

CORPORATE PROSECUTIONS

Pressure to Fire Executives Raises Constitutional Issues

**MICHAEL A. ASARO AND
ROBERT H. HOTZ JR.**

Much has been written about the tremendous leverage that white-collar prosecutors hold over corporations faced with the prospect of vicarious criminal liability for the wrongful acts of their employees. The government has taken full advantage of this leverage in recent years by allowing companies to escape criminal liability through deferred prosecution or non-prosecution agreements in exchange for cooperating with its investigations.¹ While this concept sounds reasonable on its face, as the old saying goes, the devil is in the details. The Department of Justice (DOJ) has come under heavy criticism by the defense bar, members of Congress and the judiciary for defining cooperation to require companies to take extraordinary steps such as waiving privilege, making substantial charitable donations to organizations with ties to local prosecutors, and refusing to advance attorneys fees for employees that the government deems “non-cooperative.”² There now appears to be a new trend developing where federal prosecutors have once again raised the bar

Michael A. Asaro and Robert H. Hotz Jr. are litigation partners at Akin Gump Strauss Hauer & Feld and former Eastern and Southern District assistant U.S. attorneys.



MICHAEL A. ASARO



ROBERT H. HOTZ JR.

for corporate cooperation by demanding that companies fire high-ranking executives who have not been charged with any crime, presumably because the government lacks sufficient evidence to mount a successful prosecution.

Most recently, in April 2008, the DOJ reportedly demanded that General Re fire its CEO, against whom no official charges had ever been filed, even though he cooperated with the government’s investigation without seeking a grant of immunity.³ In September 2006, the U.S. Attorney’s Office for the District of New Jersey publicly pressured Bristol-Myers Squibb, a company that had already entered into a deferred prosecution agreement, to terminate its CEO even though a spokesman for that office acknowledged that there had been no finding that the company or its executives had engaged in any criminal wrongdoing.⁴ In yet another reported incident going back to 2004, a former federal prosecutor

acknowledged that his prior office had ousted an executive of Symbol Technologies who was never charged because the executive was “too close to the fraud, albeit not an active participant.”⁵

This growing phenomenon raises the question of whether the executives and employees who have lost their jobs at the government’s urging have any legal recourse. One obvious alternative would be for the executive or employee to sue his or her prior employer.⁶ Such a lawsuit would fail to address the government’s actions, however, which essentially dictate what steps the company must take. Another more creative approach, which does not appear to have been pursued in the past, would be to file an action directly against the government for violating the employee’s rights under the Due Process Clause. This article explores the possibility and potential consequences of such a constitutional challenge.

The McNulty Memo

Since 1999, the DOJ has maintained a set of internal guidelines that federal prosecutors must follow when determining whether to exercise their discretion to indict corporations or other forms of business entities. The latest version of these guidelines, known as the McNulty Memo, was issued in December 2006.⁷ There is language in the McNulty Memo that arguably authorizes prosecutors to

encourage companies to terminate managers and employees who have not been and may never be criminally charged. Among the factors that the government must consider when determining whether to indict a corporation are “whether the corporation appears to be protecting its culpable employees and agents” and what “remedial actions” were taken by the corporation, including any “efforts...to replace responsible management, [or] to discipline or terminate wrongdoers.” The McNulty Memo is conspicuously silent, however, on the standard that prosecutors should apply when determining who the “culpable employees” and “wrongdoers” are. The McNulty Memo therefore appears to leave it to the discretion of individual prosecutors to determine when enough proof of wrongdoing exists for the government to penalize a corporation for failing to terminate executives who were in positions of authority when the allegedly criminal conduct occurred. One of the obvious risks of this approach is that individuals are found to be culpable or are labeled as wrongdoers at very early stages of an investigation before the facts are developed.

It is worth noting that the DOJ recently announced its intention to revise the McNulty Memo. According to a letter that the Deputy Attorney General (DAG) sent to members of the Senate in July 2008, these revisions would provide, among other things, that “[h]ow and whether a corporation disciplines culpable employees...will not be taken into account for purposes of evaluating cooperation.”⁷⁸ The DAG’s letter goes on to state, however, that a corporation’s decision to terminate or discipline so-called “culpable employees” may still “bear on the quality of its remedial measures or its compliance program.” It therefore appears that the proposed changes will still allow federal prosecutors to pressure companies to fire employees who have not been charged with any crime by taking the position that a failure to do so would constitute a lack of appropriate remedial measures or evidence of an insufficient compliance program. Put simply, while the proposed revisions seem to acknowledge that there should be limitations on a prosecutor’s

ability to pressure a company to fire or sanction its employees, they do not appear to change the way the McNulty Memo deals with this issue in any meaningful way.

