducted the opening salvo in a war to consider D&O indemnification when evaluating corporate cooperation with business prosecutions. The general principle of the DOJ's approach was that

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

The DOJ's policy was operating on two levels at the same time. The DOJ was not merely interested in pursuing corporations themselves, but also in pursuing cases against the individuals within corporations who were responsible for immediate wrongdoing. As the DOJ explained,

[c]harging a corporation, however, does not mean that individual directors, officers, employees, or shareholders should not also be charged. Prosecution of a corporation is not a substitute for the prosecution of criminally culpable individuals within or without the corporation. Further, imposition of individual criminal liability on such individuals provides a strong deterrent against future corporate wrongdoing.<sup>cxix</sup>

In making the determination to charge the corporation itself, as opposed to limiting prosecutions to individuals, the Holder Memorandum instructed prosecutors to consider how cooperative the corporation is during the government's investigation of the alleged wrongdoing.<sup>cx</sup> In the words of the Memorandum, "[i]n gauging the extent of the corporation's cooperation, the prosecutor may consider the corporation's willingness to identify the culprits within the corporation, including senior executives, to make witnesses available, to disclose the complete results of its internal investigation, and to

waive the attorney-client and work product privileges.”<sup>cxii</sup>

The DOJ was particularly concerned that the extent and value of a corporation’s cooperation be weighed in light of its “promise of support to culpable employees and agents, either through the advancing of attorneys fees, through retaining the employees without sanction for their misconduct, or through providing information to the employees about the government’s investigation pursuant to a joint defense agreement.”<sup>cxiii</sup> A footnote in the text recognized that “[s]ome states require corporations to pay the legal fees of officers under investigation prior to a formal determination of their guilt. Obviously, a corporation’s compliance with governing law should not be considered a failure to cooperate.”<sup>cxiiii</sup>

## 2. *The Thompson and McCallum Memoranda*

In its 2003 Thompson Memorandum,<sup>cxiv</sup> the DOJ withstood intense attacks to its new approach, as will be discussed, mainly on its requests for corporations to waive attorney-client privilege,<sup>cxv</sup> but also on D&O indemnification.

The Thompson Memorandum more specifically described what prosecutors should look for in considering the extent of a corporation’s cooperation with a government investigation. In three separate paragraphs quoted below, the Thompson Memorandum warned about threats that fall loosely into three categories: (1) the potential for corporations to stonewall a government investigation through their use of D&O indemnification; (2) insincere offers of cooperation while the corporation coordinates with its employees or their counsel to impede the investigation; and (3) incentives for corporations to throw their employees ‘under the bus’ to curtail more comprehensive punishment of the corporation itself or its other employees.

In the paragraph about the potential for corporations to stonewall a government investigation in various ways, the Thompson Memorandum advised prosecutors that

[a]nother factor to be weighed by the prosecutor is whether the corporation appears to be protecting its culpable employees and agents. Thus, while cases will differ depending on the circumstances, a corporation’s promise of support to culpable employees and agents, either through the advancing of attorneys fees, through retaining the employees without sanction for their misconduct, or through providing information to the employees about the government’s investigation pursuant to a joint defense agreement, may be considered by the prosecutor in weighing the extent and value of a corporation’s cooperation. By the same token, the prosecutor should be wary of attempts to shield corporate officers and employees from liability by a willingness of the corporation to plead guilty.<sup>cxvi</sup>

Equally specific is the paragraph about the danger of insincere offers of corporate cooperation while the corporation coordinates with its employees or their counsel to impede the investigation:

[a]nother factor to be weighed by the prosecutor is whether the corporation, while purporting to cooperate, has engaged in conduct that impedes the investigation (whether or not rising to the level of criminal obstruction). Examples of such conduct include: overly broad assertions of corporate representation of employees or former employees; inappropriate directions to employees or their counsel, such as directions not to cooperate openly and fully with the investigation including, for example, the direction to decline to be interviewed; making presentations or submissions that contain misleading assertions or omissions; incomplete or delayed production of records; and failure to promptly disclose illegal conduct known to the corporation.<sup>cxvii</sup>

In the paragraph about incentives for a corporation to throw its employees ‘under the bus’ to curtail more comprehensive punishment of the corporation itself or its other employees, the Thompson Memorandum cautioned prosecutors that:

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

In its 2005 McCallum Memorandum,<sup>cxix</sup> the DOJ attempted to limit controversy over the attorney-client privilege issue by instructing United States Attorneys to establish a “written review process for [their] district or component” to control requests that corporations waive attorney-client privilege.<sup>cxx</sup> But the DOJ’s position on D&O indemnification remained unchanged.

### *3. The DOJ’s Three Main Policy Concerns Distilled*

Thus, in articulating its policy for effective corporate criminal prosecutions between 1999 and 2005, the DOJ was concerned with at least three main threats which also contain a core element of legitimate threat to the ability of employees to defend themselves properly, independent of the interests of the corporation.

First, because a corporation that pays for employee’s counsel typically controls the employee’s defense, the corporation may seek to stonewall potential settlement with the employee if the terms of the settlement require that the employee cooperate with the government against the corporation. If a corporation controls the purse strings, and therefore effectively the tactics of the employee’s defense, the corporation is more likely to issue, in the words of the Thompson Memorandum, “inappropriate directions to employees or their counsel, such as directions not to cooperate openly and fully with the investigation including, for example, the direction to decline to be interviewed.”<sup>cxxi</sup> By contrast, settlement and cooperation may have clearly been



in the individual employee's best interest, and the course that he or she would have taken had the corporation not controlled counsel.

Stonewalling tactics may be inconvenient for the DOJ's prosecution, but corporate control over employee's counsel is more fundamentally a conflict of interest for counsel and may compromise the employee's basic representation. Therefore, as will be described later, even after the DOJ ultimately backed away from its pressure on D&O indemnification, prosecutors could still ask who was paying for employee's counsel, because that issue presumably affects counsel's behavior and the range of the employee's choices.<sup>cxxii</sup>

Second, the DOJ was concerned about the danger of insincere offers of corporate cooperation while the corporation simultaneously coordinates with its employees or their counsel to impede the investigation. Both the 1999 Holder and the 2003 Thompson memoranda instructed prosecutors, for example, to consider as an impediment to cooperation "providing information to the employees about the government's investigation pursuant to a joint defense agreement."<sup>cxxiii</sup>

Not only may Joint Defense Agreements (JDAs) inappropriately allow a corporation and its employees to share information about the government's investigation in coordinating their defense, but the real danger of JDAs to the government's ability to prosecute, and more importantly, to an employee's right to defend himself or herself, is additionally two-fold. JDAs may restrict, similar to concerns above about stonewalling, the employee from cooperating with the government against the corporation even when cooperation is in the employee's best interest. In addition, the JDA may force the employee to waive his or her attorney-client privilege vis-à-vis the corporation and other defendants such that the employee cannot trust and confide in his or her own attorney to plan an appropriate defense. Both the Holder and Thompson memoranda encourage corporations, in order to receive cooperation credit, "to identify the culprits within the corporation, including senior executives, to make witnesses available, to disclose the complete results of its internal investigation, and to waive the attorney-client and work product privileges,"<sup>cxxiv</sup> all of which could be prohibited under a JDA.

Third, the DOJ was concerned that corporations have incentives to throw employees 'under the bus' to curtail damage to the corporation itself from a more comprehensive government prosecution. Both the Holder and Thompson memoranda emphasized that "[a] corporation should not be able to escape liability merely by offering up its directors, officers, employees, or agents as in lieu of its own prosecution."<sup>cxxv</sup> As one top DOJ official related in a 2000 speech to corporate ethics officers in also discussing waiver of attorney-client privilege, "It should not come as a surprise to you that prosecutors may well view a company's version of the key events relevant to possible criminal liability with some skepticism. Prosecutors will ask themselves whether the corporation is putting a 'spin' on the facts to minimize or even hide other culpable conduct or to protect certain employees while sacrificing others."<sup>cxxvi</sup>

Naturally, being 'thrown under the bus' is not in an employee's best interest either. More insidiously, counsel controlled by the corporation both may be less interested in facts that would allow the employee to strike a better deal with the government by revealing the extent of greater wrongdoing by the corporation, and less likely vigorously to defend the employee against charges when the

corporation is eager for the controversy to disappear.

Decided a year after the 1999 Holder Memorandum was published, the case of *U.S. v. Josleyn*<sup>cxxvii</sup> nicely illustrates both the prosecutorial problem that the DOJ was concerned about in corporations throwing their employees ‘under the bus,’ and the harm that employees themselves incur when corporations exercise their influence over employees’ counsel to curtail government investigations. According to the U.S. Court of Appeals for the First Circuit in *Josleyn*, “[w]idespread bribery, kickbacks, and other fraud infected the operations of the American Honda Motor Company from the 1970s to the early 1990s.”<sup>cxxviii</sup> Although two American Honda executives were convicted of conspiring to defraud their employer, subsequent litigation revealed that American Honda had, at proffer meetings with prosecutors regarding the two executives’ behavior, “attempted to persuade the prosecutor that [the corporation] was ‘innocent of any wrongdoing’ and that it was ‘ignorant of the crimes committed by its former executives who were under investigation.’”<sup>cxxix</sup> Because the company feigned innocence and blamed all of its problems on the few executives whom the prosecutor had already targeted, “the extent of American Honda’s knowledge was concealed from the prosecutor.”<sup>cxxx</sup>

Evidence of American Honda’s misuse of the corporation’s control over counsel in this situation was particularly compelling. In the subsequent class-action case against American Honda, a judge for the U.S. Court of Appeals for the Fourth Circuit concluded that the “apparent breadth of American Honda’s design to enlist the assistance, knowing or otherwise, of its attorneys in concealing evidence of gratuities supports the district court’s finding that the [Sixth-Amendment-based confidentiality] privileges asserted in the instant case are negated by the crime-fraud exception.”<sup>cxxx</sup> Accordingly, the court held that the district court judge in the class-action case could properly vitiate American Honda’s attorney-client and work-product privileges.<sup>cxxxii</sup>

The Sixth Amendment again emerges as central to the court’s decision: courts require attorney-client confidentiality to protect attorney-client relationships free from conflicts of interest or abuse.<sup>cxxxiii</sup>

#### *4. The DOJ’s Arguments as Rooted in Conflict of Interest Concerns under the Sixth Amendment*

The DOJ’s best arguments against the way that D&O indemnification operates in prosecutions should be the way that current forms of D&O indemnification impede employees’ Sixth Amendment right to representation free from conflicts of interest. Those very employees, as the DOJ may begin to realize, could be the government’s best allies in reporting and preventing corporate crime.<sup>cxxxiv</sup> The DOJ correctly identified the most problematic ways in which the current terms of D&O indemnification prevent employees from cooperating with the government and bind employees to the corporation’s interest in mounting their defense. But the way in which the DOJ sought to put pressure on corporations not to indemnify their employees at all, and to waive attorney-client privilege under the threat of being seen as uncooperative with a government investigation, was overly broad and failed to recognize the legitimate place of D&O indemnification as a right due to the employee. Most

ironically, the DOJ's efforts to put pressure on these issues created new violations of the Sixth Amendment and galvanized massive support for repealing the DOJ's initiative.

## *B. Attacks on the DOJ's Initiative*

### *1. The Stein Case*

In June 2006, U.S. District Court Judge Lewis Kaplan's decision in *U.S. v. Stein*<sup>cxv</sup> railed against the DOJ's policy of putting pressure on corporations not to pay their employees' attorneys' fees.<sup>cxvi</sup> The government had indicted thirteen former partners and employees of the massive accounting firm KPMG, LLP, for alleged violations of tax regulations regarding the use of tax shelters.<sup>cxvii</sup> As part of a deferred prosecution agreement with the government to protect the partnership itself, KPMG cut off payments of all legal fees and expenses to the defendants.<sup>cxviii</sup> Because, as Judge Kaplan found, "KPMG's decision. . . was the direct consequence of the pressure applied by the Thompson Memorandum and the USAO [United States Attorney's Office],"<sup>cxix</sup> the DOJ's policy could not survive strict scrutiny, and the DOJ's actions violated the defendants' Sixth Amendment right to counsel.<sup>cxl</sup>

As Judge Kaplan explained, the scope of the Sixth Amendment not only provides that "[i]n all criminal prosecutions, the accused shall enjoy the right to . . . have the Assistance of Counsel for his defence,"<sup>cxli</sup> but the Amendment "guarantees more than the mere presence of a lawyer at a criminal trial. It protects, among other things, an individual's right to choose the lawyer or lawyers he or she desires and to use one's own funds to mount the defense that one wishes to present."<sup>cxlii</sup> Because the KPMG employees could no longer be represented as they chose due to constraints on the "resources lawfully available to them,"<sup>cxliii</sup> the government had created a new violation of defendants' Sixth Amendment right to counsel.

Judge Kaplan further explained that society has a greater interest in ensuring that trials are fair than in making sure that the guilty are convicted. The DOJ's pressure on the defendants' Sixth Amendment rights in *Stein* improperly balanced those interests.<sup>cxliv</sup> As Judge Kaplan wrote in regard to the KPMG employees,

[j]ustice is not done when the government uses the threat of indictment—a matter of life and death to many companies and therefore a matter that threatens the jobs and security of blameless employees—to coerce companies into depriving their present and even former employees of the means of defending themselves against criminal charges in a court of law. If those whom the government suspects are culpable in fact are guilty, they should pay the price. But the determination of guilt or innocence must be made fairly—not in a proceeding in which the government has obtained an unfair advantage long before the trial even has begun.<sup>cxlv</sup>

### *2. The ABA's Resolution 302B*

In August 2006, the American Bar Association's House of Delegates

unanimously<sup>cxlvi</sup> passed Resolution 302B,<sup>cxlvii</sup> which forcefully articulated the ABA's opposition to DOJ pressure on D&O indemnification. Resolution 302B stated that the ABA "opposes government policies, practices and procedures that have the effect of eroding the constitutional and other legal rights of current or former employees, officers, directors or agents. . . by requiring, encouraging or permitting prosecutors. . . to take into consideration" any of a list of factors "in making a determination of whether an organization has been cooperative in the context of a government investigation."<sup>cxlviii</sup> The four factors that the ABA listed in its resolution were:

- (1) that the organization provided counsel to, or advanced, reimbursed or indemnified the legal fees and expenses of, an Employee;
- (2) that the organization entered into or continues to operate under a joint defense, information sharing and common interest agreement with an Employee with whom the organization believes it has a common interest in defending against the investigation;
- (3) that the organization shared its records or other historical information relating to the matter under investigation with an Employee; or
- (4) that the organization chose to retain or otherwise declined to sanction an Employee who exercised his or her Fifth Amendment right against self-incrimination in response to a government request for an interview, testimony, or other information.<sup>cxlix</sup>

As described in the American Bar Association's (ABA's) Criminal Justice Section Newsletter that fall, there was an intense debate within its House of Delegates while drafting the resolution over whether the resolution should have so strongly defended joint defense agreements (JDAs).<sup>cl</sup> As the ABA's newsletter explained, some delegates believed that the government should not be in the business of putting pressure on parties to withdraw from JDAs by denying cooperation credits to parties who participate in the agreements.<sup>cli</sup> Other delegates thought that the government should be able to "take an organization's participation in a joint defense agreement into consideration, if a party to the agreement had engaged in unlawful conduct or was thought by the government to be 'culpable,' in the words of the Thompson Memorandum."<sup>clii</sup>

Key to this dispute among ABA delegates was that joint defense agreements only become an issue under the DOJ's policies when one of the parties does want to cooperate with the government.<sup>cliii</sup> Thus, if a corporation is seeking credit for cooperating with an investigation, the corporation should "reasonably be expected to assist the investigation, not undermine it."<sup>cliv</sup> More precisely,

[c]ontinuing to participate in a joint defense agreement with a culpable party, under which privileged information concerning the progress of the investigation may be shared, may logically be seen as inconsistent with an obligation to cooperate. More to the point, having made the decision to cooperate, the organization's interests will diverge from those of other JDA members whom the organization believes to have acted unlawfully in connection with the matter under investigation.<sup>clv</sup>

In sum, the debate among ABA delegates focused on the potential—if not, by definition, the realized—conflict of interest between the members of the JDA when at least one party to the agreement wants to cooperate with the government. The way that the ABA delegates resolved their disagreement enough to craft Resolution 302B was to look hard at the only two parties that they thought could control decisions by counsel in a JDA situation: the business organization or the government. As between those two parties, the delegates could agree that the determination on cooperation “should be made by the organization, not the government.”<sup>clvi</sup> But the delegates failed to consider the rights of a third party: the individual employee.

### *3. Proposed Anti-DOJ Legislation*

In September 2006, in response to pressure from the ABA, as well as from a large coalition of business and legal organizations,<sup>clvii</sup> the U.S. Senate Committee on the Judiciary began to hold hearings on the DOJ’s policies as originally articulated in the Thompson Memorandum.<sup>clviii</sup> The majority of the hearing was devoted to the DOJ’s position on requesting waiver of the attorney-client privilege, rather than on D&O indemnification, but, in his statement defending the Thompson Memorandum, Deputy Attorney General McNulty described five “realities” that provided a window into the DOJ’s position on both issues.<sup>clix</sup> Ultimately, however, McNulty recognized that he and the rest of the DOJ were under tremendous pressure to back down on all controversial parts of the Thompson Memorandum.<sup>clx</sup>

On December 8, 2006, to put additional pressure on the DOJ to change both its waiver of attorney-client privilege and its anti-D&O indemnification policies, U.S. Senator Arlen Specter introduced proposed legislation entitled The Attorney-Client Privilege Protection Act of 2006.<sup>clxi</sup> Section three of the proposed legislation tracked, almost word-for-word, the ABA’s Resolution 302B.<sup>clxii</sup> With regard to D&O indemnification issues, the proposed Act would have prohibited the government from evaluating a business organization’s cooperation by considering whether the business organization (1) provided counsel to an employee of the organization,<sup>clxiii</sup> (2) had entered into a JDA,<sup>clxiv</sup> (3) shared information relevant to the investigation with the employee,<sup>clxv</sup> (4) failed to terminate or to sanction the employee,<sup>clxvi</sup> or for the government (5) to “demand or request that an organization, or person affiliated with that organization, not take”<sup>clxvii</sup> any of the actions described above.

