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## WHITE-COLLAR CRIME

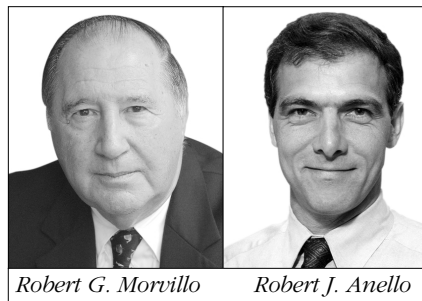
BY ROBERT G. MORVILLO AND ROBERT J. ANELLO

### *Criminal-Case Compensation of Fees: Not a Defendant's Right?*

The greatest imbalance between prosecution and defense in the criminal justice system is money. Prosecutors have no recognizable monetary boundaries on any given case and can rely on unlimited government resources as they see fit, while the overwhelming number of individuals have limited and considerably less funds with which to defend themselves.

One of the few balancing mechanisms in this area is the right to legal expense indemnification and advancement if the alleged crime stemmed from a subject's employment by a corporation.

Apparently unsatisfied with its 97 percent guilty plea and conviction rate and, in an attempt to eradicate the last vestiges of the adversarial system, some prosecutors are attempting to cut off this source of funding to subjects of investigations and/or defendants in criminal cases. Thus, a January 2003 memorandum by Deputy Attorney General Larry D. Thompson states: "[A] corporation's promise of support to culpable employees and agents... through the advancing of attorneys fees... may be



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considered by the prosecutor in weighing the extent and value of a corporation's cooperation."<sup>1</sup>

And, in May 2004, the Securities and Exchange Commission (SEC) fined Lucent Technologies \$25 million for not cooperating in an investigation, citing in part the corporation's payment of legal fees for employees.<sup>2</sup> More recently, federal prosecutors questioned advances made to a corporation's former employees who were tried and convicted of fraud for failing to follow the procedural niceties of indemnification.<sup>3</sup>

An ongoing prosecution in the District of Kansas, *United States v. Wittig*, provides an example of an extreme attempt on the part of the government to prevent two defendants from being indemnified in connection with the prosecution.

### Background

In December 2003, the federal government filed a 40-count indictment charging David C. Wittig and Douglas T. Lake with, among other violations,

conspiracy, circumvention of internal controls, wire fraud, false statements and money laundering during the course of their employment at Westar Energy Inc., a Kansas electrical utility.<sup>4</sup> Mr. Wittig was president, CEO, and chairman of the board of directors of Westar. Mr. Lake was its executive vice president.

A forfeiture count in the indictment sought forfeiture of "all property... involved in and derived from the... offenses [except the false statement charge] and all property traceable to such property, or proceeds." The forfeiture count also specifically sought "[a] money judgment against defendants Wittig and Lake in an amount equal to that required to be expended by Westar, for attorney and related expenses in the criminal case..., because of corporate by-laws and employment agreements."

Kansas law authorizes employers to pay "[e]xpenses incurred by a director or officer in defending a civil or criminal action, suit or proceeding...in advance of the final disposition of such action, suit or proceeding."<sup>5</sup> This was made mandatory by Westar's articles of incorporation.

On April 5, 2004, on the government's ex parte application, the District Court granted a restraining order enjoining Westar from "making any payments, including, but not limited to, compensation and benefits, directly or indirectly to or on behalf of the defendants."<sup>6</sup>

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## First Modification of Order

Mr. Lake moved to modify and Mr. Wittig moved to vacate the restraining order. Mr. Lake argued that the effect of the order as signed—"obviously not intended by the [c]ourt"—was to stop Westar from advancing legal fees and expenses in connection with the criminal case. Mr. Lake contended that the restraining order should be modified to exclude the prohibition to pay legal fees.<sup>7</sup> Mr. Wittig made similar arguments and urged that, in the alternative, Westar should be ordered to pay him the compensation and benefits to which he was entitled and those monies should be placed in escrow pending the outcome of the criminal case.<sup>8</sup>

The government argued that, under the U.S. Court of Appeals for the Tenth Circuit case of *United States v. Jones*,<sup>9</sup> prior to being able to challenge or even obtain a hearing on a post-indictment, pre-conviction restraining order, defendants had the initial burden of showing: (1) they had no funds other than the restrained assets to hire private counsel or to pay for living expenses; and (2) a bona fide reason to believe that the grand jury erred in determining that the restrained assets constituted or were derived, directly or indirectly, from gross proceeds traceable to the commission of the offense.<sup>10</sup>

Mr. Lake and Mr. Wittig, not surprisingly, took issue with the government's response. They argued in their reply briefs, among other things, that the prosecution: (1) failed to establish that the legal fees it sought to prevent Westar from advancing constituted property subject to forfeiture; (2) relied on insufficient authority; (3) ignored the fact that Westar was required to advance legal fees pursuant to its articles of incorporation and Kansas law; and (4) misled the court into signing an overly broad freeze order, in violation of Kansas disciplinary rules.<sup>11</sup>

