STATEMENT OF

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BEFORE THE UNITED STATES SENATE

COMMITTEE ON THE JUDICIARY

REGARDING THE THOMPSON MEMORANDUM'S EFFECT ON THE RIGHT TO COUNSEL IN CORPORATE INVESTIGATIONS

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Chairman Specter, Ranking Member Leahy, and Members of the Committee:

Thank you for inviting my views on the United States Department of Justice's policies and procedures for investigating suspected financial crimes by business organizations, including the Justice Department's January 2003 memorandum, *Principles of Federal Prosecution of Business Organizations*, commonly referred to as the Thompson Memorandum.[2] For the record, I served as the United States Attorney General from 1985-1988. I am currently the Ronald Reagan Distinguished Fellow in Public Policy at The Heritage Foundation and also serve as Chairman of The Heritage Foundation's Center for Legal and Judicial Studies.

The subject of today's hearing raises important questions that reach beyond waivers of the attorney-client privilege, beyond employers' payments of their employees' legal defense fees, and beyond even the Thompson Memorandum itself.[3] Thus, I am grateful to the Committee for addressing these issues, including in today's hearing.

Judge Lewis Kaplan of the United States District Court for the Southern District of New York framed the issue well in his written opinions this summer delivering two important rulings in *United States v. Stein et al.*,[4] a case involving the Justice Department's investigation and prosecution of KPMG's now-admitted tax-shelter abuses. At the outset of the first of Judge Kaplan's two opinions finding that the Thompson Memorandum, coupled with the specific conduct of the federal prosecutors, violated the Fifth and Sixth Amendment rights of twelve former KPMG employees, he addressed the fundamental duties of the government whenever it exercises its law enforcement power.

> Those who commit crimes – regardless of whether they wear white or blue collars – must be brought to justice. The government, however, has let its zeal get in the way of its judgment. It has violated the Constitution it is sworn to defend.[5]

Judge Kaplan's observation reminds me of key points made in a speech by Robert Jackson, who would later serve as an associate justice of the Supreme Court. Before he became a justice, and before he served as the chief prosecutor in the Nuremberg trials of Nazi war criminals, Robert Jackson served in President Franklin Roosevelt's Administration as Attorney General of the United States. I used this speech by Attorney General Jackson during my tenure as Attorney General because I believe its analysis and principles are timeless.

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[2] Memorandum from Larry D. Thompson, Deputy Attorney General, Department of Justice, to Heads of Department Components and United States Attorneys (January 20, 2003) ("Thompson Memorandum") (*located at* www.usdoj.gov/dag/dftf/business_organizations.pdf).

[3] I direct the Committee's attention to a forthcoming publication by my colleague at The Heritage Foundation on the subject of today's hearing. Brian W. Walsh, *What We Have Here, Is a Failure to Cooperate: The Thompson Memorandum and Federal Prosecutions of Business Organizations* (The Heritage Foundation, forthcoming).

[4] *United States v. Stein*, No. S1 05 Crim. 0888, 2006 WL 2060430 (S.D.N.Y. July 25, 2006); *United States v. Stein* ("*Stein I*"), 435 F. Supp. 2d 330 (S.D.N.Y. June 26, 2006).

[5] *Stein I*, 435 F. Supp. 2d at 336.

When he addressed a meeting of all United States Attorneys at the Justice Department in Washington in April 1940, Attorney General Jackson started by putting them in mind of the great power they wielded in their offices. "The prosecutor has more control over life, liberty, and reputation than any other person in America," Jackson said. "His discretion is tremendous." Jackson went on to enumerate some of the temptations that confront a prosecutor to misuse his power, often in subtle manners that no one would ever be able to prove wrongful even if all the objective facts were known. He admonished them to rededicate themselves "to the spirit of fair play and decency that should animate the federal prosecutor" and not to measure their success based primarily on convictions or similar statistics.

