704 Indemnifying Your Officers, Directors, & Employees

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Faculty Biographies

Laura Ariane Miller

Laura Ariane Miller chairs the government investigations and white-collar defense practice at the law firm of Nixon Peabody LLP. Ms. Miller specializes in internal investigations and the white-collar defense of civil and criminal allegations against corporations, corporate executives, and high-profile individual defendants. She has extensive experience in all facets of criminal litigation, including investigations, grand jury practice, motions practice, and trials.

Prior to joining Nixon Peabody, Ms. Miller was deputy commissioner of the United States Administration for Children, Youth, and Families, and special assistant to the secretary of the U.S. Department of Health and Human Services.

Ms. Miller was selected as one of the top 20 litigators in Washington DC by Legal Times. She was named by Washingtonian Magazine as one of the top "Go To" litigators in Washington DC. She has also been named a "Star of the Bar" by the Women's Bar Association. Laurie has chaired the criminal litigation committee of the ABA. She has also served as a commissioner of the Justice Kennedy Commission and is on the executive committee of the Yale Law School Association.

Ms. Miller is a Phi Beta Kappa graduate of the University of Michigan. She received her advanced degree from the John F. Kennedy School of Government at Harvard University where she was class marshal, and her J.D. from the Yale Law School where she won the John Fletcher Caskey Prize.

Monica J. Palko

Monica J. Palko is associate corporate counsel - litigation for BearingPoint, Inc. in the company's headquarters office in McLean, Virginia. Her responsibilities include managing many of the company's major commercial litigation matters. These include contract disputes, regarding for example software integration, as well as corporate matters, and internal investigations. Ms. Palko is also responsible for managing BearingPoint's fee advancement and indemnification issues, whatever the underlying claim.

Prior to joining BearingPoint, Ms. Palko was a trial attorney in the commercial litigation branch of the U.S. Department of Justice in Washington, DC. While at the Department of Justice, Ms. Palko handled claims against the United States in a variety of substantive areas, including government contracts, international trade, and personnel management. Prior to joining the Department of Justice, Ms. Palko was an attorney with Bracewell & Giuliani, LLP (then Bracewell & Patterson) where she handled environmental and commercial litigation.

Ms. Palko received her B.A. from Hendrix College and her law degree from George Washington University.

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Table of Documents for ACC Program on Indemnification of Legal Fees

1. Thompson Memorandum (January 20, 2003)
2. Holder Memorandum (June 16, 1999)
3. U.S. Attorneys Manual, Sections 9-27.600, "Entering into Non-prosecution Agreements in Return for Cooperation – Generally" and 9-27.620, "Entering into Non-prosecution Agreements in Return for Cooperation – Considerations to be Weighed"
4. 2004 Federal Sentencing Guidelines, § 8C2.5, Culpability Score, with commentary relating to waiver of attorney-client privilege and of work product protections
5. News Release, *U.S. Sentencing Commission Votes to Amend Guidelines*, deleting 2004 commentary relating to waiver of attorney-client privilege and of work product protections (April 11, 2006)

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6. *Memorandum and Order*, Judge Lewis A. Kaplan, calling for a hearing May 8 on the question of advancement of legal fees (April 18, 2006)
7. *Government's Supplemental Memorandum on Issues Concerning the Defendants' Right to Counsel*, Michael J. Garcia, U.S. Attorney (April 27, 2006)
8. *Amended Motion of the Securities Industry Association, the Association of Corporate Counsel, the Bond Market Association, and the Chamber of Commerce of the United States of America for Leave to File Brief Amici Curiae*, Howard M. Shapiro of Wilmer Cutler Pickering Hale & Dorr LLP, Washington, DC (May 3, 2006)
9. *Defendants' (Amended) Pre-hearing Memorandum*, David Spears of Richards Spears Kibbe & Orbe LLP, New York, NY (May 7, 2006)
10. *Government's Post-hearing Memorandum on Issues Concerning the Defendants' Right to Counsel*, with Appendix, Michael J. Garcia, U.S. Attorney (May 22, 2006)
11. *Brief of Amici Curiae of the New York Council of Defense Lawyers and the National Association of Criminal Defense Lawyers*, Lewis J. Liman of Cleary Gottlieb Steen & Hamilton LLP, New York, NY (May 22, 2006)
12. *Supplemental Brief for Amici Curiae the Securities Industry Association, the Association of Corporate Counsel, the Bond Market Association, and the Chamber of Commerce of the United States of America*, Howard M. Shapiro of Wilmer Cutler Pickering Hale & Dorr LLP, Washington, DC (May 22, 2006)

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13. *Memorandum of Non-party KPMG LLP Submitted at the Invitation of the Court Regarding Certain Issues Relating to Defendants' Fee Advancement Motion*, Charles A. Stillman of Stillman, Friedman & Shechtman, PC, New York, NY (May 25, 2006)

14. *Opinion*, Judge Lewis A. Kaplan (June 26, 2006)

U.S. Department of Justice

Office of the Deputy Attorney General

The Deputy Attorney General

Washington, D.C. 20530

January 20, 2003

MEMORANDUM

TO: Heads of Department Components
United States Attorneys

FROM: Larry D. Thompson
Deputy Attorney General

SUBJECT: Principles of Federal Prosecution of Business Organizations

As the Corporate Fraud Task Force has advanced in its mission, we have confronted certain issues in the principles for the federal prosecution of business organizations that require revision in order to enhance our efforts against corporate fraud. While it will be a minority of cases in which a corporation or partnership is itself subjected to criminal charges, prosecutors and investigators in every matter involving business crimes must assess the merits of seeking the conviction of the business entity itself.

Attached to this memorandum are a revised set of principles to guide Department prosecutors as they make the decision whether to seek charges against a business organization. These revisions draw heavily on the combined efforts of the Corporate Fraud Task Force and the Attorney General's Advisory Committee to put the results of more than three years of experience with the principles into practice.

The main focus of the revisions is increased emphasis on and scrutiny of the authenticity of a corporation's cooperation. Too often business organizations, while purporting to cooperate with a Department investigation, in fact take steps to impede the quick and effective exposure of the complete scope of wrongdoing under investigation. The revisions make clear that such conduct should weigh in favor of a corporate prosecution. The revisions also address the efficacy of the corporate governance mechanisms in place within a corporation, to ensure that these measures are truly effective rather than mere paper programs.

Further experience with these principles may lead to additional adjustments. I look forward to hearing comments about their operation in practice. Please forward any comments to Christopher Wray, the Principal Associate Deputy Attorney General, or to Andrew Hruska, my Senior Counsel.

Federal Prosecution of Business Organizations[1]

I. Charging a Corporation: General

A. General Principle: Corporations should not be treated leniently because of their artificial nature nor should they be subject to harsher treatment. Vigorous enforcement of the criminal laws against corporate wrongdoers, where appropriate results in great benefits for law enforcement and the public, particularly in the area of white collar crime. Indicting corporations for wrongdoing enables the government to address and be a force for positive change of corporate culture, alter corporate behavior, and prevent, discover, and punish white collar crime.

B. Comment: In all cases involving corporate wrongdoing, prosecutors should consider the factors discussed herein. First and foremost, prosecutors should be aware of the important public benefits that may flow from indicting a corporation in appropriate cases. For instance, corporations are likely to take immediate remedial steps when one is indicted for criminal conduct that is pervasive throughout a particular industry, and thus an indictment

often provides a unique opportunity for deterrence on a massive scale. In addition, a corporate indictment may result in specific deterrence by changing the culture of the indicted corporation and the behavior of its employees. Finally, certain crimes that carry with them a substantial risk of great public harm, e.g., environmental crimes or financial frauds, are by their nature most likely to be committed by businesses, and there may, therefore, be a substantial federal interest in indicting the corporation.

Charging a corporation, however, does not mean that individual directors, officers, employees, or shareholders should not also be charged. Prosecution of a corporation is not a substitute for the prosecution of criminally culpable individuals within or without the corporation. Because a corporation can act only through individuals, imposition of individual criminal liability may provide the strongest deterrent against future corporate wrongdoing. Only rarely should provable individual culpability not be pursued, even in the face of offers of corporate guilty pleas.

Corporations are "legal persons," capable of suing and being sued, and capable of committing crimes. Under the doctrine of *respondeat superior*, a corporation may be held criminally liable for the illegal acts of its directors, officers, employees, and agents. To hold a corporation liable for these actions, the government must establish that the corporate agent's actions (i) were within the scope of his duties and (ii) were intended, at least in part, to benefit the corporation. In all cases involving wrongdoing by corporate agents, prosecutors should consider the corporation, as well as the responsible individuals, as potential criminal targets.

Agents, however, may act for mixed reasons -- both for self-aggrandizement (both direct and indirect) and for the benefit of the corporation, and a corporation may be held liable as long as one motivation of its agent is to benefit the corporation. In *United States v. Automated Medical Laboratories*, 770 F.2d 399 (4th Cir. 1985), the court affirmed the corporation's conviction for the actions of a subsidiary's employee despite its claim that the employee was acting for his own benefit, namely his "ambitious nature and his desire to ascend the corporate ladder." The court stated, "*Partucci* was clearly acting in part to benefit AML since his advancement within the corporation depended on AML's well-being and its lack of difficulties with the FDA." Similarly, in *United States v. Cincotta*, 689 F.2d 238, 241-42 (1st Cir. 1982), the court held, "criminal liability may be imposed on the corporation only where the agent is acting within the scope of his employment. That, in turn, requires that the agent be performing acts of the kind which he is authorized to perform, and those acts must be motivated -- at least in part -- by an intent to benefit the corporation." Applying this test, the court upheld the corporation's conviction, notwithstanding the substantial personal benefit reaped by its miscreant agents, because the fraudulent scheme required money to pass through the corporation's treasury and the fraudulently obtained goods were resold to the corporation's customers in the corporation's name. As the court concluded, "Mystic--not the individual defendants--was making money by selling oil that it had not paid for."

Moreover, the corporation need not even necessarily profit from its agent's actions for it to be held liable. In *Automated Medical Laboratories*, the Fourth Circuit stated:

> [B]enefit is not a "touchstone of criminal corporate liability; benefit at best is an evidential, not an operative, fact." Thus, whether the agent's actions ultimately redounded to the benefit of the corporation is less significant than whether the agent acted with the intent to benefit the corporation. The basic purpose of requiring that an agent have acted with the intent to benefit the corporation, however, is to insulate the corporation from criminal liability for actions of its agents which be inimical to the interests of the corporation or which may have been undertaken solely to advance the interests of that agent or of a party other than the corporation.

770 F.2d at 407 (emphasis added; quoting *Old Monastery Co. v. United States*, 147 F.2d 905, 908 (4th Cir.), cert. denied, 326 U.S. 734 (1945)).

II. Charging a Corporation: Factors to Be Considered

A. General Principle: Generally, prosecutors should apply the same factors in determining whether to charge a corporation as they do with respect to individuals. *See* USAM § 9-27.220, *et seq.* Thus, the prosecutor should weigh all of the factors normally considered in the sound exercise of prosecutorial judgment: the sufficiency of the evidence; the likelihood of success at trial,; the probable deterrent, rehabilitative, and other consequences of conviction; and the adequacy of noncriminal approaches. *See* id. However, due to the nature of the corporate "person," some additional factors are present. In conducting an investigation, determining whether to bring

charges, and negotiating plea agreements, prosecutors should consider the following factors in reaching a decision as to the proper treatment of a corporate target:

1. the nature and seriousness of the offense, including the risk of harm to the public, and applicable policies and priorities, if any, governing the prosecution of corporations for particular categories of crime (*see* section III, *infra*);

2. the pervasiveness of wrongdoing within the corporation, including the complicity in, or condonation of, the wrongdoing by corporate management (*see* section IV, *infra*);

3. the corporation's history of similar conduct, including prior criminal, civil, and regulatory enforcement actions against it (*see* section V, *infra*);

4. the corporation's timely and voluntary disclosure of wrongdoing and its willingness to cooperate in the investigation of its agents, including, if necessary, the waiver of corporate attorney-client and work product protection (*see* section VI, *infra*);

5. the existence and adequacy of the corporation's compliance program (*see* section VII, *infra*);

6. the corporation's remedial actions, including any efforts to implement an effective corporate compliance program or to improve an existing one, to replace responsible management, to discipline or terminate wrongdoers, to pay restitution, and to cooperate with the relevant government agencies (*see* section VIII, *infra*);

7. collateral consequences, including disproportionate harm to shareholders, pension holders and employees not proven personally culpable and impact on the public arising from the prosecution (*see* section IX, *infra*); and

8. the adequacy of the prosecution of individuals responsible for the corporation's malfeasance;

9. the adequacy of remedies such as civil or regulatory enforcement actions (*see section X, infra*).

B. Comment: As with the factors relevant to charging natural persons, the foregoing factors are intended to provide guidance rather than to mandate a particular result. The factors listed in this section are intended to be illustrative of those that should be considered and not a complete or exhaustive list. Some or all of these factors may or may not apply to specific cases, and in some cases one factor may override all others. The nature and seriousness of the offense may be such as to warrant prosecution regardless of the other factors. Further, national law enforcement policies in various enforcement areas may require that more or less weight be given to certain of these factors than to others.

In making a decision to charge a corporation, the prosecutor generally has wide latitude in determining when, whom, how, and even whether to prosecute for violations of Federal criminal law. In exercising that discretion, prosecutors should consider the following general statements of principles that summarize appropriate considerations to be weighed and desirable practices to be followed in discharging their prosecutorial responsibilities. In doing so, prosecutors should ensure that the general purposes of the criminal law -- assurance of warranted punishment, deterrence of further criminal conduct, protection of the public from dangerous and fraudulent conduct, rehabilitation of offenders, and restitution for victims and affected communities -- are adequately met, taking into account the special nature of the corporate "person."

III. Charging a Corporation: Special Policy Concerns

A. General Principle: The nature and seriousness of the crime, including the risk of harm to the public from the criminal conduct, are obviously primary factors in determining whether to charge a corporation. In addition, corporate conduct, particularly that of national and multi-national corporations, necessarily intersects with federal economic, taxation, and criminal law enforcement policies. In applying these principles, prosecutors must consider the practices and policies of the appropriate Division of the Department, and must comply with those policies to the extent required.

