

# New York Law Journal



Web address: <http://www.nylj.com>

VOLUME 238—NO. 26

TUESDAY, AUGUST 7, 2007

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## WHITE-COLLAR CRIME

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### *The Cost of Defense*

*"I will know I have made it when I can afford to hire myself as an attorney."*

This statement often has been spoken in jest by white-collar defense attorneys. Several recent prosecutions of individual corporate executives have highlighted just how expensive and complex a reasonable defense has become.

Today's white-collar business person often is found working for a multinational corporation or a sophisticated financial institution dealing in matters of increasing intricacy. As a result, when legal questions are raised, these executives often find themselves in need of the expertise and investigative analysis of complex, highly skilled—and increasingly expensive legal representation. Recent court decisions have revealed the cost of an individual's defense can reach as high as \$20 million to \$40 million. Moreover, as these cases demonstrate, the corporate employer's obligation to fund the defense is often not a matter of largesse. Rather, it is required as part of the cost of engaging in the lucrative modern business world.

#### Changes in White-Collar Practice

With varying degrees of success, the federal government and states have developed systems for providing indigent criminal defendants the generally modest representation they require to meet the Sixth Amendment's guarantee of effective representation. Typically, the corporate executive does not qualify for such free representation, and undoubtedly, society



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is not prepared to provide the level of defense that a modern white-collar case requires. Courts, however, recently have concluded that the benefits reaped by modern corporations' participation in complex businesses may require that they step up to the plate when their employees face trial.

Many states have broad legislation requiring companies to indemnify employees for legal fees. Delaware law provides that a corporation must indemnify an employee—which includes officers, directors and agents—for expenses reasonably incurred, including attorney's fees, where the employee successfully defends the case.<sup>1</sup> New York's Business Corporation Law similarly protects an employee's indemnification rights and permits a court to direct the payment of such expenses where the corporation has failed to do so, even if the corporation's board or shareholders have passed a resolution specifically deciding not to indemnify the employee.<sup>2</sup> In addition, many corporations have mandatory indemnification provisions in their bylaws or incorporating documents.<sup>3</sup> Many corporations avail themselves of director and officer insurance to supplement their financial obligations which seem to be increasing dramatically.<sup>4</sup> Recent reports regarding the extraordinary defense costs incurred in high-profile white-collar prosecutions demonstrate the need for this protection.

Not too long ago, most private criminal defense and white-collar work was handled by small, specialized law firms. Concomitant with the broadening reach of corporate America and the increased government focus on corporate and financial scandals, many large and international law firms, in order to provide full service to their institutional clients, also have developed criminal defense practices. This, in addition to the multifaceted nature of white-collar prosecutions, has, by necessity, resulted in increasing costs in legal fees and expenses. As with other types of litigation, today's white-collar cases often involve analysis of millions of electronic documents, restoration of electronic information, use of forensic accountants, and international travel and investigation.

#### The Financial Cost

The former CEO of Enron, Jeffrey Skilling, was charged with multiple counts of conspiracy and fraud related to that corporation's financial collapse. He was convicted of conspiracy, insider trading, making false statements, and securities fraud in a trial that lasted approximately four months. Media reports have listed his defense costs as more than \$40 million.<sup>5</sup> The federal government has estimated that Skilling's defense team of 12 lawyers, five paralegals and additional temporary staff cost closer to \$70 million.<sup>6</sup>

Dennis Kozlowski, the former CEO of Tyco International, was accused of misappropriating more than \$400 million of the company's funds. His first trial resulted in a hung jury; the second trial resulted in a conviction. The government estimates the total cost of his defense of both trials to be approximately \$26 million.<sup>7</sup> The Wall Street Journal reported that Mr. Kozlowski sought reimbursement from an insurer of "nearly \$17.8 million" for the first trial alone.<sup>8</sup>

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In 2005, Richard Scrushy, the founder and CEO of HealthSouth, was acquitted of all 36 counts brought against him related to a reported \$2.7 billion fraud on HealthSouth. The length of Mr. Scrushy's trial was five months. His acquittal in that case allowed him to seek mandatory indemnification under Delaware law for millions in legal fees from HealthSouth, which some media accounts report to be as high as \$31 million.<sup>9</sup> Government lawyers in *Stein* estimated these costs to be around \$21 million.<sup>10</sup>