Subsequent additional briefing by the

parties addressed the financial condition of Mr. Lake and Mr. Wittig the "classic 'catch-22'" as Mr. Wittig described it, where the employer was not allowed to advance legal fees, but the employees also were restrained by another court order from using the only funds they had available.<sup>12</sup> In turn, the government contended that the defendants had withheld from the court information as to their "sumptuous lifestyles" and questioned the number of attorneys that had appeared on behalf of Mr. Lake and Mr. Wittig, an issue it admitted ordinarily is "of no moment to the government."<sup>13</sup> (Several months later, the government would also claim that defendants' counsel had "extracted" what it deemed to be "obscene" legal fees. In so doing, it did not expose how much the government had spent in support of its case.)<sup>14</sup>

After extensive briefing by the parties, the court entered an order<sup>15</sup> modifying the April 5 restraining order and removed restrictions on Westar's payments to the defendants, instead enjoining the defendants from transferring any such payments, including payments in the form of advanced legal fees to their attorneys. The court further ordered that any advancements of legal fees by Westar were to be placed in an escrow account.

After noting that it had become "apparent that Westar was taking the position that the restraining order effectively vitiated its obligation to advance defendants any attorney fees," the court clarified that "the intent of its restraining order was to preserve the status quo and the assets for potential forfeiture." The court found no need for a pretrial hearing as to the forfeitability of the restrained assets or the restraint of the advanced legal fees because defendants had not demonstrated need as required by *Jones*.

In addition to discussing *Jones*, the court looked to the federal forfeiture statutes<sup>16</sup> and their legislative history and

relied on the Supreme Court's decision in *United States v. Monsanto*.<sup>17</sup>

## Further Modification

In July 2004, the government filed its first superseding indictment.<sup>18</sup> On Aug. 3, Mr. Lake filed a *Jones* submission, supplementing his showing of need, requesting a *Jones* hearing and renewing his motion to modify the April 5 restraining order. At an Aug. 10 hearing, the court found that Mr. Lake "had demonstrated that he had no available unrestrained assets to pay defense counsel" and that Mr. Lake "had made a prima facie showing of a bona fide reason to believe the grand jury erred in determining that the restrained assets [we]re traceable proceeds of the charged offenses."<sup>19</sup> The court granted a *Jones* hearing.

At the hearing, the government offered no factual evidence linking any criminal act allegedly committed by the defendants to the right to advancement and indemnification of attorney's fees. "The government," the court wrote, "did not present any evidence in support of its theory that defendant [Mr.] Lake's right to advancement of legal fees is derived from the scheme or conspiracy to commit the underlying charges." Rather, the government continued to argue that "the alleged scheme to deprive Westar of its assets began the day defendant Wittig joined Westar in 1995 and morphed into a conspiracy the day [Mr.] Lake joined Westar in 1998." In the government's view, because Mr. Lake and Mr. Wittig "fraudulently assumed their employment with Westar," every benefit obtained from the operation of the alleged scheme to loot Westar was forfeitable.<sup>20</sup>

The court, in an Aug. 13, 2004 order,<sup>21</sup> found that the government had not satisfied its burden concerning the traceability of the assets. The court concluded that, "[e]ven assuming...that the underlying charges as alleged in the

Superseding Indictment are true and the scheme and conspiracy date back to defendants' respective employment dates, the government has failed to provide any factual basis or evidentiary support that the right to advancement of fees was derived from the underlying charges."

The court concluded that Westar was "authorized by Kansas law and mandated by its Articles of Incorporation to advance both defendants' legal fees for their defense in the criminal case."

In making its ruling, the court "acknowledge[d] that the practice of corporate advancement of fees is often perceived as unjust—as in this case, criminal allegations against corporate officers often involve acts that defrauded the company by depriving it of defendant's honest services." But, the court wrote, "in a criminal proceeding, a defendant is always presumed innocent." The court observed that, if the defendants were acquitted of the charges against them, "it is difficult to conceive of an argument that would deprive them of their legal fees and expenses resulting from proceedings focusing on their conduct as officers of Westar."

A seven-week trial in *United States v. Wittig* from October to December 2004 ended in a mistrial. A new trial date has been set for June 14.

At the end of the 2004 trial, the government made a motion to reinstate the restraining order, based on evidence produced at the trial. Five months later, on May 23, 2005, the court granted the government's motion, reinstating the restraining order and the escrow arrangements for the legal fees.<sup>22</sup>

The court based its reversal of its prior ruling on evidence presented at trial, including Mr. Lake's testimony that he "oversaw the unregulated assets to be spun-off into an unregulated company." The evidence, the court found, "supports the government's theory that defendant Lake fraudulently assumed his employ-

ment with Westar, and that he joined the company in collaboration with defendant Wittig to 'bust out' an unregulated corporation with significant assets and no debt, triggering defendants' change in control agreements." The court held that the evidence was "sufficient to establish probable cause to believe the restrained assets constitute or are derived from proceeds traceable to the underlying offense."

