Nos. 05-3217 & 05-3218

IN THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

UNITED STATES OF AMERICA,

Plaintiff-Appellee,

v.

DOUGLAS T. LAKE and DAVID C. WITTIG,

Defendants-Appellants.

Appeal from the United States District Court
for the District of Kansas – Judge Julie A. Robinson

BRIEF *AMICUS CURIAE* OF THE ASSOCIATION OF CORPORATE COUNSEL ("ACC") IN SUPPORT OF APPELLANTS

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STATEMENT OF INTEREST

The Association of Corporate Counsel (ACC, formerly known as the American Corporate Counsel Association, or ACCA) was formed in 1982 as the bar association for in-house counsel. With over 17,500 members from over 8,000 private sector organizations in 54 countries, ACC members represent a diverse range of domestic and international public, private, and not-for-profit companies. ACC's members are employed by both large and small companies, both privately-held and publicly-traded. Its members represent 98 of the Fortune 100 companies; internationally, its members represent 74 of the Global 100 companies.

While ACC serves its members with a variety of bar association resources (including CLE, online resources, and practice committees and chapters), one of its primary missions is to act as the voice of the in-house bar on matters that concern corporate legal practice and the ability of its members to fulfill their functions as in-house legal counsel to their companies.

ACC seeks leave to file its brief *amicus curiae* because this appeal concerns matters of great importance to ACC's members and their legal representation of their clients. In-house counsel regularly advise their corporate clients about the company's decision to provide officers and directors with indemnification coverage and the advancement of legal fees when officers or directors are prosecuted for actions related to their corporate actions or status.

In addition, many of ACC's members are also corporate officers. In that capacity, those members themselves frequently enjoy the right to indemnification or defense-cost advancement under corporate articles or bylaws. As such, those members have a direct interest in the manner in which such rights are interpreted and applied in connection with criminal prosecutions. In fact, ACC's members may have a greater interest than other corporate officers in the availability of indemnification or advancement rights in appropriate circumstances. Even where corporations maintain Directors & Officers ("D&O") liability insurance, such policies may exclude or limit coverage for the actions of licensed professionals. Further, ACC surveys on indemnification and insurance of in-house lawyers suggest that only about 10% of in-house counsel are covered by some kind of employed lawyers liability insurance.

If this Court affirms the District Court's decision to deny Appellants the benefit of their company's advancement policies, it will cast doubt on a long-established and vital practice common to companies and non-profits across the country and across every industry. Since the provision of officer and director indemnification and advancement serves important public policy goals, ACC respectfully requests permission to present the Court with its view of the practical ramifications of the question presented to American corporations and their highly ranked officers and directors.

SUMMARY OF ARGUMENT

The District Court's injunction imposes what may well be an unprecedented pre-trial restraint on Appellants' rights to advancement of legal fees and expenses from their former employer, under pre-existing, generally applicable, statutorily authorized corporate policies. The District Court's order should be reversed.

Corporate indemnification and advancement rights are ubiquitous in responsible companies. As courts have recognized, such rights are essential to companies' hiring and retention of qualified officers and directors, particularly in the litigious environment in which companies currently operate. These rights are authorized by statute in virtually every state, including some States which go so far as to require that indemnification and/or advancement be provided.

Advancement rights, in particular, are designed to provide "real-time" funding to officers or directors for what may, in many instances, be a lengthy, and high-cost, criminal defense. Pre-trial restraint of such rights effectively destroys them, and will permanently and irreparably alter an executive's decisions as to choice of counsel and litigation strategy, and weaken an executive's defense of an ongoing action. For these very reasons, prosecutors may feel that they have compelling tactical reasons to seek such restraints.

In these circumstances, this Court should provide much-needed certainty and hold that advancement rights are not subjected to pre-trial restraint where those

rights are derived from generally applicable company policies, adopted independently of the hiring or retention of particular officers or directors. It cannot plausibly be argued that an individual officer's advancement rights under such generally applicable corporate policies are "derived from" or "traceable to" alleged criminal conduct within the meaning of 18 U.S.C. § 981(a)(1)(C), particularly for purposes of an extraordinary pre-trial attachment order. The District Court's order imposing such a restraint must accordingly be reversed.

ARGUMENT

I. The Grant of Indemnification and Advancement Rights to Corporate Officers and Directors Is Standard Corporate Practice, and Is Essential to the Hiring and Retention of Top-Level Corporate Officers and Directors.