B. Comment: In determining whether to charge a corporation, prosecutors should take into account federal law enforcement priorities as discussed above. *See* USAM § 9-27-230. In addition, however, prosecutors must be aware of the specific policy goals and incentive programs established by the respective Divisions and regulatory agencies. Thus, whereas natural persons may be given incremental degrees of credit (ranging from immunity to lesser charges to sentencing considerations) for turning themselves in, making statements against their penal interest, and cooperating in the government's investigation of their own and others' wrongdoing, the same approach may not be appropriate in all circumstances with respect to corporations. As an example, it is entirely proper in many investigations for a prosecutor to consider the corporation's pre-indictment conduct, *e.g.*,voluntary disclosure, cooperation, remediation or restitution, in determining whether to seek an indictment. However, this would not necessarily be appropriate in an antitrust investigation, in which antitrust violations, by definition, go to the heart of the corporation's business and for which the Antitrust Division has therefore established a firm policy, understood in the business community, that credit should not be given at the charging stage for a compliance program and that amnesty is available only to the first corporation to make full disclosure to the government. As another example, the Tax Division has a strong preference for prosecuting responsible individuals, rather than entities, for corporate tax offenses. Thus, in determining whether or not to charge a corporation, prosecutors should consult with the Criminal, Antitrust, Tax, and Environmental and Natural Resources Divisions, if appropriate or required.

IV. Charging a Corporation: Pervasiveness of Wrongdoing Within the Corporation

A. General Principle: A corporation can only act through natural persons, and it is therefore held responsible for the acts of such persons fairly attributable to it. Charging a corporation for even minor misconduct may be appropriate where the wrongdoing was pervasive and was undertaken by a large number of employees or by all the employees in a particular role within the corporation, *e.g.*, salesmen or procurement officers, or was condoned by upper management. On the other hand, in certain limited circumstances, it may not be appropriate to impose liability upon a corporation, particularly one with a compliance program in place, under a strict *respondeat superior* theory for the single isolated act of a rogue employee. There is, of course, a wide spectrum between these two extremes, and a prosecutor should exercise sound discretion in evaluating the pervasiveness of wrongdoing within a corporation.

B. Comment: Of these factors, the most important is the role of management. Although acts of even low-level employees may result in criminal liability, a corporation is directed by its management and management is responsible for a corporate culture in which criminal conduct is either discouraged or tacitly encouraged. As stated in commentary to the Sentencing Guidelines:

> Pervasiveness [is] case specific and [will] depend on the number, and degree of responsibility, of individuals [with] substantial authority ... who participated in, condoned, or were willfully ignorant of the offense. Fewer individuals need to be involved for a finding of pervasiveness if those individuals exercised a relatively high degree of authority. Pervasiveness can occur either within an organization as a whole or within a unit of an organization.

USSG §8C2.5, comment. (n. 4).

V. Charging a Corporation: The Corporation's Past History

A. General Principle: Prosecutors may consider a corporation's history of similar conduct, including prior criminal, civil, and regulatory enforcement actions against it, in determining whether to bring criminal charges.

B. Comment: A corporation, like a natural person, is expected to learn from its mistakes. A history of similar conduct may be probative of a corporate culture that encouraged, or at least condoned, such conduct, regardless of any compliance programs. Criminal prosecution of a corporation may be particularly appropriate where the corporation previously had been subject to non-criminal guidance, warnings, or sanctions, or previous criminal charges, and yet it either had not taken adequate action to prevent future unlawful conduct or had continued to engage in the conduct in spite of the warnings or enforcement actions taken against it. In making this determination, the corporate structure itself, *e.g.*, subsidiaries or operating divisions, should be ignored, and enforcement actions taken against the corporation or any of its divisions, subsidiaries, and affiliates should be considered. *See* USSG § 8C2.5(c) & comment. (n. 6).

VI. Charging a Corporation: Cooperation and Voluntary Disclosure

A. General Principle: In determining whether to charge a corporation, that corporation's timely and voluntary disclosure of wrongdoing and its willingness to cooperate with the government's investigation may be relevant factors. In gauging the extent of the corporation's cooperation, the prosecutor may consider the corporation's willingness to identify the culprits within the corporation, including senior executives; to make witnesses available; to disclose the complete results of its internal investigation; and to waive attorney-client and work product protection.

B. Comment: In investigating wrongdoing by or within a corporation, a prosecutor is likely to encounter several obstacles resulting from the nature of the corporation itself. It will often be difficult to determine which individual took which action on behalf of the corporation. Lines of authority and responsibility may be shared among operating divisions or departments, and records and personnel may be spread throughout the United States or even among several countries. Where the criminal conduct continued over an extended period of time, the culpable or knowledgeable personnel may have been promoted, transferred, or fired, or they may have quit or retired. Accordingly, a corporation's cooperation may be critical in identifying the culprits and locating relevant evidence.

In some circumstances, therefore, granting a corporation immunity or amnesty or pretrial diversion may be considered in the course of the government's investigation. In such circumstances, prosecutors should refer to the principles governing non-prosecution agreements generally. *See* USAM § 9-27.600-650. These principles permit a non prosecution agreement in exchange for cooperation when a corporation's "timely cooperation appears to be necessary to the public interest and other means of obtaining the desired cooperation are unavailable or would not be effective." Prosecutors should note that in the case of national or multi-national corporations, multi-district or global agreements may be necessary. Such agreements may only be entered into with the approval of each affected district or the appropriate Department official. *See* USAM §9-27.641.

In addition, the Department, in conjunction with regulatory agencies and other executive branch departments, encourages corporations, as part of their compliance programs, to conduct internal investigations and to disclose their findings to the appropriate authorities. Some agencies, such as the SEC and the EPA, as well as the Department's Environmental and Natural Resources Division, have formal voluntary disclosure programs in which self-reporting, coupled with remediation and additional criteria, may qualify the corporation for amnesty or reduced sanctions.[2] Even in the absence of a formal program, prosecutors may consider a corporation's timely and voluntary disclosure in evaluating the adequacy of the corporation's compliance program and its management's commitment to the compliance program. However, prosecution and economic policies specific to the industry or statute may require prosecution notwithstanding a corporation's willingness to cooperate. For example, the Antitrust Division offers amnesty only to the first corporation to agree to cooperate. This creates a strong incentive for corporations participating in anti-competitive conduct to be the first to cooperate. In addition, amnesty, immunity, or reduced sanctions may not be appropriate where the corporation's business is permeated with fraud or other crimes.

One factor the prosecutor may weigh in assessing the adequacy of a corporation's cooperation is the completeness of its disclosure including, if necessary, a waiver of the attorney-client and work product protections, both with respect to its internal investigation and with respect to communications between specific officers, directors and employees and counsel. Such waivers permit the government to obtain statements of possible witnesses, subjects, and targets, without having to negotiate individual cooperation or immunity agreements. In addition, they are often critical in enabling the government to evaluate the completeness of a corporation's voluntary disclosure and cooperation. Prosecutors may, therefore, request a waiver in appropriate circumstances.[3] The Department does not, however, consider waiver of a corporation's attorney-client and work product protection an absolute requirement, and prosecutors should consider the willingness of a corporation to waive such protection when necessary to provide timely and complete information as one factor in evaluating the corporation's cooperation.

Another factor to be weighed by the prosecutor is whether the corporation appears to be protecting its culpable employees and agents. Thus, while cases will differ depending on the circumstances, a corporation's promise of support to culpable employees and agents, either through the advancing of attorneys fees,[4] through retaining the employees without sanction for their misconduct, or through providing information to the employees about the government's investigation pursuant to a joint defense agreement, may be considered by the prosecutor in weighing the extent and value of a corporation's cooperation. By the same token, the prosecutor

should be wary of attempts to shield corporate officers and employees from liability by a willingness of the corporation to plead guilty.

Another factor to be weighed by the prosecutor is whether the corporation, while purporting to cooperate, has engaged in conduct that impedes the investigation (whether or not rising to the level of criminal obstruction). Examples of such conduct include: overly broad assertions of corporate representation of employees or former employees; inappropriate directions to employees or their counsel, such as directions not to cooperate openly and fully with the investigation including, for example, the direction to decline to be interviewed; making presentations or submissions that contain misleading assertions or omissions; incomplete or delayed production of records; and failure to promptly disclose illegal conduct known to the corporation.

Finally, a corporation's offer of cooperation does not automatically entitle it to immunity from prosecution. A corporation should not be able to escape liability merely by offering up its directors, officers, employees, or agents as in lieu of its own prosecution. Thus, a corporation's willingness to cooperate is merely one relevant factor, that needs to be considered in conjunction with the other factors, particularly those relating to the corporation's past history and the role of management in the wrongdoing.

VII. Charging a Corporation: Corporate Compliance Programs

A. General Principle: Compliance programs are established by corporate management to prevent and to detect misconduct and to ensure that corporate activities are conducted in accordance with all applicable criminal and civil laws, regulations, and rules. The Department encourages such corporate self-policing, including voluntary disclosures to the government of any problems that a corporation discovers on its own. However, the existence of a compliance program is not sufficient, in and of itself, to justify not charging a corporation for criminal conduct undertaken by its officers, directors, employees, or agents. Indeed, the commission of such crimes in the face of a compliance program may suggest that the corporate management is not adequately enforcing its program. In addition, the nature of some crimes, *e.g.*, antitrust violations, may be such that national law enforcement policies mandate prosecutions of corporations notwithstanding the existence of a compliance program.

B. Comment: A corporate compliance program, even one specifically prohibiting the very conduct in question, does not absolve the corporation from criminal liability under the doctrine of *respondeat superior. See United States v. Basic Construction Co.*, 711 F.2d 570 (4th Cir. 1983) ("a corporation may be held criminally responsible for antitrust violations committed by its employees if they were acting within the scope of their authority, or apparent authority, and for the benefit of the corporation, even if... such acts were against corporate policy or express instructions."). In *United States v. Hilton Hotels Corp.*, 467 F.2d 1000 (9th Cir. 1972), *cert. denied,* 409 U.S. 1125 (1973), the Ninth Circuit affirmed antitrust liability based upon a purchasing agent for a single hotel threatening a single supplier with a boycott unless it paid dues to a local marketing association, even though the agent's actions were contrary to corporate policy and directly against express instructions from his superiors. The court reasoned that Congress, in enacting the Sherman Antitrust Act, "intended to impose liability upon business entities for the acts of those to whom they choose to delegate the conduct of their affairs, thus stimulating a maximum effort by owners and managers to assure adherence by such agents to the requirements of the Act."[5] It concluded that "general policy statements" and even direct instructions from the agent's superiors were not sufficient; "Appellant could not gain exculpation by issuing general instructions without undertaking to enforce those instructions by means commensurate with the obvious risks." *See also United States v. Beusch,* 596 F.2d 871, 878 (9th Cir. 1979) ("[A] corporation may be liable for the acts of its employees done contrary to express instructions and policies, but ... the existence of such instructions and policies may be considered in determining whether the employee in fact acted to benefit the corporation."); *United States v. American Radiator & Standard Sanitary Corp.*, 433 F.2d 174 (3rd Cir. 1970) (affirming conviction of corporation based upon its officer's participation in price-fixing scheme, despite corporation's defense that officer's conduct violated its "rigid anti-fraternization policy" against any socialization (and exchange of price information) with its competitors; "When the act of the agent is within the scope of his employment or his apparent authority, the corporation is held legally responsible for it, although what he did may be contrary to his actual instructions and may be unlawful.").

While the Department recognizes that no compliance program can ever prevent all criminal activity by a corporation's employees, the critical factors in evaluating any program are whether the program is adequately designed for maximum effectiveness in preventing and detecting wrongdoing by employees and whether corporate management is enforcing the program or is tacitly encouraging or pressuring employees to engage in misconduct to achieve business objectives. The Department has no formal guidelines for corporate compliance programs. The fundamental questions any prosecutor should ask are: "Is the corporation's compliance program well designed?" and "Does the corporation's compliance program work?" In answering these questions, the prosecutor should consider the comprehensiveness of the compliance program; the extent and pervasiveness of the criminal conduct; the number and level of the corporate employees involved; the seriousness, duration, and frequency of the misconduct; and any remedial actions taken by the corporation, including restitution, disciplinary action, and revisions to corporate compliance programs.[6] Prosecutors should also consider the promptness of any disclosure of wrongdoing to the government and the corporation's cooperation in the government's investigation. In evaluating compliance programs, prosecutors may consider whether the corporation has established corporate governance mechanisms that can effectively detect and prevent misconduct. For example, do the corporation's directors exercise independent review over proposed corporate actions rather than unquestioningly ratifying officers' recommendations; are the directors provided with information sufficient to enable the exercise of independent judgment, are internal audit functions conducted at a level sufficient to ensure their independence and accuracy and have the directors established an information and reporting system in the organization reasonable designed to provide management and the board of directors with timely and accurate information sufficient to allow them to reach an informed decision regarding the organization's compliance with the law. *In re: Caremark,* 698 A.2d 959 (Del. Ct. Chan. 1996).

Prosecutors should therefore attempt to determine whether a corporation's compliance program is merely a "paper program" or whether it was designed and implemented in an effective manner. In addition, prosecutors should determine whether the corporation has provided for a staff sufficient to audit, document, analyze, and utilize the results of the corporation's compliance efforts. In addition, prosecutors should determine whether the corporation's employees are adequately informed about the compliance program and are convinced of the corporation's commitment to it. This will enable the prosecutor to make an informed decision as to whether the corporation has adopted and implemented a truly effective compliance program that, when consistent with other federal law enforcement policies, may result in a decision to charge only the corporation's employees and agents.

Compliance programs should be designed to detect the particular types of misconduct most likely to occur in a particular corporation's line of business. Many corporations operate in complex regulatory environments outside the normal experience of criminal prosecutors. Accordingly, prosecutors should consult with relevant federal and state agencies with the expertise to evaluate the adequacy of a program's design and implementation. For instance, state and federal banking, insurance, and medical boards, the Department of Defense, the Department of Health and Human Services, the Environmental Protection Agency, and the Securities and Exchange Commission have considerable experience with compliance programs and can be very helpful to a prosecutor in evaluating such programs. In addition, the Fraud Section of the Criminal Division, the Commercial Litigation Branch of the Civil Division, and the Environmental Crimes Section of the Environment and Natural Resources Division can assist U.S. Attorneys' Offices in finding the appropriate agency office and in providing copies of compliance programs that were developed in previous cases.