### 'United States v. Stein': KPMG Prosecution

The immense financial burden placed on individuals defending against white-collar prosecutions and the "reasonableness" of those expenses in light of the complexity of today's business prosecutions recently was analyzed by a federal court in *United States v. Stein*, the prosecution of some KPMG partners in the U.S. District Court for the Southern District of New York. Last year, Judge Lewis A. Kaplan determined that the government had violated the defendants' Sixth Amendment right to counsel and right to substantive due process when it encouraged KPMG to decline to pay the defendants' attorney's fees.<sup>11</sup> More recently, Judge Kaplan dismissed the tax fraud charges as against 13 former KPMG executives on the basis of these violations. In determining whether dismissal was the proper remedy for the government's actions, Judge Kaplan raised as an issue the cost of defending the case.

Of the 13 defendants who received dismissal, the Court determined that three were insolvent or close to it and therefore were unable to defend the case in any meaningful way. As for the remaining 10 defendants, the Court found that each individual had net assets ranging from around \$1 million to more than \$5 million. Despite these relatively high net worths, Judge Kaplan found that the defendants' assets were "not sufficient for any of them to defend this case as they would have defended it absent the government's actions."<sup>12</sup> In other words, the government's intrusion, which caused KPMG to decide not to pay the defendants' legal fees, did not allow any of the thirteen individual defendants to put forth the type of defense they would have if KPMG had advanced defense costs in the case.

The Court based this determination on the cost of the case to date, plus estimates of the cost of the case proceeding to trial. The defendants' costs incurred to date ranged from

\$500,000 to \$3.6 million, averaging roughly \$1.7 million per defendant.<sup>13</sup> In addition, the Court noted that the upcoming six- to eight-month trial likely would be the most expensive part of the case. With respect to the cost of trial, the defendants' attorneys submitted declarations to the Court estimating defense costs in the range of \$7 million to \$24 million per defendant—an average of \$13 million per defendant.<sup>14</sup>

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Judge Kaplan also considered a number of other logistical factors contributing to the exorbitant cost of a trial in the case. The indictment charged 19 defendants with conspiracy and tax evasion. Judge Kaplan noted that as of Nov. 11, 2006, the government had produced more than 22 million pages of material and that more than 1 million additional pages had been produced since June 1, 2007, "with no end in sight." The government had designated almost 70 witnesses and 2,000 exhibits for its case in chief and the overall length of the trial was estimated between six and eight months. Finally, the Court stated that "[t]he nature of the tax shelter transactions, the transactional documents, and the tax law that is pertinent to the case all are extremely complex." Accordingly, defense counsel would be required to rely on tax experts in understanding the material and preparing for trial.<sup>15</sup>

Judge Kaplan looked to the defense attorneys to offer estimates of the costs of defending the case. The attorneys relied on their personal experience in defending other white-collar cases to estimate the cost of the *Stein* case.<sup>16</sup> In a declaration submitted to the Court, counsel for the lead defendant, Jeffrey Stein, detailed the actual cost of defending a similar, but smaller, white-collar case. He

stated that the defense team in the other case included three lawyers (one partner and two associates) and a legal assistant. Further, he noted that the case involved six defendants, a six week trial and approximately two million documents. Finally, the attorney stated that the firms' cost in defending a client at that trial were approximately \$3.3 million. Mr. Stein's counsel said that the amount of work required in the *Stein* case to provide the same level of thoroughness was "many multiples of the amount of work required in that prior case."<sup>17</sup>

### 'As If KPMG Paid the Bills'

Ultimately, Mr. Stein's attorney estimated that the cost of defending Mr. Stein properly would have been more than \$10 million. As noted by the Court, this amount represents the cost of defending Mr. Stein "as [counsel] would have defend[ed] him were KPMG paying the bills" in the case.<sup>18</sup> As noted by Mr. Stein's attorney, if Mr. Stein had been indemnified by KPMG from the beginning, providing more abundant resources, counsel would have engaged in additional tasks to prepare for trial. These include: (1) retaining an electronic evidence consultant to assist in analyzing and sorting the 22 million pages of electronic files; (2) added additional staff to the defense team, which currently consisted of only one attorney and one legal assistant; and (3) retaining a forensic accountant and other experts.<sup>19</sup> In estimating the legal fees that would have been incurred if KPMG were paying the legal fees of its ex-employees, defense counsel submitted numbers to the Court ranging from \$10 million to \$44 million.<sup>20</sup>

