

SECURITIES LITIGATION & REGULATION

Congress' Role in Investigating Fraud

Are Legislators' Aggressive Approach in Hearings Helping or Hindering the Process?

BY RICHARD B. ZABEL
AND JAMES J. BENJAMIN JR.

SECURITIES FRAUD cases have traditionally been investigated and prosecuted along two parallel tracks, by criminal authorities such as the Department of Justice, and regulators such as the Securities and Exchange Commission (SEC). This year, however, the traditional pattern of parallel proceedings has expanded into a more complex regime of "trilateral proceedings" as a third investigator, Congress, has injected itself into many of the corporate scandals that have dominated the headlines.

Some would argue that Congress has played a constructive role by developing evidence quickly, releasing information publicly, and reassuring the public that wrongdoers will be called to account. And to its credit, Congress has not only conducted investigations, it has attempted to combat the plague of fraud by enacting legislation in the Sarbanes-Oxley Act of 2002. But the onslaught of congressional investigations in 2002 has been striking, both in its volume and in its intensity, and these investigations have presented risks and challenges for prosecutors and defense lawyers.

In 2002, Congress devoted an extraordinary amount of time and energy to investigations of corporate scandals. By our count, nine separate congressional committees held hearings spanning some 44 days. The committees, ranging in jurisdiction from the House Energy and Commerce Committee to

Richard B. Zabel and **James J. Benjamin Jr.** are litigation partners at Akin Gump Strauss Hauer & Feld LLP in New York and former assistant U.S. attorneys in the Southern District of New York. **Matthew Atlas**, a law clerk at the firm and a law student at the University of Virginia, assisted in the preparation of this article.

the Senate Health, Education, Labor and Pensions Committee, called over 235 witnesses to testify.

The hearings focused on many of the year's major corporate scandals, including Enron, WorldCom, Global Crossing and ImClone, and generated memorable and newsworthy moments, including the invocation of the Fifth Amendment by figures such as Bernard Ebbers, WorldCom's ex-CEO, and David Duncan, the lead auditor on Arthur Andersen's Enron engagement. The very titles of these hearings reveal a sharply critical tone, for example, "The Watchdogs Didn't Bark: Enron and Wall St. Analysts,"¹ "Wrong Numbers: The Accounting Problems at WorldCom,"² and "Capacity Swaps by Global Crossing and Qwest: Sham Transactions Designed to Boost Revenues."³

What are the problems and challenges that these congressional investigations have presented for lawyers who have sought to navigate their way through these triangulated investigations? This article discusses a few facets of this question.

Public Statements

Congressional investigations unfold in the public eye. Grand jury and SEC investigations are governed by strict rules of confidentiality that are both venerable and strictly enforced.⁴ As the Supreme Court has recognized, grand jury secrecy rules serve both to preserve the integrity of ongoing investigations and to "assure that persons who are accused but exonerated by the grand jury will not be held up to public ridicule."⁵ The SEC's confidentiality rules protect similar interests.⁶

For lawyers accustomed to the normal rules of grand jury and SEC confidentiality, it would be unthinkable for the government, in mid-investigation, to issue tendentious public statements characterizing the state of

an investigation. Yet this was often the case in recent congressional investigations. For example, in February 2002, in national TV broadcasts shortly before a hearing at which ex-Enron CEO Kenneth Lay was scheduled to testify, legislators asserted, "Ken Lay obviously had to know that this was a giant pyramid scheme — a giant shell game," "maybe somebody ought to go to the pokey for this," and Enron had "almost a culture of corporate corruption."⁷

In this hostile environment, Mr. Lay unsurprisingly announced his intention to invoke the Fifth Amendment, which a spokesman for the House Energy and Commerce Committee met with scorn: "What was he expecting coming to Washington? A debutante ball?"⁸

A similar pattern unfolded during the WorldCom investigation, as this same spokesman asserted that WorldCom attorneys had told House Committee investigators that "Bernie [Ebbers] was aware that hundreds of millions of dollars had been moved" in connection with accounting irregularities. Once again, the spokesman used rhetorical flourish: "This is the first evidence that we've seen that the muddy little footprints may lead back to Bernie Ebbers' doorstep."⁹

The same spokesman repeatedly made provocative comments to the press in connection with the Martha Stewart investigation. Referring to alleged discrepancies in the accounts of Ms. Stewart, her broker and the broker's assistant in connection with Ms. Stewart's sale of ImClone stock, the spokesman asserted: "They are all in conflict. Clearly someone is lying to us."¹⁰ Later, the spokesman warned that Stewart's "credibility has been stretched pretty thin."¹¹

In a criminal or SEC investigation, comments such as these would be unacceptable and, indeed, would likely lead to disciplinary actions. But Congress is not bound by the

same rules and traditions as the Department of Justice or the SEC.

