Government Investigations and Litigation Bulletin

1998-11-01

"Exculpatory no" doctrine rejected by United States Supreme Court

***Brogan v. United States*, ___ U.S. ___, 118 S.Ct. 805 (1998).**

A union officer, James Brogan, who accepted illegal cash payments from a real estate company whose employees were represented by the union, was visited at his home by federal agents from the Department of Labor and the IRS. The agents identified themselves and informed Brogan that they wanted his cooperation in an investigation of the real estate company and various individuals. The agents then told Brogan that if he wished to cooperate, he should have his attorney contact the U.S. Attorney's Office.

The agents asked Brogan if he would answer a few questions, and Brogan agreed. Among other questions, the agents asked if Brogan had received any cash or gifts from the real estate company when he was a union officer. Brogan answered "no." At that point, the agents disclosed to Brogan that they had evidence, obtained from a search of the real estate company, that showed that Brogan had accepted payments. The agents also told Brogan that lying to federal agents in the course of an investigation was a crime. Brogan did not modify his answers and the interview ended.

Brogan was indicted for accepting unlawful cash payments and for making a false statement within the jurisdiction of a federal agency in violation of 18 U.S.C. §1001 ("Section 1001"). Section 1001 provides that anyone who makes a false statement of any kind in any matter within the jurisdiction of any federal department or agency "shall be fined not more than $10,000 or imprisoned not more than five years, or both." 18U.S.C. §1001.

Brogan argued to the United States Supreme Court that his answer fell under the doctrine of the "exculpatory no," which had been adopted by several federal courts. The "exculpatory no" doctrine essentially provides that a simple denial of guilt does not fall under Section 1001 because that section only criminalizes those statements to government investigators that "prevent governmental functions," and simple denials of guilt do not prevent governmental functions if they do not cause the investigators to divert from the course of their investigation.

The majority of the Supreme Court rejected this doctrine of the "exculpatory no" and held that the plain language of Section1001 does not limit the types of false statements that are made to government investigators to exclude an "exculpatory no."

Justice Ginsberg and Justice Souter concurred in the majority decision but urged Congress to rethink the language of Section1001, which, in the opinion of these two Justices, confers on prosecutors the authority to manufacture crimes. The concurring opinion also noted that Brogan, had he had the advice of counsel, might more properly have withdrawn his original answer of no by saying, "strike that; I plead not guilty."

Justice Stevens, joined by Justice Breyer, dissented from the majority opinion and stated that "[t]he mere fact that a false denial fits within the unqualified language of 18U.S.C. §1001 is not, in my opinion, a sufficient reason for rejecting a well-settled interpretation of that statute." *Brogan*, __ U.S. at __, 118 S.Ct. at 817 (Stevens, J., dissenting).

Limitations on Ex Parte Contacts with Former Employees of an Opposing Party

***United States ex rel. O'Keefe v. McDonnell Douglas Corp.*, 132 F.3d 1252 (8th Cir. 1998).**

This qui tam action brought under the False Claims Act, alleged mischarging of labor hours by employees of McDonnell Douglas while working on United States military contracts. During the course of investigating the claims, the Department of Justice's ("DOJ") investigating agents made ex parte contacts with various present and former low-level employees of McDonnell Douglas without the consent of McDonnell Douglas's counsel. McDonnell Douglas sought and obtained a protective order to prevent the DOJ's further ex parte contact with its current employees. The district court, however, allowed ex parte contact with former employees subject to the DOJ's preservation and disclosure to McDonnell Douglas of all information obtained from ex parte contacts.

McDonnell Douglas argued that these ex parte contacts were banned by a Missouri Supreme Court rule that provides: "in representing a client, a lawyer shall not communicate about the subject of the representation with a party the lawyer knows to be represented by another lawyer in the matter, unless the lawyer has the consent of the other lawyer or is authorized to do so." *McDonnell Douglas*, 132 F.3d at 1253 (quoting Mo.Sup.Ct.R. 4-4.2).