## Conclusion

Of late, the government has expressed increasing interest in denying subjects and inditees advancement of legal fees. Unlike the Wittig case, this campaign is not being waged directly but is being carried out through pressure and threats to corporations as to the consequences of their being classified as uncooperative by virtue of advancing fees. This tactic not only eviscerates the presumption of innocence, but is affecting the ability of subjects of investigations and criminal defendants to maintain an effective and competent defense.



1. Memorandum from Deputy Attorney General Larry D. Thompson, United States Department of Justice, to Heads of Department Components, U.S. Attorneys, "Principles of Federal Prosecution of Business Organizations," §VI (Jan. 20, 2003); see also Memorandum from Deputy Attorney General to All Component Heads and U.S. Attorneys, "Bringing Criminal Charges Against Corporations," §VI (June 16, 1999) (containing identical language), both available at [www.usdoj.gov](http://www.usdoj.gov). These memos do contain a footnote recognizing obligations imposed by State law and indicating that compliance with these statutes should not be considered failure of cooperation.

2. See SEC Litigation Release No. 18715, *SEC v. Lucent Technologies, Inc.*, Civ. Action No. 04-2315 (WHW) (D.N.J. May 17, 2004) (available at [www.sec.gov](http://www.sec.gov)).

3. See John R. Emshwiller & Kara Scannell, "Merrill Faces Issue of Enron Legal Fees: To Pay or Not to Pay?," *Wall St. J.*, May 11, 2005.

4. Indictment, *United States v. Wittig*, No. 03-40142-JAR (D. Kan. Dec. 3, 2004) (available at [www.usdoj.gov](http://www.usdoj.gov)).

5. K.S.A. §17-6305(e). The Kansas statute is patterned on the Delaware corporation code.

6. *United States v. Wittig*, No. 03-40142-JAR (D. Kan. April 5, 2004) (restraining order) (emphasis added).

7. See Douglas T. Lake's Motion to Modify Restraining Order of April 5, 2004, *United States v. Wittig*, No. 03-40142-JAR, Apr. 9, 2004. Mr. Lake also asked the court to modify the restraining order to allow advancement of legal fees and expenses for civil cases and an arbitration pending against him.

8. See David C. Wittig's Motion to Vacate Ex Parte Restraining Order, *United States v. Wittig*, No. 03-40142-JAR, Apr. 9, 2004.

9. 160 F3d 641 (10th Cir. 1998).

10. See Government's Combined Response in Opposition to Wittig's Motion to Vacate and Lake's Motion to Modify the Post-Indictment Restraining Order, *United States v. Wittig*, No. 03-40142-JAR, April 19, 2004.

11. See Douglas C. Lake's Reply Papers in Support of his Motion to Modify Restraining Order & Defendant David C. Wittig's Reply to Government's Opposition to Motion to Vacate Ex Parte Restraining Order, *United States v. Wittig*, No. 03-40142-JAR, Apr. 29, 2004.

12. Defendant Wittig's Supplemental Memorandum in Support of Motion to Vacate Restraining Order, *United States v. Wittig*, No. 03-40142-JAR, June 8, 2004. In addition to its order of April 5, 2004, the court also had entered a restraining order on Feb. 13, 2004 directed against defendants' stock and other assets.

13. Government's Combined Response, *United States v. Wittig*, No. 03-40142-JAR, May 27, 2004.

14. Government's Motion to Reinstate Restraining Order, *United States v. Wittig*, No. 03-40142-JAR, Dec. 18, 2004.

15. *United States v. Wittig*, No. 03-40142-JAR, 2004 WL 1490406 (D. Kan. June 30, 2004).

16. 18 USC §§981, 982; 21 USC §853; 28 USC §2461.

17. 491 US 600 (1989).

18. Superseding Indictment, *United States v. Wittig*, No. 03-40142-JAR (D. Kan. July 14, 2004) (available at [www.usdoj.gov](http://www.usdoj.gov)).

19. *United States v. Wittig*, 333 F. Supp.2d 1048 (D. Kan. 2004).

20. *United States v. Wittig*, 333 F.Supp2d 1048 (D. Kan. 2004); see also Supplemental Argument Concerning the Defendants' Motions to Vacate/Modify the Court's Restraining Order, *United States v. Wittig*, No. 03-40142-JAR, Aug. 11, 2004.

21. *United States v. Wittig*, 333 F.Supp2d 1048 (D. Kan. 2004).

22. See Memorandum and Order Granting Government's Motion to Reinstate Restraining Order, *United States v. Wittig*, No. 03-40142-JAR, May 23, 2005.