Interestingly, congressional rules do not require that investigations be played out in front of the press. To the contrary, House and Senate rules permit a committee to hold its hearings in closed session if a majority of the committee finds, respectively, that public hearings “may tend to defame, degrade, or incriminate any person,”¹² or if a public hearing “will tend to charge an individual with crime or misconduct, to disgrace or injure the professional standing of an individual, or otherwise expose an individual to public contempt or obloquy.”¹³

Surely some of this year’s more sensational hearings could fit within these descriptions, but legislators have not seen fit to invoke these rules. Nor are we aware of any instance in which a witness in any of the recent hearings has invoked House Rule XI(3)(f)(2), which gives a witness who has been served with a subpoena an absolute right to demand no broadcast or photographic coverage of his or her testimony.

Broad Latitude

Normal rules of evidence and procedure do not apply in Congress. The Federal Rules of Evidence do not apply in congressional hearings. To the contrary, members of Congress customarily enjoy broad latitude to ask argumentative, rambling questions that would be impermissible under normal evidentiary rules and improper before the grand jury or in an SEC investigation. For example, hearings regarding Arthur Andersen’s destruction of documents featured the following “loaded” question from Rep. Michael Bilirakis (R-Fla.):

Q. Mr. Andrews, what I’m trying to get at is — you heard my opening statement about lack of credibility and that sort of thing. The documents that were used by your firm to determine that — to, basically — I’m going to use the word “hide” and not; I don’t mean that necessarily as bad as it sounds — to hide the truth regarding Enron, et cetera, the misstatements, the voodoo accounting, if you will, that I consider voodoo and the chairman referred to; those documents were a part of your audit, your work papers, right?¹⁴

At a hearing on the ImClone scandal, when asking an ImClone board member as to whether outside counsel had questioned Sam Waksal, ImClone’s president, about an apparent forgery by Mr. Waksal, Rep. Peter Deutsch (D-Fla.) adopted an argumentative posture:

Q. And wouldn’t that have been an appropriate question to ask?

A. Very possibly.

Q. I mean — very possibly it would be appropriate? You can’t say yes or no? That’s the most ridiculous answer I’ve heard in a very long time. And we’ve had everyone. We’ve had Enron and we’ve had WorldCom and that’s up there. I mean, “very possibly?” Your CEO — it’s the head of the company — forged a — this is wacky. I mean, this is wacky. A guy’s forging documents and you’re keeping him in charge of the company — and your outside directors. I mean¹⁵

At a hearing on Global Crossing, Rep. Michael Capuano (D-Mass.) announced his intention to dispense with questions altogether:

But I’m going to tell you that I don’t have a whole lot of questions because, honestly, I don’t like the answers I’m getting. I don’t think we’re going to get the answers, I don’t think

But I will tell you that that’s why I’m not asking questions today, because I don’t expect to get answers that are going to be clear and concise. I don’t expect to get answers that are going to do anything to help the employees that you have hurt, the shareholders that you have hurt, and I don’t see any way that we can take steps to reconstitute the trust the American people once had in the American business community.¹⁶

At a trial or other court proceeding, counsel could object to these types of “questions,” and those objections would be sustained. But at congressional hearings, counsel has no opportunity to object, or even to participate meaningfully in the proceedings. The House rules, for example, expressly state that the role of counsel is “solely for the purpose of advising [witnesses] concerning their constitutional rights.”¹⁷ Likewise, case law makes clear that counsel has no authority to cross-examine witnesses or present evidence on a client’s behalf,¹⁸ or to engage in oral argument.¹⁹ Needless to say, these features ensure that a congressional hearing bears scant resemblance to a trial or similar judicial proceeding.

Invoking Fifth Amendment

Congressional testimony may present a risk of jeopardy in subsequent proceedings. In any congressional investigation, careful analysis is required as to whether a witness should invoke the Fifth Amendment, a privilege which is recognized in congressional

proceedings.²⁰ This is often a difficult choice in a traditional parallel investigation, but it can be even more impenetrable in congressional investigations because they move so quickly. In a fast-moving congressional matter, counsel may not have a realistic sense of where a criminal investigation is headed and thus may struggle to assess the client’s risk of jeopardy.