State Action

For a private employee’s termination to amount to a constitutional violation, the government’s involvement must be sufficient for the company’s conduct to be considered “state action.”⁹ Courts have typically found state action where there is government coercion on a private party.¹⁰ Where prosecutors who are in a position to indict a corporation have demanded that one of its employees be fired, it would seem that there is a strong argument that state action has occurred.¹¹

Due Process

The Fifth Amendment Due Process Clause states that “[n]o person shall be...deprived of life, liberty, or property, without due process of law.” The Supreme Court has held that, at least under certain circumstances, the right to “hold specific employment” can be considered “property” for Fifth Amendment purposes.¹² To establish a constitutionally protected property interest an employee must demonstrate “more than a unilateral expectation”; he “must, instead, have a legitimate claim of entitlement.”¹³ In examining whether there is an entitlement, courts are required to look beyond the Constitution to “existing rules and understandings that stem from an outside source such as state law.”

To determine whether there is an entitlement to continued employment under state law, courts have often focused on the contractual relationship between the employee and the employer.¹⁴ Where an employment contract only allows termination for “cause,” courts have held that a property interest exists for due process purposes.¹⁵

Where the aggrieved party is an “at will” employee courts have adopted differing views. A number of courts have declined to recognize a property interest in “at will” employment and therefore held that the Due Process Clause does not apply.¹⁶ At least one

Circuit Court of Appeals has held, however, that even “at will” employees are entitled to due process protection from unwarranted government interference with the employer-employee relationship.

In *Chernin v. Lyng*, the U.S. Department of Agriculture (USDA) refused to provide a private meatpacking company with inspection services, which were required for the company to operate legally, until the company fired the plaintiff.¹⁷ The USDA believed that the plaintiff was an unfit employee as a result of his status as a convicted felon. After being terminated at the USDA’s request, the plaintiff sued the USDA for injunctive relief, contending that his due process rights had been violated. The Eighth Circuit upheld the plaintiff’s due process claim, reasoning that “employees and employers have an interest in their employment relations which the Fifth Amendment protects from arbitrary government interference, regardless of whether the same employees and employers may dissolve their relationship at will.”¹⁸ It remains to be seen whether *Chernin* will continue to be an outlier, or whether its reasoning will persuade other courts to adopt a similar approach.¹⁹

Assuming the Due Process Clause in fact applies, there is still the question of what process is due. At a minimum, due process generally requires that the party being deprived of liberty or property be given notice and a meaningful opportunity to be heard.²⁰ Depending on the nature and surrounding circumstances of the deprivation, courts have approved of a number of procedures designed to satisfy the government’s due process obligations, ranging from pre-termination hearings to, in some cases, hearings after the deprivation of liberty or property has occurred.²¹ Given the McNulty Memo’s lack of clarity as to when and how the government is permitted to demand the termination of a so-called “wrongdoer” or “culpable employee,” a compelling argument can be made that the existing procedural framework fails to satisfy even the most minimal due process requirements.

Remedies

Once it has been determined that the

constitutional rights of a terminated executive or employee have in fact been violated, an action could be filed in federal court against the DOJ. Such an action would need to seek injunctive relief because the doctrine of sovereign immunity would likely block any claim against the government for monetary damages.²² In addition, one could theoretically bring suit for monetary damages against the prosecutors who caused the violation in their individual capacities.²³ Potential obstacles to such an action are the doctrines of absolute prosecutorial immunity and qualified immunity, both of which often protect prosecutors from personal liability for actions taken in their roles as government officials.²⁴

Conclusion

The DOJ's recent push to oust managers and other corporate employees it cannot otherwise punish raises serious constitutional questions, which could result in lawsuits by the individuals who have lost their jobs due to the government's conduct. Such an action could shine yet another spotlight on the recurring problems with the McNulty Memo and its predecessors. Our legal system is an adversarial one—with justice being the byproduct where the prosecution and defense present their cases in court. Prosecutors are the government's advocates in court; to be sure that is a critically important function and many prosecutors do an outstanding job of it. But the McNulty Memo has transformed the white collar prosecutor into something different and greater than a mere advocate—a dictator of corporate policy and action based on the mere threat of indictment. There already have been repeated calls for the adoption of a new framework for corporate criminal liability that would scale back the nearly unfettered discretion that prosecutors now enjoy.²⁵ At the end of the day, the DOJ's failure to exercise restraint in its application of the McNulty Memo may result in these calls being answered.