### *C. The DOJ Retreats from its Initiative*

#### *1. The McNulty Memorandum*

Ultimately, in the face of concerted opposition grounded in objection to its policies’ overreaching new impact on the Sixth Amendment, the DOJ caved. In its December 2006 McNulty Memorandum,<sup>clxviii</sup> the DOJ backtracked both on requesting waiver of attorney-client privilege and on evaluating D&O indemnification in assessing corporate cooperation. Although congratulating its prosecutors for “unprecedented success in prosecuting corporate fraud during the last four years. . . [including] aggressively root[ing] out corruption in financial markets and corporate boards rooms across the country,”<sup>clxix</sup> the

McNulty Memorandum acknowledged that its pressure on corporations to waive attorney-client privilege “may be discouraging full and candid communications between corporate employees and legal counsel.”<sup>clxx</sup> Following publication of the McNulty Memorandum, “[p]rosecutors may only request waiver of attorney-client or work product protections when there is a legitimate need for the privileged information to fulfill their law enforcement obligations,”<sup>clxxi</sup> and they must request the authorization in writing from the U.S. Attorney in cooperation with main Justice.<sup>clxxii</sup>

Regarding the advancement of attorney’s fees, the McNulty Memorandum announced that only “[i]n extremely rare cases”<sup>clxxiii</sup> could prosecutors take the advancement of attorney’s fees into account “when the totality of the circumstances show that it was intended to impede a criminal investigation. . . [and such acts provided evidence that] the corporation is acting improperly to shield itself and its culpable employees from government scrutiny.”<sup>clxxiv</sup> But prosecutors had to obtain approval directly from the Deputy Attorney General even to consider the advancement of attorney’s fees,<sup>clxxv</sup> and, as with other requests in this category, the Memorandum’s repeated emphasis was that use of this information should be “rare.”<sup>clxxvi</sup> The last surviving piece of the DOJ’s policy regarding D&O indemnification was that prosecutors were still permitted to ask “how and by whom attorneys’ fees are paid. . . [because this information] may be necessary to assess other issues, such as conflict-of-interest.”<sup>clxxvii</sup>

## 2. *The Filip Memorandum*

By the time the DOJ published its 2008 Filip Memorandum,<sup>clxxviii</sup> the DOJ had taken away even the ability of its prosecutors to consider, with written authorization, whether a corporation was advancing attorney’s fees for its employees. In the Filip Memorandum, the DOJ flatly prohibited prosecutors from “tak[ing] into account whether a corporation is advancing or reimbursing attorneys’ fees or providing counsel to employees, officers, or directors under investigation or indictment. Likewise, prosecutors may not request that a corporation refrain from taking such an action [to indemnify its employees].”<sup>clxxix</sup> Prosecutors could still “ask[] questions about an attorney’s representation of a corporation or its employees, officers, or directors, where otherwise appropriate under the law,” and criminal obstruction of justice charges could apply, for example, “if fees were advanced on the condition that an employee adhere to a version of the facts that the corporation and the employee knew to be false.”<sup>clxxx</sup>

Regarding JDAs, the Filip Memorandum directed that “the mere participation by a corporation in a joint defense agreement does not render the corporation ineligible to receive cooperation credit, and prosecutors may not request that a corporation refrain from entering into such agreements.”<sup>clxxxi</sup> The DOJ was sensitive to the possibility that the “corporation may wish to avoid putting itself in the position of being disabled, by virtue of a particular joint defense or similar agreement, from providing some relevant facts to the government.”<sup>clxxxii</sup> Corporations could be bound against the government in this way “if the corporation gathers facts from employees who have entered into a joint defense agreement with the corporation, and [those employees] later seek to prevent the corporation from disclosing the facts it has acquired.”<sup>clxxxiii</sup>

But again, the DOJ made no mention of the danger that employees—potentially the DOJ’s best allies—may be bound against their own interests to the corporation’s cause from cooperating with the government within the same arrangement. The closest that the DOJ came to discussing the position of employees bound by JDAs in the Filip Memorandum was reminding corporations that, “as it does with individuals, the government may properly request that, if a corporation wishes to receive credit for cooperation, the information provided by the government to the corporation not be transmitted to others—for example, where the disclosure of such information could lead to flight by individual subjects, destruction of evidence, or dissipation or concealment of assets.”<sup>clxxxiv</sup> In this statement, the DOJ still failed to recognize that the employee could be its potential ally in addition to the corporation, painting the bound employee as the entity most likely to flee, to destroy evidence, or to dissipate or conceal assets.<sup>clxxxv</sup>

Admittedly, the DOJ issued the Filip Memorandum in response to tremendous pressure from corporations, and the DOJ knew that it needed to appease those corporations in drafting its revised language. But technically the Memorandum, addressed to “Heads of Department Components” and “United States Attorneys,” was an internal document designed to shape the way that the DOJ’s prosecutors think about basic issues of strategy. The DOJ thus made a significant strategic mistake, and missed an important opportunity in not reframing prosecutors’ strategy in the Memorandum to include corporate employees—and spectacularly those employees being ‘thrown under the bus’ by their corporations—as potential allies during corporate investigations.

### 3. *The Current U.S. Attorney’s Manual*

In its current U.S. Attorneys’ Manual provision on “Offering Cooperation: No Entitlement to Immunity”<sup>clxxxvi</sup> as of August 2008 to present, the DOJ does continue to express a concern that corporations will throw employees ‘under the bus’ to curtail prosecution of the corporation itself and/or to appear falsely cooperative. As the DOJ Manual still warns, a “corporation should not be able to escape liability merely by offering up its directors, officers, employees, or agents.”<sup>clxxxvii</sup> The Manual retains the statement from the McNulty Memorandum that prosecutors may ask questions about what entity pays the attorney’s fees, and the admonition that forcing an employee to adhere to facts that the corporation and the employee know to be false may be an obstruction of justice.<sup>clxxxviii</sup> In addition, the Manual contains the same language about corporations bound by JDAs and the sharing of sensitive information.<sup>clxxxix</sup> But nothing else is left in the current Manual of the DOJ’s former crusade against the dangers of how D&O indemnification may be manipulated by corporations against both employees and government prosecutions.

## IV. A SOLUTION TO MULTI-DIMENSIONAL CONFLICTS OF INTEREST: *CUMIS* COUNSEL IN CALIFORNIA

The problem that remains is how to blunt the dangers that the DOJ perceived in how D&O indemnification may be manipulated by corporations, while still honoring the place that D&O indemnification has in protecting employees. The Authors propose the solution of adopting criminal *Cumis* counsel. California was at the forefront of developing and adopting a

mechanism for the appointment of independent counsel when the interests of an insurance company and its insured come into conflict. Most compellingly, the California courts best identified, described, and created a remedy to address the multi-dimensional conflict of interest at the heart of these cases.

Insurance defense cases in which the interests of the insured differ from the interests of the insurance company can be complex and, especially after widespread use of D&O insurance, such cases tend to have the same characteristics as litigation involving D&O indemnification. This Part of the Article will discuss how California courts correctly identified that the essential element of these cases is the conflict of interest inherent in an attorney being paid by a corporate entity to represent the insured when the liability of the corporate entity can be determined by the outcome of the litigation. In California's insurance cases, the corporate entity was an insurance company that had reserved its rights as to whether it would pay on the insured's policy. In the case of D&O indemnification, the corporate entity is the business organization that may not have to indemnify its employee. The argument for adoption of criminal *Cumis* counsel in prosecutions of corporate employees is even more compelling than in the *Cumis* case itself because criminal stakes are higher than the potential penalties were in the California cases, and the employee's Sixth Amendment right to be represented by counsel free of conflicts of interest is similarly elevated.

#### A. *The Cumis Decision*

Although there had been suggestions of the idea by courts as early as the 1950s and 1960s,<sup>cxv</sup> in the landmark case of *San Diego Navy Fed. Credit Union v. Cumis Ins. Soc'y, Inc.*,<sup>cxvi</sup> the California Court of Appeals for the Fourth Appellate District held for the first time that "an insurer is required to pay for independent counsel for an insured when the insurer provides its own counsel but reserves its right to assert noncoverage at a later date."<sup>cxvii</sup>

In *Cumis*, plaintiff Madgaline Eisenmann sued the San Diego Navy Federal Credit Union and two of its employees, collectively "the Credit Union," for \$750,000 in general and \$6.5 million in punitive damages. Eisenmann alleged violations of a broad range of business torts, including "tortious wrongful discharge, breach of the covenant of good faith and fair dealing, wrongful interference with and inducing breach of contract, breach of contract and intentional infliction of" emotional distress.<sup>cxviii</sup> The Credit Union submitted the Eisenmann action to its insurance company, Cumis Insurance Society, Inc.<sup>cxix</sup> Upon reviewing the submission, Cumis' associate counsel concluded that "Cumis had a duty to provide a defense to the insureds."<sup>cxv</sup>

Cumis hired a local law firm to represent the Credit Union, and told the firm that it was to "represent the insured as to all claims in the Eisenmann action, including the punitive damages claims."<sup>cxvi</sup> The insurance company, however, reserved "its right to deny coverage at a later date," and it noted that "the insurance policies did not cover punitive damages."<sup>cxvii</sup> The Credit Union retained separate, independent counsel to protect its interests, and it persuaded Cumis that the insurance company was required to pay for such independent counsel under California law.<sup>cxviii</sup> Cumis paid two invoices for the independent counsel, but refused to pay any more.<sup>cxix</sup> Cumis then instructed its local counsel to make a settlement offer to Eisenmann that was well within the



insurance company's policy limits.<sup>cc</sup> Not wanting to settle, the Credit Union sued Cumis to pay "all reasonable past and future expenses incurred by the independent counsel retained for the defense of [the Eisenmann] lawsuit" against the insured.<sup>cci</sup>

The *Cumis* court held that there was a conflict of interest among the insurance company, the insured, and the parties' counsel. As the court explained,

[i]n the usual tripartite relationship existing between insurer, insured and counsel, there is a single, common interest shared among them. Dual representation by counsel is beneficial since the shared goal of minimizing or eliminating liability to a third party is the same. A different situation is presented, however, when some or all of the allegations in the complaint do not fall within the scope of coverage under the policy.<sup>ccii</sup>

The insurance company in the *Cumis* case believed that, "if the Eisenmann action resulted in a finding of wilful conduct or an award of punitive damages,"<sup>cciii</sup> then the insurance policy would not cover those damages. In addition, "if the Eisenmann action resulted in a finding of breach of contract as against any of the insureds,"<sup>cciv</sup> the policy might not cover the claim. The insurance company agreed to defend the suit, but it reserved its rights to disclaim coverage and to seek reimbursement for its costs from the insured.<sup>ccv</sup>

The *Cumis* court recognized the extent of the multi-dimensional conflict between the insurance company and the insured, as well as the conflict of interest for counsel in serving both of those parties.

First, as between the insurer and the insured,

the standard practice of an insurer is to defend under a reservation of rights where the insurer promises to defend but states it may not indemnify the insured if liability is found. In this situation, there may be little commonality of interest. Opposing poles of interest are represented on the one hand in the insurer's desire to establish in the third party suit the insured's 'liability rested on intentional conduct,' and thus no coverage under the policy, and on the other hand in the insured's desire to 'obtain a ruling. . . such liability emanated from the nonintentional conduct within his insurance coverage.'<sup>ccvi</sup>

Second, as between the parties and counsel, the *Cumis* court wrote: "Although issues of coverage under the policy are not actually litigated in the third party suit, this does not detract from the force of these opposing interests as they operate on the attorney selected by the insurer, who has a dual agency status."<sup>ccvii</sup> The court cited other decisions that have recognized "[a]s a practical matter. . . the insurer's attorneys may have closer ties with the insurer and a more compelling interest in protecting the insurer's position [than the insured's position], whether or not it coincides with what is best for the insured."<sup>ccviii</sup> Such ties to the insurance company compromise the attorneys' representation of the insured as articulated by the American Bar Association's Code of Professional Responsibility's Ethical Consideration EC5-1, which reads: "The

professional judgment of a lawyer should be exercised, within the bounds of the new law, solely for the benefit of his client and free of compromising influences and loyalties. Neither his personal interests, the interests of other clients, nor the desires of third persons should be permitted to dilute his loyalty to his client.”<sup>ccix</sup>

Additionally, the preservation of attorney-client privilege becomes an issue between the insurance company, the insured, and counsel.<sup>ccx</sup> As the *Cumis* court noted, “As between counsel’s two clients, there is no confidentiality regarding communications intended to promote common goals. But confidentiality is essential where communication can affect coverage.”<sup>ccxi</sup>

None of the parties in the case should be compromised in their ability to express their interests: not the insurance company, not the insured, nor their counsel in its effectiveness to act on behalf of each entity. The insurance company “has no duty to sacrifice its own interests when they conflict with those of the insured.”<sup>ccxii</sup> To protect the interests of the insured, “[i]n actions in which. . . the insurer and insured have conflicting interests, the insurer may not compel the insured to surrender control of the litigation.”<sup>ccxiii</sup> Counsel’s representation of both the insurance company and the insured should not be permitted, as “[a] lawyer should never represent in litigation multiple clients with differing interests, and there are few situations in which he would be justified in representing in litigation multiple clients with potentially differing interests.”<sup>ccxiv</sup>

Because an “insurer’s contractual duty to defend cannot be avoided by creating a conflict of interest,”<sup>ccxv</sup> the *Cumis* court looked to a solution proposed by the highest court in the State of New York. The New York Court of Appeals had suggested that, “where a conflict of interest has arisen between an insurer and its insured, the attorney to defend the insured in the tort suit should be selected by the insured and the reasonable value of the professional services rendered assumed by the insurer.”<sup>ccxvi</sup> In conclusion, the *Cumis* court held that, “[d]isregarding the common interests of both insured and insurer in finding total nonliability in the third party action, the remaining interests of the two diverge to such an extent as to create an actual, ethical conflict of interest warranting payment for the insureds’ independent counsel.”<sup>ccxvii</sup>

### B. *The California Cumis Statute*

In response to the *Cumis* case,<sup>ccxviii</sup> and to abuses by attorneys who attempted to manufacture conflicts of interest to drive up fees,<sup>ccxix</sup> the California state legislature passed California Civil Code § 2860<sup>ccxx</sup> to clarify and limit *Cumis* appointment of independent counsel to cases in which an actual conflict of interest existed between the insurance company and the insured. According to the California *Cumis* statute:

- (a) If the provisions of a policy of insurance impose a duty to defend upon an insurer and a conflict of interest arises which creates a duty on the part of the insurer to provide independent counsel to the insured, the insurer shall provide independent counsel to represent the insured unless, at the time the insured is informed that a possible conflict may arise or does exist, the insured expressly waives, in writing, the right to independent counsel.<sup>ccxxi</sup>

Section (b) of the statute specifies that an actual conflict of interest may exist only when the insurer has reserved its right to payment on the insurance policy and when counsel's actions impact potential coverage of that issue.<sup>ccxxii</sup> Section (c) permits insurance companies to require that independent counsel meet certain minimum qualifications of practice, and it limits the fees that independent counsel may charge to those that an insurer would pay to counsel "in the ordinary course of business in the defense of similar actions in the community where the claim arose or is being defended."<sup>ccxxiii</sup>

Section (d) provides for the insurance company and the insured's independent counsel to work together without waiving attorney-client privileges. In the words of the statute: "it shall be the duty of [the independent] counsel and the insured to disclose to the insurer all information concerning the action except privileged materials relevant to coverage disputes, and timely to inform and consult with the insurer on all matters relating to the action."<sup>ccxxiv</sup> Section (e) provides language for an insured party to waive its right to independent counsel.<sup>ccxxv</sup> Section (f) provides that the insurer and independent counsel "shall be allowed to participate in all aspects of the litigation," and that "[c]ounsel shall cooperate fully in the exchange of information that is consistent with each counsel's ethical and legal obligation to the insured."<sup>ccxxvi</sup>

Many other states have followed California's example and have instituted, or are considering instituting, their own versions of *Cumis* counsel. In fact, a recent law review article now suggests that "most jurisdictions" have adopted some form of *Cumis* counsel provision.<sup>ccxxvii</sup> For example, Alaska,<sup>ccxxviii</sup> Florida,<sup>ccxxix</sup> Louisiana,<sup>ccxxx</sup> Nevada,<sup>ccxxxi</sup> and Mississippi<sup>ccxxxii</sup> have either passed statutes explicitly providing for independent counsel when there are conflicts of interest between insurance companies and their insured, or these states' courts have ruled, as California's appellate court initially did, that independent counsel may be necessary in such situations.

Hawai'i's Supreme Court has been the leader for the few states that buck this trend. In *Finley v. The Home Ins. Co.*,<sup>ccxxxiii</sup> the court held that the attorney for the insured has a duty under the state's ethics rules to represent solely the interests of the insured in the litigation. The court opined that an insurance company's control over an attorney's actions does not usually rise to the level of tainting the attorney's representation of the insured enough to violate the state's ethics rules.<sup>ccxxxiv</sup> But even in the *Finley* decision, the Hawai'i Supreme Court wrote that "We conclude that where a [sufficient] conflict of interest arises between an insurer and an insured, because the insurer has reserved its right to assert noncoverage at a later date, the insurer is required to pay for independent counsel for the insured."<sup>ccxxxv</sup>

What was important to the Hawai'i court's decision, and what has become central to the appointment of *Cumis* counsel in California and elsewhere, is that an insurance company's reservation of rights alone does not create the active conflict of interest such that the appointment of independent counsel becomes automatically necessary.<sup>ccxxxvi</sup> As the California courts have described after passage of the state's *Cumis* statute, the conflict of interest necessary to trigger appointment of *Cumis* counsel must be "significant, not merely theoretical, actual, not merely potential."<sup>ccxxxvii</sup>

### C. *The Use of Cumis Counsel in California*

According to surveys of cases in California, *Cumis* counsel is most likely to be appointed in a few specific circumstances after an insurance company has reserved its rights to payment under the policy. By statute, these cases must be those in which the defense attorney can control the determination of factors upon which the insurance company's coverage depends.<sup>ccxxxviii</sup> Versions of this situation commonly include settlements for claims in excess of the insurance policy's limit, and, as becomes the issue in many D&O indemnification questions, cases in which the insured party's conduct is at issue in the lawsuit being defended.<sup>ccxxxix</sup>

Moreover, in echoes of the situation to which the DOJ was objecting in joint defense agreements, *Cumis* counsel are likely to be appointed by the court in circumstances, "where, in an effort to present a common defense, the carrier defends parties other than its insured."<sup>ccxli</sup> The appointment of *Cumis* counsel is triggered when either there are co-defendants and any of those defendants may be deprived of their interests in representation by the insurance company's control of counsel, or when joint representation waives attorney-client privilege.<sup>ccxlii</sup> Once *Cumis* counsel has been appointed, defense counsel for the insured may not disclose to the insurance company confidential information about the insured's case that may result in the denial of insurance coverage.<sup>ccxliii</sup> Not only does this prohibition protect attorney-client privilege vis-à-vis the insurance company, it also protects the insured's confidential communications with his or her attorney from the insured's individual co-defendants.

One critique that has emerged in California is that the appointment of *Cumis* counsel can increase the cost of defending suits for both the insurance company and the insured. Although the *Cumis* statute limits independent counsel's fees to those that an insurer would pay to counsel "in the ordinary course of business in the defense of similar actions in the community where the claim arose or is being defended,"<sup>ccxliv</sup> practicing attorneys note both that the insurance company is only responsible for the portion of the *Cumis* counsel attorney's fees that relates directly to the insurance company's defense of the insured,<sup>ccxlv</sup> and that costs may be higher to research and to prepare an insurance case for independent counsel than for insurance companies' "panel" attorneys who routinely handle insurance cases.<sup>ccxlv</sup> Thus, in practice, the insured may bear at least the difference in the cost of extra time when independent counsel is less efficient than a panel attorney,<sup>ccxlvi</sup> and in the full cost of independent counsel's work in areas of litigation outside of the insurance company's policy coverage. As will be discussed later, however, sharing the expense of independent counsel in this manner may give the insured a positive cost incentive to be efficient in the litigation.