Under these circumstances, a witness may have no choice but to invoke the Fifth Amendment. Yet invocation of the Fifth Amendment can have disastrous collateral consequences, which are magnified in congressional investigations because the process generally occurs so publicly. An example is the case of the two senior Merrill Lynch investment bankers who were placed on leave after refusing to answer questions from a Senate subcommittee about the purchase of Nigerian barges from Enron.²¹

In addition, invocation of the Fifth Amendment may invite harsh criticism from legislators. For example, ex-WorldCom executives Bernard Ebbers and Scott Sullivan were berated by Rep. Mike Ferguson (R-N.J.) after they invoked the Fifth Amendment: “your silence may have saved you today, but we’re going to get answers ... If you flush down the drain the retirement savings of millions of investors, you will and you should go to jail.”²²

Rep. Gary Ackerman (D-N.Y.) was even more scathing: “There are thousands of people in this country who believe that you have ruined their lives and the lives of their children and their families. There are probably millions of people in this country that are attributing to you a major role in undermining the public’s faith in the free-market system. Mr. Ebbers, do you sleep well at night?”²³

As demonstrated by the Martha Stewart investigation, an individual may potentially be exposed to a risk of prosecution even if he or she never actually speaks to any representatives of a committee. Martha Stewart declined to meet with staff members of the House Committee on Energy and Commerce, and her lawyers advised the committee that she would invoke the Fifth Amendment if required to testify.²⁴ But Ms. Stewart’s lawyers submitted detailed letters to the committee in which they outlined her version of events.

The committee took issue with the content of these letters from counsel and, in early September, asked the justice department to investigate whether the letters constitute criminal false statements by Ms. Stewart in violation of Title 18, U.S. Code, §1001.²⁵ In our experience, such a prosecu-

tion would be unorthodox at best, but the referral illustrates the risks of communicating with committee staff even indirectly, through counsel. Further, counsel's role is circumscribed almost to the point of paralysis if he cannot advocate a position on behalf of his clients without creating a risk of separate bases for criminal prosecution.

Effect on Criminal Case

In our experience, it is not just defense lawyers who may take issue with the pace and direction of congressional investigations — prosecutors, too, would often prefer to conduct the investigations themselves. Among other things, public hearings in Congress may “lock in” witness testimony in ways that are not always favorable for the government, and the pressures of a public investigation may impair the government's ability to plan and execute a sound investigative strategy. On the other hand, congressional staff members often take steps to coordinate their activities with criminal investigators, which can reduce conflict and minimize damage to investigations.

The interests of prosecutors and congressional investigators almost came into conflict in the *United States v. Arthur Andersen* criminal prosecution in Houston. In advance of trial, Andersen's counsel sought to obtain certain interview notes taken by investigators for a House committee. Such notes, when taken by federal law enforcement officers during an investigation, are commonly turned over at trial pursuant to Title 18, U.S. Code, §3500 or *Giglio v. United States*, 405 U.S. 150 (1972), and Andersen's counsel sought them for use as impeachment material during the government's case.

In the Andersen case, however, the House committee successfully resisted disclosure on grounds that its investigative notes were privileged under the Speech and Debate Clause.²⁶ This ruling reduces the risk to prosecutors that congressional investigators will provide defense attorneys with additional impeachment material to be used against government witnesses at trial.

Although committee reports are typically produced by congressional staff without the opportunity for comment or objection by outsiders, parties to private litigation may seek to rely on the reports. For example, a report of the Senate Permanent Subcommittee on Investigations condemned the actions of Enron's Board of Directors during certain Enron deals.²⁷ Subsequently, plaintiffs in a class action against Enron and its directors asked a court to take judicial notice of the Senate Committee's findings.²⁸ In a similar

vein, the court-appointed examiner in Enron's bankruptcy case cited a report of a Senate subcommittee as support for a number of factual assertions in a formal report to the bankruptcy court.²⁹

Conclusion

In 2002, dramatic corporate scandals have unfolded not only in traditional venues such as courtrooms and SEC offices, but also in the more freewheeling forum of Capitol Hill. In some respects, the congressional investigations of 2002 have been even more noteworthy than the criminal investigations; certainly they have offered more for public consumption.

Reasonable people can differ as to whether this year's congressional investigations were an appropriate and socially beneficial exercise of legislative oversight or an abusive and overly political sideshow, but there can be no doubt that the investigations have had a major impact. It remains to be seen whether Congress has taken on a permanent role as an investigator in high-profile business scandals.



(1) Hearing before the Senate Committee on Governmental Affairs (Feb. 27, 2000).

(2) Hearing before House Committee on Financial Services (July 8, 2000).

(3) Hearing before the Subcommittee on Oversight and Investigations, House Committee on Energy and Commerce (Oct. 1, 2001).

(4) See Fed. R. Crim. P. 6(e); *United States v. Sells Engineering*, 463 U.S. 418, 424-25 (1983) (grand jury secrecy); 17 C.F.R. §§203.2, 203.5; *LaMorte v. Mansfield*, 438 F.2d 448, 450-51 (2d Cir. 1971) (non-public nature of SEC investigations).

(5) *Sells Engineering*, 463 U.S. at 424.

(6) See *SEC v. O'Brien*, 467 U.S. 735, 750-51 (1984); *LaMorte*, 438 F.2d at 451.