It is very common for companies to indemnify corporate executives and directors operating as the company's representatives in today's litigious marketplace, and to provide for the advancement of legal fees and expenses prior to final disposition of a proceeding. Studies conducted by ACC and the National Association of Corporate Directors indicate that Directors & Officers ("D&O") liability insurance and indemnification coverage are not only benchmarks of responsible practice in sophisticated companies, but that companies that do not provide these protections have difficulty attracting or keeping high quality, sophisticated officers and directors.

The availability of these protections of individual, high-level corporate actors is critical in the litigious atmosphere facing corporate officers and directors today. Many lawsuits are filed against corporate leaders regardless of the merits of the suit, or whether the leaders were individually involved in wrongdoing or negligent behavior. *See, e.g.*, Karl E. Stauss, *Indemnification In Delaware: Balancing Policy Goals And Liabilities*, 29 DEL. J. CORP. L. 143, 148 (2004). Often such suits have little connection to the individuals named as defendants, but instead far more to do with their corporate position and function. Indeed, by virtue of their titles and positions, corporate officers and directors become targets for such actions; effectively, it is part of their job.

Even for highly-ranked corporate leaders the cost of defending often-spurious suits is prohibitively high, particularly when such suits are frequently document-intensive, and involve complex transactions or financial accounting issues. *See, e.g., Merrill Faces Issue of Enron Legal Fees: To Pay or not to Pay?*, WALL ST. J. (May 11, 2005) (reporting legal fees of $17 million in connection with criminal defense of four Merrill Lynch executives); *Some of Scrushy's Lawyers Ask Others on Team for Money Back*, WALL ST. J. (Dec. 17, 2003) (reporting legal fees of $21 million in defense of HealthSouth Corp. chairman). As this case illustrates, complex criminal actions frequently proceed in tandem with administrative enforcement actions, and civil securities fraud or

shareholders' derivative suits, which make defense of the criminal action all the more complicated. It is the very rare executive, even amongst those who are well-compensated, who can even begin to pay the fees associated with a sophisticated defense of a complicated and prolonged battle adverse to an array of prosecutors or plaintiff's counsel with virtually unlimited resources.

The potentially cataclysmic financial consequences of a lawsuit directed at a corporate officers' performance of corporate duties is well-illustrated by this case. Appellants' prosecution has already involved a ten-week trial resulting in a hung jury. Further, beyond Appellants' advancement rights, the United States also seeks forfeiture of many of Appellants' personal assets, heightening the financial squeeze.

It is for all of these reasons that many states not only condone the adoption of indemnification and advancement policies in corporate by-laws, but even mandate them. *See generally*, Kurt A. Mayr, II, *Indemnification of Directors and Officers: The "Double Whammy" of Mandatory Indemnification under Delaware Law in Waltuch v. Conticommodity Services, Inc.*, 42 VILL. L. REV. 223, 223-24 & n.4 (1997) (collecting statutes); 3A William Meade Fletcher, FLETCHER'S CYCLOPEDIA OF PRIVATE CORPORATIONS § 1344.10 (same). Indemnification policies serve important public purposes in allowing companies to attract and keep the best talent to direct the company's work. Serving at the highest levels of

American corporations – particularly publicly-traded corporations – has now become, unfortunately, a high-risk endeavor. The function of indemnification and advancement policies is to encourage excellent leaders to accept the high-risk positions they have been offered without worry that they will be bankrupted defending themselves in actions that may have nothing to do with their individual job performance, competence, or ethics. The primary benefit of indemnification and advancement policies is thus to encourage responsible leaders to assume responsible positions; their primary purpose is *not* to shield the negligent, the criminal, or the inferior executive.

Indemnification and advancement policies are increasingly important vehicles through which companies can self-insure some of their executives' potential risks. Many companies today cannot afford to purchase or continue to renew their traditional D&O insurance, the price of which has skyrocketed to exponential levels in the post-Enron, post-Sarbanes-Oxley era. *See, e.g.*, Stauss, Karl E., *Indemnification In Delaware: Balancing Policy Goals And Liabilities*, 29 DEL. J. CORP. L. 143, 144 (2004); Amalia Deligiannis, *D&O Insurance Hikes Complicate Board Matters*, CORPORATE LEGAL TIMES, at 10 (Feb. 2003). Compounding these costs are the increasing scrutiny and prosecutorial zeal typical of State attorneys general, the Department of Justice, the plaintiff's bar, and state and federal agency regulators. There is tremendous public pressure for

government and the plaintiff's bar to help ensure a more responsible corporate America by bringing to justice those corporate leaders and entities responsible for devastating financial failures in the marketplace. Indemnification and advancement policies allow companies to self-insure for the costs of their executives' legal risks without the expense of premiums, therefore limiting costs to those actually incurred when suits or other legal actions arise for which the executive is covered. When in-house legal counsel consider the options available to their companies to cover these risks, indemnification and advancement policies are an attractive – and explicitly sanctioned or even mandated – alternative.