V. ARGUING FOR A BETTER WAY: ADOPTING CRIMINAL *CUMIS* COUNSEL IN DOJ PROSECUTIONS

A. *Corporations Should Not Control Employee's Counsel*

1. *The Conflict of Interest at Issue*

As this Article has argued, the DOJ made a fundamental error in its policy initiatives on D&O indemnification when it misidentified its objection to how employee defendants were being represented by counsel as an objection to D&O indemnification itself. The objection should have been to the *conflict of interest* inherent in counsel being controlled by corporations when such counsel nominally represents the corporations' employees. It is this conflict of interest that makes it particularly difficult for the DOJ to negotiate with employees for cooperation against the corporation or against their fellow employees.<sup>ccxlvii</sup> That same conflict of interest is at the root of the DOJ's concern about the corporation's undue influence over its employees in entering joint defense agreements,<sup>ccxlviii</sup> and at the root of the DOJ's concern over the corporation sacrificing its employees to curtail more extensive prosecution of the corporation itself.<sup>ccxlix</sup>

Ironically, this conflict of interest that is at the heart of the DOJ's objection to corporations' influence over employees' counsel is the same concern that employees themselves have about the quality of their representation.<sup>cc</sup> Agents who have served their principals faithfully are entitled to indemnification for financial burdens placed upon them by virtue of their service to principals.<sup>ccli</sup> Tradition and the Restatement have long recognized that indemnification of the cost to agents of defending themselves from lawsuits is part of those agents' rights for their service to the principals.<sup>cclii</sup> The agent, who is the ultimate holder of the right to indemnification, should be protected against any improper attempt by the principal to leverage its financial advantage against him or her. The Restatement even suggests the imposition of "fees on fees" by courts to "mitigate the risk that a corporate principal will make strategic use of its resources against an agent who has a valid claim to receive indemnity."<sup>ccliii</sup>

2. *The Restatement and the Sixth Amendment*

The argument for a principal to control the agent's defense, as well as to pay for the agent's defense, is that the principal will ultimately be liable for payments to a third party on the agent's behalf.<sup>ccliv</sup> But the Restatement specifically acknowledges that an agent's right to indemnification is not contingent on the principal's ability to control the agent's defense.<sup>cclv</sup> Indeed, the Restatement endorses an agent's decision to settle lawsuits against it when a corporation has for whatever reason declined to control its own defense, because the agent must be presumed to be acting "reasonably to protect its own interests as well as those of the principal."<sup>cclvi</sup>

If the issue is not the right of indemnification, but a corporation's control over its employee's counsel and thus the creation of a conflict of interest for that counsel, then criminal prosecution of employees who are entitled to indemnification should present an excellent situation for adoption of criminal

*Cumis* counsel. In the *Stein* appeal, for example, the U.S. Court of Appeals for the Second Circuit upheld Judge Kaplan’s conclusion that defendants’ Sixth Amendment rights were violated by interference with their ability to make all of the arguments that they wanted in their own defense because of financial “restrict[ions on] the activity of counsel” due to who was paying for the counsel.<sup>ccclvii</sup> KPMG had refused to fund defendants’ counsel in the *Stein* case, but the same restriction on an attorney’s ability to make arguments occurs when a corporation does pay for its employee’s counsel and directs that counsel. In fact, even in the *Stein* case itself, Judge Kaplan issued an order to investigate whether an additional violation of the KPMG employees’ Sixth Amendment rights had occurred because “some defendants may be represented in this case by counsel who have professional obligations to KPMG which conceivably could be at odds with their professional obligations to the clients whom they represent here.”<sup>ccclviii</sup>

Thus, following *Stein* and the commands of the Sixth Amendment, a corporation has an obligation to pay for its employee’s counsel, but the corporation should not control the actions of the employee’s counsel. The best mechanism that currently exists to achieve exactly this purpose is the *Cumis* counsel model developed in California.

### 3. *The Law is Moving in this Direction, and Insurance Companies are Already Anticipating the Spread of a Cumis Counsel Requirement*

The law is already moving in the direction of requiring independent counsel in many business situations. For example, in shareholder suits against corporations, the special litigation committee of directors not tarnished by members' self-interest hires its own counsel, and "[c]ourts should be more likely to find a special litigation committee independent if the committee retains counsel who has not represented [the suit's] individual defendants or the corporation in the past."<sup>cclix</sup> In addition, as noted earlier, courts customarily require that a corporation and a derivative suit's real defendants be represented by different counsel.<sup>cclx</sup> The reason for separate counsel in a derivative suit is that, although "it is the corporation's cause of action that is asserted in the derivative suit, [and] it is well understood that the corporation is a necessary party in the action," the corporation's interests will be "adverse to those of the suit's real defendants."<sup>cclxi</sup> Finally, in 2001, the Securities and Exchange Commission (the SEC) tightened its existing safe harbor provisions under the Securities and Exchange Act<sup>cclxii</sup> by requiring that, in order to make use of the harbor, independent directors of public corporations had to be permitted independent counsel, paid for at the corporation's expense. The SEC also required the independent counsel to give the independent directors advice on investments "free of significant conflicts of interests that might affect their legal advice."<sup>cclxiii</sup>

In fact, the *Cumis* decision has already made a big practical impact in the area of D&O insurance. Because D&O insurance claims commonly—if not almost always—involve a reservation of rights letter by the insurance company and a divergence of interests between the insurance company and its insured, D&O insurance cases are a prime area for appointment of *Cumis* counsel.

Indeed, insurance companies are aware of the spread of *Cumis* counsel procedures, and they have started to adapt their policies accordingly. Before the *Cumis* decision, much like classical corporate indemnification, many D&O insurance policies explicitly reserved payment on the policy until after the litigation had been defended.<sup>cclxiv</sup> In the wake of *Cumis*, first, insurance companies in D&O cases require that the insured select and appoint his or her own counsel, although the selection of that counsel must be approved by the insurance company; and second, D&O insurance policies increasingly provide that "the insurer will advance defense costs, either as the costs are incurred or on an interim basis, rather than at the conclusion of the litigation"<sup>cclxv</sup> in order to relieve the appearance of controlling counsel's decisions when payment depends upon the ultimate outcome of the case.

With the reservation of rights letter, however, these procedural changes are a distinction without a difference because the insurance company may still recoup its costs if the course of the litigation reveals a violation of the insurance policy's coverage.<sup>cclxvi</sup> Additionally, these procedural changes alter the operation of D&O insurance policies so that, rather than mirror corporate indemnification, they move in parallel with the corporate advancement of fees, and merely continue to blur the line between all three forms of payments.

### 4. *Criminal Cumis Counsel Should be Adopted Regardless of Whether*

*the Corporation or the Insurance Company Pays for Employee's Counsel*

The reasoning for adopting criminal *Cumis* counsel should apply whether the employee's defense is paid by D&O insurance or by the corporation itself through the advancement of fees or through indemnification, which should be seen as other types of insurance coverage for employees who serve the corporation's interests.<sup>cclxvii</sup> Like insurance coverage with a letter of reservation of rights, the advancement of fees that may have to be refunded and the payment of indemnification contingent on the outcome of the litigation all pose the same hazard for employees: they are fundamentally insecure in their right to counsel pending the outcome of that counsel's representation.

Because there will always be a trust gap when human incentives are determined ex-ante,<sup>cclxviii</sup> courts impose extraordinary obligations on insurers to defend claims in which there may be doubt over whether the insured's actions will ultimately fall within the terms of the insurance policy's coverage.<sup>cclxix</sup> Similarly, courts impose extraordinary terms on the right of employees to the advancement of funds in order for employees to defend claims in which there may be doubt whether the employee's actions will ultimately fall within the terms of the corporation's indemnification policy. As the Delaware courts have explained,

[t]he right to advancement is not dependent on the right to indemnification. The right to indemnification requires 'success on the merits or otherwise' in defending proceedings. . . . [The provision for advancement of fees], however, expressly contemplates that corporations may confer a right to advancement that is *greater* than the right to indemnification and recognizes that advances must be repaid if it is ultimately determined that the corporate official is not entitled to be indemnified.<sup>cclxx</sup>

Furthermore, if appointment of *Cumis* counsel is necessary in California to protect the rights of employees in civil suits, then the adoption of *Cumis* counsel is even more important as a mechanism to protect employees' rights in criminal cases in which penalties are presumptively more severe. Additionally, there may be a place for implementing *Cumis* counsel beyond the confines of criminal prosecutions. For example, the insurance industry is anticipating the implementation of *Cumis* counsel in D&O cases more broadly, but that argument is beyond the scope of this Article.

*B. Right to Counsel Under the Sixth Amendment*

In criminal prosecutions, as the U.S. Supreme Court has written, "the right to the assistance of counsel has been understood to mean that there can be no restrictions upon the function of counsel in defending a criminal prosecution in accord with the traditions of the adversary factfinding process that has been constitutionalized in the Sixth and Fourteenth Amendments."<sup>cclxxi</sup> Although the Court has held in the context of property forfeited in criminal seizures that "[a] defendant has no Sixth Amendment right to spend another person's money for services rendered by an attorney, even if those funds are the only way that



defendant will be able to retain the attorney of his choice,”<sup>cclxxii</sup> as supported by *Stein*’s analysis of this case and additional precedents, the funds provided through indemnification are the employee’s property to spend because they were part of the basis of the employee’s bargain with his employer.<sup>cclxxiii</sup>

Moreover, according to the Supreme Court, once a defendant can show an “actual conflict of interest which adversely affected his lawyer’s performance,”<sup>cclxxiv</sup> prejudice need not be proven to constitute a violation of the defendant’s Sixth Amendment right to counsel.<sup>cclxxv</sup> The California courts in *Cumis*, and the California legislature in its *Cumis* statute, have nicely defined exactly when such an actual conflict of interest appears in an insurance company’s control of insured’s counsel: as a precondition for the appointment of *Cumis* counsel, there must be a reservation of rights by the insurance company, and the decision about policy coverage must hinge in some way on the outcome of the litigation in which counsel is involved.<sup>cclxxvi</sup> In the case of DOJ criminal prosecutions, a corporation’s ability to defend its employees is already reserved by state statutory limitations that prohibit indemnification and/or the advancement of fees under certain circumstances, and the conditions of corporate indemnification often depend on the outcome of the litigation: explicitly under Delaware law and parts of the RMBCA in which the employee must be “successful on the merits or otherwise”<sup>cclxxvii</sup> in his or her defense.

### *C. Benefits of Adopting Criminal Cumis Counsel for the DOJ*

Regarding the DOJ, the adoption of criminal *Cumis* counsel would more deftly solve the problems inherent in corporations’ influence on the right to representation and settlement options to which the DOJ objected in its initiative to pressure corporations not to indemnify employees. Specifically, the appointment of criminal *Cumis* counsel would solve the DOJ’s three main concerns as to how corporations use D&O indemnification to hamper government prosecutions: (1) stonewalling; (2) providing insincere offers of cooperation while impeding the government’s investigation through the corporation’s exercise of control over employees and their counsel through JDAs or other agreements; and (3) by corporations throwing their employees ‘under the bus.’

#### *1. Stonewalling*

First, after the appointment of independent, *Cumis*-type counsel to represent employees, corporations would have less of an opportunity to stonewall potential settlements with employees in government investigations. If employees controlled their own counsel, corporations would not be able to issue “inappropriate directions to employees or their counsel, such as directions not to cooperate openly and fully with the investigation, for example, the direction to decline to be interviewed.”<sup>cclxxviii</sup> In addition, once an employee controls his or her own counsel, the employee may be more likely to cooperate with the government when such cooperation is in the employee’s best interest.

#### *2. Insincere Offers of Corporate Cooperation*

Second, the DOJ need not be as concerned about a corporation’s insincere offers of cooperation while the corporation impedes the government’s

investigation through the corporation's use of a JDA. Joint defense agreements among employees and the corporation in criminal prosecutions, by their very nature, trigger the Sixth Amendment conditions that should require the appointment of criminal *Cumis* counsel. The heart of this argument was made in the debate among the delegates at the ABA's convention regarding Resolution 302B. Joint defense agreements become an issue in DOJ prosecutions only when one of the parties wants to cooperate with the government, thus bringing to a head the actual conflict of interest among members to the JDA.<sup>cclxxix</sup> In their debate on the issue, the ABA's delegates could imagine only two entities that could control counsel in this situation: the corporation or the government. The third option should be to allow employees themselves to control their own counsel through the adoption of criminal *Cumis* counsel.

Thus, for the DOJ, the appointment of independent counsel for an employee would make the existence and operation of JDAs less suspect for the government as a tool of corporate control over employee's counsel. In addition, the adoption of criminal *Cumis* counsel would reduce corporations' cost incentives to force employees into JDAs for the sake of saving on legal fees, and, because corporations would not have the presumptive right to control employees' counsel through the JDA, the terms of the JDA itself may be more equitable. Joint defense agreements should exist only when the individual employees have also agreed that these arrangements are in their best interests.

### 3. *Corporations Throwing Employees 'Under the Bus'*

Third, for the DOJ, the appointment of criminal *Cumis* counsel would arrest the very thorny problem of corporations throwing their employees 'under the bus' to curtail damage to the corporation from a more comprehensive government investigation. As illustrated by the facts of the *Josleyn* case, when corporations control employees' counsel, they have a strong incentive, as American Honda did, "to enlist the assistance, knowing or otherwise, of its attorneys"<sup>cclxxx</sup> to make a government prosecution disappear as quietly as possible with the plea of the targeted employees. American Honda would never have had that type of leverage over its employees' counsel if the employees' counsel had been independent in the way described in the *Cumis* case.

The problem of a corporation throwing its employees 'under the bus' is particularly complicated for the DOJ under current methods of D&O indemnification both because it is difficult for the DOJ to assess whether the corporation, in putting pressure on its employees to plead guilty, is attempting to conceal additional wrong-doing or not, and also because the DOJ's own pressure on a corporation may backfire on the DOJ. Corporations may sacrifice their employees because they want to appear cooperative with the government, whether or not the corporation is hiding additional wrongdoing. Moreover, as can be seen by example in the *Stein* case, when KPMG bowed to political pressure from the government to cut off payment of its employees' attorneys' fees, stopping those payments violated its employees' Sixth Amendment right to counsel and exposed the employees to the government's prosecution without adequate access to the resources to which the employees were entitled for their own defense.<sup>cclxxx</sup> Although the provision of D&O insurance would generally help to mitigate the political nature of indemnification questions when

corporations are under pressure to cut off the payment of attorney's fees,<sup>cclxxxii</sup> employees' D&O insurance counsel would still be subject to the conflict of interest between the insurance company and the insured that was at the heart of the *Cumis* decision itself.<sup>cclxxxiii</sup> Only the adoption of criminal *Cumis* counsel resolves all parts of this problem.

If the KPMG employees had been appointed independent criminal *Cumis* counsel, those employees would have been able to defend themselves against the government's prosecution, both regardless of the pressure that the government exerted on KPMG, and regardless of any pressure from the corporation itself to make the government's case disappear as quickly as possible.<sup>cclxxxiv</sup> Thus, the appointment of criminal *Cumis* counsel would have preserved the employees' Sixth Amendment right to counsel free from both sources of potential prejudice: the government and the corporation. For the DOJ, appointment of criminal *Cumis* counsel would have insulated the DOJ from the type of constitutional violation that it committed in the *Stein* case, and it would have removed the DOJ's doubts as to whether the corporation was throwing its employees 'under the bus' in this way in order to curtail additional prosecution.<sup>cclxxxv</sup> In addition, once an employee's counsel has been removed from control of the corporation, the DOJ gains a potential ally to root out any additional corporate wrong-doing in the form of cooperation from the employee if such cooperation is in the employee's best interest.

#### *D. Benefits of Adopting Criminal Cumis Counsel for Corporations*

Adoption of criminal *Cumis* counsel ultimately benefits all parties to these conflicts by unwinding the tangle of the corporation's and its employees' interests that was at the core of the government's distrust of D&O indemnification and that is the cause of corporations' and employees' dissatisfaction with D&O indemnification as well.

##### *1. Easier Perception of Cooperation with Government Investigations*

Regarding benefits for corporations, the DOJ originally noted that corporations may be uncomfortably bound against their interests specifically in JDAs,<sup>cclxxxvi</sup> but corporations are uncomfortably bound more generally by their promises to indemnify employees in the face of any government investigation. Corporations generally want to be perceived as cooperating with government investigations.<sup>cclxxxvii</sup> As the general counsel of a Fortune 500 company informed the DOJ, "If I could bring a Justice Department investigation to a close by turning over an internal investigation and I did not do it, my board would fire me."<sup>cclxxxviii</sup> Similarly, the *Stein* court acknowledged that KPMG, in the wake of the disappearance of its rival Arthur Anderson after the Enron collapse, was under tremendous pressure when it cut off the payment of attorney's fees to its employees: "KPMG refused to pay [the attorney's fees] because the government held the proverbial gun to its head. Had that pressure not been brought to bear, KPMG would have paid these defendants' legal expenses."<sup>cclxxxix</sup> After adoption of criminal *Cumis* counsel, corporations would benefit by avoiding the presumptive tie between the provision of legal fees and the corporation's ability to control the employee's defense, and from more starkly drawn political and Sixth Amendment barriers protecting the representation of employees as solely the right of the employee.

## 2. *Easier Attraction and Retention of Talented Employees*

It is in corporations' interest to indemnify employees and to pay for the advancement of attorney's fees because such policies help to attract and to retain talented employees. KPMG, for example, paid over \$20 million in another case to defend four of its partners against a criminal investigation and related civil litigation brought by the SEC over KPMG's relationship with Xerox.<sup>ccxc</sup> As the court explained in *Stein*, "An entity may pay [defense costs of employees] out of a judgment that extending this benefit [i.e., the advancement of attorney's fees and indemnification in general] will aid it in keeping and hiring competent and honest employees. It may pay in recognition that an employee caught up in an investigation, or even charged with a crime, [deserves the benefit of indemnification] because the employee [who] did his or her job for the company has at least some claim to assistance, even in the absence of a legal right."<sup>ccxci</sup> In practical terms, cutting off the payment of attorney's fees in the face of government pressure not only provokes a suit from the employees entitled to indemnification (see *Stein*<sup>ccxcii</sup>), but also damages the corporation's reputation among employees whom it would like to recruit and who will not serve without adequate assurance of indemnification.<sup>ccxciii</sup>

## 3. *Relief from Political Pressures during Litigation*

A corporation is put in an uncomfortable position when it must reserve the ultimate decision on its employees' indemnification pending the outcome of the litigation. Because the employees' right to indemnification may hinge in part or entirely on whether the employees are found guilty of the crime or not,<sup>ccxciv</sup> employees have an enormous incentive to fight charges to the end instead of pleading to a lesser count and allowing the uncomfortable attention on the corporation from a government prosecution to disappear quietly. In this situation, the corporation's interests and its employees' interests are diametrically opposed, and the corporation may be liable for mandatory advancement of attorney's fees during the course of the litigation.