The district court determined that the Missouri Supreme Court Rule did not require the Department of Justice to obtain the consent of McDonnell Douglas's counsel before initiating ex parte contacts with McDonnell Douglas's former employees, unless those former employees are currently represented by counsel. The district court limited the Department of Justice's contacts, however, by ordering the government to keep a list of the names of the former employees it interviewed and the dates on which it interviewed them. The court also ordered the Department of Justice "to preserve all statements, notes, and answers to questions obtained as a result of these contacts, and to make these documents available to McDonnell Douglas for review upon request, subject to work-product limitations." Id.at1257. The Eighth Circuit affirmed the decision of the district court. [1]

Attorney-Client Privilege Only Applies To Individual Corporate Officer In Regard To Conversations With Attorney in Officer's Individual Capacity And Not As Agent Of Company When Crime-Fraud Exception Has Removed Attorney-Client Privilege of Corporation

***In re: Grand Jury Subpoenas*, 144 F.3d 653 (10th Cir. 1998).**

In this case, the president and chief executive officer of a hospital (the "CEO"), along with several hospitals, doctors and others, was the target of an ongoing grand jury investigation. In response to a grand jury subpoena, the CEO produced documents that implicated the use of two attorneys, known as John Doe and Jane Roe, to effectuate crimes. Doe and Roe provided legal services to the hospital during the period of alleged criminal activity.

Doe and Roe were called before the grand jury and both asserted the attorney-client privilege and the work-product doctrine in response to questions posed to them. The attorneys also asserted the CEO's Fifth Amendment right against self-incrimination. The district court found that the crime-fraud exception to the attorney-client privilege applied and sustained the government's motion to compel Doe and Roe's testimony. The hospital and the CEO appealed.

The Tenth Circuit addressed the issues of the CEO's standing to bring an appeal and his assertion of the attorney-client privilege. The hospital reached a settlement agreement with the government and thus ceased asserting the attorney-client privilege for itself and its officers. The CEO then had to prove the existence of the attorney-client privilege for himself in his individual capacity. The court explained that the CEO had power to assert the attorney-client privilege only in regard to confidential communications between himself and the attorneys in which he took part in his capacity as an individual, not as an agency of the hospital.

The Tenth Circuit adopted the factors employed by the Second and Third Circuits in determining whether a corporate officer may assert a personal privilege with respect to conversations with corporate counsel: (1)the officer approached corporate counsel for the purpose of seeking legal advice; (2)when the officer approached counsel he made it clear that he was seeking legal advice in his individual rather than representation capacity; (3)counsel saw fit to communicate with a corporate officer in the officer's individual capacity, knowing that a possible conflict could arise; (4)the officer's conversations with counsel were confidential;

and (5)the substance of the officer's conversations with counsel did not concern matters within the company or the general affairs of the company. After applying these five factors, the Tenth Circuit concluded that to the limited extent that the CEO sought legal advice about his personal liability without regard to corporate considerations, the CEO had standing to bring the appeal.

The court next analyzed whether the limited attorney-client privilege that existed with regard to the CEO was vitiated by the crime-fraud exception. In order to invoke the crime-fraud exception, the party attempting to invoke it must present prima facie factual evidence that the allegation of attorney participation in the crime or fraud has some foundation. "The evidence must show that the client was engaged in or was planning the criminal or fraudulent conduct when it sought the assistance of counsel and that the assistance was obtained in furtherance of the conduct or was closely related to it." In re Grand Jury, 144 F.3d at 660.

The Tenth Circuit noted that the specific level of proof needed to meet the prima facie standard has never been delineated by the Supreme Court and the circuits vary in their definitions of what is required. [2] The court went on to find that under any of the announced standards in the various circuits, the government had met its burden. The crime-fraud exception, therefore, removed the attorney-client privilege between the CEO and Roe and Doe.

Finally, the court dismissed the CEO's argument that Roe and Doe should be allowed to assert vicariously his Fifth Amendment right against self-incrimination. The court reasoned that an attorney is only allowed to invoke the Fifth Amendment on behalf of his client when he is being compelled to produce documents or information that his client could bar from production. In this case, the information that was compelled was the content of voluntary oral statements made by the CEO to his attorney. The court held that the crime-fraud exception vitiated any attorney-client privilege that might have protected these statements, and Roe and Doe could not vicariously assert the CEO's Fifth Amendment rights because voluntary statements do not constitute "compulsory self-incrimination." Id. at 663.