The importance of indemnification and advancement-of-legal-expense rights to corporate officers is heightened by the fact that, under current prosecution and criminal sentencing policies, corporations are under immense pressure to actively assist the investigation and prosecution of their own officers and directors. While in some instances a company may believe that employees acted inappropriately (and therefore merit individual investigation and prosecution), in many other cases a company may feel it has little choice other than to focus attention on individual corporate actors to avoid even more significant, entity-threatening repercussions.

When allegations are made against the company and its leaders, ACC members must represent the entity and consider how best to assure that the organization will survive the charges made against it. The pressure to hand over

anything – and anyone – the government wants in order to save the company is almost overwhelming. Formal government policies give tremendous incentives to this strategy. For example, the Department of Justice's so-called "Thompson Memorandum," sets out the nine criteria that DOJ lawyers should consider when charging a company. Memorandum of Deputy Attorney General Larry D. Thompson, *Principles for Federal Prosecution of Business Organizations* (Jan. 20, 2003), *available at* http://www.usdoj.gov/ dag/cftf/ corporate_guidelines.htm. Prominent among these nine considerations are whether the company offered evidence or otherwise facilitated the prosecution of individual employees. *Id.*[1] Under the Thompson Memorandum, non-"cooperative" companies are subject to a litany of punishments, including increased penalties, the decision to name additional corporate suite and board leaders, and the decision to not engage in settlement discussions. The federal Sentencing Guidelines reinforce these same incentives.

In these circumstances, the company's only practical course of self-protection may be to offer up company leaders who were in any way involved in alleged wrongdoing or negligent behavior. A corporate executive charged with

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[1] *See also, e.g.*, Report of Investigation Pursuant to § 21(A) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions, SEC Release No. 44969 (Oct. 23, 2001), *available at* http://www.sec.gov/litigation/investreport/34-44969.htm (similarly emphasizing the importance of corporation's assistance in enforcement actions against corporate personnel).

criminal misconduct, in a prosecution in which his (former) employer is actively (although perhaps reluctantly) assisting, is truly set adrift, without the assistance or resources of the corporation on whose behalf he or she took the actions now under scrutiny. It is inequitable, and unwarranted, to suggest that companies should not only turn on charged leaders, but should also deny them the protection that indemnification and advancement of fees offers, especially when such policies were promised as a condition of employment.

II. In Particular, the Right to Advancement of Defense Expenses During the Pendency of Litigation Is Time-Sensitive, and Cannot Be Vindicated by Post-Litigation Reimbursement.

The importance of preserving corporate executives' otherwise-applicable right to a company-funded defense is particularly acute with respect to the right at issue here: the advancement of legal expenses during the pendency of a criminal prosecution. Kansas law expressly permits a corporation to pay "[e]xpenses, including attorneys fees, incurred by a director or officer in defending a * * * criminal * * * action * * * *in advance of the final disposition of such action* * * *." K.S.A. § 17-6305(3) (emphasis added). Consistent with that statutory authorization, a provision of Westar's Articles of Incorporation adopted in September 1987 provides that the right to indemnification

> shall include the right to be paid by the Corporation the expenses incurred in defending any such proceeding *in advance of its final disposition.*

Appellant's Jt. App. 266 (emphasis added).

As Appellant Lake's Brief makes clear, the right of advancement can only be vindicated if legal expenses are paid *as the litigation progresses*; otherwise, the right of advancement is rendered meaningless, and adds nothing to a right of reimbursement, or indemnification, after a successful outcome. Lake Br. 25-26 & n.6. Kansas' indemnification statute is patterned after 8 Del. C. § 145. The Delaware Supreme Court recently affirmed a trial court's refusal to stay its order mandating that a corporation advance legal expenses to a criminally charged corporate officer, finding that the trial court had made no legal error. *Homestore, Inc. v. Tafeen*, ___ A.2d ___, 2005 WL 1383348, at *4 (Del. June 8, 2005). The Supreme Court quoted at length from the lower court's ruling explaining the public policy underlying the advancement right:

> [T]he Court of Chancery found that permitting Homestore to further delay its advancement obligations would be inimical to the public policy of this State of affording advancement claimants prompt and meaningful relief * * *. The Court of Chancery stated:
>
> > "* * * Clearly, to be of any value to the executive or director, advancement must be made promptly, otherwise its benefit is forever lost because the failure to advance fees affects the counsel the director may choose and litigation strategy that the executive or director will be able to afford. To grant Homestore's motion would allow it to continue to be derelict in its contractual protection of its directors/officers, and that would force its directors/officers to compromise their own litigations in the face of cost concerns, a result that is clearly against Delaware's policy of resolving advancement issues as quickly as possible."