After oral argument on the defendants' motions to dismiss, the Court issued an order requesting that the government provide the Court with its "estimate of the reasonable cost to each defendant of properly defending this action with privately retained counsel and the basis for those estimates." The government responded that it was not in a position to answer the Court's request.<sup>21</sup> Noting that it was unaware of any court decisions or legal authority setting forth a method for determining, in advance of trial, the "reasonable" costs associated with defending a criminal case, the government observed that the United States Attorney's Office was "ill suited" and lacking in experience to make such judgments.

Although the government stated that it could not reasonably give an opinion on the issue, it listed a number of factors the government believed would contribute to such a determination including: “how many co-counsel, associates and/or staffers are reasonably required to assist in the defense; whether a defense lawyer should charge a flat fee versus an hourly fee and the amount of a reasonable hourly fee; and whether it is reasonable to retain a lawyer from another state who would locate to New York for trial.”<sup>22</sup> Judge Kaplan noted, however, that the government had elected not to contest any of the information submitted by defense counsel and had agreed that \$3.3 million would be a “very conservative estimate” of the cost of defending the case.<sup>23</sup>

### Judge Kaplan’s Holding

In conclusion, Judge Kaplan held, “[w]ithout adopting any specific figure, the Court, based on its intimate familiarity with this case, the costs actually incurred to date, the scope of the task that lies ahead, and its awareness of the market for legal services, finds that none of the 13 KPMG defendants...has the resources to defend this case as he or she would have defended it had KPMG been paying the cost, even if he or she liquidated all property owned by the defendant.” Noting that while the Constitution does not guarantee a criminal defendant representation by a “Dream Team” of costly defense attorneys, Judge Kaplan reiterated that the Constitution does “guarantee those who can afford it the right to spend their money for the best defense that money can buy, free of unjustified interference by the government.”<sup>24</sup> As noted by one observer, “How [else] can mid- and lower-level executives, who are probably not eligible for a public defender, provide ample representation to defend themselves against government cases?”<sup>25</sup>

### Right to Choose Lawyer

• **Defense Costs’ Impact on the Right to Choose One’s Lawyer.** A recent decision from the U.S. District Court for the District of Kansas demonstrates the significance of issues related to defense costs and the ability to retain one’s counsel of choice. In *Westar Energy, Inc. v. Lake*,<sup>26</sup> the plaintiff, a Kansas utility, sought a declaratory judgment as to its liability for legal fees and expenses incurred

by its former employee and senior executive, Douglas Lake. Mr. Lake was indicted on fraud charges. While the first trial resulted in a hung jury, Mr. Lake was convicted after a second trial. This conviction was reversed by the Tenth Circuit in January 2007, and the case was remanded for a third trial.

Although Westar had paid more than \$4 million to Mr. Lake’s attorneys under a broad indemnification provision in its Articles of Incorporation, it refused to pay any more, declaring that it was obligated only to pay “reasonable” attorney’s fees. Accordingly, claiming to be owed an additional \$4 million, Mr. Lake’s attorneys sought to withdraw from representing Lake in the third trial.<sup>27</sup>

The district court addressed the issue of whether Westar must honor its obligation to advance Mr. Lake his legal fees and expenses, past due and future amounts under the terms of Westar’s incorporating documents. In analyzing the facts, the Court rejected Westar’s contention that Mr. Lake’s fees were “unreasonable” because he had retained attorneys from New York and Washington, D.C., who charged rates “exceeding those customarily charged in Kansas.” Finding that Westar could have, but did not, limit an indemnified party’s choice of counsel by rates or region in its indemnification provisions, the Court found that there were sufficiently “unusual circumstances” in Mr. Lake’s criminal case to warrant the higher hourly fees charged by Mr. Lake’s out-of-state counsel. “Major, intricate and complex white-collar defense is in no sense a ‘common specialty.’”<sup>28</sup>

Ultimately, the Court held Westar liable for the advancement of future amounts to Mr. Lake.<sup>29</sup> Commentators note the importance of this finding allowing Mr. Lake to retain his attorneys for the third trial as “likely [to] be a significant advantage because of the lawyers’ familiarity with the issues.”<sup>30</sup>

### Conclusion

At first impression, the right to indemnification for the high costs of defending white-collar cases may appear to be luxuries or perks granted to well-paid corporate executives. The reality, however, is that these increasing costs are the result of modern corporate practice. Courts properly have not shied away from enforcing a company’s obligation.