In the absence of criminal *Cumis* counsel, the corporation has incentives to put pressure on its employee's counsel to curtail costs during litigation and to put pressure on the employee himself or herself or through the employee's counsel to plead guilty so as not to pay ultimately for the employee's indemnification. These incentives poison the corporation's relationships with its employees and its reputation in general. The appointment of criminal *Cumis* counsel relieves the corporation of these political burdens, and permits the corporation to retain better relationships with both the government and its own employees independent of the outcome of the litigation.

## 4. *More Positive Public Perception of Corporations' Compliance with General Legal Standards*

After adoption of criminal *Cumis* counsel, corporations should not be punished in the public eye for complying with state law requirements to indemnify employees.<sup>ccxcv</sup> Corporations, rocked by political pressures on their boards from shareholders and the press, should be free to provide without taint the indemnification permitted and even required by state laws in order for those

corporations to attract, and to support, the best qualified employees to serve their interests. Competitive pressure to indemnify D&Os may even lead corporations to expand their indemnification of employees to enhance employees' rights and to serve as a recruiting tool. As noted earlier, social science data indicate that such expansion of D&O indemnification, especially through purchase of D&O insurance, serves to increase shareholder wealth,<sup>ccxcvi</sup> to encourage employees to be more forthcoming about negative information,<sup>ccxcvii</sup> and to provide larger benefits to society.<sup>ccxcviii</sup>

#### *E. Benefits of Adopting Criminal Cumis Counsel for Individual Employee Defendants*

Bringing political and Sixth Amendment protections to the forefront of arguments over D&O indemnification is a key contribution of adopting criminal *Cumis* counsel that benefits employees as well. As agents entitled to indemnification, employees should be more secure in their rights. As discussed, the political issues around D&O indemnification may start as soon as when the corporation hires the employee or when the corporation receives information about a government investigation. The Sixth Amendment arguments attach once the employee is subject to adversary judicial criminal proceedings.<sup>ccxcix</sup>

##### *1. More Secure Right to Conflict-Free Counsel under the Sixth Amendment*

First, the adoption of criminal *Cumis* counsel would permit employees to enjoy their right to indemnification and to the un-conflicted representation of counsel to which they are entitled without making employees the recipients of corporate or government pressure to cut off the payment of attorney's fees. Part of the Sixth Amendment's protection of the right to counsel is a defendant's ability to confer freely with that counsel, and to trust that counsel enough to be able to plan his or her defense. The U.S. Supreme Court has written that "[r]egardless of whether petitioner would have been entitled to the appointment of counsel, his right to be heard through his own counsel was unqualified. . . . A necessary corollary is that a defendant must be given a reasonable opportunity to employ and consult with counsel; otherwise, the right to be heard by counsel would be of little worth."<sup>ccc</sup>

Applying this principle to the situation in which employees are represented by counsel hired by their employers, the U.S. Supreme Court in *Wood v. Georgia*<sup>ccci</sup> held that a potential violation of the Sixth Amendment existed when a trial judge knew that counsel retained by defendants' employer to defend the employees had a conflict of interest in representing both the employees and their employer, and the trial judge failed to conduct a more extensive inquiry to establish whether actual prejudice existed and hence whether employees required their own counsel. Under criminal *Cumis* counsel, if employees instead had the right to select their own counsel, as the Court has subsequently held, when "the right at stake here is the right to counsel of choice. . . [n]o additional showing of prejudice is required to make the violation 'complete.'"<sup>cccii</sup>

Moreover, as required of remedies under the Sixth Amendment, the appointment of criminal *Cumis* counsel presents a nicely tailored solution to the

defendants' problem with their counsel's conflicts of interest without infringing on the competing interests of other parties. The U.S. Supreme Court has written that "[c]ases involving Sixth Amendment deprivations are subject to the general rule that remedies should be tailored to the injury suffered from the constitutional violation and should not unnecessarily infringe on competing interests."<sup>ccciii</sup> In adopting *Cumis* counsel in criminal D&O indemnification cases, the remedy is tailored to the injury and it does not unnecessarily infringe on competing interests. An employee's counsel's conflict of interest is remedied by making the counsel independent from the source of the conflict. The remedy does not unnecessarily infringe on competing interests because the corporation may still retain its own counsel, and it may coordinate with employee's counsel when such coordination is in the employee's best interest. Furthermore, the employee retains what the courts have recognized as his or her "qualified Sixth Amendment right to use wholly legitimate funds to hire the attorney of his choice"<sup>ccciv</sup> by redeeming the promise of funds made by his employer as part of the agent's service to his principal.<sup>cccv</sup>

## 2. *More Secure Protection of Individual Employee's Interests against Co-Defendants*

Second, the adoption of criminal *Cumis* counsel presents a nice resolution of the conflicts of interest between co-insured employees. There is a series of issues here that can be divided by considering when an issue arises in time. Initially, as has been discussed, the employees of a corporation may see coordination and information-sharing through a JDA to be in their best interests. But, as an investigation or litigation continues, the employees may realize that they may want to cooperate with the government individually or that their plan of defense has otherwise diverged from that of their co-defendants. A practical problem at this point is what can be done with the information that was provided during the course of the JDA once a member of the JDA has broken away from common defense planning.

The U.S. Court of Appeals for the Ninth Circuit has held that use of information shared in the JDA can force removal of the defendant's attorney.<sup>cccvi</sup> The U.S. Court of Appeals for the Eleventh Circuit has held that a defendant who turns state's evidence has waived his right to attorney-client protection in the information shared during the JDA,<sup>cccvii</sup> which should make defendants in the future much more guarded about sharing information inside a JDA.<sup>cccviii</sup> But, to avoid disqualifying the defense attorney entirely, the Eleventh Circuit court had to make two important assumptions about JDAs that would not necessarily apply for employee defendants in the absence of criminal *Cumis* counsel. The Eleventh Circuit had to assume (a) that "[w]hen co-defendants enter into a joint defense agreement, by contrast [with representation outside of a JDA], each defendant retains his own attorney,"<sup>cccix</sup> and (b) that "[a] duty of loyalty. . . does not exist in this situation [to the other members of the JDA]."<sup>cccix</sup>

In the absence of criminal *Cumis* counsel, employees may lose the attorney with whom they had planned their defense because the attorney may be representing the corporation and/or other individual employee co-defendants.<sup>cccxi</sup> Even if the attorney is not representing other co-defendants, the corporation may be paying for the employee's defense, and the attorney's duty

of loyalty may be divided. As the Eleventh Circuit court described, a situation in which defendants are represented by the same attorney within a JDA is “a situation that is almost always ripe with *real* conflicts of interest.”<sup>cccxi</sup>

Only with adoption of criminal *Cumis* counsel would the employees necessarily be represented by their own counsel against their co-defendants, and would that counsel’s duty of loyalty not be divided. Under Ninth Circuit precedent, the employee’s attorney may still need to be replaced if there is a danger that confidential information exchanged during the course of the JDA would be used against the employee.<sup>cccxi</sup> Not as much confidential information should be exchanged after the precedent set by the Eleventh Circuit court’s decision, however, and the two other conditions described by that court’s decision for retaining employee’s counsel of choice would still exist.

#### *F. Benefits of Adopting Criminal Cumis Counsel for Multiple Parties and for Society*

##### *1. Use of a Well-Tailored Tool to Protect Interests in the New Environment of D&O Insurance*

The fact that *Cumis* counsel was conceived of in the insurance context makes the adoption of criminal *Cumis* counsel a honed and tested tool to use in the new environment of pervasive D&O insurance. As of 2004, over ninety percent—and possibly ninety-nine percent—of public companies carry D&O insurance.<sup>cccii</sup>

Thus far, *Cumis* counsel’s impact on insurance litigation indicates that criminal *Cumis* counsel will yield benefits in this new context for all parties: corporations, the DOJ, employees, and even insurance companies. Benefits for corporations and the DOJ will be discussed in the next subsection. For employees, as discussed earlier, D&O insurance specially steps in where: (1) standard indemnification fails when the corporation becomes insolvent; (2) when the corporation withdraws its support for employees short of what an insurance company would be required to provide under the covenant of good faith and fair dealing; and (3) when there is a gap between the coverage that D&O insurance could provide that the corporation itself could not, such as in securities fraud cases and other developing areas of the law.

Intriguingly, for insurance companies, anticipating broader adoption of *Cumis* counsel has changed their D&O policies both to serve the companies’ own economic interests and to benefit employees: the provision of resources to employees to defend themselves from suit as litigation occurs results in less ultimate liability for the insurance companies because of the higher quality of counsel potentially available to their insured during the case.<sup>ccciii</sup> The changes that D&O insurance companies make in response to criminal *Cumis* counsel may thus benefit employees in the form of better results from litigation through the availability of higher-quality counsel, as well as a greater likelihood of reimbursement under the insurance policy—all while still reducing long-term costs to insurance companies.

## 2. *All Parties Benefit from Longer and More Productive Careers for Employees*

In addition, corporate employees benefit in the form of longer, more productive, and less volatile careers when D&O insurance companies, through stronger *Cumis*-counsel requirements to provide representation for employees, have incentives to educate the employees of corporations about best management practices to reduce their risk of potential litigation.<sup>cccxvi</sup>

Corporations benefit from this approach in the form of lower insurance fees, less reputational harm, and greater employee retention. Moreover, the presence of insurance companies in the D&O market helps to spread a corporation's risk of liability from litigation against its employees, and also to restrain the employees of that corporation's competitors so that the corporation has less temptation to engage in risky behavior to gain a perceived market advantage.

The DOJ benefits from the potential reduction in crime from both within the corporation and across the market: one of DOJ's "fundamentals" is that "it [is] better to prevent a crime [than] to punish one."<sup>cccxvii</sup>

## 3. *Larger Economic Benefits of Adopting Criminal Cumis Counsel*

Finally, there is a larger economic benefit to society in the way that criminal *Cumis* counsel would function to share the cost of independent counsel and to provide economic incentives to keep litigation focused on issues for which there may be D&O insurance or indemnification coverage. As noted, higher short-term insurance costs to indemnify employees with criminal *Cumis* counsel should create greater incentives for both corporations and their insurance companies to put in place stronger preventive compliance procedures and to emphasize the use of best practices, ultimately bringing down total costs. Additionally, as *Cumis* counsel was implemented in California, the insured—here the corporation's employee—would be responsible for the difference in cost between the fees of the corporation's standard counsel and those of independent counsel whenever the independent counsel is less efficient, as well as the full cost of independent counsel in areas of litigation outside of the company's D&O insurance or indemnification coverage. Spreading costs between the employee and the corporation or insurance company ensures that the employee has a cost incentive to keep excessive litigation in check. As in California, the institution of criminal *Cumis* counsel would never be a "meal ticket immunized from judicial review for reasonableness."<sup>cccxviii</sup>

## G. *Additional Challenges to, and Arguments for, Adopting Criminal Cumis Counsel*

In addition to the issue of immediate cost, which we have addressed above, we anticipate several other counterarguments from the academic literature.

First, Professor Karlan in the *Harvard Law Review*<sup>cccix</sup> was concerned about proposing a specific test for barring joint counsel between a corporation and its employees because she feared that removing defense counsel too easily would grant the government too much power in prosecutions. According to Professor Karlan, "[t]here may well be cases in which relational counsel is so much better situated to provide the innocent defendant with a successful



defense that to refuse constitutional protection to preexisting relationships would be to deny defendants effective assistance of counsel.”<sup>cccxx</sup> Professor Karlan gives the example of “a prosecution of a small business involving complex commercial activity, [in which] a lawyer familiar with the underlying transactions would better understand, and ultimately more effectively explain to the prosecutor or argue to the jury, why particular activities were not fraudulent.”<sup>cccxxi</sup>

Professor Karlan makes an excellent point about the special skills of some attorneys, but we make two important counterarguments in support of criminal *Cumis* counsel.

The first argument is that, in criminal prosecutions, there is already a significant difference from civil cases in the balance of power between the parties. For this reason, criminal prosecutors, unlike civil attorneys, have an independent responsibility to ensure that justice is done<sup>cccxxii</sup> and an obligation to respect the legal rights of defendants in the trial process.<sup>cccxxiii</sup> Moreover, our court system is well designed to protect the rights of defendants from an opposing party; it currently is much less attuned to protecting defendants against sabotage from within their own side of the adversarial process.<sup>cccxxiv</sup>

The second argument is that, although there may be highly specialized attorneys whose skills are unique to certain cases, because it is the defendant’s Sixth Amendment right to conflict-free counsel at stake, it is the defendant who should be able to make the decision up front whether to select independent counsel. Only defendants know the full dynamics of their case and how much they can trust their attorney. Furthermore, regarding the rights protected by the Sixth Amendment, the Supreme Court’s standards for evaluating the effectiveness of counsel are very low in comparison with the bright lines that the Court has drawn to delineate actual conflicts of interest in counsel’s representation.<sup>cccxxv</sup>

Professor Abramovsky writes of the danger of “house counsel” such as the Gambino crime family’s lawyer, as well as “captive” law firms whose “key feature is almost total dependence on a limited number of clients.”<sup>cccxxvi</sup> She notes that insurance “panel” attorneys like those described in the *Cumis* case fit into this model.<sup>cccxxvii</sup> Professor Abramovsky’s proposed solution to counsel’s conflicts of interest is case-by-case court intervention coupled with the institution of a database that records who pays insurance defense counsel’s fees, in order to reveal evidence of financial bias based on counsel’s revenue history.<sup>cccxxviii</sup>

The Authors are not opposed to Professor Abramovsky’s proposal, but we would be concerned that hearing so many individual cases and administering such a large database would put a substantial extra burden on the courts at a time in which funds for public resources are scarce. Moreover, given Professor Abramovsky’s proposal’s ad-hoc approach to cases, many situations in which a conflict of interest emerges between the corporation and an employee defendant may not be identified before political pressures on the corporation, for example, push defense counsel to make a government prosecution disappear as quickly and quietly as possible by sacrificing the employee. In addition, when an employee defendant<sup>cccxxix</sup> resorts to bringing such an extraordinary legal motion against a corporation, the employee has presumably already suffered tremendous damage to his or her interests. Damage from these

conflicts of interest is more difficult and expensive to remedy post-hoc than ex-ante, especially when these conflicts are so predictable.<sup>cccxxx</sup>

Alternatively, the adoption of criminal *Cumis* counsel is a much more simple and comprehensive solution that establishes bright lines for attorney conflicts of interest,<sup>cccxxxi</sup> that empowers defendants to select their own counsel before conflicts of interest cause additional damage by coming to an acute head in the case,<sup>cccxxxii</sup> and would, as the California experience has shown after passage of the state's *Cumis* statute, largely keep these issues out of the overburdened public courts.<sup>cccxxxiii</sup>

Finally, there are some additional practical issues that may require adjustment on the part of the government and the defense bar in the operation of criminal cases, but we do not anticipate that these adjustments would be overly difficult.

It may be more logistically complicated for prosecutors to communicate with multiple criminal *Cumis* counsel in cases in which a single attorney used to represent both the corporation and its employees, but prosecutors routinely deal with defendants represented by separate counsel in street-level criminal cases, such as in gang and drug prosecutions.<sup>cccxxxiv</sup>

Also, defense counsel may have to coordinate with a larger number of attorneys within JDAs.<sup>cccxxxv</sup> But, adopting criminal *Cumis* counsel would offer a distinct advantage over other options because it would create more opportunities for attorneys to represent clients in this economy while lowering overall financial costs to society.<sup>cccxxxvi</sup> This aspect of the proposal should be attractive to the defense bar.

Moreover, the effects of criminal *Cumis* counsel on the defense bar would have additional positive aspects that address Professor Karlan's and Professor Abramovsky's concerns. The potential of being selected by employee defendants as criminal *Cumis* counsel may provide a financial impetus for more defense counsel to become expert in understanding the type of complex commercial activity that Professor Karlan was concerned about attorneys being able effectively to explain to the prosecutor or to argue to the jury.<sup>cccxxxvii</sup> In addition, being on notice that independent attorneys will be involved when employee defendants have access to criminal *Cumis* counsel should prevent corporations from over-investing in exclusive "house counsel" and "captive" law-firm relationships with defense counsel that Professor Abramovsky identifies as helping to perpetuate the goals of criminal enterprises.<sup>cccxxxviii</sup>

## VI. CONCLUSION

In conclusion, the adoption of criminal *Cumis* counsel, as first identified by the California courts and now spreading across the country, would provide an excellent solution to multi-dimensional conflicts of interest inherent in D&O litigation. *Cumis* counsel should be adopted in the criminal context for both political and Sixth Amendment reasons.

Additionally, although criminal *Cumis* counsel may not currently be legally mandated to protect employees' rights in corporate criminal prosecutions, a corporation's choice to institutionalize the use of criminal *Cumis* counsel for its indemnified D&Os should send a strong signal both to the DOJ that the corporation sincerely intends to comply with prosecutions, and to the corporation's employees that it could be in their best interests to cooperate with

the government as well.

Strategic, forward-thinking corporations and defense counsel should move on their own to put criminal *Cumis* counsel in place for employee defendants of business prosecutions. The DOJ and other law-enforcement agencies should encourage and reward corporate adoption of criminal *Cumis* counsel. Legislatures should enact criminal *Cumis* counsel statutes to apply in D&O indemnification cases, and they should seize on criminal *Cumis* counsel as a way of better protecting employees' rights as well as the interests of corporations, law-enforcement agencies, and society as a whole.