Government May Dismiss Qui Tam Action Without Consent of Relator

***United States ex rel Sequoia Orange Co. v. Baird-Neece Packing Co.*, 151 F.3d 1139 (9th Cir. 1998).**

In this case an orange processor and an orange grower filed a series of False Claims Act qui tam actions against several citrus growers and packing houses, and alleged that the defendants made false statements to the government in connection with violations of marketing orders issued by the Secretary of Agriculture. Under the qui tam provisions of the False Claims Act, a private individual (known as a "relator"), may file an action on behalf of the government against any individual or company who has knowingly presented a false claim to the government for payment. A successful relator may be eligible to receive a portion of the fines imposed and for attorney's fees and costs. The government has an opportunity to investigate the relator's allegations and intervene in the action, in which case the action is then conducted by the government. The government intervened in this action and other related actions under 31 U.S.C. § 3730(b)(2), (4)(A).

The government found evidence of widespread marketing order violations. It suspended regulation of citrus allotments and requested industry input in amending the existing orders. Simultaneously, the government proposed a settlement of all False Claims Act actions. In order to facilitate the settlement, the government moved to dismiss the qui tam actions. The district court granted the government's motion to dismiss and held that the government sought dismissal for a legitimate government purpose, that the reasons it offered were rationally related to those purposes, and that the dismissal was not arbitrary or capricious.

The relators objected, arguing that their actions were meritorious and, therefore, the government could not have them dismissed. The Ninth Circuit rejected this argument and held that the government may dismiss a qui tam suit "notwithstanding the objections of the person initiating the action if the person has been notified by the Government of the filing of the motion and the court has provided the person with an opportunity for a hearing." Baird-Neece, 151 F.3d at 1143 (quoting 31 U.S.C. § 3730(c)(2)(A)). The court went on to say that the government could dismiss a qui tam action even if it did not actually intervene as long as the government offers reasons for dismissal that are rationally related to legitimate government interests.

Trader Could be Held to be a "Primary Violator" Under Section 10(b) For Following Stock Promoter's Directions

***Securities and Exchange Commission v. U.S. Environmental, Inc., et al.*, 155 F.3d 107, 1998 WL 559027 (2d. Cir. Aug. 25, 1998).**

The Second Circuit recently vacated a district court's dismissal of the SEC's claim that defendant-appellee, John Romano, a trader and registered representative of Castle Securities Corporation ("Castle"), engaged in market manipulation in violation of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. According to the SEC's complaint, Castle agreed to participate in a scheme whereby it and other defendants, including Romano, would manipulate upward the price of the stock of U.S. Environmental, Inc. ("USE").

At the direction of stock promoter Mark D'Onofrio ("D'Onofrio"), certain of the defendants or their nominees traded USE shares among themselves to create the appearance of an actual market for USE shares in order to raise the price of USE's stock. Romano participated in this market manipulation scheme by, among other things, effecting offers, purchases, and sales of USE securities in return for promises of risk-free profit for engaging in such trades. Romano also agreed to advise D'Onofrio continuously as Castle received buy and sell orders for USE shares during each trading day. Romano executed trades at D'Onofrio's direction and moved or adjusted the price Castle quoted for USE shares at D'Onofrio's direction. As a result of these manipulations from September 1989 - December 1989, the price of USE stock rose from $.05 to $5.00 per share, and Castle eventually made a profit of approximately $175,000 as a result of its market-making activity for USE.

The SEC sued USE, Castle, Romano and other individuals, alleging that the defendants violated various provisions of the securities laws in connection with their manipulation of USE stock. Romano moved to dismiss the SEC's manipulation claim against him on the ground that he was not a "primary violator" as required by the Supreme Court in Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164, 191 (1994). [3] The district court agreed with Romano's argument and dismissed the SEC's claims against him. The district court held that Romano was only an aider/abettor of securities violations, because Romano only followed directions from D'Onofrio and did not make sales himself. The district court also held that even if Romano knew that D'Onofrio was manipulating USE stock, he did not manipulate the stock himself because he did not have a manipulative purpose.