1. Delaware General Corporation Law §145(c).
2. New York Business Corporation Law §§722, 724.

3. *Westar Energy, Inc. v. Lake*, \_\_FSupp2d \_\_, 2007 WL 1856927, \*10 (D. Kansas June 28, 2007).

4. Peter J. Henning, “KPMG’s Aftermath—Revenge of the Insurance Companies?” White Collar Crime Prof Blog (June 28, 2006) (available at [http://lawprofessors.typepad.com/whitecollarcrime\\_blog/2006/06/kpmgs\\_aftermath.html](http://lawprofessors.typepad.com/whitecollarcrime_blog/2006/06/kpmgs_aftermath.html)).

5. Carrie Johnson, “After the Enron Trial, Defense Firm Is Stuck With the Tab,” Washington Post.com (June 16, 2006).

6. Letter to Honorable Lewis A. Kaplan from Michael J. Garcia, *United States v. Stein*, et al., S1 05 Cr. 888, July 9, 2007 (“Garcia Letter”) at fn 1.

7. *Id.* at fn. 4.

8. Jennifer Levitz, “Kozlowski Seeks Reimbursement,” Wall Street Journal (June 5, 2006).

9. Eric Fleischauer, “Managers Are Killing HealthSouth, Says Scrusby,” The Decatur Daily News (Aug. 22, 2006).

10. Garcia Letter at fn 1.

11. *United States v. Stein*, 435 FSupp2d 330 (S.D.N.Y. 2006) (Stein I); *United States v. Stein*, 440 FSupp2d 315 (SDNY 2006) (Stein II).

12. *United States v. Stein*, \_\_FSupp2d\_\_, 2007 WL 2050921, \*\*23-24 (SDNY July 16, 2007).

13. *Id.* at \*24.

14. *Id.*

15. 2007 WL 2050921 at \*\*19-20.

16. See, e.g., Supplemental Declaration of Susan R. Necheles Submitted in Support of Defendant Richard Rosenthal’s Motion to Dismiss the Indictment, *United States v. Stein*, S1 05 Cr. 888 (July 9, 2007).

17. Reply Declaration of David Spears on Behalf of Defendant Jeffrey Stein Regarding Prejudice, *United States v. Stein*, 05 Cr. 888 (June 29, 2007) (“Spears Decl.”).

18. 2007 WL 2050921 at \*24.

19. Spears Decl. at ¶¶19-23.

20. Beth Bar, “Defense Cost Estimates Offered in KPMG Case,” New York Law Journal (July 13, 2007) (detailing submissions made by defense attorneys).

21. Garcia Letter at p. 1.

22. *Id.* at p. 2.

23. 2007 WL 2050921 at \*24.

24. *Id.* at \*\*24-25.

25. Ellen S. Podgor, “The Cost of a White Collar Crime Trial,” White Collar Crime Prof Blog (June 5, 2006) (available at [http://lawprofessors.typepad.com/whitecollarcrime\\_blog/2006/06/how\\_much\\_does\\_it.html](http://lawprofessors.typepad.com/whitecollarcrime_blog/2006/06/how_much_does_it.html)).

26. \_\_FSupp2d\_\_, 2007 WL 1856927 (D. Kansas June 28, 2007).

27. See Peter J. Henning, “What It Costs to Defend a White-Collar Crime Prosecution,” White-Collar Crime Prof Blog (July 2, 2007) (available at [http://lawprofessors.typepad.com/whitecollarcrime\\_blog/defense\\_counsel/index.html](http://lawprofessors.typepad.com/whitecollarcrime_blog/defense_counsel/index.html)) (writing about the *Westar* case).

28. *Id.* at \*\*13, 15.

29. *Id.* at \*\*17-18.

30. Henning, “What It Costs to Defend a White-Collar Crime Prosecution.”