VIII. Charging a Corporation: Restitution and Remediation

A. General Principle: Although neither a corporation nor an individual target may avoid prosecution merely by paying a sum of money, a prosecutor may consider the corporation's willingness to make restitution and steps already taken to do so. A prosecutor may also consider other remedial actions, such as implementing an effective corporate compliance program, improving an existing compliance program, and disciplining wrongdoers, in determining whether to charge the corporation.

B. Comment: In determining whether or not a corporation should be prosecuted, a prosecutor may consider whether meaningful remedial measures have been taken, including employee discipline and full restitution.[7] A corporation's response to misconduct says much about its willingness to ensure that such misconduct does not recur. Thus, corporations that fully recognize the seriousness of their misconduct and accept responsibility for it should be taking steps to implement the personnel, operational, and organizational changes necessary to establish an awareness among employees that criminal conduct will not be tolerated. Among the factors prosecutors should consider and weigh are whether the corporation appropriately disciplined the wrongdoers and disclosed information concerning their illegal conduct to the government.

Employee discipline is a difficult task for many corporations because of the human element involved and sometimes because of the seniority of the employees concerned. While corporations need to be fair to their employees, they must also be unequivocally committed, at all levels of the corporation, to the highest standards of

legal and ethical behavior. Effective internal discipline can be a powerful deterrent against improper behavior by a corporation's employees. In evaluating a corporation's response to wrongdoing, prosecutors may evaluate the willingness of the corporation to discipline culpable employees of all ranks and the adequacy of the discipline imposed. The prosecutor should be satisfied that the corporation's focus is on the integrity and credibility of its remedial and disciplinary measures rather than on the protection of the wrongdoers.

In addition to employee discipline, two other factors used in evaluating a corporation's remedial efforts are restitution and reform. As with natural persons, the decision whether or not to prosecute should not depend upon the target's ability to pay restitution. A corporation's efforts to pay restitution even in advance of any court order is, however, evidence of its "acceptance of responsibility" and, consistent with the practices and policies of the appropriate Division of the Department entrusted with enforcing specific criminal laws, may be considered in determining whether to bring criminal charges. Similarly, although the inadequacy of a corporate compliance program is a factor to consider when deciding whether to charge a corporation, that corporation's quick recognition of the flaws in the program and its efforts to improve the program are also factors to consider.

IX. Charging a Corporation: Collateral Consequences

A. General Principle: Prosecutors may consider the collateral consequences of a corporate criminal conviction in determining whether to charge the corporation with a criminal offense.

B. Comment: One of the factors in determining whether to charge a natural person or a corporation is whether the likely punishment is appropriate given the nature and seriousness of the crime. In the corporate context, prosecutors may take into account the possibly substantial consequences to a corporation's officers, directors, employees, and shareholders, many of whom may, depending on the size and nature (e.g., publicly vs. closely held) of the corporation and their role in its operations, have played no role in the criminal conduct, have been completely unaware of it, or have been wholly unable to prevent it. Prosecutors should also be aware of non-penal sanctions that may accompany a criminal charge, such as potential suspension or debarment from eligibility for government contracts or federal funded programs such as health care. Whether or not such non-penal sanctions are appropriate or required in a particular case is the responsibility of the relevant agency, a decision that will be made based on the applicable statutes, regulations, and policies.

Virtually every conviction of a corporation, like virtually every conviction of an individual, will have an impact on innocent third parties, and the mere existence of such an effect is not sufficient to preclude prosecution of the corporation. Therefore, in evaluating the severity of collateral consequences, various factors already discussed, such as the pervasiveness of the criminal conduct and the adequacy of the corporation's compliance programs, should be considered in determining the weight to be given to this factor. For instance, the balance may tip in favor of prosecuting corporations in situations where the scope of the misconduct in a case is widespread and sustained within a corporate division (or spread throughout pockets of the corporate organization). In such cases, the possible unfairness of visiting punishment for the corporation's crimes upon shareholders may be of much less concern where those shareholders have substantially profited, even unknowingly, from widespread or pervasive criminal activity. Similarly, where the top layers of the corporation's management or the shareholders of a closely-held corporation were engaged in or aware of the wrongdoing and the conduct at issue was accepted as a way of doing business for an extended period, debarment may be deemed not collateral, but a direct and entirely appropriate consequence of the corporation's wrongdoing.

The appropriateness of considering such collateral consequences and the weight to be given them may depend on the special policy concerns discussed in section III, *supra*.

X. Charging a Corporation: Non-Criminal Alternatives

A. General Principle: Although non-criminal alternatives to prosecution often exist, prosecutors may consider whether such sanctions would adequately deter, punish, and rehabilitate a corporation that has engaged in wrongful conduct. In evaluating the adequacy of non-criminal alternatives to prosecution, *e.g.*, civil or regulatory enforcement actions, the prosecutor may consider all relevant factors, including:

1. the sanctions available under the alternative means of disposition;

2. the likelihood that an effective sanction will be imposed; and

3. the effect of non-criminal disposition on Federal law enforcement interests.

B. Comment: The primary goals of criminal law are deterrence, punishment, and rehabilitation. Non-criminal sanctions may not be an appropriate response to an egregious violation, a pattern of wrongdoing, or a history of non-criminal sanctions without proper remediation. In other cases, however, these goals may be satisfied without the necessity of instituting criminal proceedings. In determining whether federal criminal charges are appropriate, the prosecutor should consider the same factors (modified appropriately for the regulatory context) considered when determining whether to leave prosecution of a natural person to another jurisdiction or to seek non-criminal alternatives to prosecution. These factors include: the strength of the regulatory authority's interest; the regulatory authority's ability and willingness to take effective enforcement action; the probable sanction if the regulatory authority's enforcement action is upheld; and the effect of a non-criminal disposition on Federal law enforcement interests. *See* USAM §§ 9-27.240, 9-27.250.

XI. Charging a Corporation: Selecting Charges

A. General Principle: Once a prosecutor has decided to charge a corporation, the prosecutor should charge, or should recommend that the grand jury charge, the most serious offense that is consistent with the nature of the defendant's conduct and that is likely to result in a sustainable conviction.

B. Comment: Once the decision to charge is made, the same rules as govern charging natural persons apply. These rules require "a faithful and honest application of the Sentencing Guidelines" and an "individualized assessment of the extent to which particular charges fit the specific circumstances of the case, are consistent with the purposes of the Federal criminal code, and maximize the impact of Federal resources on crime." *See* USAM § 9-27.300. In making this determination, "it is appropriate that the attorney for the government consider, *inter alia*, such factors as the sentencing guideline range yielded by the charge, whether the penalty yielded by such sentencing range ... is proportional to the seriousness of the defendant's conduct, and whether the charge achieves such purposes of the criminal law as punishment, protection of the public, specific and general deterrence, and rehabilitation." *See* Attorney General's Memorandum, dated October 12, 1993.

XII. Plea Agreements with Corporations

A. General Principle: In negotiating plea agreements with corporations, prosecutors should seek a plea to the most serious, readily provable offense charged. In addition, the terms of the plea agreement should contain appropriate provisions to ensure punishment, deterrence, rehabilitation, and compliance with the plea agreement in the corporate context. Although special circumstances may mandate a different conclusion, prosecutors generally should not agree to accept a corporate guilty plea in exchange for non-prosecution or dismissal of charges against individual officers and employees.

B. Comment: Prosecutors may enter into plea agreements with corporations for the same reasons and under the same constraints as apply to plea agreements with natural persons. *See* USAM §§ 9-27.400-500. This means, *inter alia*, that the corporation should be required to plead guilty to the most serious, readily provable offense charged. As is the case with individuals, the attorney making this determination should do so "on the basis of an individualized assessment of the extent to which particular charges fit the specific circumstances of the case, are consistent with the purposes of the federal criminal code, and maximize the impact of federal resources on crime. In making this determination, the attorney for the government considers, inter alia, such factors as the sentencing guideline range yielded by the charge, whether the penalty yielded by such sentencing range ... is proportional to the seriousness of the defendant's conduct, and whether the charge achieves such purposes of the criminal law as punishment, protection of the public, specific and general deterrence, and rehabilitation." *See* Attorney General's Memorandum, dated October 12, 1993. In addition, any negotiated departures from the Sentencing Guidelines must be justifiable under the Guidelines and must be disclosed to the sentencing court. A corporation should be made to realize that pleading guilty to criminal charges constitutes an admission of guilt and not merely a resolution of an inconvenient distraction from its business. As with natural persons, pleas should be structured so that the corporation may not later "proclaim lack of culpability or even complete innocence." *See* USAM §§ 9-27.420(b)(4), 9-27.440, 9-27.500. Thus, for instance, there should be placed upon the record a sufficient factual basis for the plea to prevent later corporate assertions of innocence.

A corporate plea agreement should also contain provisions that recognize the nature of the corporate "person" and ensure that the principles of punishment, deterrence, and rehabilitation are met. In the corporate context, punishment and deterrence are generally accomplished by substantial fines, mandatory restitution, and

institution of appropriate compliance measures, including, if necessary, continued judicial oversight or the use of special masters. *See* USSG §§ 8B1.1, 8C2.1, *et seq*. In addition, where the corporation is a government contractor, permanent or temporary debarment may be appropriate. Where the corporation was engaged in government contracting fraud, a prosecutor may not negotiate away an agency's right to debar or to list the corporate defendant.

In negotiating a plea agreement, prosecutors should also consider the deterrent value of prosecutions of individuals within the corporation. Therefore, one factor that a prosecutor may consider in determining whether to enter into a plea agreement is whether the corporation is seeking immunity for its employees and officers or whether the corporation is willing to cooperate in the investigation of culpable individuals. Prosecutors should rarely negotiate away individual criminal liability in a corporate plea.

Rehabilitation, of course, requires that the corporation undertake to be law-abiding in the future. It is, therefore, appropriate to require the corporation, as a condition of probation, to implement a compliance program or to reform an existing one. As discussed above, prosecutors may consult with the appropriate state and federal agencies and components of the Justice Department to ensure that a proposed compliance program is adequate and meets industry standards and best practices. *See* section VII, *supra*.

In plea agreements in which the corporation agrees to cooperate, the prosecutor should ensure that the cooperation is complete and truthful. To do so, the prosecutor may request that the corporation waive attorney-client and work product protection, make employees and agents available for debriefing, disclose the results of its internal investigation, file appropriate certified financial statements, agree to governmental or third-party audits, and take whatever other steps are necessary to ensure that the full scope of the corporate wrongdoing is disclosed and that the responsible culprits are identified and, if appropriate, prosecuted. *See* generally section VIII, *supra*.

Footnotes:

1. While these guidelines refer to corporations, they apply to the consideration of the prosecution of all types of business organizations, including partnerships, sole proprietorships, government entities, and unincorporated associations.

2. In addition, the Sentencing Guidelines reward voluntary disclosure and cooperation with a reduction in the corporation's offense level. *See* USSG §8C2.5)g).

3. This waiver should ordinarily be limited to the factual internal investigation and any contemporaneous advice given to the corporation concerning the conduct at issue. Except in unusual circumstances, prosecutors should not seek a waiver with respect to communications and work product related to advice concerning the government's criminal investigation.

4. Some states require corporations to pay the legal fees of officers under investigation prior to a formal determination of their guilt. Obviously, a corporation's compliance with governing law should not be considered a failure to cooperate.

5. Although this case and *Basic Construction* are both antitrust cases, their reasoning applies to other criminal violations. In the Hilton case, for instance, the Ninth Circuit noted that Sherman Act violations are commercial offenses "usually motivated by a desire to enhance profits," thus, bringing the case within the normal rule that a "purpose to benefit the corporation is necessary to bring the agent's acts within the scope of his employment." 467 F.2d at 1006 & n4. In addition, in *United States v. Automated Medical Laboratories*, 770 F.2d 399, 406 n.5 (4th Cir. 1985), the Fourth Circuit stated "that Basic Construction states a generally applicable rule on corporate criminal liability despite the fact that it addresses violations of the antitrust laws."

6. For a detailed review of these and other factors concerning corporate compliance programs, see United States Sentencing Commission, GUIDELINES MANUAL, §8A1.2, comment. (n.3(k)) (Nov. 1997). *See* also USSG §8C2.5(f)

7. For example, the Antitrust Division's amnesty policy requires that "[w]here possible, the corporation [make] restitution to injured parties...."

[Signed on June 16, 1999]

MEMORANDUM

TO: All Component Heads and United States Attorneys

FROM: THE DEPUTY ATTORNEY GENERAL

SUBJECT: Bringing Criminal Charges Against Corporations

More and more often, federal prosecutors are faced with criminal conduct committed by or on behalf of corporations. The Department is committed to prosecuting both the culpable individuals and, when appropriate, the corporation on whose behalf they acted.

The attached document, *Federal Prosecution of Corporations*, provides guidance as to what factors should generally inform a prosecutor in making the decision whether to charge a corporation in a particular case. I believe these factors provide a useful framework in which prosecutors can analyze their cases and provide a common vocabulary for them to discuss their decision with fellow prosecutors, supervisors, and defense counsel. These factors are, however, not outcome-determinative and are only guidelines. Federal prosecutors are not required to reference these factors in a particular case, nor are they required to document the weight they accorded specific factors in reaching their decision.

The factors and the commentary were developed through the hard work of an *ad hoc* working group coordinated by the Fraud Section of the Criminal Division and made up of representatives of United States Attorneys' Offices, the Executive Office of United States Attorneys, and Divisions of the Department with criminal law enforcement responsibilities. Experience with these guidelines may lead to changes or adjustments in the text and commentary. Therefore, please forward any comments about the guidelines, as well as instances in which the factors proved useful or not useful in specific cases to Shirah Neiman, Deputy United States Attorney, Southern District of New York, and Philip Urofsky, Trial Attorney, Fraud Section, Criminal Division. I look forward to hearing comments from the field as to the application of these factors in practice.

Encl.

Federal Prosecution of Corporations

I. Charging Corporations: General

A. *General Principle*: Corporations should not be treated leniently because of their artificial nature nor should they be subject to harsher treatment. Vigorous enforcement of the criminal laws against corporate wrongdoers, where appropriate, results in great benefits for law enforcement and the public, particularly in the area of white collar crime. Indicting corporations for wrongdoing enables the government to address and be a force for positive change of corporate culture, alter corporate behavior, and prevent, discover, and punish white collar crime.