2005 WL 1383348, at *3.

As *Homestore* recognizes, the right to the advancement of fees on a "pay as you go" basis can only be effective if payments are timely made. *Id.*; *see also* cases cited in Lake Br. at 26 n.6. That right is of great importance to corporate officers and directors, separate and apart from any right to indemnification of legal expenses after-the-fact.

By entering its injunction denying Appellants Wittig and Lake the benefits of advancement until the prosecution is concluded, the District Court has completely destroyed that right. As Delaware caselaw recognizes, reimbursement of expenses after a successful conclusion of the prosecution cannot cure the irreparable harm inflicted by denial of Appellants' right to advancement of expenses *pendente lite*. *See also United States v. Jones*, 160 F.3d 641, 646 (10th Cir. 1998) ("the selection of one attorney over another can profoundly affect the course and outcome of trial. To improperly impede this interest would likely work a permanent deprivation on a defendant – a defendant 'needs the attorney *now* if the attorney is to do him any good.'"; citations omitted, emphasis in original).

III. The Government's Charging Decisions Cannot Be Permitted To Nullify Corporate Officers' Advancement Rights.

Boiled down to its simplest terms, in this case two executives working for a company that offered indemnification and advancement assurance in its corporate by-laws are now seeking to trigger the policy's protections because allegations of

wrongdoing – related to their corporate positions and clearly covered under the policy – have been filed against them. The government wishes to prevent them from having their costs covered (and advanced) by the company.

At one level, the government's argument to prevent advancement of defense costs appears to be based on the idea that these executives deserve no help from the company in defending themselves, because they're guilty (at least in the government's eyes). But our legal system is founded on the principle that the defendant is innocent until proven guilty; the fact that an individual has been sued, indicted or targeted for prosecution is not determinative.

The fact that a grand jury may have returned an indictment alleging the forfeitability of Appellants' advancement or indemnification rights provides little safeguard. As this Court has recognized in ordering a pre-trial hearing on forfeitability in *United States v. Jones*, 160 F.3d 641 (10th Cir. 1998):

> Although the [forfeiture] statute requires a grand jury to determine that the assets are probably traceable to the underlying offense, the nature of grand jury proceedings makes that finding susceptible to error. A grand jury investigation is not an adversarial process. For all practical purposes the prosecution directs the proceedings, and potential indictees have no ability to correct inadvertent or deliberate distortions during the grand jury's fact-finding process. "[F]airness can rarely be obtained by secret, one-sided determination of facts decisive of rights."

Id. at 646 (citations omitted).

Relying on an indictment, or even the *Jones* adversarial hearing, to negate a corporate officer's advancement-of-legal-expense rights is particularly unjust given the nature of those rights: in essence, corporate policies providing advancement are intended to provide corporate officers with insurance *for the costs of defending covered civil or criminal actions* <u>*while those actions proceed*</u>. To deny these charged executives coverage under their company's advancement policies, created for their reliance and to the company's and society's benefit, on the grounds that the executives *may* be guilty of the government's charges is contradictory to public policy and common sense. Coverage of executives' legal costs if sued or indicted is *exactly* what advancement policies are created to offer. Allowing indictment, or a *Jones* probable-cause determination, to negate such coverage nullifies company decisions to enact such policies in the first place, as well as State legislatures' endorsement (or even requirement) of such policies.

Clearly, it would make the government's job much easier if it were allowed to ensure that all corporate defendants would be cut off from the funds needed to mount a legitimate, vigorous defense. But that is not the government's decision to make, nor is it appropriate for courts to assist prosecutors in tilting the legal playing field in their favor. Such a result, nullifying protections endorsed or even mandated by state law, cannot be what Congress intended in enacting forfeiture laws, and is not in the public's best interest.

IV. This Court Should Prohibit the Pretrial Restraint of Corporate Executives' Right to Advancement of Legal Expenses under Generally Applicable Corporate Policies.