(7) Marilyn Geewax, “Lay Backs Out Of Testifying To Congress: Ex-CEO's Lawyer Calls Hearings Prosecutorial; Senate Committee Cancels Today's Proceeding,” *Austin American Statesman*, Feb. 4, 2002, at A1 (attributing quoted statements to Sen. Peter Fitzgerald (R-Ill.), Sen. Byron Dorgan (D-N.D.), and Rep. Billy Tauzin (R-La.), respectively).

(8) *Id.*

(9) Yochi J. Dreazen, et. al., “Leading The News: Sullivan Says Ebbers Knew Of WorldCom Methods,” *Wall Street Journal*, July 12, 2002, at A3.

(10) Leigh Strobe, “Stewart Gives Info to House Panel,” *AP Online*, Aug. 20, 2002.

(11) Keith Naughton, “More Head Wind For Martha: As Investigators Run Out Of Patience, The Diva Of Domesticity May Be Ordered To Testify In Washington,” *Newsweek*, Sept. 2, 2002.

(12) House R. XI(2)(k)(5).

(13) Senate R. XXVI(5)(b)(3).

(14) *The Destruction of Enron-Related Documents By Andersen Personnel*, Hearing Before the Subcommittee on Oversight and Investigations, House Energy and Commerce Committee, 107th Cong., 2d Sess., Serial No. 107-80, at 128 (Jan 24, 2002).

(15) *An Inquiry Into the ImClone Cancer-Drug Story*, Hearing before the Subcommittee on Oversight and Investigations, House Energy and Commerce Committee, 107th Cong., 2d Sess. (Oct. 10, 2001) (transcript available on Lexis; official transcript not yet available).

(16) *The Effects of the Global Crossing Bankruptcy on Investors, Markets, and Employees*, Hearing before the Subcommittee on Oversight and Investigations, House Fin. Servs. Comm., 107th Cong., 2d Sess., at 30-31 (March 21, 2002).

(17) House R. XI(2)(k)(3).

(18) *United States v. Fort*, 443 F.2d 670, 678-82 (D.C. Cir. 1970).

(19) *Yellin v. United States*, 374 U.S. 109, 112 (1963).

(20) See *Watkins v. United States*, 354 U.S. 178, 188 (1957); *United States v. Fort*, 443 F.2d at 678.

(21) The two investment bankers were subsequently fired when they invoked the Fifth Amendment during Department of Justice and SEC proceedings. See Patrick McGeehan and David Barboza, “Merrill Fires 2 for Avoiding Enron Inquiry,” *New York Times*, Sept. 19, 2002.

(22) Susan Pulliam et al., “Congressmen Say Executives Mismanaged Company; Grubman Draws Criticism,” *Wall Street Journal*, July 9, 2002, at A3.

(23) Peter S. Goodman, “On The Hill, A Taciturn Ebbers: Former WorldCom CEO's Silence Enrages Some Committee Members,” *Wash. Post.*, July 9, 2002, at E1. Ebbers arguably invited some of the criticism by giving a statement in which he professed his innocence and said he was “proud” of his work at WorldCom before eventually invoking the Fifth Amendment. This procedure infuriated some members of the House Financial Services Committee, who suggested that Ebbers had waived his privilege and should be held in contempt for refusing to answer questions. See *id.*; see also Susan Pulliam et al., “Congressmen Say Executives Mismanaged Company; Grubman Draws Criticism,” *Wall Street Journal*, July 9, 2002, at A3.

(24) See Letter dated Sept. 10, 2002, from Rep. Tauzin to Attorney General Ashcroft (available on the Internet at http://energycommerce.house.gov/107/letters/09102002_714.htm).

(25) *Id.*

(26) Motion by House Committee on Energy and Commerce to quash subpoena, *U.S. v. Arthur Andersen*, (S.D. Tex. 2002) (No. 02-CR-121); Order granting motion to quash, *U.S. v. Arthur Andersen*, (No. 02-CR-121).

(27) Staff of Senate Permanent Subcommittee on Investigations, 107th Cong., *The Role of the Board of Directors in Enron's Collapse*, S. Rep. No. 107-70 (2002).

(28) Plaintiff's Motion for Judicial Notice of Senate Report on the role of the Board of Directors in Enron's collapse, *Tittle, et. al. v. Enron Corp.*, (S.D. Tex. 2002) (No. 01-CV-3913).

(29) See First Interim Report of Neal Batson, Court-Appointed Examiner in *In Re: Enron Corp., Debtor*, Case No. 01-16034 (AJG) (Bankr. S.D.N.Y.), at 3 n.10, 7-8 n.26, 58 n.145, 59 n.147.

This article is reprinted with permission from the December 16, 2002 edition of the *NEW YORK LAW JOURNAL*. © 2002 NLP IP Company. All rights reserved. Further duplication without permission is prohibited. For information contact, American Lawyer Media, Reprint Department at 800-888-8300 x6111. #070-01-03-0007