B. *Comment*: In all cases involving corporate wrongdoing, prosecutors should consider the factors discussed herein. First and foremost, prosecutors should be aware of the important public benefits that may flow from indicting a corporation in appropriate cases. For instance, corporations are likely to take immediate remedial steps when one is indicted for criminal conduct that is pervasive throughout a particular industry, and thus an indictment often provides a unique opportunity for deterrence on a massive scale. In addition, a corporate indictment may result in specific deterrence by changing the culture of the indicted corporation and the behavior of its employees. Finally, certain crimes that carry with them a substantial risk of great public harm,*e.g.*, environmental crimes or financial frauds, are by their nature most likely to be committed by businesses, and there may, therefore, be a substantial federal interest in indicting the corporation.

Charging a corporation, however, does not mean that individual directors, officers, employees, or shareholders should not also be charged. Prosecution of a corporation is not a substitute for the prosecution of criminally culpable individuals within or without the corporation. Further, imposition of individual criminal liability on such individuals provides a strong deterrent against future corporate wrongdoing.

Corporations are "legal persons," capable of suing and being sued, and capable of committing crimes. Under the doctrine of *respondeat superior*, a corporation may be held criminally liable for the illegal acts of its directors, officers, employees, and agents. To be held liable for these actions, the government must establish that the corporate agent's actions (i) were within the scope of his duties and (ii) were intended, at least in part, to benefit the corporation. In all cases involving wrongdoing by corporate agents, prosecutors should consider the corporation, as well as the responsible individuals, as potential criminal targets.

Agents, however, may act for mixed reasons -- both for self-aggrandizement (both direct and indirect) and for the benefit of the corporation, and a corporation may be held liable as long as one motivation of its agent is to benefit the corporation. Thus, in *United States v. Automated Medical Laboratories*, 770 F.2d 399 (4th Cir. 1985), the court affirmed the corporation's conviction for the actions of a subsidiary's employee despite its claim that the employee was acting for his own benefit, namely his "ambitious nature and his desire to ascend the corporate ladder." The court stated, "Partucci was clearly acting in part to benefit AML since his advancement within the corporation depended on AML's well-being and its lack of difficulties with the FDA." Similarly, in *United States v. Cincotta*, 689 F.2d 238, 241-42 (1st Cir. 1982), the court held, "criminal liability may be imposed on the corporation only where the agent is acting within the scope of his employment. That, in turn, requires that the agent be performing acts of the kind which he is authorized to perform, and those acts must be motivated -- at least in part -- by an intent to benefit the corporation." Applying this test, the court upheld the corporation's conviction, notwithstanding the substantial personal benefit reaped by its miscreant agents, because the fraudulent scheme required money to pass through the corporation's treasury and the fraudulently obtained goods were resold to the corporation's customers in the corporation's name. As the court concluded, "Mystic--not the individual defendants--was making money by selling oil that it had not paid for."

Moreover, the corporation need not even necessarily profit from its agent's actions for it to be held liable. In *Automated Medical Laboratories*, the Fourth Circuit stated:

> [B]enefit is not a "touchstone of criminal corporate liability; benefit at best is an evidential, not an operative, fact." Thus, whether the agent's actions ultimately redounded to the benefit of the corporation is less significant than whether the agent acted with the intent to benefit the corporation. The basic purpose of requiring that an agent have acted with the intent to benefit the corporation, however, is to insulate the corporation from criminal liability for actions of its agents which be inimical to the interests of the corporation or which may have been undertaken *solely* to advance the interests of that agent or of a party other than the corporation.

Id. at 407 (emphasis added; quoting *Old Monastery Co. v. United States*, 147 F.2d 905, 908 (4th Cir.), *cert. denied*, 326 U.S. 734 (1945)).

II. Charging Corporations -- Factors to Be Considered

A. *General Principle*: Generally, prosecutors should apply the same factors in determining whether to charge a corporation as they do with respect to individuals. *See* U.S.A.M. § 9-27.220, *et seq*. Thus, the prosecutor should weigh all of the factors normally considered in the sound exercise of prosecutorial judgment: the sufficiency of the evidence, the likelihood of success at trial, the probable deterrent, rehabilitative, and other consequences of conviction, and the adequacy of non-criminal approaches. *See id.* However, due to the nature of the corporate "person," some additional factors are present. In conducting an investigation, determining whether to bring charges, and negotiating plea agreements, prosecutors should consider the following factors in reaching a decision as to the proper treatment of a corporate target:

1. The nature and seriousness of the offense, including the risk of harm to the public, and applicable policies and priorities, if any, governing the prosecution of corporations for particular categories of crime (*see* section III,*infra*);
2. The pervasiveness of wrongdoing within the corporation, including the complicity in, or condonation of, the wrongdoing by corporate management (*see* section IV, *infra*);
3. The corporation's history of similar conduct, including prior criminal, civil, and regulatory enforcement actions against it (*see* section V, *infra*);
4. The corporation's timely and voluntary disclosure of wrongdoing and its willingness to cooperate in the investigation of its agents, including, if necessary, the waiver of the corporate attorney-client and work product privileges (*see* section VI, *infra*);
5. The existence and adequacy of the corporation's compliance program (*see* section VII, *infra*);
6. The corporation's remedial actions, including any efforts to implement an effective corporate compliance program or to improve an existing one, to replace responsible management, to discipline or terminate wrongdoers, to pay restitution, and to cooperate

with the relevant government agencies (*see* section VIII, *infra*);

7. Collateral consequences, including disproportionate harm to shareholders and employees not proven personally culpable (*see* section IX, *infra*); and
8. The adequacy of non-criminal remedies, such as civil or regulatory enforcement actions (*see* section X, *infra*).

B. *Comment*: As with the factors relevant to charging natural persons, the foregoing factors are intended to provide guidance rather than to mandate a particular result. The factors listed in this section are intended to be illustrative of those that should be considered and not a complete or exhaustive list. Some or all of these factors may or may not apply to specific cases, and in some cases one factor may override all others. Further, national law enforcement policies in various enforcement areas may require that more or less weight be given to certain of these factors than to others.

In making a decision to charge a corporation, the prosecutor generally has wide latitude in determining when, whom, how, and even whether to prosecute for violations of Federal criminal law. In exercising that discretion, prosecutors should consider the following general statements of principles that summarize appropriate considerations to be weighed and desirable practices to be followed in discharging their prosecutorial responsibilities. In doing so, prosecutors should ensure that the general purposes of the criminal law -- assurance of warranted punishment, deterrence of further criminal conduct, protection of the public from dangerous and fraudulent conduct, rehabilitation of offenders, and restitution for victims and affected communities -- are adequately met, taking into account the special nature of the corporate "person."

III. Charging a Corporation: Special Policy Concerns

A. *General Principle*: The nature and seriousness of the crime, including the risk of harm to the public from the criminal conduct, are obviously primary factors in determining whether to charge a corporation. In addition, corporate conduct, particularly that of national and multi-national corporations, necessarily intersects with federal economic, taxation, and criminal law enforcement policies. In applying these principles, prosecutors must consider the practices and policies of the appropriate Division of the Department, and must comply with those policies to the extent required.

B. *Comment*: In determining whether to charge a corporation, prosecutors should take into account federal law enforcement priorities as discussed above. *See* § 9-27.230. In addition, however, prosecutors must be aware of the specific policy goals and incentive programs established by the respective Divisions and regulatory agencies. Thus, whereas natural persons may be given incremental degrees of credit (ranging from immunity to lesser charges to sentencing considerations) for turning themselves in, making statements against their penal interest, and cooperating in the government's investigation of their own and others' wrongdoing, the same approach may not be appropriate in all circumstances with respect to corporations. As an example, it is entirely proper in many investigations for a prosecutor to consider the corporation's pre-indictment conduct, *e.g.*, voluntary disclosure, cooperation, remediation or restitution, in determining whether to seek an indictment. However, this would not necessarily be appropriate in an antitrust investigation, in which antitrust violations, by definition, go to the heart of the corporation's business and for which the Antitrust Division has therefore established a firm policy, understood in the business community, that credit should not be given at the charging stage for a compliance program and that amnesty is available only to the first corporation to make full disclosure to the government. As another example, the Tax Division has a strong preference for prosecuting responsible individuals, rather than entities, for corporate tax offenses. Thus, in determining whether or not to charge a corporation, prosecutors should consult with the Criminal, Antitrust, Tax, and Environmental and Natural Resources Divisions, if appropriate or required.

IV. Charging a Corporation: Pervasiveness of Wrongdoing Within the Corporation

A. *General Principle*: A corporation can only act through natural persons, and it is therefore held responsible for the acts of such persons fairly attributable to it. Charging a corporation for even minor misconduct may be appropriate where the wrongdoing was pervasive and was undertaken by a large number of employees or by all the employees in a particular role within the corporation, *e.g.*, salesmen or procurement officers, or was condoned by upper management. On the other hand, in certain limited circumstances, it may not be appropriate to impose liability upon a corporation, particularly one with a compliance program in place, under a strict *respondeat superior* theory for the single isolated act of a rogue employee. There is, of course, a wide spectrum between these two extremes, and a prosecutor should exercise sound discretion in evaluating the pervasiveness of wrongdoing within a corporation.

B. *Comment*: Of these factors, the most important is the role of management. Although acts of even low-level employees may result in criminal liability, a corporation is directed by its management and management is responsible for a corporate culture in which criminal conduct is either discouraged or tacitly encouraged. As stated in commentary to the Sentencing Guidelines:

> Pervasiveness [is] case specific and [will] depend on the number, and degree of responsibility, of individuals [with] substantial authority . . . who participated in, condoned, or were willfully ignorant of the offense. Fewer individuals need to be involved for a finding of pervasiveness if those individuals exercised a relatively high degree of authority. Pervasiveness can occur either within an organization as a whole or within a unit of an organization.

U.S.S.G. § 8C2.5, comment. (n. 4).

V. Charging the Corporation: The Corporation's Past History

A. *General Principle*: Prosecutors may consider a corporation's history of similar conduct, including prior criminal, civil, and regulatory enforcement actions against it, in determining whether to bring criminal charges.

B. *Comment*: A corporation, like a natural person, is expected to learn from its mistakes. A history of similar conduct may be probative of a corporate culture that encouraged, or at least condoned, such conduct, regardless of any compliance programs. Criminal prosecution of a corporation may be particularly appropriate where the corporation previously had been

subject to non-criminal guidance, warnings, or sanctions, or previous criminal charges, and yet it either had not taken adequate action to prevent future unlawful conduct or had continued to engage in the conduct in spite of the warnings or enforcement actions taken against it. In making this determination, the corporate structure itself, *e.g.*, subsidiaries or operating divisions, should be ignored, and enforcement actions taken against the corporation or any of its divisions, subsidiaries, and affiliates should be considered. *See* U.S.S.G. § 8C2.5(c) & comment. (n. 6).

VI. Charging the Corporation: Cooperation and Voluntary Disclosure

A. *General Principle*: In determining whether to charge a corporation, that corporation's timely and voluntary disclosure of wrongdoing and its willingness to cooperate with the government's investigation may be relevant factors. In gauging the extent of the corporation's cooperation, the prosecutor may consider the corporation's willingness to identify the culprits within the corporation, including senior executives, to make witnesses available, to disclose the complete results of its internal investigation, and to waive the attorney-client and work product privileges.

B. *Comment*: In investigating wrongdoing by or within a corporation, a prosecutor is likely to encounter several obstacles resulting from the nature of the corporation itself. It will often be difficult to determine which individual took which action on behalf of the corporation. Lines of authority and responsibility may be shared among operating divisions or departments, and records and personnel may be spread throughout the United States or even among several countries. Where the criminal conduct continued over an extended period of time, the culpable or knowledgeable personnel may have been promoted, transferred, or fired, or they may have quit or retired. Accordingly, a corporation's cooperation may be critical in identifying the culprits and locating relevant evidence.

In some circumstances, therefore, granting a corporation immunity or amnesty may be considered in the course of the government's investigation. In such circumstances, prosecutors should refer to the principles governing non-prosecution agreements generally. See USAM § 9-27.600-650. Specifically, these principles permit a non-prosecution agreement in exchange for cooperation when a corporation's "timely cooperation appears to be necessary to the public interest and other means of obtaining the desired cooperation are unavailable or would not be effective." Prosecutors should note that in the case of national or multi-national corporations, multi-district or global agreements may be necessary. See USAM § 9-27.641.

In addition, the Department, in conjunction with regulatory agencies and other executive branch departments, encourages corporations, as part of their compliance programs, to conduct internal investigations and to disclose their findings to the appropriate authorities. Some agencies, such as the SEC and the EPA, as well as the Department's Environmental and Natural Resources Division, have formal voluntary disclosure programs in which self-reporting, coupled with remediation and additional criteria, may qualify the corporation for amnesty or reduced sanctions.[(1)] Even in the absence of a formal program, prosecutors may consider a corporation's timely and voluntary disclosure in evaluating the adequacy of the corporation's compliance program and its management's commitment to the compliance program. However, prosecution and economic policies specific to the industry or statute may require prosecution notwithstanding a corporation's willingness to cooperate. For example, the Antitrust Division offers amnesty only to the first corporation to agree to cooperate. This creates a strong incentive for corporations participating in anti-competitive conduct to be the first to cooperate. In addition, amnesty, immunity, or reduced sanctions may not be appropriate where the corporation's business is permeated with fraud or other crimes.

One factor the prosecutor may weigh in assessing the adequacy of a corporation's cooperation is the completeness of its disclosure including, if necessary, a waiver of the attorney-client and work product protections, both with respect to its internal investigation and with respect to communications between specific officers, directors, and employees and counsel. Such waivers permit the government to obtain statements of possible witnesses, subjects, and targets, without having to negotiate individual cooperation or immunity agreements. In addition, they are often critical in enabling the government to evaluate the completeness of a corporation's voluntary disclosure and cooperation. Prosecutors may, therefore, request a waiver in appropriate circumstances.[(2)] The Department does not, however, consider waiver of a corporation's privileges an absolute requirement, and prosecutors should consider the willingness of a corporation to waive the privileges when necessary to provide timely and complete information as only one factor in evaluating the corporation's cooperation.

Another factor to be weighed by the prosecutor is whether the corporation appears to be protecting its culpable employees and agents. Thus, while cases will differ depending on the circumstances, a corporation's promise of support to culpable employees and agents, either through the advancing of attorneys fees,[(3)] through retaining the employees without sanction for their misconduct, or through providing information to the employees about the government's investigation pursuant to a joint defense agreement, may be considered by the prosecutor in weighing the extent and value of a corporation's cooperation. By the same token, the prosecutor should be wary of attempts to shield corporate officers and employees from liability by a willingness of the corporation to plead guilty.

