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When Legal Bills Become a Cause for Dispute

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R. Allen Stanford has been sitting in jail in Texas since he was charged in June 2009, along with other officers of the **Stanford Financial Group**, with conspiracy, securities fraud and money laundering for running what prosecutors say was a \$7 billion Ponzi scheme. When the Securities and Exchange Commission obtained an order freezing the company's assets, Mr. Stanford could not afford to pay a lawyer to defend himself, so the federal public defender's office has been representing him.

But that may change soon. Judge David Hittner has ruled in Federal District Court in Houston that under a company insurance policy **Lloyd's of London** is responsible for paying up to nearly \$100 million for the defense of Mr. Stanford and the other officers. While that should go a long way toward paying the legal fees of the defendants, don't be surprised if the total legal bills exceed even that seemingly generous pool of money.

White-collar crime prosecutions and related civil actions are enormously expensive to defend, and defense costs can reach the tens of millions of dollars fairly quickly. One reason is the complexity of the cases, which require defense lawyers to spend months digging through piles of documents while trying to interview dozens of witnesses. It is fairly common for cases to come to trial a year or more after the criminal indictment, and there are often dozens of pretrial motions that will have been briefed and argued in that time.

And white-collar trials are usually measured in weeks, if not months, and that only compounds the expenses. Mr. Stanford's trial is set to begin in January 2011, and don't be surprised if the trial requires three months (or more) to complete.

The lawyers who work high-profile white-collar cases come from some of the leading firms in New York, Washington and elsewhere, charging steep hourly rates — there are no contingent fees in criminal matters — and staffing them with a phalanx of partners, associates and paralegals. While it was almost unknown for leading Wall Street law firms to do criminal work 30 years ago, white-collar defense is now a major source of fees and one that appears to be largely immune to the recession that has hit the firms over the past two years. When was the last time you heard about layoffs in the white-collar department?

Someone has to pay for all those lawyers, of course, and when the case involves a corporation it is usually the company that is obligated to pay for separate counsel for each of its employees who get caught up in the criminal and civil investigations and prosecutions. Companies in turn buy insurance for their directors and officers to cover at least part of the legal fees, as the Stanford Financial Group did from Lloyd's.

Corporations are usually not very happy about paying to defend former officers accused of misconduct that has dragged the corporate brand through the mud. Often, such cases result in companies agreeing to a deferred or nonprosecution agreement for the ex-officers' wrongdoing. And what insurer has ever jumped at the chance to pay out on claims for misconduct under a directors and officers insurance policy.

It seems to be more common lately for companies and insurers to resist paying for the lawyers because there is little prospect of recovering those fees if a corporate officer is found guilty. Companies usually include in their articles of incorporation or bylaws a provision requiring them to advance attorney's fees to directors, officers and employees who are caught up in investigations or charged in criminal or civil actions. Although the companies and insurers may balk, the courts — especially those in Delaware where so many large companies are incorporated — have been particularly protective of the right to advancement of legal expenses.

The costs of defending these cases can be staggering. Jeffrey K. Skilling, the former **Enron** chief executive, spent approximately \$70 million through the conclusion of his trial, and the subsequent appeals have probably pushed that total past \$100 million, with the prospect of another trial if the Supreme Court rules in his favor. A filing in the prosecution of Gregory Reyes, the former chief executive of **Brocade Communications**, showed that as of early 2008 the company paid out almost \$65 million to lawyers for various corporate officers and employees, including \$46 million for Mr. Reyes's defense in criminal and S.E.C. cases. Mr. Reyes won a new trial after an appeal, so his costs may well exceed \$100 million by the time the case is over.

Without the fee advances from the company or its insurer, defendants are usually unable to afford the lawyers who have been representing them. In the prosecution in Kansas of Douglas Lake, a former senior executive of **Westar Energy**, his New York law firm sought to withdraw when it no longer received its fees from the company and Mr. Lake was unable to afford the multimillion-dollar cost of a third trial in the case. The United States Court of Appeals for the Tenth Circuit ordered Westar to pay some of the fees, but the company continues to fight over paying Mr. Lake's lawyer as he awaits another trial.

When one considers the underfunding problem that plagues the system for indigent defense, it is difficult to feel much sympathy for white-collar defendants who seek millions of dollars to pay for their defense. At the same time, companies and insurers agreed to fund these costs, and simply hanging a former officer or employee out to dry before there has been an adjudication of guilt is hardly fair — and wouldn't cure the

problems facing indigent defendants. It is not as if companies or insurers would put that money toward hiring more lawyers for the poor.

In Mr. Stanford's case, Judge Hittner rejected the argument by Lloyd's that it did not have to pay the costs of defending the criminal and civil cases because the policy included an exclusion from coverage when the officers are charged with committing money laundering. The language of the insurance policy does not require a "final adjudication" of that issue before coverage can be terminated, so Lloyd's claimed it could decide not to pay the cost of the lawyers. Judge Hittner, however, applied a legal doctrine known as the "eight corners rule" to find that Lloyd's could not invoke this exclusion to deny coverage until there has been a final adjudication on the allegations of money laundering. For an excellent analysis of Judge Hittner's decision, see Kevin LaCroix's discussion at The D&O Diary.

Lloyd's can appeal the decision that it must pay for the Stanford defendants' lawyers to the tune of \$100 million, and such a challenge could take months to decide, so the money is not necessarily available quite yet. But the decision is one in a growing line of cases requiring the payment of attorney's fees for corporate directors, officers and employees accused of wrongdoing.

– *Peter J. Henning*

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