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i. Much has been written in the academic literature about the DOJ's Holder Memorandum and subsequent debate, but no other article has identified the adoption of criminal *Cumis* counsel as the answer to the DOJ's concerns expressed in that and subsequent memoranda. See, e.g., David M. Zornow & Keith D. Krakaur, *On The Brink Of A Brave New World: The Death Of Privilege In Corporate Criminal Investigations*, 37 AM. CRIM. L. REV. 147, 148-49 (2000) (protesting the DOJ's pressure on corporations to waive attorney-client privilege); Rachel E. Barkow, *Institutional Design and the Policing of Prosecutors: Lessons from Administrative Law*, 61 STAN. L. REV. 869, 918-20 (2009) (presenting the DOJ's initiatives on the waiver of attorney-client privilege and corporate indemnification as abuses of power); Sarah Ribstein, *A Question Of Costs: Considering Pressure On White-Collar Criminal Defendants*, 58 DUKE L.J. 857, 860-61 (2009) (arguing against DOJ pressure corporations not to indemnify employees as increasing the cost of white collar defense cases; and asserting that "[d]efendants are, in effect, coerced into pleading guilty because they simply do not have the financial resources to defend themselves at trial, where they often risk harsh sentences many times greater than the ones they could receive under a plea bargain"); Peter Margulies, *Legal Hazard: Corporate Crime, Advancement Of Executives' Defense Costs, and The Federal Courts*, 7 U.C. DAVIS BUS. L.J. 55, 121-24 (2006) (supporting DOJ's pressure on corporations not to indemnify employees, and recommending even broader repeal of employees' right to indemnification).

ii. See Memorandum from Paul J. McNulty, Deputy Att'y Gen., to Heads of Dep't Components & U.S. Attorneys, on Principles of Federal Prosecution of Business Organizations (Dec. 12, 2006), available at [http://www.justice.gov/dag/speeches/2006/mcnulty\\_memo.pdf](http://www.justice.gov/dag/speeches/2006/mcnulty_memo.pdf) [hereinafter 2006 McNulty Memorandum] ("While these guidelines refer to corporations, they apply to the consideration of the prosecution of all types of business organizations, including partnerships, sole proprietorships, government entities, and unincorporated associations.").

iii. *Corporate Crime and Abuse: Tracking the Problem*, CTR. FOR CORP. POLICY, <http://www.corporatepolicy.org/issues/crimedata.htm> (last visited June 15, 2012) ("The association's estimate works out to 6 percent of employers' revenue, or \$4,500 per employee. [Note, however, that] [t]hese crimes are considered crimes against the corporation by employees, not corporate crimes against outside interests or employees.") (internal parenthesis omitted). In a speech delivered in 2000, a senior DOJ official estimated that abuse and fraud in the healthcare industry alone accounted for the loss of \$100 billion a year. James K. Robinson, Ass't Att'y Gen., Crim. Div. of the U.S. Dep't of Justice, Address to the Sponsoring Partner Forum Ethics Officer Association (Apr. 6, 2000), at [www.justice.gov/criminal/fraud/pr/speech/2000/04-06-200-speechjkrobinson.pdf](http://www.justice.gov/criminal/fraud/pr/speech/2000/04-06-200-speechjkrobinson.pdf) [hereinafter 2000 Robinson Speech]; see also Press Release, U.S. Dep't of Justice, GlaxoSmithKline to Plead Guilty and Pay \$3 Billion to Resolve Fraud Allegations and Failure to Report Safety Data: Largest Health Care Fraud Settlement in U.S. History (July 2, 2012), available at <http://www.justice.gov/opa/pr/2012/July/12-civ-842.html> (describing the single \$3 billion settlement of a three-count criminal information and additional civil liabilities to the federal and state governments).

iv. *Corporate Crime and Abuse*, *supra* note 3.

v. *Id.*

vi. *Id.* (citing "Illegal Corporate Behavior," U.S. Department of Justice, Law Enforcement Assistance Administration, National Institute of Law Enforcement and Criminal Justice, October 1979).

vii. These data points are 92 in 1999; 133 in 2000; 94 in 2001; 143 in 2002; 90 in 2003; 49 in 2004; 20 in 2005; 108 in 2006; 89 in 2007; 198 in 2008; 177 in 2009; and 148 in 2010. See U.S. Sentencing Comm'n, *1992-2010 Sourcebooks of Federal Sentencing Statistics*, tbl 51, "Organizations Receiving Fines or Restitution by Primary Offense Category", available at [http://www.ussc.gov/Data\\_and\\_Statistics/index.cfm](http://www.ussc.gov/Data_and_Statistics/index.cfm). An "organization," according to the sourcebooks, is "a 'person other than an individual,' according to 18 U.S.C. § 18. The term includes corporations, partnerships, associations, joint-stock companies, unions, trusts, pension funds, unincorporated organizations, governments and political subdivisions thereof, and nonprofit organizations." *Id.* at app. A.

viii. The insurance companies that provide indemnification insurance to their policyholders are, of course, an additional interest group that will be discussed later in the Article.

ix. There is a lively and important debate in the academic literature about how to keep the independence of counsel in important situations in which the advice and function of counsel may otherwise be compromised. This Article fits well into the academic debate because we rely on the excellent work on independent counsel that has been done before, and we specifically apply those

concepts to the condition of individual employees entitled to indemnification. *See generally* Norman W. Spaulding, *Independence and Experimentalism in the Department of Justice* 63 STAN. L. REV. 409, 415-19 (2011) (examining the independence of counsel inside the Department of Justice); Lawrence Lessig & Cass R. Sunstein, *The President And The Administration*, 94 COLUM. L. REV. 1, 14-22 (1994) (discussing the history and place of the Independent Counsel Act in the executive branch of government); Harvard Law Review, *Developments In The Law--Corporations And Society*, 117 HARV. L. REV. 2181, 2183, 2192 n.59 (2004) (discussing corporate directors and noting their ability to hire independent counsel). In the corporate context, there has been some discussion of conflicts of interest for counsel divided between the corporation that hires counsel and the employee whom counsel has been hired to represent. Professor Karlan nicely distinguished “discrete” attorney-client relationships that courts have historically protected from newly emerging “relational” relationships that dominate corporate and criminal enterprise cases, and that should be subject to greater court review for ethics problems, particularly the work of attorneys in potentially advancing the goals of criminal enterprises. Professor Karlan, however, stopped short of proposing a specific test for when joint counsel between a corporation and its employees should be retained, and she warned of undue prosecutorial influence in removing defense counsel too easily. Pamela S. Karlan, *Discrete and Relational Criminal Representation: The Changing Vision of the Right to Counsel*, 105 HARV. L. REV. 670, 720-23 (1992). Another recent law review article questioned whether ethics rules should prevent corporations from controlling employees’ counsel, but the article was framed as an examination of the no-contact rule preventing prosecutors from contacting employee defendants directly while employees are represented by corporate counsel, thereby muzzling the employees’ First Amendment right to speak, but not considering the impact of joint representation on the employees’ Sixth Amendment right to conflict-free counsel. Joan Colson, *Rule of Ethics or Substantive Law: Who Controls An Individual’s Right to Choose a Lawyer in Today’s Corporate Environment*, 38 J. MARSHALL L. REV. 1265, 1275-81 (2005).

In the insurance context, there has been significant recognition that there is a conflict of interest for insurance attorneys in representing both the insurance company and the insured, but no discussion of how adopting criminal *Cumis* counsel could address the concerns underlying the DOJ’s initiative. *See generally* John C. Coffee, Jr., *Litigation Reform Since The PSLRA: A Ten-Year Retrospective: Panel One: Private Securities Litigation Reform Act: Reforming The Securities Class Action: An Essay On Deterrence And Its Implementation*, 106 COLUM. L. REV. 1534, 1546-47 (2006) (discussing misplaced incentives in payments from D&O insurance in derivative suits); Charles Silver & Kent Syverud, *The Professional Responsibilities of Insurance Defense Lawyers*, 45 DUKE L.J. 255, 262-63 (1995) (noting that “[i]nsurance defense lawyers are integral parts of the engine that drives civil litigation, and the rules that govern their conduct are both extraordinarily vague and often wrong”); Douglas R. Richmond, *Walking a Tightrope: The Tripartite Relationship Between Insurer, Insured, and Insurance Defense Counsel*, 73 NEB. L. REV. 265, 279-81 (1994) (discussing conflicts of interest for attorneys from the tripartite relationship among insurance counsel, the insurance company, and the insured, especially in joint representation); Chad G. Marzen, *Can (and Should) an Insurance Defense Attorney Be Held Liable for Insurance Bad Faith?*, 7 VA. L. & BUS. REV. 97, 98-103 (2012) (surveying the insurance attorney’s conflicts of interest in representing both the insurance company and the insured, and suggesting that some attorneys’ actions may rise even to the level of bad faith in their representation of the insured).

The only article in the insurance area on conflicts of interest that touches squarely on criminal law issues focuses on so-called “house counsel,” attorneys such as Bruce Cutler, the Gambino family lawyer who famously helped multiple generations of that crime family to avoid legal punishment, and “captive” law firms in which the “key feature is almost total dependence on a limited number of clients.” *See* Aviva Abramovsky, *The Enterprise Model of Managing Conflicts of Interest in the Tripartite Insurance Defense Relationship*, 27 CARDOZO L. REV. 193, 193 (2005) (quoting John Gotti and Texas Supreme Court Justice Raul A. Gonzales); *id.* at 194-96 (elaborating on the concept of “house counsel”); *id.* at 219-23 (elaborating on the concept of “captive” law firms). The Authors completely agree with Professor Abramovsky’s observation that “house counsel” loyalty is “relational to fee payment,” and that the enterprise assumes that its “interests will be placed ahead of those of any given nominal defendant... [because] the lawyer’s pecuniary interest is to retain repeat business from the enterprise.” *Id.* at 195. Professor Abramovsky’s proposed solution to counsel’s conflict of interest is case-by-case court intervention and a database of who pays insurance defense counsel’s fees to reveal evidence of financial bias based on their revenue histories. *See also id.* at 227-28, 231. This Article is a new contribution to the literature because Professor Abramovsky failed to import her solution into the D&O insurance context, or to recognize the significance of the corporation’s control of employees’ counsel as a threat to the employee defendants’ Sixth Amendment rights. In addition, her article failed to recognize the significance of the *Cumis* case’s solution for employees entitled to corporate indemnification or to the growth of D&O insurance coverage, which is dramatically changing the landscape of D&O indemnification. The adoption of criminal *Cumis* counsel would solve more of these problems in a more comprehensive manner.

x. *San Diego Navy Fed. Credit Union v. Cumis Ins. Soc’y, Inc.*, 162 Cal. App. 3d 358, 375 (1984).

xi. *Wood v. Georgia*, 450 U.S. 261 (1981).

xii. *Id.* at 269 n.15 (quoting *In re Abrams*, 266 A. 2d 275, 278 (N.J. 1970)).

xiii. Representing multiple clients is a common conflict of interest issue for in-house counsel, for example. As one commentator has explained, “It is more economical to use fewer lawyers, and even cheaper to use in-house counsel than to retain outside counsel. In this age of shrinking resources, minimizing aggregate legal costs is not an inconsiderable factor. Second, and perhaps more important, in-house counsel often believe that using a single attorney gives the company more control of the

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situation, including the ability both to present a 'consistent and unified version of events that give rise to potential liability' and to exercise 'control over the strategic legal decisions relating to the matter.'" Nancy J. Moore, *Conflicts of Interest for In-House Counsel: Issues Emerging from the Expanding Role of the Attorney-Employee*, 39 S. TEX. L. REV. 497, 507-08 (1998) (internal citations omitted).

xiv. RESTATEMENT (THIRD) OF AGENCY § 8.14 cmt. b (2006) ("Agent's right to indemnification--in general. In general, a principal's obligation to indemnify an agent arises when the agent makes a payment or incurs an expense or other loss while acting on behalf of the principal."); *id.* (specifically including the costs of litigation in the agents' right to indemnification).

xv. *Id.* at cmt. d ("Because the principal will be subject to liability for any payment due the third party, the principal has the primary interest in defending against the third party's claim.").

xvi. U.S. CONST. amend VI (original spelling in the U.S. Constitution).

xvii. *Strickland v. Washington*, 466 U.S. 668, 686 (1984) ("Defendants... have the right to effective assistance of counsel."); *Yarborough v. Gentry*, 540 U.S. 1, 5 (2003) ("The Sixth Amendment guarantees criminal defendants the effective assistance of counsel."); *accord* *Wheat v. United States*, 486 U.S. 153, 159 (1988) (holding that, in considering attorney conflicts of interest, "the essential aim of the [Sixth] Amendment is to guarantee an effective advocate for each criminal defendant rather than to ensure that a defendant will inexorably be represented by the lawyer whom he prefers.").

xviii. *Wood*, 450 U.S. at 271; *accord* *Wheat*, 486 U.S. at 160 ("[A] court confronted with and alerted to possible conflicts of interest must take adequate steps to ascertain whether the conflicts warrant separate counsel.").

xix. *Id.*

xx. *Holloway v. Arkansas*, 435 U.S. 475, 489-490 (1978).

xxi. Public defenders, for example, are typically paid by the government, but they owe a duty of loyalty to their clients, not to the entity that issues their salaries.

xxii. MODEL RULES OF PROF'L CONDUCT R. 1.7 (2010) [hereinafter Rule 1.7].

xxiii. *Id.*

xxiv. *See, e.g.,* Moore, *supra* note 13, at 507-08 (discussing common conflicts of interest and pressures on corporate counsel).

xxv. Rule 1.7, *supra* note 16.

xxvi. In addition, Fed. R. Crim. P. 44(c) provides for courts to inquire into joint representation of defendants in criminal cases, but, under the Rule, joint representation occurs only when "two or more defendants have been charged jointly under Rule 8(b)," or when they have been "joined for trial under Rule 13." The situation of employee defendants indemnified by corporations is different than many other types of prosecutions because employee defendants and the corporations that indemnify them are often not charged at the same time. *See, e.g.,* U.S. Dep't of Justice, U.S. Attorneys' Manual, § 9-28.300, cmt. a (downloaded May 24, 2012), available at [http://www.justice.gov/usao/eousa/foia\\_reading\\_room/usam/title9/28mcrm.htm](http://www.justice.gov/usao/eousa/foia_reading_room/usam/title9/28mcrm.htm) [hereinafter U.S. Attorneys' Manual] (describing different criteria for charging corporations than for employee defendants, "due to the nature of the corporate 'person'").

xxvii. James D. Cox, *Symposium: Lessons from Enron, How Did Corporate and Securities Law Fail? Managing and Monitoring Conflicts of Interest: Empowering the Outside Directors with Independent Counsel*, 48 VILL. L. REV. 1077, 1086 (2003) (citing *Bell Atl. Corp. v. Bolger*, 2 F.3d 1304 (3d Cir. 1993) (holding dual representation improper when suit involves "serious charges of wrongdoing")); *Lewis v. Shaffer Stores Co.*, 218 F. Supp. 238 (S.D.N.Y. 1963) (holding that corporation and individual directors named in suit cannot share the same counsel); *see also generally* *Int'l Bhd. of Teamsters v. Hoffa*, 242 F. Supp. 246 (D.D.C. 1965) (holding that union and its officers charged with wrongdoing in suit brought on behalf of union cannot be represented by same attorney).

xxviii. RESTATEMENT (THIRD) OF AGENCY § 8.14 cmt. b (2006) ("Agent's right to indemnification--in general. In general, a principal's obligation to indemnify an agent arises when the agent makes a payment or incurs an expense or other loss while acting on behalf of the principal.").

xxix. *Id.* (specifying that, in the context of indemnification, "[a]ctions taken by an agent may also result in litigation against the agent brought by third parties with whom the agent has interacted on the principal's behalf.").

xxx. N.Y. BUS. CORP. LAW § 722 (Consol. 2012).

xxxi. DEL. CODE ANN. tit. 8, § 145 (2012).

xxxii. CAL. CORP. CODE § 317 (Deering 2012).

xxxiii. As of 2008, twenty-four states have adopted the RMBCA in its full form; twenty-six states, in addition to the District of Columbia, have enacted portions of the RMBCA. David Carnes, *Model Business Corporations Act*, LEGAL ZOOM, <http://info.legalzoom.com/model-business-corporations-act-21003.html> (last visited May 25, 2012).

xxxiv. REV. MODEL BUS. CORP. ACT § 8.52 (2007) [hereinafter RMBCA] ("A corporation shall indemnify a director who was wholly successful, on the merits or otherwise, in the defense of any proceeding to which he was a party because he was a director of the corporation against expenses incurred by him in connection with the proceeding."); *id.* at § 8.56 (extending indemnification to officers of corporations who are not directors).

xxxv. *Id.* at § 8.54(a) ("A director who is a party to a proceeding because he is a director may apply for indemnification or an advance for expenses to the court conducting the proceeding or to another court of competent jurisdiction."); *id.* at § 8.56(c) (extending mandatory indemnification to officers of corporations who are not directors).

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xxxvi. CAL. CORP. CODE § 317(a); *see also id.* (expansively defining the potential principal of the agent as not only the current corporation, but entities for which the agent “is or was serving at the request of the corporation as a director, officer, employee or agent of another foreign or domestic corporation, partnership, joint venture, trust or other enterprise, or was a director, officer, employee or agent of a foreign or domestic corporation which was a predecessor corporation of the corporation or of another enterprise at the request of the predecessor corporation.”).

xxxvii. DEL. CODE ANN. tit. 8, § 145.

xxxviii. *See id.* (expansively defining the potential indemnified party as not the merely the agent of the corporation but also potentially the agent of other business entities if that party was “serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise.”).

xxxix. N.Y. BUS. CORP. LAW § 722(a).

xl. RMBCA § 8.50(2).

xli. DEL. CODE ANN. tit. 8, § 145(c).

xlii. *See Merritt-Chapman & Scott Corp. v. Wolfson*, 321 A.2d 138, 141 (Del. Super. Ct. 1974) (holding that, even when the employee is being prosecuted by the corporation itself for alleged fraud against the corporation’s shareholders, the court explained: “Success is vindication. In a criminal action, any result other than conviction must be considered success.”).

xliii. *See id.* (“The statute does not require complete success.... Claimants are therefore entitled to partial indemnification if successful on a count of an indictment, which is an independent criminal charge, even if unsuccessful on another, related count.”).

xliv. N.Y. BUS. CORP. LAW § 722(a).

xlv. *Id.* at § 722(b).

xlvi. CAL. CORP. CODE § 317(b) (allowing corporations to indemnify any person who fits the statute’s requirements “if that person acted in good faith and in a manner the person reasonably believed to be in the best interests of the corporation and, in the case of a criminal proceeding, had no reasonable cause to believe the conduct of the person was unlawful”); *see also id.* (“The termination of any proceeding by judgment, order, settlement, conviction, or upon a plea of nolo contendere or its equivalent shall not, of itself, create a presumption that the person did not act in good faith and in a manner which the person reasonably believed to be in the best interests of the corporation or that the person had reasonable cause to believe that the person’s conduct was unlawful.”).

xlvii. CAL. LABOR CODE § 2802(a) (Deering 2012).

xlviii. RMBCA § 2.02(b)(5).

xlix. *See, e.g.,* Richard A. Posner, *An Economic Theory Of The Criminal Law*, 85 COLUM. L. REV. 1193, 1199 (1985) (describing criminal states of mind, and also noting that “the subset of intentional torts that consists of pure coercive transfers... represents the largest category of criminal acts”).

l. RMBCA § 8.51.

li. *Id.* at § 8.52.

lii. *Id.* at § 8.56(a)(1).

liii. *Id.* at § 8.56(c).

liv. A.L.I. PRINCIPLES OF CORP. GOVERNANCE: ANALYSIS & RECOMMENDATIONS § 7.19 (1994).

lv. Cynthia A. Williams, *Corporate Compliance with the Law in the Era of Efficiency*, 79 N.C. L. REV. 1265, 1312 (1998).

lvi. ALI PRINCIPLES OF CORP. GOVERNANCE: ANALYSIS & RECOMMENDATIONS § 7.19 cmt. f (1994).

lvii. *See also* KENT GREENFIELD, *THE FAILURE OF CORPORATE LAW: FUNDAMENTAL FLAWS AND PROGRESSIVE POSSIBILITIES* 252 n.8 (2006) (“Even in the celebrated *Caremark* case, often cited for the proposition that corporate directors have the duty to erect internal monitoring systems to ensure compliance with law, the defendant directors in that case were held not to have violated their duty of care because of the firm’s criminal activities. The directors thus escaped liability under corporate law even though the unlawful activity had cost the firm \$250 million in fines.”) (citing *In re Caremark Int’l Inc. Derivative Litig.*, 698 A.2d 959 (Del. Ch. 1996)).