Finally, a corporation's offer of cooperation does not automatically entitle it to immunity from prosecution. A corporation should not be able to escape liability merely by offering up its directors, officers, employees, or agents as in lieu of its own prosecution. Thus, a corporation's willingness to cooperate is merely one relevant factor, one that needs to be considered in conjunction with the other factors, particularly those relating to the corporation's past history and the role of management in the wrongdoing.

VII. Charging a Corporation: Corporate Compliance Programs

A. *General Principle*: Compliance programs are established by corporate management to prevent and to detect misconduct and to ensure that corporate activities are conducted in accordance with all applicable criminal and civil laws, regulations, and rules. The Department encourages such corporate self-policing, including voluntary disclosures to the government of any problems that a corporation discovers on its own. However, the existence of a compliance program is not sufficient, in and of itself, to justify not charging a corporation for criminal conduct undertaken by its officers, directors, employees, or agents. Indeed, the commission of such crimes in the face of a compliance program may suggest

that the corporate management is not adequately enforcing its program. In addition, the nature of some crimes, *e.g.*, antitrust violations, may be such that national law enforcement policies mandate prosecutions of corporations notwithstanding the existence of a compliance program.

B. Comment. A corporate compliance program, even one specifically prohibiting the very conduct in question, does not absolve the corporation from criminal liability under the doctrine of respondeat superior. *See United States v. Basic Construction Co.*, 711 F.2d 570 (4th Cir. 1983) ("a corporation may be held criminally responsible for antitrust violations committed by its employees if they were acting within the scope of their authority, or apparent authority, and for the benefit of the corporation, even if . . . such acts were against corporate policy or express instructions."). Thus, in *United States v. Hilton Hotels Corp.*, 467 F.2d 1000 (9th Cir. 1972), *cert. denied*, 409 U.S. 1125 (1973), the Ninth Circuit affirmed antitrust liability based upon a purchasing agent for a single hotel threatening a single supplier with a boycott unless it paid dues to a local marketing association, *even though the agent's actions were contrary to corporate policy and directly against express instructions from his superiors.* The court reasoned that Congress, in enacting the Sherman Antitrust Act, "intended to impose liability upon business entities for the acts of those to whom they choose to delegate the conduct of their affairs, thus stimulating a maximum effort by owners and managers to assure adherence by such agents to the requirements of the Act." (4) It concluded that "general policy statements" and even direct instructions from the agent's superiors were not sufficient; "Appellant could not gain exculpation by issuing general instructions without undertaking to enforce those instructions by means commensurate with the obvious risks." *See also United States v. Beusch*, 596 F.2d 871, 878 (9th Cir. 1979) ("[A] corporation may be liable for the acts of its employees done contrary to express instructions and policies, but . . . the existence of such instructions and policies may be considered in determining whether the employee in fact acted to benefit the corporation."); *United States v. American Radiator & Standard Sanitary Corp.*, 433 F.2d 174 (3rd Cir. 1970) (affirming conviction of corporation based upon its officer's participation in price-fixing scheme, despite corporation's defense that officer's conduct violated its "rigid anti-fraternization policy" against any socialization (and exchange of price information) with its competitors; "When the act of the agent is within the scope of his employment or his apparent authority, the corporation is held legally responsible for it, although what he did may be contrary to his actual instructions and may be unlawful.").

While the Department recognizes that no compliance program can ever prevent all criminal activity by a corporation's employees, the critical factors in evaluating any program are whether the program is adequately designed for maximum effectiveness in preventing and detecting wrongdoing by employees and whether corporate management is enforcing the program or is tacitly encouraging or pressuring employees to engage in misconduct to achieve business objectives. The Department has no formal guidelines for corporate compliance programs. The fundamental questions any prosecutor should ask are: "Is the corporation's compliance program well designed?" and] "Does the corporation's compliance program work?" In answering these questions, the prosecutor should consider the comprehensiveness of the compliance program, the extent and pervasiveness of the criminal conduct; the number and level of the corporate employees involved; the seriousness, duration, and frequency of the misconduct, and any remedial actions taken by the corporation, including restitution, disciplinary action, and revisions to corporate compliance programs. (5) Prosecutors should also consider the promptness of any disclosure of wrongdoing to the government and the corporation's cooperation in the government's investigation.

Prosecutors should therefore attempt to determine whether a corporation's compliance program is merely a "paper program" or whether it was designed and implemented in an effective manner. In addition, prosecutors should determine whether the corporation has provided for a staff sufficient to audit, document, analyze, and utilize the results of the corporation's compliance efforts. In addition, prosecutors should determine whether the corporation's employees are adequately informed about the compliance program and are convinced of the corporation's commitment to it. This will enable the prosecutor to make an informed decision as to whether the corporation has adopted and implemented a truly effective compliance program that, when consistent with other federal law enforcement policies, may result in a decision to charge only the corporation's employees and agents.

Compliance programs should be designed to detect the particular types of misconduct most likely to occur in a particular corporation's line of business. Many corporations operate in complex regulatory environments outside the normal experience of criminal prosecutors. Accordingly, prosecutors should consult with relevant federal and state agencies with the expertise to evaluate the adequacy of a program's design and implementation. For instance, state and federal banking, insurance, and medical boards, the Department of Defense, the Department of Health and Human Services, the Environmental Protection Agency, and the Securities and Exchange Commission have considerable experience with compliance programs and can be very helpful to a prosecutor in evaluating such programs. In addition, the Fraud Section of the Criminal Division, the Commercial Litigation Branch of the Civil Division, and the Environmental Crimes Section of the Environment and Natural Resources Division can assist U.S. Attorneys' Offices in finding the appropriate agency office and in providing copies of compliance programs that were developed in previous cases.

VIII. Charging the Corporation: Restitution and Remediation

A. *General Principle*: Although neither a corporation nor an individual target may avoid prosecution merely by paying a sum of money, a prosecutor may consider the corporation's willingness to make restitution and steps already taken to do so, as well as other remedial actions such as implementing an effective corporate compliance program, improving an existing one, and disciplining wrongdoers, in determining whether to charge the corporation.

B. *Comment*: In determining whether or not a corporation should be prosecuted, a prosecutor may consider whether meaningful remedial measures have been taken, including employee discipline and full restitution. (6) A corporation's response to misconduct says much about its willingness to ensure that such misconduct does not recur. Thus, corporations that fully recognize the seriousness of their misconduct and accept responsibility for it should be seen to be taking steps to implement the personnel, operational, and organizational changes necessary to establish an awareness among employees that criminal conduct will not be tolerated. Among the factors prosecutors should consider and weigh are whether the corporation appropriately disciplined the wrongdoers and disclosed information concerning their illegal conduct to the government.
Employee discipline is a difficult task for many corporations because of the human element involved and sometimes because of the seniority of the employees concerned. However, while corporations need to be fair to their employees, they must also be unequivocally

committed, at all levels of the corporation, to the highest standards of legal and ethical behavior. Effective internal discipline can be a powerful deterrent against improper behavior by a corporation's employees. In evaluating a corporation's response to wrongdoing, prosecutors may evaluate the willingness of the corporation to discipline culpable employees of all ranks and the adequacy of the discipline imposed. The prosecutor should satisfy himself or herself that the corporation's focus is on the integrity and credibility of its remedial and disciplinary measures rather than on the protection of the wrongdoers.

In addition to employee discipline, two other factors in evaluating a corporation's remedial efforts are restitution and reform. As with natural persons, the decision whether or not to prosecute should not depend upon the target's ability to pay restitution. A corporation's efforts to pay restitution even in advance of any court order is, however, evidence of its "acceptance of responsibility" and, consistent with the practices and policies of the appropriate Division of the Department entrusted with enforcing specific criminal laws, may be considered in determining whether to bring criminal charges. Similarly, although the inadequacy of a corporate compliance program is a factor to consider when deciding whether to charge a corporation, that corporation's quick recognition of the flaws in the program and its efforts to improve the program are also factors to consider.

IX. Charging the Corporation: Collateral consequences

A. *General Principle*: Prosecutors may consider the collateral consequences of a corporate criminal conviction in determining whether to charge the corporation with a criminal offense.

B. *Comment*: One of the factors in determining whether to charge a natural person or a corporation is whether the likely punishment is appropriate given the nature and seriousness of the crime. In the corporate context, prosecutors may take into account the possibly substantial consequences to a corporation's officers, directors, employees, and shareholders, many of whom may, depending on the size and nature (*e.g.*, publicly *vs.* closely held) of the corporation and their role in its operations, have played no role in the criminal conduct, have been completely unaware of it, or have been wholly unable to prevent it. Further, prosecutors should also be aware of non-penal sanctions that may accompany a criminal charges, such as potential suspension or debarment from eligibility for government contracts or federal funded programs such as health care. Whether or not such non-penal sanctions are appropriate or required in a particular case is the responsibility of the relevant agency, a decision that will be made based on the applicable statutes, regulations, and policies.

Virtually every conviction of a corporation, like virtually every conviction of an individual, will have an impact on innocent third parties, and the mere existence of such an effect is not sufficient to preclude prosecution of the corporation. Therefore, in evaluating the severity of collateral consequences, various factors already discussed, such as the pervasiveness of the criminal conduct and the adequacy of the corporation's compliance programs should also be considered in determining the weight to be given to this factor. For instance, the balance may tip in favor of prosecuting corporations in situations where the scope of the misconduct in a case is widespread and sustained within a corporate division (or spread throughout pockets of the corporate organization). In such cases, the possible unfairness of visiting punishment for the corporation's crimes upon shareholders may be of much less concern where those shareholders have substantially profited, even unknowingly, from widespread or pervasive criminal activity. Similarly, where the top layers of the corporation's management or the shareholders of a closely-held corporation were engaged in or aware of the wrongdoing and the conduct at issue was accepted as a way of doing business for an extended period, debarment may be deemed not collateral but a direct and entirely appropriate consequence of the corporation's wrongdoing.

The appropriateness of considering such collateral consequences and the weight to be given them may depend on the special policy concerns discussed in section III,*supra*.

X. Charging a Corporation: Non-Criminal Alternatives

A. *General Principle*: Although non-criminal alternatives to prosecution often exist, prosecutors may consider whether such sanctions would adequately deter, punish, and rehabilitate a corporation that has engaged in wrongful conduct. In evaluating the adequacy of non-criminal alternatives to prosecution, *e.g.*, civil or regulatory enforcement actions, the prosecutor may consider all relevant factors, including:

1. The sanctions available under the alternative means of disposition;
2. the likelihood that an effective sanction will be imposed; and
3. the effect of non-criminal disposition on Federal law enforcement interests.

B. *Comment*. The primary goals of criminal law are deterrence, punishment, and rehabilitation. Non-criminal sanctions may not be an appropriate response to an egregious violation, a pattern of wrongdoing, or a history of non-criminal sanctions without proper remediation. In other cases, however, these goals may be satisfied without the necessity of instituting criminal proceedings. In determining whether federal criminal charges are appropriate, the prosecutor should consider the same factors (modified appropriately for the regulatory context) considered when determining whether to leave prosecution of a natural person to another jurisdiction or to seek non-criminal alternatives to prosecution, i.e., the strength of the regulatory authority's interest; the regulatory authority's ability and willingness to take effective enforcement action, the probable sanction if the regulatory authority's enforcement action is upheld, and the effect of a non-criminal disposition on Federal law enforcement interests. *See* USAM §§ 9-27.240, 9-27.250.

XI. Charging a Corporation: Selecting Charges

A. *General Principle*: Once a prosecutor has decided to charge a corporation, the prosecutor should charge, or should recommend that the grand jury charge, the most serious offense that is consistent with the nature of the defendant's conduct and that is likely to result in a sustainable conviction.

B. *Comment*: Once the decision to charge is made, the same rules as govern charging natural persons apply. These rules require "a faithful and honest application of the Sentencing Guidelines" and an "individualized assessment of the extent to which particular charges fit the specific circumstances of the case, are consistent with the purposes of the Federal criminal code, and maximize the impact of Federal resources on crime." *See* USAM § 9-27.300. In making this determination, "it is appropriate that the attorney for the government

consider, *inter alia*, such factors as the sentencing guideline range yielded by the charge, whether the penalty yielded by such sentencing range . . . is proportional to the seriousness of the defendant's conduct, and whether the charge achieves such purposes of the criminal law as punishment, protection of the public, specific and general deterrence, and rehabilitation." *See* Attorney General's Memorandum, dated October 12, 1993.

XII. Plea Agreements with Corporations

A. *General Principle*: In negotiating plea agreements with corporations, prosecutors should seek a plea to the most serious, readily provable offense charged. In addition, the terms of the plea agreement should contain appropriate provisions to ensure punishment, deterrence, rehabilitation, and compliance with the plea agreement in the corporate context. Although special circumstances may mandate a different conclusion, prosecutors generally should not agree to accept a corporate guilty plea in exchange for non-prosecution or dismissal of charges against individual officers and employees.

B. *Comment*: Prosecutors may enter into plea agreements with corporations for the same reasons and under the same constraints as apply to plea agreements with natural persons. *See* USAM §§ 9-27.400-500. This means, *inter alia*, that the corporation should be required to plead to the most serious, readily provable offense charged. As is the case with individuals, the attorney making this determination should do so "on the basis of an individualized assessment of the extent to which particular charges fit the specific circumstances of the case, are consistent with the purposes of the federal criminal code, and maximize the impact of federal resources on crime. In making this determination, the attorney for the government consider, *inter alia*, such factors as the sentencing guideline range yielded by the charge, whether the penalty yielded by such sentencing range . . . is proportional to the seriousness of the defendant's conduct, and whether the charge achieves such purposes of the criminal law as punishment, protection of the public, specific and general deterrence, and rehabilitation." *See* Attorney General's Memorandum, dated October 12, 1993. In addition, any negotiated departures from the Sentencing Guidelines must be justifiable under the Guidelines and must be disclosed to the sentencing court. In addition, corporations should be made to realize that pleading guilty to criminal charges constitutes an admission of *guilt* and not merely a resolution of an inconvenient distraction from its business. Thus, as with natural persons, pleas should be structured so that the corporation may not later "proclaim lack of culpability or even complete innocence." *See* USAM §§ 9-27.420(b)(4), 9-27.440, 9-27.500. Thus, for instance, there should be placed upon the record a sufficient factual basis for the plea to prevent later corporate assertions of innocence.