> Your positions are of such independence and importance that while you are being diligent, strict, and vigorous in law enforcement you can also afford to be just. Although the government technically loses its case, it has really won if justice has been done. The lawyer in public office is justified in seeking to leave behind him a good record. But he must remember that his most alert and severe, but just, judges will be the members of his own profession, and that lawyers rest their good opinion of each other not merely on results accomplished but on the quality of the performance.[6]

The tension that Attorney General Jackson identified between obtaining impressive conviction statistics and taking care to do justice has always confronted prosecutors and probably always will.

What does change is the type of crimes a federal prosecutor is asked to focus on. In the 1960s and 1970s, the focus was on violent crime that was increasingly making it unsafe in America to walk the streets. In the 1980s and 1990s, it was on the destructive effects illicit drugs and drug-dealing organizations were having upon our inner cities and families.

In this decade the focus is necessarily on terrorism and, particularly after the collapses of Enron and WorldCom, on white-collar crime. Nevertheless, it remains necessary to ensure that members and suspected members of whatever criminal class that the public most wants punished still receive the full benefit of the constitutional rights and fairness considerations that belong to every American.

Deferring to others to engage in a more detailed analysis of Judge Kaplan's legal conclusions, I will focus primarily on the facts of the *Stein* case as well as the relevant Justice Department policies and practices.

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[6] Robert H. Jackson, The Federal Prosecutor, Address to the United States Attorneys (Apr. 1, 1940), *available at* http://www.roberthjackson.org/Man/theman2-7-6-1/ (*originally published at* 31 J. OF CRIM. L. & CRIMINOLOGY 3 (1940)).

When an individual's constitutional rights are implicated, the government may not do indirectly – through others – what it is forbidden to do directly.[7] The Constitution would not have allowed the prosecutors in the *Stein* case to, for example, subject the KPMG defendants' bank accounts to forfeiture with the sole justification and for the sole purpose of depriving them of the money they needed to retain competent legal counsel. The Constitution would not allow the prosecutors to threaten the KPMG defendants with the loss of employment if they refused to proffer testimony during the investigation or invoked their Fifth Amendment rights.

Instead of accomplishing these ends directly, Judge Kaplan found that the prosecutors made keen use of the enormous pressure placed upon KPMG by the existence of the Thompson Memorandum and the realities of what a federal indictment may mean to a financial services firm. The indictment and swift demise of the Arthur Andersen accounting firm has taught every business organization a stern lesson: Failure to meet federal prosecutors' expectations for your cooperation in the government's criminal investigation of your employees could result in a death sentence, well before a jury is ever impaneled or opening statements are delivered at trial.

Before being indicted for its alleged wrongdoing in the Enron scandal, Arthur Andersen was an 89-year-old accounting powerhouse with annual worldwide revenues of $9.3 billion and 28,000 employees. Long before the Supreme Court reversed Andersen's conviction, the firm was gone, its partners and employees dispersed. All that remained were relatively paltry assets against which numerous litigants have asserted claims, most of which piggy-back on Justice Department allegations of Enron-related wrongdoing.

The Thompson Memorandum understandably sought to achieve the effective prosecution of white-collar crime and to prevent companies from deliberately or inadvertently obstructing the investigation and prosecution of criminal offenses by misusing the attorney-client privilege or through the payment of employees' attorney fees. Nevertheless, experience has shown that the Memorandum has resulted in the dilution of essential rights encompassed by the attorney-client relationship.