lviii. John A. Edie, *Directors and Officers: Liability Insurance and Indemnification*, COUNCIL ON FOUNDATIONS 4 (2007), available at [www.cof.org/files/Documents/Legal/DandO.pdf](http://www.cof.org/files/Documents/Legal/DandO.pdf).

lix. Securities Exchange Act of 1934, Pub. L. No. 73-291, 48 Stat. 881 (codified as amended at 15 U.S.C. § 78a et seq. (2012)).

lx. I.R.C. (2006).

lxi. Employee Retirement Income Security Act (ERISA) of 1974, Pub. L. No. 93-406 (1974) (codified as amended at 29 USC § 1002 et seq. (2012)).

lxii. Occupational Safety and Health Act (OSHA) of 1970, Pub. L. No. 91-596, 84 Stat. 1590 (1970) (codified as amended at 29 U.S.C. § 651 et seq. (2012)).

lxiii. Edie, *supra* note 52, at 4.

lxiv. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002).

lxv. Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203 (2010).

lxvi. Racketeer Influenced and Corrupt Organizations Act (RICO) was originally enacted by Section 901(a) of the Organized Crime Control Act of 1970, Pub. L. No. 91-452, 84 Stat. 922 (1970)

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(codified as amended at 8 U.S.C. §§ 1961–1968 (2012)).

lxvii. See generally Pamela H. Bucy, *Indemnification of Corporation Executives Who Have Been Convicted of Crimes: An Assessment and Proposal*, 24 IND. L. REV. 279, 288-89 (1991) (surveying the broad variety of cases and statutes in which corporate executives have been indemnified for criminal convictions by corporations).

lxviii. *Homestore, Inc. v. Tafeen*, 888 A.2d 204, 211 (Del. 2005).

lxix. *Directors & Officers (D&O) Liability Insurance*, Report Presented to Wyoming Library Association (Feb. 2007), available at [wyla.org/files/feb07/bdcoverage.pdf](http://wyla.org/files/feb07/bdcoverage.pdf).

lxx. See, e.g., *Homestore*, 888 A.2d at 211; *Miller v. Miller*, No. 2011-0024, 2012 Ohio LEXIS 1673, slip op. at 12-13 (Ohio July 3, 2012) (quoting the language of *Homestore* above); In re *Aguilar*, 344 S.W.3d 41, 46 (Tex. App. 2011) (citing *Homestore* for the same proposition).

lxxi. See RESTATEMENT (THIRD) OF AGENCY § 8.14 cmt. b (2006) (“A contract between a principal and an agent may anticipate the possibility that the agent will incur pecuniary losses, specify when and to what extent the principal has a duty to indemnify the agent, and prescribe procedures to be followed by the agent in claiming rights to indemnity under the contract.”).

lxxii. See, e.g., RMBCA § 8.53 (describing when corporations may advance expenses to directors, specifically “funds to pay for or reimburse the expenses incurred in connection with the proceeding by an individual who is a party to the proceeding”); see also *id.* § 8.54 (providing for court-ordered indemnification and advances for expenses).

lxxiii. See, e.g., *Homestore*, 888 A.2d at 211 (“Advancement is an especially important corollary to indemnification as an inducement for attracting capable individuals into corporate service.”).

lxxiv. *Id.*

lxxv. See, e.g., Costa N. Kensington & Helen J. Williamson, *United States: Corporate Responses to D&O Indemnification Following Schoon v. Troy*, available at <http://www.mondaq.com/unitedstates/article.asp?articleid=86492> (last visited May 29, 2012) (discussing empirical findings on mandatory advancement from recent SEC filings).

lxxvi. Compare RMBCA § 8.54 (providing for court-ordered indemnification and advances for expenses), with DEL. CODE ANN. tit. 8, § 145(e) (permitting corporations to advance fees “upon such terms and conditions, if any, as the corporation deems appropriate”).

lxxvii. Sean J. Griffith, *Uncovering a Gatekeeper: Why the SEC Should Mandate Disclosure of Details Concerning Directors’ and Officers’ Liability Insurance Policies*, 154 U. PA. L. REV. 1147, 1168 (2006) (reporting 2004 survey results that over ninety percent of public companies carry D&O insurance and citing Tillinghast, Towers Perrin, 2004 Directors and Officers Liability Survey, at 21 fig. 12, in which 99 percent of U.S. respondents reporting purchasing coverage in 2004); accord *Edie, supra* note 52, at 17 (reporting that, in a 2001 survey of non-corporate foundations with over \$10 million in assets, “86 percent of respondents now carry D&O insurance, a substantial increase from 62 percent in the 1990 survey”).

lxxviii. Joseph W. Bishop, Jr., THE LAW OF CORPORATE OFFICERS AND DIRECTORS: INDEMNIFICATION AND INSURANCE § 8.01 (rev. ed. 1998) (“All states authorize the corporation to purchase and maintain insurance on behalf of directors or officers against liabilities incurred in such capacities, whether or not the corporation would have the power to indemnify against such liabilities.”).

lxxix. See *id.*; see also RMBCA § 8.57 (“A corporation may purchase and maintain insurance on behalf of an individual who is a director or officer of the corporation... whether or not the corporation would have power to indemnify or advance expenses to him against the same liability under this subchapter.”).

lxxx. D&O insurance may either be an indemnity policy or a liability policy. An indemnity policy will reimburse the insured for expenses such as legal fees to defend the suit and even claims before a judgment or settlement has been entered. A liability policy, by contrast, pays the insured only once a judgment or settlement becomes final. See generally Lee R. Russ & Thomas F. Segalla, *Directors and Officers: General Coverage Terms*, in 9A COUCH ON INSURANCE § 131:31 (2011).

lxxxi. There are three common forms of D&O insurance: first, direct (or “Side-A”) coverage, which covers the individual directors and officers; second, indirect (or “Side B”) coverage, which reimburses the company when it has indemnified its directors or officers for a loss; and third, entity (or “Side C”) coverage, which insures the company for claims brought immediately against it. See, e.g., John M. Wunderlich, *Bankruptcy’s Protection for Non-debtors from Securities Fraud Litigation*, 16 FORDHAM J. CORP. & FIN. L. 375, 399-400 (2011) (describing D&O liability insurance policy forms).

lxxxii. Conner Strong & Buckelew, *Executive Protection: Indemnification and D&O Insurance, The Basics*, available at <http://www.connerstrong.com/resources/site1/news/1414CSB%20ER%20Nuts%20&%20Bolts-Final.pdf> (last visited May 30, 2012).

lxxxiii. Wells Fargo, *Directors and Officers Liability Insurance Basics*, available at [https://www.wellsfargo.com/biz/insurance/property\\_liability/directors\\_officers/basics](https://www.wellsfargo.com/biz/insurance/property_liability/directors_officers/basics) (last visited May 29, 2012).

lxxxiv. Assuming that the D&O insurance is a liability policy. See discussion of policy types, *supra* note 74.

lxxxv. See Rodger D. Wiegley, *D&O Insurance: Do Private Companies Need It? (Part II of II)*, THE CORP. SEC’Y’S BLOG (Aug. 30, 2011), <http://thecorpsec.wordpress.com/2011/08/30/do-insurance-do-private-companies-need-it-part-ii-of-ii> (describing the practical operation of D&O insurance policies).

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lxxxvi. *See, e.g.*, CAL. INS. CODE § 533 (Deering 2012) (prohibiting insurers from paying for the “willful act” of an insured); *see also* CAL. CIV. CODE § 1668 (Deering 2012) (prohibiting any contract to indemnify an individual for his own fraud or for willful injury to another).

lxxxvii. *See generally* Conner Strong & Buckelew, *supra* note 76 (describing the function of D&O insurance policies).

lxxxviii. Wiegley, *supra* note lxxxv.

lxxxix. *Id.*

xc. *See* Lindsay Fisher, *D&O Insurance: The Tension Between Cooperating with the Insurance Company and Protecting Privileged Information from Third Party Plaintiffs*, 32 SEATTLE UNIV. L.R. 201, 207 (2008) (describing the difference in coverage between D&O insurance policies and general liability insurance claims).

xc. *Id.*

xcii. *Id.*

xciii. *See* Stephen S. Ashley, BAD FAITH ACTIONS: LIABILITY AND DAMAGES §§ 2.08, 2.15 (2d ed. 1997) (describing how, by the late 1990s, courts in nearly thirty states had recognized the cause of bad faith actions against insurers, and how the legislatures of nineteen states had enacted statutes specifically authorizing such claims against insurance companies); *see also* Egan v. Mut. of Omaha Ins. Co., 24 Cal. 3d 809, 820 (Cal. 1979) (“As a supplier of a public service rather than a manufactured product, the obligations of insurers go beyond meeting reasonable expectations of coverage. The obligations of good faith and fair dealing encompass qualities of decency and humanity inherent in the responsibilities of a fiduciary. Insurers hold themselves out as fiduciaries, and with the public’s trust must go private responsibility consonant with that trust.”) (citation omitted).

xciv. Mark J. Browne, Ellen S. Pryor, & Bob Puelz, *The Effect of Bad-Faith Laws on First-Party Insurance Claims Decisions*, 33 J. LEGAL STUD. 355, 356 (2004), available at <http://www.jstor.org/stable/10.1086/423189> (footnotes omitted).

xcv. Rodger D. Wiegley, *D&O Insurance: Do Private Companies Need It? (Part I of II)*, THE CORP. SEC’Y’S BLOG (Aug. 18, 2011), <http://the.corpsec.wordpress.com/2011/08/18/do-insurance-do-private-companies-need-it-part-i>; *see also* Jacqueline Palank, *Judge: MF Global Officers Entitled to Use Insurance*, WALL ST. J., April 30, 2012, available at <http://online.wsj.com/article/SB10001424052702340450304577376072657060672.html> (describing a judge’s denial of an attempt to block the corporation’s executives from accessing the bankrupt firm’s D&O insurance).

xcvi. *Id.*

xcvii. *See id.* (describing the dynamics of this ‘under the bus’ scenario).

xcviii. *See, e.g.*, Kensington & Williamson, *supra* note 69, at n.13 (citing DEL. CODE ANN. tit. 8, § 145(g), and N.Y. BUS. CORP. LAW §726(a)(3), (e)), as well as the case of PepsiCo v. Cont’l Cas. Co., 640 F. Supp. 656 (S.D.N.Y. 1986); *accord* JOHN F. OLSON, ET AL., DIRECTOR & OFFICER LIABILITY: INDEMNIFICATION AND INSURANCE § 12:1 (2011) (“[I]t is now clear that D&O insurance often can protect directors and officers against the consequences of conduct for which a corporation cannot legally indemnify them.”).

xcix. Sanjai Bhagat, James A. Brickley, & Jeffrey L. Coles, *Managerial Indemnification and Liability Insurance: The Effect on Shareholder Wealth*, 54 J. RISK INS. 721, 733 (1987), available at <http://www.jstor.org/stable/253119>.

c. *See id.* (arguing that, because “D&O insurance may align the interests of managers and shareholder,” the ground-breaking report found that “the empirical evidence suggests that the effect of D&O insurance on shareholder wealth is positive”).

ci. Jinyoung Park, *The Effect of Directors’ and Officers’ Liability Insurance and Indemnification on Voluntary Disclosure: Evidence From Canadian Firms*, U. MICH. - FLINT SCH. OF MGMT. 30 (2005-06), available at [http://som.umflint.edu/research/docs/20052006/200506\\_JP\\_I.pdf](http://som.umflint.edu/research/docs/20052006/200506_JP_I.pdf) (discussing evidence regarding firms cross-listed in the United States); *see also id.* (providing “new empirical evidence that the timing decision to announce actual earnings is a function of legal liability coverage and the presence of voluntary disclosures in the form of management forecasts.”).

cii. *Id.* at 2 (discussing evidence regarding firms cross-listed in the United States); *see also id.* (providing “new empirical evidence that the timing decision to announce actual earnings is a function of legal liability coverage and the presence of voluntary disclosures in the form of management forecasts.”).

ciii. Although Canadian companies are required to disclose D&O insurance information, U.S. companies are not.

civ. Park, *supra* note 95, at 2.

cv. *Id.* at 5.

cvi. Memorandum from Eric H. Holder, Deputy Att’y Gen., to Heads of Dep’t Components & U.S. Attorneys, on Bringing Criminal Charges Against Corporations (June 16, 1999), available at <http://www.justice.gov/criminal/fraud/documents/reports/1999/charging-corps.PDF> [hereinafter 1999 Holder Memorandum].

cvii. 1999 Holder Memorandum, *supra* note cvi.

cviii. *Id.* at 1-2.

cix. *Id.* at 2.

cx. *Id.* at 5.

cx. *Id.*



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- cxii. *Id.* at 6 (footnote omitted).
- cxiii. *Id.* at n.3.
- cxiv. Memorandum from Larry D. Thompson, Deputy Att’y Gen., to Heads of Dep’t Components & U.S. Attorneys, on Principles of Federal Prosecution of Business Organizations (Jan. 20, 2003), *available at* [http://www.justice.gov/dag/cftf/corporate\\_guidelines.htm](http://www.justice.gov/dag/cftf/corporate_guidelines.htm) [hereinafter 2003 Thompson Memorandum].
- cxv. *See, e.g.*, 2000 Robinson Speech, *supra* note 3, at 5 (“One issue that comes up over and over again in the self-reporting context is the waiver of the attorney-client privilege.”); *see also* discussion of ABA Resolutions and Congressional action *infra* pp. 25-28.
- cxvi. 2003 Thompson Memorandum, *supra* note 108, at 5 (footnote omitted). The footnote noting that some states require D&O indemnification by law was carried over into this version of the DOJ’s memorandum.
- cxvii. *Id.* at 5.
- cxviii. *Id.*
- cxix. Memorandum from Robert D. McCallum, Jr., Acting Deputy Att’y Gen., to Heads of Dep’t Components & U.S. Attorneys, on Waiver of Corporate Attorney-Client and Work Product Production (Oct. 21, 2005), *available at* [http://www.federalevidence.com/pdf/ Corp\\_Prosec/McCallum\\_Memo\\_10\\_21\\_05. pdf](http://www.federalevvidence.com/pdf/Corp_Prosec/McCallum_Memo_10_21_05.pdf).
- cxx. *Id.* at 1.
- cxxi. 2003 Thompson Memorandum, *supra* note 108, at 5.
- cxxii. As the DOJ explained in its 2006 McNulty Memorandum: “Routine questions regarding the representation status of a corporation and its employees, including how and by whom attorneys’ fees are paid, frequently arise in the course of an investigation. They may be necessary to assess other issues, such as conflict-of-interest. Such questions are appropriate and this guidance is not intended to prohibit such inquiry.” 2006 McNulty Memorandum, *supra* note 2, at 12 n.4.
- cxxiii. 1999 Holder Memorandum, *supra* note 100, at 6; 2003 Thompson Memorandum, *supra* note 108, at 5.
- cxxiv. 1999 Holder Memorandum, *supra* note 100, at 5; 2003; Thompson Memorandum, *supra* note 108, at 7.
- cxxv. 1999 Holder Memorandum, *supra* note 100, at 6; 2003 Thompson Memorandum, *supra* note 108, at 5.
- cxxvi. 2000 Robinson Speech, *supra* note 3, at 6.
- cxxvii. *United States v. Josleyn*, 206 F.3d 144 (1st Cir. 2000).
- cxxviii. *Id.* at 144.
- cxxix. *Id.* at 149.
- cxxx. *Id.*
- cxxxi. *Id.* (quoting United States Court of Appeals for the Fourth Circuit order of March 24, 1998, denying American Honda’s request to stay district court order vitiating American Honda’s attorney-client and work product privileges on the basis of the crime-fraud exception).
- cxxxi. *Id.*
- cxxxi. *See id.*; *accord* *Mohawk Industries, Inc. v. Carpenter*, 558 U.S. 100, \_\_\_, 130 S. Ct. 599, 606 (2009) (“We readily acknowledge the importance of the attorney-client privilege, which ‘is one of the oldest recognized privileges for confidential communications.’ *Swidler & Berlin v. United States*, 524 U. S. 399, 403 (1998). By assuring confidentiality, the privilege encourages clients to make ‘full and frank’ disclosures to their attorneys, who are then better able to provide candid advice and effective representation. *Upjohn Co. v. United States*, 449 U. S. 383, 389 (1981). This, in turn, serves ‘broader public interests in the observance of law and administration of justice.’ *Ibid.*”).
- cxix. *See, e.g.*, David W. Ogden, Deputy Att’y Gen., Compliance Week Keynote Address (June 4, 2009), *available at* <http://www.justice.gov/dag/speeches/2009/dag-speech-090604.html> (describing, in an address to members of the legal profession, how “we—and our clients—have a common interest in restoring and preserving the public’s faith in corporate America, and in making certain that responsible corporate citizenship is encouraged and rewarded”).
- cxix. *United States v. Jeffrey Stein*, 435 F. Supp. 2d 330, 367-73 (S.D.N.Y. decided June 26, 2006, as amended July 14, 2006) [hereinafter Stein I], *add’l proceedings in* *U.S. v. Stein*, 440 F. Supp. 2d 315 (S.D.N.Y. 2006) [hereinafter Stein II] (suppressing proffer statements obtained in violation of the Fifth Amendment), *add’l proceedings in* *U.S. v. Stein*, 452 F. Supp. 2d 230 (S.D.N.Y. 2006) [hereinafter Stein III] (finding ancillary jurisdiction over defendants’ civil suit against KPMG, LLP, for advancement of attorneys fees), *vacated by* *Stein v. KPMG, LLP*, 486 F.3d 753 (2d Cir. 2007), *add’l proceedings in* *U.S. v. Stein*, 452 F. Supp. 2d 390 (S.D.N.Y. 2007) [hereinafter Stein IV] (holding that dismissal of the indictment was the appropriate remedy for the government’s violations of defendants’ constitutional rights), *dismissal of indictment aff’d by* *U.S. v. Stein*, 541 F.3d 130 (2d Cir. 2008) [hereinafter Stein Appeal].
- cxix. *Stein I*, 435 F. Supp. 2d at 364-65. According to the court, “The argument that payment of legal fees to employees and former employees is relevant to gauging the extent of a company’s cooperation also is problematic. There is no necessary inconsistency between an entity cooperating with the government and, at the same time, paying defense costs of individual employees and former employees. An entity may pay out of a judgment that extending this benefit will aid it in keeping and hiring competent and honest employees. It may pay in recognition that an employee caught up in an

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investigation, or even charged with a crime, because the employee did his or her job for the company has at least some claim to assistance, even in the absence of a legal right.... For these reasons, this aspect of the Thompson Memorandum is not narrowly tailored to achieve a compelling objective. It discourages and, as a practical matter, often prevents companies from providing employees and former employees with the financial means to exercise their constitutional rights to defend themselves. It does so in the face of state indemnification statutes that expressly permit businesses entities to provide those means because the states have determined that legitimate public interests may be served.... It therefore burdens excessively the constitutional rights of the individuals whose ability to defend themselves it impairs and, accordingly, fails strict scrutiny. The legal fee advancement provision violates the Due Process Clause.”