A corporate plea agreement should also contain certain provisions that recognize the nature of the corporate "person" and ensure that the principles of punishment, deterrence, and rehabilitation are met. In the corporate context, punishment and deterrence are generally accomplished by substantial fines, mandatory restitution, and institution of appropriate compliance measures, including, if necessary, continued judicial oversight or the use of special masters. *See* U.S.S.G. §§ 8B1.1, 8C2.1, *et seq*. In addition, where the corporation is a government contractor, permanent or temporary debarment may be appropriate. Where the corporation was engaged in government contracting fraud, a prosecutor may not negotiate away an agency's right to debar or to list the corporate defendant.

In negotiating a plea agreement, prosecutors should also consider the deterrent value of prosecutions of individuals within the corporation. Therefore, one factor that a prosecutor may consider in determining whether to enter into a plea agreement is whether the corporation is seeking immunity for its employees and officers or whether the corporation is willing to cooperate in the investigation of culpable individuals. Generally, prosecutors should rarely negotiate away individual criminal liability in a corporate plea.

Rehabilitation, of course, requires that the corporation undertake to be law-abiding in the future. It is, therefore, appropriate to require the corporation, as a condition of probation, to implement a compliance program or to reform an existing one. As discussed above, prosecutors may consult with the appropriate state and federal agencies and components of the Justice Department to ensure that a proposed compliance program is adequate and meets industry standards and best practices. *See* section VII, *supra*.

In plea agreements in which the corporation agrees to cooperate, the prosecutor should ensure that the cooperation is complete and truthful. To do so, the prosecutor may request that the corporation waive the attorney-client and work product privileges, make employees and agents available for debriefing, disclose the results of its internal investigation, file appropriate certified financial statements, agree to governmental or third-party audits, and take whatever other steps are necessary to ensure that the full scope of the corporate wrongdoing is disclosed and that the responsible culprits are identified and, if appropriate, prosecuted. *See generally* section VIII, *supra*.

Footnotes

1. In addition, the Sentencing Guidelines reward voluntary disclosure and cooperation with a reduction in the corporation's offense level. *See* U.S.S.G. § 8C2.5(g).
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2. This waiver should ordinarily be limited to the factual internal investigation and any contemporaneous advice given to the corporation concerning the conduct at issue. Except in unusual circumstances, prosecutors should not seek a waiver with respect to communications and work product related to advice concerning the government's criminal investigation.
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3. Some states require corporations to pay the legal fees of officers under investigation prior to a formal determination of their guilt. Obviously, a corporation's compliance with governing law should not be considered a failure to cooperate.
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4. Although this case and *Basic Construction* are both antitrust cases, their reasoning applies to other criminal violations. In the *Hilton* case, for instance, the Ninth Circuit noted that Sherman Act violations

are commercial offenses "usually motivated by a desire to enhance profits," thus bringing the case within the normal rule that a "purpose to benefit the corporation is necessary to bring the agent's acts within the scope of his employment." 467 F.2d at 1006 & n.4. In addition, in *United States v. Automated Medical Laboratories*, 770 F.2d 399, 406 n.5 (4th Cir. 1985), the Fourth Circuit stated that *Basic Construction* states a generally applicable rule on corporate criminal liability despite the fact that it addresses violations of the antitrust rules."
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5. For a detailed review of these and other factors concerning corporate compliance programs,see United States Sentencing Commission, **Guidelines Manual**, § 8A1.2, comment. (n. 3(k)) (Nov. 1997). *See also* U.S.S.G. § 8C2.5(f).
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6. For example, the Antitrust Division's amnesty policy specifically requires that "[w]here possible, the corporation [make] restitution to injured parties . . . ."
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Last Updated: March 9, 2000
usdoj/criminal/fraud/jmh

9-27.600 Entering into Non-prosecution Agreements in Return for Cooperation -- Generally

A. Except as hereafter provided, the attorney for the government may, with supervisory approval, enter into a non-prosecution agreement in exchange for a person's cooperation when, in his/her judgment, the person's timely cooperation appears to be necessary to the public interest and other means of obtaining the desired cooperation are unavailable or would not be effective.
B. Comment.
   1. In many cases, it may be important to the success of an investigation or prosecution to obtain the testimonial or other cooperation of a person who is himself/herself implicated in the criminal conduct being investigated or prosecuted. However, because of his/her involvement, the person may refuse to cooperate on the basis of his/her Fifth Amendment privilege against compulsory self-incrimination. In this situation, there are several possible approaches the prosecutor can take to render the privilege inapplicable or to induce its waiver.
      a. First, if time permits, the person may be charged, tried, and convicted before his/her cooperation is sought in the investigation or prosecution of others. Having already been convicted himself/herself, the person ordinarily will no longer have a valid privilege to refuse to testify and will have a strong incentive to reveal the truth in order to induce the sentencing judge to impose a lesser sentence than that which otherwise might be found appropriate.
      b. Second, the person may be willing to cooperate if the charges or potential charge against him/her are reduced in number or degree in return for his/her cooperation and his/her entry of a guilty plea to the remaining charges. An agreement to file a motion pursuant to Sentencing Guideline 5K1.1 or Rule 35 of the Federal Rules of Criminal Procedure after the defendant gives full and complete cooperation is the preferred method for securing such cooperation. Usually such a concession by the government will be all that is necessary, or warranted, to secure the cooperation sought. Since it is certainly desirable as a matter of policy that an offender be required to incur at least some liability for his/her criminal conduct, government attorneys should attempt to secure this result in all appropriate cases, following the principles set forth in USAM 9-27.430 to the extent practicable.
      c. The third method for securing the cooperation of a potential defendant is by means of a court order under 18 U.S.C. §§ 6001-6003. Those statutory provisions govern the conditions under which uncooperative witnesses may be compelled to testify or provide information notwithstanding their invocation of the privilege against compulsory self incrimination. In brief, under the so-called "use immunity" provisions of those statutes, the court

may order the person to testify or provide other information, but neither his/her testimony nor the information he/she provides may be used against him/her, directly or indirectly, in any criminal case except a prosecution for perjury or other failure to comply with the order. Ordinarily, these "use immunity" provisions should be relied on in cases in which attorneys for the government need to obtain sworn testimony or the production of information before a grand jury or at trial, and in which there is reason to believe that the person will refuse to testify or provide the information on the basis of his/her privilege against compulsory self-incrimination. *See* USAM 9-23.000. Offers of immunity and immunity agreements should be in writing. Consideration should be given to documenting the evidence available prior to the immunity offer.

d. Finally, there may be cases in which it is impossible or impractical to employ the methods described above to secure the necessary information or other assistance, and in which the person is willing to cooperate only in return for an agreement that he/she will not be prosecuted at all for what he/she has done. The provisions set forth hereafter describe the conditions that should be met before such an agreement is made, as well as the procedures recommended for such cases.

It is important to note that these provisions apply only if the case involves an agreement with a person who might otherwise be prosecuted. If the person reasonably is viewed only as a potential witness rather than a potential defendant, and the person is willing to cooperate, there is no need to consult these provisions.

USAM 9-27.600 describes three circumstances that should exist before government attorneys enter into non-prosecution agreements in return for cooperation: the unavailability or ineffectiveness of other means of obtaining the desired cooperation; the apparent necessity of the cooperation to the public interest; and the approval of such a course of action by an appropriate supervisory official

2. **Unavailability or Ineffectiveness of Other Means.** As indicated above, non-prosecution agreements are only one of several methods by which the prosecutor can obtain the cooperation of a person whose criminal involvement makes him/her a potential subject of prosecution. Each of the other methods--seeking cooperation after trial and conviction, bargaining for cooperation as part of a plea agreement, and compelling cooperation under a "use immunity" order--involves prosecuting the person or at least leaving open the possibility of prosecuting him/her on the basis of independently obtained evidence. Since these outcomes are clearly preferable to permitting an offender to avoid any liability for his/her conduct, the possible use of an alternative to a non-prosecution agreement should be given serious consideration in the first instance.

Another reason for using an alternative to a non-prosecution agreement to obtain cooperation concerns the practical advantage in terms of the person's credibility if he/she testifies at trial. If the person already has been convicted, either after trial or upon a guilty plea, for participating in the events about which he/she testifies, his/her testimony is apt to be far more credible than if it appears to the trier of fact that he/she is getting off "scot free." Similarly, if his/her testimony is compelled by a court order, he/she cannot properly be portrayed by the defense as a person who has made a "deal" with the government and whose testimony is, therefore, suspect; his/her testimony will have been forced from him/her, not bargained for.

In some cases, however, there may be no effective means of obtaining the person's timely cooperation short of entering into a non-prosecution agreement. The person may be unwilling to cooperate fully in return for a reduction of charges, the delay involved in bringing him/her to trial might prejudice the investigation or prosecution in connection with which his/her cooperation is sought and it may be impossible or impractical to rely on the statutory provisions for compulsion of testimony or production of evidence. One example of the latter situation is a case in which the cooperation needed does not consist of testimony under oath or the production of information before a grand jury or at trial. Other examples are cases in which time is critical, or where use of the procedures of 18 U.S.C. §?-6003 would unreasonably disrupt the presentation of evidence to the grand jury or the expeditious development of an investigation, or where compliance with the statute of limitat ions or the Speedy Trial Act precludes timely application for a court order.

Only when it appears that the person's timely cooperation cannot be obtained by other means, or cannot be obtained effectively, should the attorney for the government consider entering into a non-prosecution agreement.

3. **Public Interest.** If he/she concludes that a non-prosecution agreement would be the only effective method for obtaining cooperation, the attorney for the government should consider whether, balancing the cost of foregoing prosecution against the potential benefit of the person's cooperation, the cooperation sought appears necessary to the public interest. This "public interest" determination is one of the conditions precedent to an application under 18 U.S.C. § 6003 for a court order compelling testimony. Like a compulsion order, a non-prosecution agreement limits the government's ability to undertake a subsequent prosecution of the witness. Accordingly, the same "public interest" test should be applied in this situation as well. Some of the considerations that

may be relevant to the application of this test are set forth in USAM 9-27.620.

4. **Supervisory Approval.** Finally, the prosecutor should secure supervisory approval before entering into a non-prosecution agreement. Prosecutors working under the direction of a United States Attorney must seek the approval of the United States Attorney or a supervisory Assistant United States Attorney. Departmental attorneys not supervised by a United States Attorney should obtain the approval of the appropriate Assistant Attorney General or his/her designee, and should notify the United States Attorney or Attorneys concerned. The requirement of approval by a superior is designed to provide review by an attorney experienced in such matters, and to ensure uniformity of policy and practice with respect to such agreements. This section should be read in conjunction with USAM 9-27.640, concerning particular types of cases in which an Assistant Attorney General or his/her designee must concur in or approve an agreement not to prosecute in ret urn for cooperation.

9-27.620 Entering into Non-prosecution Agreements in Return for Cooperation -- Considerations to be Weighed

A. In determining whether, a person's cooperation may be necessary to the public interest, the attorney for the government, and those whose approval is necessary, should weigh all relevant considerations, including:
   1. The importance of the investigation or prosecution to an effective program of law enforcement;
   2. The value of the person's cooperation to the investigation or prosecution; and
   3. The person's relative culpability in connection with the offense or offenses being investigated or prosecuted and his/her history with respect to criminal activity.

B. Comment. This paragraph is intended to assist Federal prosecutors, and those whose approval they must secure, in deciding whether a person's cooperation appears to be necessary to the public interest. The considerations listed here are not intended to be all-inclusive or to require a particular decision in a particular case. Rather they are meant to focus the decision-maker's attention on factors that probably will be controlling in the majority of cases.
   1. **Importance of Case.** Since the primary function of a Federal prosecutor is to enforce the criminal law, he/she should not routinely or indiscriminately enter into non-prosecution agreements, which are, in essence, agreements not to enforce the law under particular conditions. Rather, he/she should reserve the use of such agreements for cases in which the cooperation sought concerns the commission of a serious offense or in which successful prosecution is otherwise important in achieving effective enforcement of the criminal laws. The relative importance or unimportance of the contemplated case is therefore a significant threshold consideration.
   2. **Value of Cooperation.** An agreement not to prosecute in return for a person's cooperation binds the government to the extent that the person carries out his/her part of the bargain. *See Santobello v. New York* 404 U.S. 257 (1971); *Wade v. United States*, 112 S. Ct. 1840 (1992). Since such an agreement forecloses enforcement of the criminal law against a person who otherwise may be liable to prosecution, it should not be entered into without a clear understanding of the nature of the quid pro quo and a careful assessment of its probable value to the government. In order to be in a position adequately to assess the potential value of a person's cooperation, the prosecutor should insist on an "offer of proof" or its equivalent from the person or his/her attorney. The prosecutor can then weigh the offer in terms of the investigation or prosecution in connection with which cooperation is sought. In doing so, he/she should consider such questions as whether the cooperation will in fact be forthcoming, whether the testimony or other information provided will be credible, whether it can be corroborated by other evidence, whether it will materially assist the investigation or prosecution, and whether substantially the same benefit can be obtained from someone else without an agreement not to prosecute. After assessing all of these factors, together with any others that may be relevant, the prosecutor can judge the strength of his/her case with and without the person's cooperation, and determine whether it may be in the public interest to agree to forego prosecution under the circumstances.
   3. **Relative Culpability and Criminal History.** In determining whether it may be necessary to the public interest to agree to forego prosecution of a person who may have violated the law in return for that person's cooperation, it is also important to consider the degree of his/her apparent culpability relative to others who are subjects of the investigation or prosecution as well as his/her history of criminal involvement. Of course, ordinarily it would not be in the public interest to forego prosecution of a high-ranking member of a criminal enterprise in exchange for his/her cooperation against one of his/her subordinates, nor would the public interest be served by bargaining away the opportunity to prosecute a person with a long history of serious criminal involvement in order to obtain the conviction of someone else on less serious charges. These are matters with regard to which the attorney for the government may find it helpful to consult with the investigating agenc y or with other prosecuting authorities who may have an interest in the person or his/her associates.

It is also important to consider whether the person has a background of cooperation with law enforcement officials, either as a witness or an informant, and whether he/she has previously been the subject of a compulsion order under 18 U.S.C. §?-6003 or has escaped prosecution by virtue of an agreement not to prosecute. The information regarding compulsion orders may be available by telephone from the Immunity Unit in the Office of Enforcement Operations of the Criminal Division.