1. See Audrey Strauss, "New Voices Question Corporate Criminal Liability," NYLJ, July 5, 2007 (describing recent

complaints by practitioners over current legal regime governing corporate criminal liability); Steven R. Peikin, "Deferred Prosecution Agreements: Standard for Corporate Probes," NYLJ, Jan. 31, 2005 ("Once used almost exclusively to dispose of minor cases against individual offenders, DPAs have become a standard means of resolving major corporate investigations").

2. See Sara Johnson, "Senator Takes on DOJ's Thompson Memo," CFO.com, Sept. 14, 2006; Lisa Brennan, "Deferred White Collar Prosecutions: New Terrain, Few Sign Posts," NYLJ, April 11, 2006; See generally *United States v. Stein*, 495 F. Supp. 2d 390 (S.D.N.Y. 2007).

3. See Amir Efrati, "Buffet Pressed to Dump Chief of General Re," The Wall Street Journal, April 7, 2008, at C1.

4. See Stephanie Saul, "A Corporate Nanny Turns Assertive," New York Times, Sept. 19, 2006; Brooke A. Masters, "Bristol-Myers Ousts Its Chief at Monitor's Urging," Washington Post, Sept. 13, 2006.

5. See Erin Coe, "Prosecutors' Push for Personnel Changes Draws Fire," Securities Law360, April 15, 2008.

6. The viability of such a lawsuit would be governed by matters of employment law that are beyond the scope of this article.

7. Memorandum from Deputy Attorney General Paul J. McNulty to Heads of Department Components and United States Attorneys (Dec. 12, 2006), available at http://www.usdoj.gov/dag/speeches/2006/mcnulty_memo.pdf [hereinafter "McNulty Memo"].

8. Letter from Deputy Attorney General Mark Filip to Senators Patrick J. Leahy and Arlen Specter (July 9, 2008); See also Joe Palazzolo, "DOJ to Overhaul the McNulty Memo," Legal Times, July 11, 2008.

9. See *United States v. International Bd. of Teamsters*, 941 F.2d 1292, 1295 (2d Cir. 1991) ("Because the United States Constitution regulates only the Government, not private parties, a litigant claiming that his constitutional rights have been violated must first establish that the challenged conduct constitutes 'state action.'").

10. *Blum v. Yaretsky*, 457 U.S. 991, 1004 (1982) (a private entity's conduct amounts to "state action" attributable to the government when: (1) "there is a sufficiently close nexus between the State and the challenged action"; and (2) the State "has exercised coercive power or has provided such significant encouragement, either overt or covert, that the choice must in law be deemed to be that of the State"); See also *Desiderio v. NASD*, 191 F.3d 198, 206 (2d Cir. 1999).

11. See *United States v. Stein*, 440 F. Supp.2d 315, 337 (S.D.N.Y. 2006) (Suppressing proffer statements because "the government, both through the Thompson Memorandum and the actions of the [United States Attorney's Office], quite deliberately coerced, and in any case significantly encouraged, KPMG to pressure its employees to surrender their Fifth Amendment rights.")

12. See *FDIC v. Mallen*, 486 U.S. 230, 240 (1988) ("It is undisputed that appellee's interest in the right to continue to serve as president of the bank and to participate in the conduct of its affairs is a property right protected by the Fifth Amendment Due Process Clause."); *United States v. Briggs*, 514 F.2d 794, 798 (5th Cir. 1975) (The right to "hold specific employment and to follow a chosen profession free from unreasonable governmental interference comes within the 'liberty' and 'property' concepts of the Fifth Amendment.") (citing *Greene v. McElroy*, 360 U.S. 474, 492 (1959)).

13. *Board of Regents v. Roth*, 408 U.S. 564, 577 (1972).