For example, the pressure on KPMG apparently came from two sources. First, the Thompson Memorandum itself pressures companies to fulfill its nine factors, including by waiving their attorney-client privilege and cutting off their employees' attorney fees. Even if no prosecutor ever mentions either factor to a company, the fact that the Thompson Memorandum requires federal prosecutors to take all nine of its factors into consideration when deciding whether to indict a business organization necessarily places great pressure on the company to

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[7] *Cf. Rutan v. Republican Party of Ill.*, 497 U.S. 62, 77-78 (1990) ("What the First Amendment precludes the government from commanding directly, it also precludes the government from accomplishing indirectly."); *Perry v. Sindermann*, 408 U.S. 593, 597 (1972) ("[I]f the government could deny a benefit to a person because of his constitutionally protected speech or associations, his exercise of those freedoms would in effect be penalized and inhibited. This would allow the government 'to produce a result which [it] could not command directly.' Such interference with constitutional rights is impermissible." (internal citation omitted)).

take these two steps.[8] As the Thompson Memorandum itself emphasizes, a "prosecutor generally has wide latitude in determining when, whom, how, and even whether to prosecute" a business organization.[9] The company and its counsel know that the prosecution team will eventually go through each of the nine factors point-by-point. Any outright 'No' in response to whether the company has cooperated with one of the factors will be glaringly apparent.[10] In light of these realities, it is no wonder that KPMG's chief in-house counsel testified at a deposition that "KPMG's objective was 'to be able to say at the right time with the right audience, we're in full compliance with the Thompson Guidelines.'"[11] Anything less might well have constituted legal malpractice.

The second source of pressure on KPMG to persuade its employees to forego their rights and cooperate with the government was the Thompson Memorandum itself. Much of the Memorandum's coercive power lies in its lack of specific, concrete language explaining how the prosecutors will decide whether to indict and what weight they will assign to the various factors. Justice Department officials may point to this lack of specificity as illustrating that the Thompson Memorandum's factors are voluntary rather than mandatory. The Memorandum does not, they might suggest, state that a company will definitely be indicted if it chooses not to waive its attorney-client privilege or to pay attorney fees for employees the Department suspects of wrongdoing.

However, the Memorandum also fails to specify which of the examples under each of its nine factors prosecutors can or may ignore, and in what circumstances. It is axiomatic that when a governmental body or agency defines rules for its own conduct that are vague and indefinite, it thereby retains to itself near-absolute discretion to act as it may choose in any given circumstance. No independent third-party is available to an indicted business organization to review whether prosecutors applied the factors in a fair and rational manner.

Companies reasonably consider each of the Thompson Memorandum factors to be mandatory. Given the Thompson Memorandum's indefiniteness about how the government will weigh its nine factors and the examples provided for each, in my judgment, corporate counsel would be irresponsible to advise their clients otherwise.

Not only are the Department's written policies on indicting business organizations coercive in their own right, Judge Kaplan found that the conduct of the prosecutors in the KPMG tax-shelter case parlayed that pressure into a method for using the firm to do what the Department could not do directly, including pressuring KPMG's partners and employees into

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[8] As one commentator recently noted, "The mandatory nature of the Thompson Memo is not lost on defense counsel, and the evidence in *Stein* illustrated this point." Stephanie A. Martz, *Report from the Front Lines: The Thompson Memo and the KPMG Tax Shelter Case*, 10 WALL ST. LAWYER No. 8, at 5, 6 (Aug. 2006).

[9] Thompson Memorandum, *supra* note 2, § II.B.

[10] *See* Martz, *supra* note 8, at 6 ("[I]t cannot be gainsaid that if a company decides to ignore any individual factor set forth in the Thompson Memo, or any subset of factors, it does so at its own peril.").

[11] *Stein I*, 435 F. Supp. 2d at 348 & n.78 (quoting deposition testimony of KPMG's chief legal officer, former United States District Judge Sven Erik Holmes).

forfeiting constitutional rights. The prosecution team planned before its first meeting with KPMG's counsel to ask several questions about the firm's plans for paying its employees' attorney fees. During the first meeting, prosecutors repeatedly returned to the subject, mentioned the Thompson Memorandum as something that must be considered in the firm's decision whether to pay fees, and at the very least strongly suggested that any decision that KPMG made to pay fees would be scrutinized closely in the prosecution team's decision whether to indict the firm.