As shown above, indemnification rights in general, and advancement rights in particular, serve important public policies by allowing companies to attract and retain qualified officers and directors in what have regrettably become high-risk positions. State legislatures have recognized the value of these rights by passing, virtually unanimously, statutes that authorize – or indeed even mandate – the provision of indemnification and/or advancement of legal fees to corporate officers and directors. These rights protect responsible company personnel from potentially bankrupting liabilities for actions taken in their corporate capacities. The right of advancement of legal expenses *pendente lite* is peculiarly time-sensitive, and is effectively destroyed by a pre-trial restraint like that imposed by the District Court here. Prosecutorial discretion and grand-jury review do not provide meaningful safeguards for such advancement rights, particularly since the prosecution may believe it can obtain significant tactical advantages by cutting executives off from corporate funding of defense fees and expenses.

The United States will only be entitled to forfeiture of Appellants' advancement rights upon a showing that those rights are somehow "derived from" or "traceable to" criminal conduct. 18 U.S.C. § 981(a)(1)(C). Particularly in light of the other compelling considerations described above, ACC submits that the

United States cannot satisfy this standard – particularly for purposes of an extraordinary order of pre-trial attachment – where the advancement rights at issue arise from corporate policies which are generally applicable to all personnel holding particular positions, and have been promulgated independently of negotiations for the hiring or retention of the accused executive. In such circumstances, there simply is no plausible basis for the Government to argue that advancement rights are "derived from" or "traceable to" alleged criminal activity – to the contrary, such rights are entirely independent of the accusations in a particular case.

Prohibiting pretrial restraint of such generally applicable advancement rights would advance an additional interest implicated here: the need for certainty in the application of such corporate policies. ACC's members are all too frequently required to advise their corporate clients as to the interpretation and application of corporate indemnification and advancement rights with respect to ongoing or threatened criminal, civil, or administrative proceedings. While such advice may raise difficult legal or factual questions in a particular case, entirely independent of federal forfeiture law, this Court should avoid adding yet another layer of uncertainty to the availability of these rights.[2] Besides making it more difficult for

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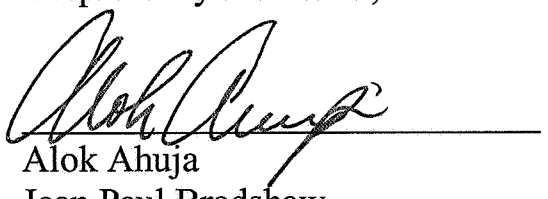
[2] Ironically, affirming the District Court's decision might suggest that a corporation which has the temerity to *honor* its indemnity and advancement

companies and their counsel to decide how to honor these corporate commitments, such added uncertainty reduces the value of such policies in the recruitment of qualified personnel, and could only make skilled and experienced individuals hesitate to take high-profile, responsible positions where litigation risks are substantial.

CONCLUSION

For the foregoing reasons, ACC respectfully requests that the Court reverse the decision below, and allow Appellants Wittig and Lake the advancement of fees to which they are entitled under Kansas law.

Respectfully submitted,



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Dated: July 12, 2005

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obligations somehow breaches a fiduciary duty to shareholders. One hesitates to think how such a ruling might be applied by an imaginative plaintiff's lawyer.

CERTIFICATE OF COMPLIANCE WITH TYPE-VOLUME LIMITATION, AND TYPEFACE AND TYPE STYLE REQUIREMENTS

I hereby certify that this brief complies with the type-volume limitation of Fed. R. App. P. 29 (d) and 32(a)(7)(B) because this brief contains 3,706 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

I further certify that this brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using the Word 2002 word processing program, in 14-point Times New Roman type style.

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CERTIFICATE OF SERVICE

I hereby certify that on July 12, 2005, two copies of the foregoing brief were served in the manner indicated below, and addressed as follows:

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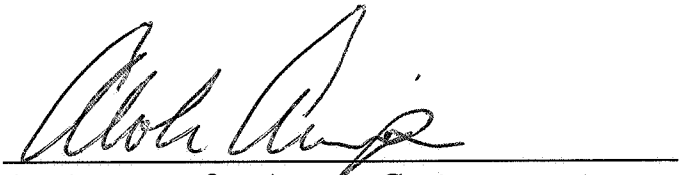
I further certify that, on July 12, 2005, the original and eight (8) copies of the foregoing brief were filed with the United States Court of Appeals for the Tenth Circuit by sending the same to the Court by Federal Express, Priority Overnight delivery, addressed to Patrick Fisher, Clerk, United States Court of Appeals for the Tenth Circuit, Byron White United States Courthouse, 1823 Stout Street, Denver, CO 80257.



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