2004 FEDERAL SENTENCING GUIDELINES
CHAPTER 8 - PART C - FINES
DETERMINING THE FINE – OTHER ORGANIZATIONS

§8C2.5. CULPABILITY SCORE

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(g) Self-Reporting, Cooperation, and Acceptance of Responsibility

If more than one applies, use the greatest:

(1) If the organization (A) prior to an imminent threat of disclosure or government investigation; and (B) within a reasonably prompt time after becoming aware of the offense, reported the offense to appropriate governmental authorities, fully cooperated in the investigation, and clearly demonstrated recognition and affirmative acceptance of responsibility for its criminal conduct, subtract **5** points; or

(2) If the organization fully cooperated in the investigation and clearly demonstrated recognition and affirmative acceptance of responsibility for its criminal conduct, subtract **2** points; or

(3) If the organization clearly demonstrated recognition and affirmative acceptance of responsibility for its criminal conduct, subtract **1** point.

Commentary

Application Notes:

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12. To qualify for a reduction under subsection (g)(1) or (g)(2), cooperation must be both timely and thorough. To be timely, the cooperation must begin essentially at the same time as the organization is officially notified of a criminal investigation. To be thorough, the cooperation should include the disclosure of all pertinent information known by the organization. A prime test of whether the organization has disclosed all pertinent information is whether the information is sufficient for law enforcement personnel to identify the nature and extent of the offense and the individual(s) responsible for the criminal conduct. However, the cooperation to be measured is the cooperation of the organization itself, not the cooperation of individuals within the organization. If, because of the lack of cooperation of particular individual(s), neither the organization nor law enforcement personnel are able to identify the culpable individual(s) within the organization despite the organization's efforts to cooperate fully, the organization may still be given credit for full cooperation. **Waiver of attorney-client privilege and of work product protections is not a prerequisite to a reduction in culpability score under subdivisions (1) and (2) of subsection (g) unless such waiver is necessary in order to provide timely and thorough disclosure of all pertinent information known to the organization. (emphasis added)**

I. News Release

U.S. Sentencing Commission
One Columbus Circle NE
Washington, DC 20002-8002

For Immediate Release
April 11, 2006

Contact: Michael Courlander
Public Affairs Officer
(202) 502-4597

II. U.S. SENTENCING COMMISSION VOTES TO AMEND GUIDELINES FOR TERRORISM, FIREARMS, AND STEROIDS

WASHINGTON, D.C. (April 11, 2006) — At its April 5 public meeting, the United States Sentencing Commission voted to promulgate and submit to Congress sentencing guideline amendments regarding offenses that include terrorism, firearms, and steroids. The Commission, an independent agency in the judicial branch of the federal government, was established in 1985 to develop national sentencing guidelines for the federal courts. Any amendments made by the Commission to the guidelines must be submitted to Congress on or before May 1 of each year and become effective on November 1 if not disapproved by Congress.

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The Commission also voted to promulgate –

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- an amendment deleting 2004 commentary to the organizational sentencing guidelines stating that waiver of attorney-client privileges and work product protections is not a pre-requisite for an organization to receive credit for cooperation at sentencing. The Commission had held public hearings on November 15, 2005, and March 15, 2006, concerning this issue.

USDC SDNY
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DATE FILED: 4/18/06

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK
----------x
UNITED STATES OF AMERICA,

-against-

S1 05 Crim. 0888 (LAK)

JEFFREY STEIN, et al.,

Defendants.
----------x

MEMORANDUM AND ORDER

LEWIS A. KAPLAN, *District Judge.*

Certain defendants have moved to dismiss the indictment or for other relief on the ground, broadly stated, that the government, through the Thompson memorandum and perhaps otherwise, has violated defendants' right to counsel by improperly interfering with KPMG's ability to choose to advance to defendants legal fees and other defense costs and, in at least one case, with inducing KPMG to breach an alleged contractual obligation to advance such expenses. Defendants seek an evidentiary hearing and limited discovery on these issues.

In papers dated April 11, 2006, the government takes the position that no discovery or hearing is warranted because the prosecution team did not seek to persuade KPMG not to advance expenses. It has submitted a declaration that purports to disclose the substance of all discussions on the subject between the prosecution team and KPMG.

Assuming *arguendo* that the government's account of the discussions with KPMG is accurate, and the Court has no reason to suppose that it is not, the government's presentation may not be a sufficient response to the defendants' position. It ignores, among other things, the defendants' allegations that (1) the Thompson memorandum, insofar as it deals with advancement

of defense costs as a factor relevant to whether a prospective corporate defendant will be prosecuted, is an improper interference with the defendants' rights to obtain counsel of their choice and to mount a defense consistent with their means, and (2) KPMG's decision not to advance defense costs was influenced by the Thompson memorandum and KPMG's desire to avoid prosecution. Moreover, the government's declaration concedes that the lead prosecutor in this case inquired in February 2004 about KPMG's obligations and plans with respect to payment of legal fees of partners and employees. Against the background of the Thompson memorandum, the inquiry itself arguably was a signal to KPMG as to actions that would promote its chances of avoiding prosecution.

In the circumstances, limited discovery and an evidentiary hearing are appropriate for the proper resolution of this aspect of the motions. The hearing will begin at 11 a.m. on May 8, 2006. The issues for consideration are whether the government, through the Thompson memorandum or otherwise, affected KPMG's determination(s) with respect to the advancement of legal fees and other defense costs to present or former partners and employees with respect to the investigation and prosecution of this case and such subsidiary issues as relate thereto.

The Court urges the parties to reach stipulations as to the communications between the prosecution team and KPMG on this subject and KPMG's practice, if any, with respect to the advancement of legal fees and other defense costs. It seems likely that the latter is objectively determinable and that there should be no need to take testimony on it. In addition, the Court invites the submission of memoranda, on or before April 27, 2006, addressing the question whether defendants are obliged to establish prejudice and the appropriate remedy in the event the Court finds that defendants rights have been violated.

In preparation for the hearing, the government, in the absence of a stipulation with the defendants as to facts concerning the communications between the prosecution team and KPMG, shall respond, on or before May 1, 2006, to the questions set forth in Section A and produce the documents requested in Section B of the discovery requests in Mr. DePetris' April 5, 2006 letter. Defendants may serve a Rule 17(c) subpoena on KPMG seeking production, on or before April 21, 2006, of documents described in Section B, although this order is without prejudice to any objections that KPMG may interpose.

The parties shall notify the Court, on or before May 5, 2006, of the witnesses they intend to call at the hearing and of its anticipated length.

SO ORDERED.

Dated: April 12, 2006

Lewis A. Kaplan
United States District Judge

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

UNITED STATES OF AMERICA	:	
- against -	:	S1 05 Cr. 888 (LAK)
JEFFREY STEIN, JOHN LANNING, RICHARD SMITH, JEFFREY EISCHEID, PHILIP WIESNER, JOHN LARSON, ROBERT PFAFF, DAVID AMIR MAKOV, LARRY DELAP, STEVEN GREMMINGER, RAYMOND J. RUBLE, also known as "R.J. Ruble," GREGG RITCHIE, RANDY BICKHAM, MARK WATSON, CAROL WARLEY, DAVID RIVKIN, CARL HASTING, RICHARD ROSENTHAL, and DAVID GREENBERG,	:	
Defendants.	:	

GOVERNMENT'S SUPPLEMENTAL MEMORANDUM
ON ISSUES CONCERNING THE DEFENDANTS' RIGHT TO COUNSEL

The Government respectfully submits this brief in response to the Court's invitation for legal memoranda, by Memorandum and Order dated April 12, 2006, on the following issues raised in the first instance by a motion filed by certain defendants (hereafter, the "defendants") alleging violations of their constitutional rights to counsel and to a fair trial. The issues on which the Court invited submissions are:

(i) whether the defendants are obliged to establish prejudice in order to succeed on their claims; and

(ii) in the event the Court finds that the defendants' rights were violated, what is the appropriate remedy.

In short, each moving defendant bears the burden of establishing his or her own prejudice in order to succeed on these claims, which prejudice is found in rare circumstances and only in factual scenarios well beyond the prejudice posited by the defense to date. With respect to the second issue, any remedies to be considered are in the first instance driven by the specific nature of the alleged constitutional violation. Even assuming some finding of a constitutional violation, the Government respectfully submits that the only appropriate remedy would be to have KPMG reconsider its decision without reference to the Thompson memo provision concerning the advancement of legal fees. In this setting, the Government would represent to KPMG, as it did previously to the Court, that a decision to resume payment of attorneys' fees would not be a breach of the deferred prosecution agreement, and would not be viewed as such.

The Government maintains that this proposed remedy is the only proper remedy which would comport with Sixth Amendment jurisprudence and this Court's jurisdiction in fashioning a remedy. Under no circumstances should the defendants be permitted to recover legal fees from the money paid, and scheduled to be paid, by KPMG to the Government pursuant to KPMG's deferred prosecution agreement. First, such a decision would subvert controlling Supreme Court precedent, which confirms that a defendant's right to counsel does not include the right to compel a third party to pay for that counsel. Second, this money comprises criminal fines to the Government, restitution to the Internal

Revenue Service, and a civil penalty to the Internal Revenue Service, each of which entails powers properly exercised on the part of the Executive and Legislative Branches. To conclude that this money can be diverted to pay defense costs would, it is respectfully submitted, infringe upon the separation of powers guaranteed under the Constitution.

Factual Background

The Government's position with respect to the disputed provision in the Thompson memo, as well as the Government's communications with KPMG on the subject of KPMG's payment of legal fees prior to KPMG's March 11, 2004 decision to condition the payment of fees, is set forth in greater detail in the Government's letter to the Court dated April 11, 2006, including the Declaration of AUSA Justin Weddle attached thereto. Since that time, KPMG has provided the parties with certain documents relevant to the Court's inquiry, and the parties have stipulated to certain facts concerning KPMG's past practices with respect to the payment of legal fees. In broad summary, KPMG is a limited liability company registered in Delaware, a state that permits, but does not require, that partnerships advance legal fees for employees and partners in connection with civil and criminal investigations and prosecutions that arise out of the employee or partner's work on behalf of the partnership. *See* 6 Del. C. § 17-108. During the relevant time period, KPMG did not have a by-law or other written undertaking or written policy to advance such fees. The company did have an informal practice of advancing legal fees to partners, principals, and employees of the firm in civil, criminal, or regulatory inquiries. However, KPMG had only one instance in which its partners, principals, or employees were indicted on criminal charges arising out of their work for the company, an instance significantly smaller in scope than the present matter. KPMG believes that in that case, which arose some thirty years before the events at issue in this case, legal fees were advanced pre- and post- indictment.

Argument

For purposes of this submission only, the Government assumes that the Thompson Memo's reference to the payment of attorney's fees, as well as the Government's inquiry at the February 25, 2004 meeting with KPMG's attorneys regarding KPMG's history and plan with respect to the payment of fees, was a factor[1] in KPMG's decision to advance fees to the defendants subject to certain conditions. As detailed below, such facts do not give rise to any constitutional violation the extent of which would compel a remedy beyond permitting KPMG to decide whether to pay any particular defendant's legal fees

[1] Specifically, for purposes of this brief, the Government assumes, as the Court suggested in its April 12, 2006 Memorandum and Order, that the Government's February 2004 inquiry into KPMG's obligations and plans regarding the payment of legal fees, viewed "[a]gainst the background of the Thompson memorandum," could arguably have been perceived by KPMG "as a signal as to actions that would promote its chances of avoiding prosecution." *See* April 12 Order at 2. The Government assumes this despite, among other things, the fact that under a fair reading, the Thompson memo does not provide that prosecutors should negatively evaluate the payment of legal fees to anyone under investigation or indictment, but rather provides that payment of fees may be considered in weighing whether an entity purporting to cooperate was genuinely cooperating or actually impeding an investigation. The Thompson memo does not suggest that the mere payment of legal fees without more should be held against an entity.

knowing that such a decision would not be considered a breach of KPMG's deferred prosecution agreement.

I.

No Remedy Can Be Applied To KPMG's Decision To Condition The Advancement Of Legal Fees, As No Sixth Amendment Rights Existed At That Time

KPMG's decision to advance legal fees to its partners and employees subject to certain conditions was communicated no later than March 11, 2004, when KPMG sent letters concerning this decision to counsel for its partners and employees under investigation. (Weddle Dec. ¶ 4, Ex.A). Importantly, this decision was made more than 17 months before any partner or employee was indicted on any charges by the Government. Because defendants' right to counsel did not attach until they were formally charged, their claim, which is grounded in the Sixth Amendment, should be rejected. Consequently, to the extent the defendants' claims are based upon pre-indictment conduct, no Sixth Amendment violation remedy is available.

The Sixth Amendment to the United States Constitution guarantees that "[i]n all criminal prosecutions, the accused shall enjoy the right . . . to have the Assistance of Counsel for his defense." U.S. Const., Amend. VI. The right to counsel, however, does not attach until the initiation of formal judicial proceedings, "whether by way of formal charge, indictment, preliminary hearing, information, or arraignment." *Kirby* v. *United States*, 406 U.S. 682, 689 (1972) (plurality opinion); *McNeil* v. *Wisconsin*, 501 U.S. 171, 175 (1991); *United States* v. *Gouveia*, 467 U.S. 180, 185-90 (1984); *United States* v. *Massiah*, 377 U.S. 201 (1964); *United States* v. *Holmes*, 44 F.3d 1150, 1159-60 (2d Cir. 1995); *In re Doe*, 781 F.2d 238, 244 (2d Cir. 1986) (*en banc*).

As Justice Stewart stated for the Court in *Kirby*:

> The initiation of judicial criminal proceedings is far from a mere formalism. It is the starting point of our whole system of adversary criminal justice. For it is only then that the government has committed itself to prosecute, and only then that the adverse positions of government and defendant have solidified. It is then that a defendant finds himself faced with the prosecutorial forces of organized society, and immersed in the intricacies of substantive and procedural criminal law. It is this point, therefore, that marks the commencement of the "criminal prosecutions" to which alone the explicit guarantees of the Sixth Amendment are applicable.

Kirby, 406 U.S. at 689-90.

Accordingly, the fact that "a person is the subject of a criminal investigation is not enough to trigger his Sixth Amendment right to counsel," *United States* v. *Vasquez*, 675 F.2d 16, 17 (2d Cir. 1982) (*per curiam*), even if the subject already has counsel at that time. *Moran* v. *Burbine*, 475 U.S. 412, 431 (1986); *see also Holmes*, 44 F. 3d at 1160 (finding that unindicted target has no Sixth Amendment rights).