KPMG's counsel made it clear from the start that the firm would do anything the government wanted in order to avoid indictment and that its objectives did not include protecting any current or former employees. As Judge Kaplan noted,[12] KPMG no doubt had taken to heart the lesson of Arthur Andersen. This should have caused the prosecution team to tread lightly and ensure that KPMG did not overstep the bounds of fairness or use its economic leverage over its employees in an improper manner.

Instead, when KPMG told the government that it would like to be informed whenever one of its employees was not cooperating so that, the implication was clear, KPMG could pressure them to do so, the government did just that. Judge Kaplan found several instances in which KPMG employees changed their course after the firm stated that it would cut off their attorney fees, strongly implied that it would fire them, or both. When recalcitrant witnesses whom the government reported to KPMG suddenly decided to be cooperative, prosecutors could not have failed to notice that the system was working.

The judge asserted that the government nevertheless asked for more. Dissatisfied with the language and tone of KPMG's form letter encouraging its employees to cooperate with the government investigation, prosecutors went so far as to craft language that it wanted the firm to use. The language the government wanted KPMG to use emphasized that the employees were free to meet with government investigators "without the assistance of counsel." KPMG used a version of this language in a follow-up document to its employees.

The government apparently did not encourage KPMG to inform its employees that the firm's objectives did not include protecting its employees or that KPMG and the government were, in effect, working as a team. In light of the prosecutors' expressions of displeasure that KPMG's initial form letter did not go far enough, the firm itself certainly could not afford to inform its employees of these important facts affecting their essential rights and interests.

Judge Kaplan concluded that this conduct violated the KPMG defendants' Fifth and Sixth Amendment rights. This is a simple application of the rule that prosecutors must be careful not to accomplish through others what they are forbidden to do directly.

There is now widespread feeling among business counsel that methods and tactics similar to those engaged in by the prosecutors in the KPMG tax-shelter investigation are frequently part

[12] *Id.* at 341.

of the Justice Department's standard procedures and practices in white-collar criminal investigations. A few days after the first *Stein* ruling, the Justice Department sent Judge Kaplan a short letter that speaks volumes. The media focused on the letter's request that, in order to protect the individual prosecutors' professional reputations, Judge Kaplan remove their names from his opinion. But the first sentence of the letter's second paragraph is more relevant here. It states:

> The Government appreciates the Court's acknowledgement that the prosecutors' conduct in this case was in accordance with established Department of Justice policy that had never before been addressed by a court.[13]

This admission is not surprising given recent surveys of corporate attorneys, including both in-house and outside counsel. In a survey conducted by the Association of Corporate Counsel (ACC), the National Association of Criminal Defense Lawyers (NACDL), and several other organizations that have joined together to defend the attorney-client privilege from encroachments by the federal government, approximately 75% of respondents agreed that a "culture of waiver" exists "in which governmental agencies believe it is reasonable and appropriate for them to expect a company under investigation to broadly waive [its] attorney-client privilege."[14] This survey demonstrates that waiver is at least common.

The Justice Department has criticized this survey, including in testimony by then-Deputy Associate Attorney General Robert McCallum before a House judiciary subcommittee in March. McCallum claimed that the survey's results could not be trusted because the respondents were self-selected.

Nevertheless, only the Justice Department has access to the actual numbers regarding how frequently federal prosecutors request privilege waivers and how many times companies have in fact waived, either upon request or "voluntarily." The Department has not been willing to date to collect and publish its own statistics that would allow interested parties to determine how prevalent waiver is.

The McCallum Memorandum

The Department of Justice has represented that the directive it issued in 2005 to all U.S. Attorneys and all Heads of Department Components through a memorandum from Robert McCallum[15] is a significant reform by the Justice Department to the Thompson Memorandum

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[13] Letter from Michael J. Garcia, United States Attorney, to Hon. Lewis A. Kaplan, United States District Judge 1 (June 30, 2006) (*available at* http://online.wsj.com/public/resources/documents/kpmg-20060630-letter.pdf).