cxxxvii. *Id* at 350; *accord Stein Appeal*, 541 F.3d at 135.

cxxxviii. *Stein I*, 435 F. Supp. 2d at 349-50.

cxxxix. *Id.* at 353.

cxli. *Id.* at 356, 366.

cxlii. *Id.* at 366 (quoting U.S. CONST. amend VI) (original spelling in the U.S. Constitution).

cxliii. *Id.* at 366 (citing *Wheat v. U.S.*, 486 U.S. 153, 164 (1988), and *Caplin & Drysdale, Chartered v. U.S.*, 491 U.S. 617, 624 (1989)).

cxliiii. *Id.* at 369.

cxliv. *Id.* at 381 (quoting *Berger v. United States*, 295 U.S. 78, 88 (1935)); *see also* *Brady v. Maryland*, 373 U.S. 83, 87 (1963) (“Society wins not only when the guilty are convicted but when criminal trials are fair; our system of the administration of justice suffers when any accused is treated unfairly. An inscription on the walls of the Department of Justice states the proposition candidly under the federal domain: ‘The United States wins a point whenever justice is done its citizens in the courts.’”).

cxlv. *Stein I*, 435 F. Supp. 2d at 381-82 (footnote omitted).

cxlvi. *See* Jan L. Handzlik, *Protecting Employee Rights Under The Thompson Memorandum*, 15 ABA CRIM. JUST. SECTION NEWSLETTER 10 (Fall 2006), *available at* [http://www.americanbar.org/content/dam/aba/publishing/criminal\\_justice\\_section\\_newsletter/crimjust\\_newsletterfall2006.pdf-48k-2011-06-29](http://www.americanbar.org/content/dam/aba/publishing/criminal_justice_section_newsletter/crimjust_newsletterfall2006.pdf-48k-2011-06-29) (describing the ABA House of Delegates’ unanimous passage of Resolution 302B).

cxlvii. ABA Res. 302B, ABA HOUSE OF DELEGATES (adopted Aug. 7-8, 2006), *available at* <http://www.americanbar.org/content/dam/aba/migrated/leadership/2006/annual/dailyjournal/threehundredtwob.doc>.

cxlviii. *Id.* at 1.

cxlix. *Id.*

cli. Handzlik, *supra* note 139, at 10-11.

clii. *Id.* at 10.

cliii. *Id.* at 10-11.

cliiii. *Id.* at 11.

cliv. *Id.*

clv. *Id.* (footnote omitted).

clvi. *Id.*

clvii. The various pressure groups in addition to the ABA involved in prompting the U.S. Senate Committee to hold this hearing on the 2003 Thompson Memorandum included the American Chemistry Council, the American Civil Liberties Union, the Association of Corporate Counsel, Business Civil Liberties, Inc., the Business Roundtable, the Frontiers of Freedom, the National Association of Criminal Defense Lawyers, the National Association of Manufacturers, the National Defense Industrial Association, the Retail Industry Leaders Association, the U.S. Chamber of Commerce, and the Washington Legal Foundation. N. Richard Janis, *The McNulty Memorandum: Much Ado About Nothing*, THE WASH. LAWYER (Feb. 2007), *available at* [http://www.dcb.org/for\\_lawyers/resources/publications/washington\\_lawyer/february\\_2007/stand.cfm](http://www.dcb.org/for_lawyers/resources/publications/washington_lawyer/february_2007/stand.cfm).

clviii. *Senate Hearing 109-835 - The Thompson Memorandum's Effect on the Right to Counsel in Corporate Investigations*, 109th Cong. 1 (Sept. 12, 2006), CHRG-109shrg34117.pdf, *available at* <http://www.judiciary.senate.gov/resources/transcripts/109transcripts.cfm> [hereinafter *Senate Hearing*].

clix. In McNulty’s words: “Reality number 1, Federal prosecutors have a duty to the taxpayers of this country to hold corporate officials and corporations accountable for criminal wrongdoing.... Reality number 2, those corporations want out from under the dark clouds of criminal wrongdoing as quickly as possible.... Reality number 3, most corporations, therefore, are anxious to cooperate with Government investigations.... Reality number 4, there are many ways for Government investigators to get the facts in a corporate fraud investigation, to find out who did what when. Some ways are faster and more productive than others. One of the most productive ways to get the facts is for a cooperating corporation to tell the Government what it knows.... Reality number 5, once a corporation has turned over the internal report and the prosecutor is ready to decide, indict or not indict, the corporation will insist, will demand that its cooperation be given full consideration along with other relevant factors in deciding not to indict the company.” *Id.* at 2-4 (statement of Deputy Attn’y Gen. McNulty).

clx. *See, e.g., id.* at 12 (response to questioning by Deputy Attn’y Gen. McNulty) (“Look, I have got the Chairman, the Ranking Member upset. I have got former DOJ officials writing letters. We have got everybody complaining. The easiest thing for me to do today would be to come here and say we are just going to go ahead and change this policy and make everybody happy.”).

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clxi. The Attorney-Client Privilege Protection Act of 2006, S. 30, 109th Cong. (2006), *available at* <http://www.govtrack.us/congress/bills/109/s30/text> [hereinafter Specter Bill]; *see also* The Attorney-Client Privilege Protection Act of 2007, H.R. 3013, 109th Cong. (2007) (passing the House in 2007); The Attorney-Client Privilege Protection Act of 2008, S. 3217, 110th Cong. (2008) (reintroducing the bill in its House version, but failing to pass the Senate); The Attorney-Client Privilege Protection Act of 2009, S. 445, 111th Cong. (2009) (failing to pass the Senate).

clxii. *Compare* ABA Res. 302B at 1 (listing numbered objections one through four), *with* Specter Bill, *supra* note 154, at § 3(b)(2)(B)-(E) (listing the same objections in the same order).

clxiii. Specter Bill, *supra* note 154, at § 3(b)(2)(B) (prohibiting the government from evaluating cooperation on “the provision of counsel to, or contribution to the legal defense fees or expenses of, an employee of that organization”).

clxiv. *Id.* at § 3(b)(2)(C) (prohibiting the government from evaluating cooperation on “the entry into a joint defense, information sharing, or common interest agreement with an employee of that organization if the organization determines it has a common interest in defending against the investigation or enforcement matter”).

clxv. *Id.* at § 3(b)(2)(D) (prohibiting the government from evaluating cooperation on “the sharing of information relevant to the investigation or enforcement matter with an employee of that organization”).

clxvi. *Id.* at § 3(b)(2)(E) (prohibiting the government from evaluating cooperation on “a failure to terminate the employment of or otherwise sanction any employee of that organization because of the decision by that employee to exercise the constitutional rights or other legal protections of that employee in response to a Government request”).

clxvii. *Id.* at § 3(b)(3).

clxviii. 2006 McNulty Memorandum, *supra* note 2.

clxix. *Id.* at 1.

clxx. *Id.*

clxxi. *Id.* at 8.

clxxii. *Id.* at 9 (“Before requesting that a corporation waive the attorney-client or work product protections for Category I information [purely factual information relating to the underlying misconduct], prosecutors must obtain written authorization from the United States Attorney who must provide a copy of the request to, and consult with, the Assistant Attorney General for the Criminal Division before granting or denying the request.”); *see also id.* at 10 (requiring that requests for “Category II” information consisting of attorney-client communications or non-factual attorney work product be approved through ultimate written authorization of the Deputy Attorney General himself; and “[p]rosecutors are cautioned that Category II information should only be sought in rare circumstances.”).

clxxiii. *Id.* at 11 n.3.

clxxiv. *Id.*

clxxv. *Id.*

clxxvi. *Id.* at 10 (describing use of Category II information).

clxxvii. *Id.* at 12 n.4.

clxxviii. Memorandum from Mark Filip, Deputy Att’y Gen., to Heads of Dep’t Components & U.S. Attorneys, on Principles of Federal Prosecution of Business Organizations (Aug. 28, 2008), *available at* <http://www.justice.gov/dag/readingroom/dag-memo-08282008.pdf>[hereinafter2008 FilipMemorandum].

clxxix. *Id.* at 13.

clxxx. *Id.*

clxxxi. *Id.*

clxxxii. *Id.*

clxxxiii. *Id.*

clxxxiv. *Id.*

clxxxv. *Id.*

clxxxvi. U.S. Attorneys’ Manual, *supra* note 20, at §§ 9-28.00, 9-28.740.

clxxxvii. *Id.* at 9-28.740.

clxxxviii. *Id.* at 9-28.730.

clxxxix. *Id.*

cx. *See, e.g.,* Prashker v. U.S. Guar. Co., 136 N.E. 2d 871, 876 (N.Y. 1956) (suggesting that the insurance company pay for independent counsel as a way of curing expected conflicts of interest); Emp’rs Fire Ins. Co. v. Beals, 240 A.2d 397, 403-04 (R.I. 1968) (raising two possible ways of procuring independent counsel), *invalidated on other grounds by* Peerless Ins. Co. v. Viegas, 667 A.2d 785 (R.I. 1995).

cxci. *San Diego Navy Fed. Credit Union*, 162 Cal. App. 3d 358 (1984).

xcii. *Id.* at 361.

xciii. *Id.*

xciv. *Id.*

xcv. *Id.*

xcvi. *Id.* at 361.

xcvii. *Id.* at 362.

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xcviii. *Id.* at 362.

xcix. *Id.* at 362-63.

cc. *Id.* at 363.

cci. *Id.* at 361.

ccii. *Id.* at 364.

cciii. *Id.* at 362.

cciv. *Id.*

ccv. *See id.* (describing the insurance company's position); *see also id.* at n.2 (quoting from the reservation of rights letter that the insurance company sent the insured).

ccvi. *Id.* at 364 (citations omitted).

ccvii. *Id.* at 364-65 (citations omitted).

ccviii. *Id.* at 364 n.3 (quoting *Purdy v. Pac. Auto. Ins. Co.*, 157 Cal. App. 3d 76 (1984)).

ccix. *Id.* at 366 (quoting ABA Code as cited).

ccx. Note that conflicts of interest in representation, and problems with attorney-client privilege in dual representations are two separate issues. As the *Cumis* court explained in part by incorporation, "[The] basis for the rule against representing conflicting interests is broader than the basis for the attorney-client evidentiary privilege. The evidentiary privilege and the ethical duty not to disclose confidences both arise from the need to encourage clients to disclose all possibly pertinent information to their attorneys, and both protect only the confidential information disclosed. The duty not to represent conflicting interests, on the other hand, is an outgrowth of the attorney-client relationship itself, which is confidential, or fiduciary, in a broader sense. Not only do clients at times disclose confidential information to their attorneys; they also repose confidence in them." *Id.* at 366 n.5 (quoting *E. F. Hutton & Co. v. Brown*, 305 F. Supp. 371, 393-394 (S.D. Tex. 1969) (internal references omitted), and citing *Parsons v. Cont'l Nat'l Am. Grp.*, 113 Ariz. 223 (1976)).

ccxi. *Id.* at 366 (internal citations omitted).

ccxii. *Id.* at 369 (quoting Robert E. Keeton, *Liability Insurance & Responsibility for Settlement*, 67 HARV. L. REV. 1136, 1170 (1954), available at <http://www.jstor.org/stable/1337021>).

ccxiii. *Id.* (quoting *Tomerlin v. Canadian Indem. Co.*, 61 Cal. 2d 638, 648 (1964)).

ccxiv. *Id.* at 366-67 (quoting MODEL CODE OF PROF'L RESPONSIBILITY EC5-15 (1983)).

ccxv. *Id.* at 368 (citing *Gray v. Zurich Ins. Co.*, 65 Cal. 2d 263 (1966)).

ccxvi. *Id.* at 371 (quoting *Exec. Aviation, Inc. v. Nat'l Ins. Underwriters*, 16 Cal. App. 3d 799, 809 (1971) (describing *Prashker v. U.S. Guar. Co.*, 1 N.Y.2d 584 (1956))).

ccxvii. *Id.* at 375.

ccxviii. *See Buss v. Super. Ct.*, 16 Cal. 4th 35, 59-60 (1997).

ccxix. *See, e.g., Douglas R. Richmond, supra* note 9, at 274-75. (describing how the initial *Cumis* decision, before the enactment of the limiting state statute, had "extremely adverse economic consequences" in California and other states following California's lead, driving up litigation costs. The *Cumis* economic burden was the product of several elements. First, unscrupulous attorneys were able to masquerade as necessary *Cumis* counsel by manufacturing phony conflicts of interest, thereby defrauding insurers. Second, *Cumis* counsel are often able to charge insurers fees well in excess of those insurers negotiate with their regular panel counsel.")(internal citations omitted).

ccxx. CAL. CIV. CODE § 2860 (Deering 2012) [hereinafter *Cumis* Statute].

ccxxi. *Id.* at § 2860(a); *see also id.* ("An insurance contract may contain a provision which sets forth the method of selecting that counsel consistent with this section.").

ccxxii. *Id.* at § 2860(b) (stating that, "when an insurer reserves its rights on a given issue and the outcome of that coverage issue can be controlled by counsel first retained by the insurer for the defense of the claim, a conflict of interest may exist").

ccxxiii. *Id.* at § 2860(c).

ccxxiv. *Id.* at § 2860(d); *see also id.* ("Any claim of privilege asserted is subject to in camera review in the appropriate law and motion department of the superior court. Any information disclosed by the insured or by independent counsel is not a waiver of the privilege as to any other party.").

ccxxv. *Id.* at § 2860(e).

ccxxvi. *Id.* at § 2860(f).

ccxxvii. *Fisher, supra* note 84, at 208 ("Most jurisdictions resolve this conflict [of interest for attorneys] by permitting the insured to appoint independent counsel, at the expense of the insurer, when the insurer has issued a reservation of rights letter. This counsel is referred to as *Cumis* counsel, after the leading case establishing the insurer's obligation to pay for independent counsel.") (footnotes omitted).

ccxxviii. Alaska Stat. § 21.96.100 (2012).

ccxxix. Fla. Stat. § 627.426(2)(b)(3) (2012).

ccxxx. *See Melissa Claire Scioneaux, Louisiana Recognizes the Insurance Policyholder's Entitlement to Select Independent Counsel, Now What?: A Legislative Proposal*, 81 TUL. L. REV. 537, 541, 555-56 (2006) (describing the Louisiana court's recognition of *Cumis* counsel conflicts in insurance representation and proposing the adoption of a state statute as California did to regulate the appointment of independent counsel).

ccxxxi. *See Jeffrey W. Stempel, The Relationship Between Defense Counsel, Policyholders, and Insurers: Nevada Rides Yellow Cab Toward "Two-Client" Model of Tripartite Relationship. Are Cumis Counsel and Malpractice Claims by Insurers Next?* 15 NEVADA LAWYER 20, 24 (2007) ("Although

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*Yellow Cab* does not expressly embrace the California approach or California's *Cumis* statute or line of cases, it would appear that Nevada will follow California's lead in this regard.") (internal citation omitted).

ccxxxii. See Amy Bland, *Insurance—Duty to Defend—Defense Under Reservation of Rights Requires Insurer to Provide Independent Counsel to Insured*, 66 MISS. L.J. 597, 602-08 (1997) (describing *Cumis* counsel and citing a Mississippi court's holding, that "[t]o protect the insured's interests and give effect to the requirement of independent counsel, the insured's selected defense attorney should control the defense.").

ccxxxiii. 975 P.2d 1145 (Haw. 1998).

ccxxxiv. *Id.* at 1152-54; see also *id.* at 1148 ("With respect to Count VI [requesting reimbursement of attorney's fees in the *Finley* case], the Court finds that the *Cumis* doctrine is not recognized in Hawai'i."). The Hawai'i court's decision in *Finley* started the division between so-called "one-client" versus "two-client" states. The few one-client states have held, as Hawai'i's has, that insurance counsel, even though they are paid by the insurance company have an ethical duty to consider the insured to be counsel's only client. See, e.g., *Tank v. State Farm Fire & Cas. Co.*, 715 P.2d 1133, 1137 (Wash. 1986) (holding that "[Washington State's ethics rule] 5.4(c) demands that [carrier-retained] counsel understand that he or she represents only the *insured*, not the [insurance] company") (emphasis in original); *In re Rules of Prof'l Conduct & Insurer Imposed Rules & Procedures*, 2 P.3d 806, 815 (Mont. 2000) (holding that, under Montana's ethics rules, the insured is the attorney's "sole client"). The vast majority of jurisdictions are two-client states. See Abramovsky, *supra* note 9, at 197 n.27 (discussing prevalence of the one-client versus two-client model). Two-client states acknowledge that insurance counsel does indeed have two clients: the insurance company who pays for the attorney's services, and the insured. Acknowledging the ethical dilemma posed for attorneys who represent two clients may actually be liberating to those attorneys because they then have access to tools such as *Cumis* counsel to release them from conflicts. See generally Fred C. Zacharias, *Waiving Conflicts of Interest*, 108 YALE L.J. 407, 426 (1998) (discussing the limitations of waivers of conflicts of interest).

ccxxxv. *Id.* at 1149.

ccxxxvi. See *id.* at 1151 ("The insured does not have the right to select counsel to represent its interests solely due to an insurer's reservation of rights.").

ccxxxvii. *Dynamic Concepts Inc. v. Truck Ins. Exch.*, 61 Cal. App. 4th 999, 1007 (1998).

ccxxxviii. *Cumis* Statute at § 2860(b); see also Seymour B. Everett III & Samantha E. Kohler, *A Complex Web of Loyalties: The Tri-partite Relationship & Cumis Counsel*, 54 ORANGE COUNTY LAWYER 33, 33 (2012).

ccxxxix. *Id.*

ccxl. *Id.*

ccxli. *Id.*

ccxlii. *Id.*

ccxlili. *Cumis* Statute at § 2860(c).

ccxliv. See Max H. Stern, *The Cumis Conundrum: Lawyers Face Ethical Dilemmas When Considering Independent Counsel*, THE RECORDER, Jan. 10, 2005, at 1-2, available at <http://www.law.com/jsp/ca/PubArticleCA.jsp?id=900005421436&slreturn=1> and [www.duanemorris.com/articles/static/MHSCumisConundrum.pdf](http://www.duanemorris.com/articles/static/MHSCumisConundrum.pdf); see also *United Pac. Ins. v. Hall*, 199 Cal. App. 3d 551, 557 (1988) ("While *Cumis* may prohibit an insurer from dictating the tactics of litigation, it does not delegate to *Cumis* counsel a meal ticket immunized from judicial review for reasonableness.").

ccxlv. Stern, *supra* note ccxliv, at 1-2.

ccxlvi. *Id.* at 2; accord Douglas R. Richmond, *Independent Counsel in Insurance*, 48 SAN DIEGO L. REV. 857, 881 (2011) ("This requirement protects insurers against 'runaway legal fees.'").