14. See, e.g., *Goetz v. Windsor Cent. School Dist.*, 698 F.2d 606, 608 (2d Cir. 1983) (Under the Due Process clause, "a property interest in employment can be created by local ordinance or by implied contract").

15. See, e.g., *Merritt v. Mackey*, 827 F.2d 1368, 1371 (9th Cir. 1987) (Private company's policy allowing termination only for "just cause," which was part of employment contract under state law, created property interest within the meaning of the Due Process Clause).

16. See, e.g., *Abramson v. Pataki*, 278 F.3d 93, 99 (2d Cir. 2002) (Recognizing that "a protectable property interest may

arise in a situation where an employee may be removed only for cause," but dismissing due process claim because plaintiff was "at will" employee).

17. 874 F.2d 501, 506 (8th Cir. 1989).

18. *Chernin*, 874 F.2d at 506 (footnote omitted).

19. It is worth noting that *Chernin* has been criticized by another panel of Eighth Circuit Judges. See *Holloway v. Conger*, 896 F.2d 1131, 1136 (8th Cir. 1990) (observing that the panel was bound by *Chernin* even though it disagreed with its result). *Chernin* has not been reversed, however, and in fact the Eighth Circuit reaffirmed its validity several years later. See *Waddell v. Forney*, 108 F.3d 889, 893-94 (8th Cir. 1997).

20. See *Cleveland Bd. of Educ. v. Loudermill*, 470 U.S. 532, 542 (1985) ("An essential principle of due process is that a deprivation of life, liberty, or property 'be preceded by notice and opportunity for hearing appropriate to the nature of the case.'") (quoting *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306, 313 (1950)).

21. See *Loudermill*, 470 U.S. at 542-45 (1985) (state employees entitled to administrative hearing before they could be terminated); *Mallen*, 486 U.S. at 240-41 (where bank president was suspended by order of the Federal Deposit Insurance Corporation (FDIC) based on the fact that he had been indicted, post-deprivation hearing was sufficient due process); See also *Mathews v. Eldridge*, 424 U.S. 319, 335 (1976) (setting forth the factors that must be considered when determining whether a particular set of procedures comport with the Due Process Clause).

22. See *Mitchum v. Hurt*, 73 F.3d 30, 35 (3rd Cir. 1995) ("The power of the federal courts to grant equitable relief for constitutional violations has long been established.") (Alito, J.); See also *Sprecher v. Graber*, 716 F.2d 968 (2d Cir. 1983) (recognizing that 5 U.S.C. §702 waives sovereign immunity for federal agencies in actions seeking injunctive relief); *MacFarlane v. Grasso*, 696 F.2d 217, 225 (2d Cir. 1982) ("Sovereign immunity does not bar a suit which seeks to prevent an official of the United States from... exercising his statutory authority in an unconstitutional manner, or from exercising statutory authority which is itself unconstitutional").

23. See *Biens v. Six Unknown Fed. Narcotics Agents*, 403 U.S. 388 (1971) (creating private cause of action for damages against federal officials who violate the plaintiff's constitutional rights). In cases where the constitutional violation is attributable to state as opposed to federal officials, a similar action for both an injunction and damages could be brought under 42 U.S.C. §1983.

24. See *Zahrey v. Coffey*, 221 F.3d 342, 346 (2d Cir. 2000) (explaining that prosecutors are entitled to unlimited immunity from suit for actions taken as an advocate and limited qualified immunity for actions taken as an investigator).

25. See, e.g., Preet Bharara, "Corporations Cry Uncle and Their Employees Cry Foul: Rethinking Prosecutorial Pressure on Corporate Defendants," 44 Am. Crim. L. Rev. 53, 113 (2007) ("Only a narrower, better-fitting corporate liability rule will achieve preferred levels of discretion and respect for the rights and privileges of individual defendants. It is time that the underlying law of corporate criminal liability is brought in line with both common sense and common practice.").

Reprinted with permission from the July 31, 2008 edition of the New York Law Journal © 2008 ALM Properties, Inc. All rights reserved. Further duplication without permission is prohibited. For information, contact 800.888.8300 or reprintscustomerservice@incisivemedia.com. ALM is now Incisive Media, www.incisivemedia.com. # 070-07-08-0055