[14] *White Collar Enforcement (Part I): Attorney-Client Privilege and Corporate Waivers Before the Subcomm. on Crime, Terrorism, and Homeland Sec. of the House Comm. on the Judiciary*, 108th Congress 109-112 (app., *The Decline of the Attorney-Client Privilege in the Corporate Context: Survey Results*, at 69, 71-72) (*also available at* http://www.acca.com/Surveys/attyclient2.pdf).

[15] Robert McCallum was then the Acting Deputy Attorney General.

policies in response to concerns and criticism of those policies by the legal profession and business community. I greatly appreciate the Justice Department's willingness to listen to and engage in discussion with those who disagree with or fault its policies as well as the Department's willingness to make changes that reflect the legitimate concerns that are being raised. I believe such openness has served the Department and the nation well and will continue to do so as we work toward a common solution to these concerns.

Nevertheless, it appears that the McCallum Memorandum does not represent a sufficient improvement. The main objectives of the Memorandum included providing greater uniformity, predictability, and transparency to the process that federal prosecutors use when requesting a waiver of a business organization's attorney-client privilege. But the McCallum Memorandum does nothing to address the inherently coercive nature of the Thompson Memorandum factors that take into account whether a company has waived its privilege.

As to the specifics, because the McCallum Memorandum does not require the written waiver processes established by each U.S. Attorney to be made publicly available to business organizations, companies have no better understanding today than they did before October 2005 as to whether and when they must waive privilege in order to satisfy prosecutors' expectations. Justice requires citizens to be fully informed of what the law and law enforcement officials expect so that citizens may conform their conduct to those expectations.

The McCallum Memorandum similarly fails to require any uniformity in the waiver request process among the 93 U.S. Attorneys Offices. Rather, it encourages each U.S. Attorney to adopt the procedures that he or she deems best for that local office. Presumably, at least the waivers requested in that office will conform to a fixed set of principles and procedures, but even that is not assured because the Memorandum neither requires nor recommends that a U.S. Attorney put in place any oversight or accountability mechanisms to ensure that individual prosecutors conform their practices for requesting waiver to the Office's policies.

Recommendations

- My primary recommendation on the subject of today's hearing is that the Thompson Memorandum be amended to eliminate any reference to the waiver of attorney-client privilege or work-product protections in the context of determining whether to indict a business organization. In the same manner and same context, all references in the Memorandum to a company's payment of its employees' legal fees should be eliminated. In my experience, justice is always best served when all parties to litigation are well-represented by experienced, diligent counsel. We should be deeply suspicious of anything that undermines such representation. If government action is involved, as the *Stein* case illustrates, it may well violate fundamental Fifth and Sixth Amendment rights.

- Further, the Justice Department's written policies should explicitly state that requests for waiver will not be approved apart from exceptional circumstances. Exceptional

circumstances should be limited to those that would bring into operation the well-established crime-fraud exception to the attorney-client privilege.

- In the meantime, in order for any interim reforms – such as those attempted by the McCallum Memorandum – to be meaningful, the Justice Department must make available to the public specific, uniform national policies and procedures governing waiver requests. All requests for waiver by federal prosecutors and other Justice Department officials should require approval at the national level. Only published national procedures and national oversight can ensure that the waiver request process is uniform, predictable, and transparent.

- In order to promote the responsible use of waiver requests – as well as to counter the culture of waiver – the Justice Department should collect and publish statistics on how often waiver is requested, how often business organizations agree to such requests, and how often organizations waive even apart from any request from prosecutors.

Hearings such as this are of great value. They convey the sense of Congress's views to the Justice Department on the inestimable importance of the attorney-client relationship as it has been constituted by centuries of Anglo-American law and on the proper policies and practices for enforcing our white-collar criminal laws.

Thank you for inviting me to share my views.