The SEC appealed the dismissal, and Romano contended that he could not be held primarily liable under Section 10(b) for following a stock promoter's directions to execute trades that Romano knew, or was reckless in not knowing, were manipulative, and where Romano did not share the promoter's ultimate manipulative purpose to raise the stock price. The Second Circuit rejected this argument and held that "whether Romano was a primary violator rather than an aider and abettor turns on the nature of his act, not on his state of mind when he performed them" U.S. Environmental, 155 F.3d at 111.

The court went on to say that as long as Romano knew of the prescribed activity, or recklessly participated in the manipulation, and effected the manipulative buy and sell orders, his personal motivation for manipulating the market is irrelevant in determining whether he violated Section 10(b). The court found that Romano had not simply failed to disclose information when there was no duty to do so (as in Shapiro v. Canton, 123 F.3d 717 (2d Cir. 1997)) or failed to prevent another party from engaging in a fraudulent act (as in Central Bank, 511 U.S. at 177), by effecting the very buy and sell orders that manipulated USE's stock upward. Finally, the court concluded that "[l]ike lawyers, accountants, and banks who engage in fraudulent or deceptive practices at their clients' direction, Romano is a primary violator despite the fact that someone else directed the market manipulation scheme." U.S. Environmental 155 F.3d at 112. [4]

[1] A number of federal courts have rejected the notion that Department of Justice attorneys are immune from state ethical rules that bar ex parte communication with represented parties. See *United States v. Lopez*, 4 F.3d 1455, 1458-63 (9th Cir. 1993); *Matter of Doe*, 801 F. Supp.

478, 484-87 (D.N.M. 1992). *Cf. United States v. Housing Authority of Town of Milford*, 179 F.R.D. 69, 75 (D. Conn. 1997) (holding that in a discrimination case, the public interest comes into play, and as long as Government counsel makes it clear at the outset of the ex parte interview that privileged communications are not to be divulged, and as long as the defendant's counsel is free to educate the former employee regarding what communications are privileged, precluding ex parte communication is not necessary to protect the attorney-client privilege).

[2] The First Circuit recently defined the level of proof needed to establish a crime-fraud exception as requiring more than innocent or involuntary action on the part of the privilege holder; rather, "wrongful complicity" is required to forfeit the attorney-client privilege. *United States v. Rakes*, 136 F.3d 1, 5 (1st Cir. 1998).

[3] In *Central Bank* the Supreme Court held that private civil liability under Section 10(b) does not apply to aiders and abettors of violations but only to those who "engage in the manipulative or deceptive practices." *Central Bank*, 511 U.S. at 167. The Court reasoned that "[a]iding and abetting is `a method by which courts create secondary liability' in persons other than the violator [or violators] of the statute." Id. at 184 (quoting *Pinter v. Dahl*, 486 U.S. 622, 648, n.24 (1988)).

[4] Although the Second Circuit did not address this factor in reaching its decision because it was not raised by the parties on appeal, the court noted that The Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, enacted after *Central Bank*, provides that, in SEC actions, "any person that knowingly provides substantial assistance to another person in violation of a provision of [the Securities Exchange Act], or of any rule or regulation issued under [the Securities Exchange Act], shall be deemed to be in violation of such provision to the same extent as the person to whom such assistance is provided." 15 U.S.C. § 78t(f). "Thus, unlike private plaintiffs, the SEC now has authority to assert aiding and abetting claims under §10(b). . . . It remains unclear, however, whether the SEC could bring aiding/abetting claims in cases based on conduct occurring prior to the enactment of the Reform Act." *U.S. Environmental,* _155 F.3d at 113 , (citations omitted).

Authors

Stephen A. Jonas

RETIRED PARTNER

+1 617 526 6000

Robert D. Keefe

SENIOR COUNSEL

robert.keefe@wilmerhale.com

+1 617 526 6334