ccxlvii. See 2003 Thompson Memorandum, *supra* note 108, at 5 (discussing the dangers of corporate control over employees' counsel).

ccxlviii. See 1999 Holder Memorandum, *supra* note 100, at 6 (discussing JDAs); 2003 Thompson Memorandum, *supra* note 108, at 5 (same).

ccxlix. See 1999 Holder Memorandum, *supra* note 100, at 6; 2003 Thompson Memorandum, *supra* note 108, at 5-6.

cccl. See, e.g., *United States v. Stein, et al.*, S1-05-Crim-0888(LAK), 2006 U.S. Dist. LEXIS 49435, at \*4-5 (S.D.N.Y. July 20, 2006) [hereinafter *Stein Conflict of Interest Order*] (noting, based on defendants' motion that "some defendants may be represented in this case by counsel who have professional obligations to KPMG which conceivably could be at odds with their professional obligations to the clients whom they represent here"); see also Mark Knopfler, *Punish the Monkey, on Kill to Get Crimson* (Warner Bros. 2007), available at <http://www.songs-lyrics.net/so-Mark-Knopfler-lyrics-Kill-to-Get-Crimson-lyrics-Punish-The-Monkey-lyrics-iuxmqbev.html> (documenting in popular song lyrics the lament of the employee forced to "take the fall" for his employer: "You've been talking to a lawyer/Are you gonna pretend/that you and your employer/are still the best of friends?/Somebody's going to take the fall/There's your quid pro quo.").

cccli. RESTATEMENT (THIRD) OF AGENCY § 8.14 cmt. b (2006) (defining an agent's right to indemnification).

cccli. *Id.* (specifically including the costs of litigation in the agents' right to indemnification).

cccliii. *Id.* at § 8.14 cmt. d.

cccliv. *Id.* ("Because the principal will be subject to liability for any payment due the third party, the

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principal has the primary interest in defending against the third party's claim.”).

cclv. *Id.* (“A principal's decision to remain uninvolved in defending the suit should not deprive the agent of indemnity rights if the agent reasonably exercises its discretion in good faith.”).

cclvi. *Id.*

cclvii. *Stein Appeal*, 541 F.3d at 157 (quoting *Stein I*, 435 F. Supp. 2d at 418).

cclviii. *See, e.g.*, *Stein Conflict of Interest Order*, 2006 U.S. Dist. LEXIS at \*4-5.

cclix. *Einhorn v. Culea*, 612 N.W. 2d 78, 90 (Wis. 2000).

cclx. *See generally Cox, supra* note 21, at 1086 (citing *Bell Atl. Corp.*, 2 F.3d 1304) (3d Cir. 1993) (holding dual representation improper when suit involves “serious charges of wrongdoing”); *Lewis v. Shaffer Stores Co.*, 218 F. Supp. 238 (S.D.N.Y. 1963) (holding that corporation and individual directors named in suit cannot share the same counsel); *cf. Int'l Bhd. of Teamsters v. Hoffa*, 242 F. Supp. 246 (D.D.C. 1965) (holding that union and its officers charged with wrongdoing in suit brought on behalf of union cannot be represented by same attorney)).

cclxi. *Cox, supra* note 21, at 1086.

cclxii. *See sources cited supra* note 53.

cclxiii. *Cox, supra* note 21, at 1088 (quoting *Role of Independent Directors of Investment Companies*, 66 Fed. Reg. 3734 (Jan. 16, 2001) (to be codified at 17 C.F.R. pts. 239, 240, 270, and 274)).

cclxiv. *Fisher, supra* note 84, at 204 (citing *Olson, supra* note 92).

cclxv. *Id.* at 209.

cclxvi. In fact, these changes in how D&O insurance policies are being administered have redounded to the economic benefit of the insurance companies because paying for the cost of the insured's litigation as the litigation occurs may decrease the insurance company's ultimate liability under the policy because of the higher quality of counsel potentially available to its insured in the case. *See id.* at 209 (citing *Olson, supra* note 92, at § 12:25).

cclxvii. In fact, in yet another example of practice continuing to blur the lines among the various types of payment systems (indemnification, the advancement of fees, and insurance coverage), it is becoming increasingly common practice for insurance companies not to pay directly for the defense of employees, but to reimburse the corporation for those required costs. *See generally Griffith, supra* note 71, at 1166. (describing how “[p]ayments under Side B coverage are... triggered when the corporation incurs an obligation to indemnify its managers”); Tom Baker & Sean J. Griffith, *The Missing Monitor in Corporate Governance: The Director' & Officers' Liability Insurer*, 95 GEO. L.J. 1795, 1829-30, 1832 (2007). (noting a gap in the market for Side A direct employee coverage alone, and speculating that the growth of other forms of coverage may be due to “executives... [who are] motivated to purchase B and C Side coverage to protect their own positions and pay packages in spite of the fact that it may be a negative net present value investment from the shareholders' perspective”). This Article later argues that there may be social benefits to insurance companies being involved in the active defense of employees rather than in merely reimbursing corporate indemnification or the advancement of fees, but the need for adoption of criminal *Cumis* counsel to address attorneys' conflicts of interest is the same in any of these circumstances.

cclxviii. *See generally Lynn A. Stout, Killing Conscience: The Unintended Behavioral Consequences of 'Pay For Performance'* 6 (Oct. 12, 2011) (unpublished manuscript on file with the Authors), *similar abstract available at* <http://ssrn.com/abstract=1608247> (“Ex ante agreement to an objective metric is essential because optimal contract theory... leaves no room for trust.”).

cclxix. *See generally* discussion of the imposition of the special obligation of good faith and fair dealing on insurance companies, *supra* note xciii.

cclxx. *Homestore*, 888 A.2d 204, 212-13 (emphasis in original) (footnotes omitted).

cclxxi. *Herring v. New York*, 422 U.S. 853, 857 (1975).

cclxxii. *Caplin & Drysdale v. U.S.*, 491 U.S. 617, 626 (1989).

cclxxiii. *See Stein I*, 435 F. Supp. 2d at 367 (“*Caplin & Drysdale* recognized that the Sixth Amendment does protect a defendant's right to spend his own money on a defense. Here, the KPMG Defendants had at least an expectation that their expenses in defending any claims or charges brought against them by reason of their employment by KPMG would be paid by the firm. The law protects such interests against unjustified and improper interference. Thus, both the expectation and any benefits that would have flowed from that expectation—the legal fees at issue now—were, in every material sense, their property, not that of a third party.”) (footnotes omitted); *see also id.* at 361-62 (holding that a criminal defendant's “right to obtain and use in order to prepare a defense resources lawfully available to him or her, free of knowing or reckless government interference... [to be] basic to our concepts of justice and fair play. It is fundamental.”).

cclxxiv. *Cuyler v. Sullivan*, 446 U.S. 335, 348-50 (1980).

cclxxv. *Id.*

cclxxvi. *Cumis* Statute, , at § 2860(b).

cclxxvii. DEL. CODE ANN. tit. 8, § 145(c); *see also* RMBCA § 8.52 (providing for mandatory indemnification of a director “who was wholly successful, on the merits or otherwise, in the defense of any proceeding to which he was a party because he was a director of the corporation against expenses incurred by him in connection with the proceeding”).

cclxxviii. 2003 Thompson Memorandum, *supra* note 108, at 5.

cclxxix. *See Handzlik, supra* note 139, at 11.

cclxxx. *Josleyn*, 206 F.3d at 149.

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cclxxxi. *Stein I*, 435 F. Supp. 2d at 356, 366.

cclxxxii. *See* Wiegley, *supra* note 89.

cclxxxiii. *Cumis*, 162 Cal. App. 3d at 364.

cclxxxiv. It must be carefully stated here that there was no articulated suspicion in the *Stein* case itself that KPMG was cutting off payment of its employees' attorneys' fees to cover up additional wrongdoing—as has been the case in situations with other companies, *see* 2000 Robinson Speech, *supra* note 3, at 6 (describing another corporate cover-up)—but only to bring the government's investigation against the partnership to a close in general.

cclxxxv. *Cf. Stein I*, 435 F. Supp. 2d at 364 (“The argument that payment of legal fees to employees and former employees is relevant to gauging the extent of a company's cooperation also is problematic. There is no necessary inconsistency between an entity cooperating with the government and, at the same time, paying defense costs of individual employees and former employees.”).

cclxxxvi. *See* 2008 Filip Memorandum, *supra* note 171, at 13.

cclxxxvii. *See* Senate Hearing, *supra* note clviii, at 2-3 (statement of Deputy Attn'y Gen. McNulty) (“Reality number 2, those corporations want out from under the dark clouds of criminal wrongdoing as quickly as possible.... Reality number 3, most corporations, therefore, are anxious to cooperate with Government investigations.”).

cclxxxviii. *Id.* at 3 (statement of Deputy Attn'y Gen. McNulty).

cclxxxix. *Stein I*, 435 F. Supp. 2d at 336.

ccxc. *Id.* at 340.

ccxc. *Id.* at 364.

ccxcii. *Id.*

ccxciii. *See D&O Liability Insurance*, *supra* note 63, at 2.

ccxciv. *See, e.g.,* DEL. CODE ANN. tit. 8, § 145(c) (requiring that the employee have been “successful on the merits or otherwise in defense of any action, suit or proceeding” for corporate indemnification).

ccxcv. The very fact that the DOJ had to include a footnote in its instructions to prosecutors not to consider a corporation's compliance with state statutes requiring the indemnification of its employees as negatively reflecting on the corporation, *see* 1999 Holder Memorandum, *supra* note cvi, at n.3, suggests that the DOJ, for example, was concerned that exactly this public perception exists against corporations who indemnify their employees in criminal cases.

ccxcvi. Bhagat, Brickley, & Coles, *supra* note 93, at 733.

ccxcvii. Park, *supra* note ci, at 2.

ccxcviii. *Id.* at 5.

ccxcix. *See* Kirby v. Illinois, 406 U.S. 682, 689 (1972) (holding that the Sixth Amendment right to counsel attaches at “the initiation of adversary judicial criminal proceedings—whether by way of formal charge, preliminary hearings, indictment, information, or arraignment”).

ccc. Chandler v. Fretag, 348 U.S. 3, 9-10 (1954).

ccci. Wood, 450 U.S. 261, 271-72 (1981).

cccii. United States v. Gonzales-Lopez, 548 U.S. 140, 146 (2006).

ccciii. United States v. Morrison, 449 U.S. 361, 364 (1981).

ccciv. United States v. Farmer, 274 F.3d 800, 804 (4th Cir. 2001).

cccv. *Accord Stein Appeal*, 541 F.3d at 155 (citing *U.S. v. Farmer* in the context of an employer's advancement of fees to employees); *see also id.* at 156 (“In a nutshell, the Sixth Amendment protects against unjustified governmental interference with the right to defend oneself using whatever assets one has or might reasonably and lawfully obtain.”).

cccvii. United States v. Henke, 222 F.3d 633, 637 (9th Cir. 2000) (holding that the attorney should be removed when “proceed[ing] against a co-defendant of a former client wherein the subject matter of the present controversy is substantially related to the matters in which the attorney was previously involved, and wherein confidential exchanges of information took place between the various co-defendants in preparation of a joint defense”)(quoting *Wilson P. Abraham Constr. Corp. v. Armco Steel Corp.*, 559 F.2d 250, 253 (5th Cir. 1977)).

cccvii. United States v. Almeida, 341 F.3d 1318, 1326 (11th Cir. 2003) (“We hold that when each party to a joint defense agreement is represented by his own attorney, and when communications by one co-defendant are made to the attorneys of other co-defendants, such communications do not get the benefit of the attorney-client privilege in the event that the co-defendant decides to testify on behalf of the government in exchange for a reduced sentence.”).

cccviii. *Id.* at 1324, 1326 (acknowledging that the court's decision would hamper incentives to exchange information inside a JDA).

cccx. *Id.* at 1323.

cccx. *Id.*

cccx. As the *Almeida* court explained, if the attorney represented more than one defendant in this situation, that attorney would have to be removed. *See id.* at 1323 n.17 (“The duty of loyalty sometimes continues even after the attorney-client relationship ceases to exist, and so conflicts of interest can still arise even if the attorney represents only one party.”).

cccxii. *Id.* at 1324 (emphasis in original).

cccxiii. *See, e.g.,* William E. White & Catherine E. Creely, *Once a Friend, Always a Friend? Joint*

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*Defense Agreements and Their Impact On Cross-Examination and Impeachment of Allies Who Turn Government Witness*, Bloomberg Law Reports, June 13, 2012, available at <https://www.bloomberglaw.com/info/practitioner-contributions/joint-defense-agreements-and-their-impact/index.html> (last visited July 9, 2012) (reading application of the *Henke* decision very broadly).

- cccxiv. Griffith, *supra* note lxxvii, at 1168.
- ccc xv. Fisher, *supra* note 84, at 209 (citing Olson, *supra* note 92, at § 12:25).
- ccc xvi. Cf. Griffith, *supra* note lxxvii, at 1149 (“D&O insurers have strong incentives to act as corporate governance gatekeepers.”).
- ccc xvii. 2000 Robinson Speech, *supra* note 3, at 6.
- ccc xviii. *United Pac. Ins.*, 199 Cal. App. 3d at 557.
- ccc xix. Karlan, *supra* note ix, at 720-23.
- ccc xx. *Id.* at 721.
- ccc xxi. *Id.*
- ccc xxii. MODEL CODE OF PROF’L RESPONSIBILITY EC 7-13 (1983) (“The responsibility of a public prosecutor differs from that of the usual advocate; his duty is to seek justice, not merely to convict.”).
- ccc xxiii. MODEL RULES OF PROF’L CONDUCT R. 3.8 cmt. 1 (2010) (promulgating that the “Special Responsibility of a Prosecutor” includes “the responsibility of a minister of justice and not simply that of an advocate”); see also Fred C. Zacharias, *Structuring the Ethics of Prosecutorial Trial Practice: Can Prosecutors Do Justice?*, 44 VAND. L. REV. 45, 46 (1991) (discussing a prosecutor’s ethical duty to seek justice in the legal process).
- ccc xxiv. Cf. Karlan, *supra* note ix, at 673-74 (accurately describing many of the faults with courts’ ability to evaluate attorney-client relationships and citing additional scholarship).
- ccc xxv. *Compare, e.g.,* Caplin & Drysdale, 491 U.S. at 630-31 (finding that no Sixth Amendment “per se” ineffective assistance of counsel claim may be established due to the complexity of a case), *with* Cuyler, 446 U.S. at 355 (holding that, once defendant can show an “actual conflict of interest which adversely affected his lawyer’s performance,” no additional prejudice need to be proven to constitute a violation of his Sixth Amendment rights).
- ccc xxvi. Abramovsky, *supra* note ix, at 193 (quoting John Gotti on the subject of the Gambino crime family’s “house counsel,” and Texas Supreme Court Justice Raul A. Gonzales on “captive” law firms); see also *id.* at 194-96 (elaborating on the concept of “house counsel”); *id.* at 219-23 (elaborating on the concept of “captive” law firms).
- ccc xxvii. *Id.* at 199 (“As we will see, the business reality for lawyers hired by insurance companies, the contractual limitations placed on the scope of their representation of the policyholder-client and the limited options such attorneys would face in the event of the loss of insurance company business will lead to an understanding that the tripartite relationship increases the risk that the attorney’s long-term retention will place the lawyer’s own pecuniary self-interest in conflict with his policyholder-client. For, just as in the criminal ‘house counsel’ structure, any appropriate ethical review of an insurance tripartite relationship must require the inclusion of this pecuniary interest factor.”)(footnote omitted); see also *id.* at 216 (citing the *Cumis* case).
- ccc xxviii. *Id.* at 227-28.
- ccc xxix. In addition, consider how difficult in practice it would be for an employee defendant to file a successful motion for disqualification of counsel when his or her counsel is being controlled by the corporation, which is, of course, the basis of the employee’s motion. Furthermore, the employee defendant who files such a motion to disqualify counsel has probably chosen to consult independent counsel to know even that such a motion was possible. All of this extra procedure is costly and takes time. In the short term, it would cost the employee defendant additional money out of pocket to consult the independent attorney, and to have the attorney prepare the motion, before a court could grant the motion. In the longer-term, the employee’s litigation overall may be more costly because independent counsel may have to remedy damage done to the employee’s position by the corporation’s control over previous counsel. See *infra*, note 32, for an example in the *Josleyn* case.
- ccc xxx. Consider, for example, the time, expense, and extraordinary litigation involved in revealing, and eventually attempting to remedy, the actions of American Honda in sacrificing its executives to curtail further government prosecution. *Josleyn*, 206 F.3d at 144. Full evidence of American Honda’s abuse of corporate counsel was only revealed in a subsequent class-action case, see *In re Am. Honda Motor Co. Dealer Relations Litig.*, MDL Case No. 1069, slip op. at 1 (D. Md. June 3, 1998), and the executives had to bring additional proceedings to attempt to remedy their personal situations. See *Josleyn*, 206 F.3d at 148. This entire process took at least five years of litigation. See *United States v. Billmeyer*, 1995 U.S. Dist. LEXIS 385 (D.N.H. Jan. 5, 1995) (deciding in 1995 on one of the American Honda’s defendant’s motion to dismiss the government’s indictment against him); *Josleyn*, 206 F.3d at 160-61 (deciding in 2000 on defendants’ motions for new trial based on the newly discovered evidence about American Honda’s abuses revealed through the class action suit).
- ccc xxxi. See *Cumis* Statute, §§ 2860(b)-(f) (outlining the specific provisions of California’s *Cumis* statute).
- ccc xxxii. See, e.g., discussion about the costs of the *Josleyn* case, *supra* note ccc xxx.
- ccc xxxiii. As of the summer of 2012, there were, for example, only five federal cases involving litigation over California’s *Cumis* counsel, and none of them involved legal disputes important enough for the decisions to be published. Given how widespread *Cumis* counsel is in California, and now in other states around the country, five unpublished cases in federal court would seem to indicate a solution



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functioning without the need for much judicial intervention. There are, of course, more cases about *Cumis* counsel in California courts, but that litigation also dropped off dramatically after passage and initial interpretation of the state's *Cumis* statute.

cccxxxiv. In fact, even in the corporate context, prosecutors are already in the practice of coordinating with individual employees' defense counsel in qui tam cases, and the empirical evidence so far indicates that such coordination is not overly burdensome. *See, e.g.,* Pamela Bucy, et al., *States, Statutes, And Fraud: A Study Of Emerging State Efforts To Combat White Collar Crime*, 31 CARDOZO L. REV. 1523, 1562 (2010) (recording state attorneys' general responses to Question V(e) about their working relationship with relators' counsel in qui tam cases).

cccxxxv. *See generally* discussion in text *supra* regarding representation within JDAs under subheading "More Secure Protection of Individual Employees' Interests Against Co-Defendants."

cccxxxvi. *See generally* discussion in text *supra* under subheading "Larger Economic Benefits of Adopting Criminal *Cumis* Counsel."

cccxxxvii. Karlan, *supra* note ix, at 721.

cccxxxviii. Abramovsky, *supra* note ix, at 194-96.