Here, the defendants assert that the Government, through the existence of the Thompson memo and/or the Government's inquiry regarding KPMG's plan to pay legal fees, violated their Sixth Amendment right to counsel. However, even assuming that the Thompson Memo and/or the Government's inquiry played a role in KPMG's decision to

condition the payment of legal fees to its partners and employees, these circumstances cannot serve as the basis of a Sixth Amendment violation where, as here, the right did not yet exist. Accordingly, defendants' Sixth Amendment claim with respect to any pre-indictment conduct lacks merit, and no remedy is available to the defendants in this criminal case.

Notwithstanding the absence of an available remedy for the alleged pre-indictment conduct, the Government reiterates its stance at the March 30, 2006 oral argument that KPMG may decide whether to pay any particular defendant's legal fees without fear that the Government will consider any such payments to constitute a breach of KPMG's deferred prosecution agreement. For the reasons further set forth below, the Government maintains that even upon a finding of a violation of any defendant's rights in this context, this would be the only appropriate remedy.

II.

Because The Defendants Are Adequately Represented, No Sixth Amendment Violation Exists, And No Remedy Is Available

The defendants are presently represented by the counsel of their choice and, for this reason, have suffered no denial of their Sixth Amendment rights. The defendants do not argue that they have been ill-served by their counsel, nor do they assert that their attorneys are incompetent, nor do they seek the appointment of counsel. Instead, the defendants assert that a third party, namely KPMG, has failed to pay their legal bills, even though neither Delaware law nor an individual contract compels such payment.[2] Through the instant claim, the defendants are seeking to transmute an alleged interference with their respective business relationships with KPMG into a constitutional violation. Sixth Amendment jurisprudence has made clear that a defendant's right to counsel is not unfettered; that it can be subject to economic constraints; and that a defendant does not have a Sixth Amendment right to have a third party fund his or her defense. Thus, even assuming a violation of some right could be found, the Court should not impose the payment of the defendants' legal fees on another party as the defendants have no such Sixth Amendment right to third party payment of fees.

A defendant "does not have the absolute right to counsel of her own choosing." *United States* v. *Locascio*, 6 F.3d 924, 931 (2d Cir. 1993). As the Supreme Court explained in *Wheat* v. *United States*, 486 U.S. 153 (1988), the right to counsel is intended to ensure that criminal defendants receive a fair trial; thus, the constitutional guarantee "focuses on the adversarial process, not on the accused's relationship with his lawyer as

[2] Defendant Jeffrey Stein stands in a different factual footing than the other defendants, inasmuch as he had entered into a severance agreement in January 2004, before the commencement of the federal investigation, which Stein alleges specified KPMG's obligations to provide for advancement of legal fees. *See* Stein Letter dated April 5, 2006. Stein asserts that KPMG continued to pay his legal fees until May 2005, which fees exceeded the $400,000 cap imposed by KPMG on others. *See id.* at 3. As noted in prior submissions, the Government was not aware of the fee provisions of Stein's severance agreement, and in fact had no communications with KPMG concerning the advance of fees for Stein. The Government's recollection of events was confirmed by KPMG in a letter to the parties dated April 19, 2006, which was attached as an exhibit to KPMG's letter to the Court dated April 20, 2006, requesting modifications to the Fed. R. Crim. P. 17(c) subpoena issued by the defendants, as well as certain protections for confidential information. *See* KPMG 4/19/06 Letter at 5.

such." *Id.* at 159; *see also United States* v. *Cronic*, 466 U.S. 648, 657 n.21 (1984). "[T]he essential aim of the [Sixth] Amendment is to guarantee an effective advocate for each criminal defendant rather than to ensure that a defendant will inexorably be represented by the lawyer whom he prefers." *Wheat*, 486 U.S. at 159.

Accordingly, the Sixth Amendment right to choose one's own counsel is circumscribed in several important respects. *Id.* First, the Sixth Amendment guarantees defendants in criminal cases the right to adequate representation. *Caplin & Drysdale* v. *United States*, 491 U.S. 617, 624 (1989). The Government understands that the Sixth Amendment guarantees a defendant the right to be represented by an otherwise qualified attorney whom that defendant can afford to hire, or who is willing to represent the defendant, *id.*, however, the Sixth Amendment does not guarantee a defendant the right to his first-choice attorney. *United States* v. *Goldberger & Dubin, P.C.*, 935 F.2d 501, 504 (2d Cir. 1991); *United States* v. *Mills*, 895 F.2d 897, 904 (2d Cir. 1990); *see also Morris* v. *Slappy*, 461 U.S. 1, 13-14 (1983) (Sixth Amendment does not include a right to a meaningful attorney-client relationship); *United States* v. *Schmidt*, 105 F.3d 82, 89 (2d Cir. 1997) ("a trial court may require a defendant to proceed to trial with counsel not of defendant's choosing; although it may not compel defendant to proceed with incompetent counsel").

Second, "a defendant may not insist on representation by an attorney he cannot afford." *Wheat*, 486 U.S. at 159; *Caplin*, 491 U.S. at 624. Although the Sixth Amendment creates a right to counsel, *Powell* v. *Alabama*, 287 U.S. 45, 53 (1932), the Constitution does not demand that every defendant receive the counsel he most desires. *Morris*, 461 U.S. at 13-15 (district court did not violate the Sixth Amendment by requiring defendant to go to trial with adequate counsel although defendant preferred a different lawyer). The right is to *adequate* counsel, *see Strickland* v. *Washington*, 466 U.S. 668, 686 (1984), not to the best lawyer money can buy or a particular lawyer. *In re Klein*, 776 F.2d 628, 633 (7th Cir. 1985). Accordingly, a defendant has no right to insist upon being represented by his preferred choice, particularly when the defendant cannot afford such legal representation. *Wheat*, 486 U.S. at 159; *Caplin*, 491 U.S. at 624.

Third, and equally important, a defendant has no right to spend another person's money for legal services. As the Supreme Court has previously stated:

> Whatever the full extent of the Sixth Amendment's protection of one's right to retain counsel of his choosing, that protection does not go beyond "the individual's right to spend his own money to obtain the advice and assistance of . . . counsel." A defendant has no Sixth Amendment right to spend another person's money for services rendered by an attorney, even if those funds are the only way that that defendant will be able to retain the attorney of his choice.

Caplin, 491 U.S. at 626 (citations and quotations omitted). Accordingly, "there is no constitutional principle that gives one person the right to give another's property to a third party, even where the person seeking to complete the exchange wishes to do so in order to exercise a constitutionally protected right." *Id.* at 628; *United States* v. *Rogers*, 984 F.2d 314, 316 (9th Cir. 1993).

The Government submits that, in light of this well-established case law, no Sixth Amendment violation, even based upon post-indictment conduct, can be found based upon the assumed circumstances here. It follows that any remedy which orders the payment of defendants' legal fees by another party would run counter to this Sixth Amendment precedent. To the extent the defendants suggest that they may have certain civil claims — whether it be a claim in contract against KPMG for failing to advance the legal fees or a purported claim in tort against the Government for allegedly interfering in the defendants' contractual relationship with KPMG — these civil claims cannot be transformed into a violation of the defendants' Sixth Amendment rights. Moreover, no potential civil claims should be addressed before this Court in the context of this criminal case. Thus, while the Government has not and does not object to KPMG making a choice regarding the payment of any particular defendant's legal fees, the Sixth Amendment does not provide for any additional remedies.

III

No Remedy Is Available For The Defendants' Fifth Amendment Claims

The defendants also contend that an evidentiary hearing is necessary to determine whether the Government's conduct violated their rights under the Due Process Clause of the Fifth Amendment. However, the defendants' Fifth Amendment claim, to the extent one has been asserted, essentially rests upon the same underpinning as their Sixth Amendment claim — the purported interference with the right to counsel. Thus, for the same reasons set forth above, even assuming a constitutional violation, there is no proper remedy other than having KPMG determine whether to pay the defendants' fees.

To be sure, the Second Circuit has recognized a due process defense to prosecution, "if the government violated a protected right of the defendant" and "if the government's conduct 'reached a demonstrable level of outrageousness.'" *United States* v. *Cuervelo*, 949 F.2d 559, 565 (2d Cir. 1991) (quoting *Hampton* v. *United States*, 425 U.S. 484, 495 n.7 (1976) (Powell, J., concurring)); *see also United States* v. *Chin*, 934 F.2d 393, 399 n.4 (2d Cir. 1991); *United States* v. *Alexandro*, 675 F.2d 34, 39-40 (2d Cir. 1982). However, the existence of a due process violation turns on whether the governmental conduct, standing alone, is "so offensive that it shocks the conscience." *Chin*, 934 F.2d at 398 (citing *Rochin* v. *California*, 342 U.S. 165 (1952)). Not surprisingly, therefore, courts have rarely, if ever, found such a violation. *United States* v. *Berkovich*, 168 F.3d 64, 69 (2d Cir. 1999) (citing *United States* v. *LaPorta*, 46 F.3d 152, 160 (2d Cir. 1994)). What constitutes "a demonstrable level of outrageousness" cannot be identified with precision, but "the due process claim, in the rare instances when successful, has prevailed to restrain law enforcement activities that involve coercion . . . or outrageous violation of physical integrity," *United States* v. *Myers*, 692 F.2d 823, 837 (2d Cir. 1982), or psychological integrity. *Cuervelo*, 949 F.2d at 565.

Here, defendants do not assert that they have suffered some psychological or physical harm as a result of the actions of the Government. Instead, they argue that

because a third party, KPMG, was allegedly prevented by the Government from providing its partners and employees with paid representation beyond a certain monetary limit, their Fifth Amendment right was violated. In essence, their Fifth Amendment claim rests upon their Sixth Amendment claim regarding right to counsel, and thus does not provide any separate basis to impose any remedy. To support their argument, defendants rely on inapposite case law involving tortious interference with contract and witness tampering. (Deft's Fees Br. at 16-20). Similarly unavailing is defendant's reliance upon the dissenting opinions in *Caplin & Drysdale* and a subsequent forfeiture case, *United States* v. *Monsanto*, 491 U.S. 600 (1989).

In *Caplin*, the Supreme Court's controlling majority opinion held that neither the Fifth nor Sixth Amendment is offended when criminal defendants are prohibited from using assets adjudged to be forfeitable to pay attorney's fees, merely because those assets are in their possession. *Caplin*, 491 U.S. at 632-33. Defendants attempt to distinguish *Caplin* by arguing that, unlike this situation here, in *Caplin*, the Government had a property interest in the forfeitable assets.[3] However, in emphasizing this distinction, defendants ignore an equally important principle enunciated by the *Caplin* Court that is particularly applicable here: "A defendant has no Sixth Amendment right to spend another person's money for services rendered by an attorney, even if those funds are the only way that that defendant will be able to retain the attorney of his choice." *Id.* at 626.

[3] In fact, here the Government does have a property interest in the money received through KPMG's payment of fines, penalties, and restitution.

The defendants' attempts to explain away *Monsanto* also fail, because the *Monsanto* Court adopted the reasoning in *Caplin* to explain why neither a Fifth nor Sixth Amendment violation was present in that case. *Id.* at 614 ("We rely on our conclusion in [*Caplin*] to dispose of the similar constitutional claims raised by respondent here.").

As both *Caplin* and *Monsanto* make clear, a defendant has no right to spend another person's money for legal services. Accordingly, because defendants cannot establish a violation of their Fifth Amendment rights, much less prejudice, their Fifth Amendment claims do not warrant the imposition of a remedy beyond that proposed by the Government.

IV.

The Defendants Must Establish The Requisite Prejudice

If the Court determines that the defendants have demonstrated that they had extant Sixth Amendment rights that were violated by the Government's conduct — two issues with which the Government obviously disagrees — the next issue concerns whether the defendants are required to establish that they have been prejudiced by the alleged violation. While the Government believes that the *Strickland* prejudice standard, which places the burden on each defendant to establish prejudice, is the most analogous to this case, it respectfully submits that the defendants cannot demonstrate prejudice under any potentially applicable standard.

Sixth Amendment violations fall into three categories, which are distinguished by the severity of the deprivation and the concomitant showing of prejudice required of the defendant in order to succeed on his or her claim. *See generally United States* v. *O'Neil*, 118 F.3d 65, 70 (2d Cir. 1997). The first category encompasses circumstances so severe as to constitute *per se* violations of the Sixth Amendment. *Bellamy* v. *Cogdell*, 974 F.2d 302, 306 (2d Cir. 1992) (*en banc*). For example, the Second Circuit has found *per se* violations in the following limited circumstances, neither of which is applicable here: (1) where the attorney was not licensed to practice law because he failed to satisfy the substantive requirements of admission to the bar, and (2) where the attorney was implicated in the defendant's crime. *O'Neil*, 118 F.3d at 70-71. Thus, the Government submits that even if there were a Sixth Amendment violation, the *per se* rule discussed in *O'Neil* does not apply and the defendants must show prejudice.

The second category involves conflicts of interest between attorney and client that do not rise to the level of *per se* violations, but may jeopardize the adequacy of representation. *Id.* at 71; *United States* v. *Cancilla*, 725 F.2d 867, 870 (2d Cir. 1984). "In order to prevail on a conflict of interest claim, the defendant must establish an actual conflict of interest that resulted in a lapse of representation." *O'Neil*, 118 F.3d at 71 (quotation omitted). Thus, because no conflict of interest has been asserted, this standard is inapplicable here. Nevertheless, even if the Court were to apply the conflict of interest standard in this context, the defendants would have to establish a "lapse of representation," which they simply cannot.

All remaining Sixth Amendment claims require a showing of prejudice. *See, e.g.*, *United States* v. *Morrison*, 449 U.S. 361, 365-66 (1981) (holding that, absent some "adverse effect upon the effectiveness of counsel's representation" or "some other prejudice to the defense," "there is no basis for imposing a remedy" in a criminal case for a Sixth Amendment violation); *Strickland* v. *Washington,* 466 U.S. at 687 (holding that defendant bears burden of establishing prejudice for Sixth Amendment claim). *Strickland* requires a defendant to show "(1) that his attorney's performance fell below an 'objective standard of reasonableness,' and (2) that 'there is a reasonable probability that, but for counsel's unprofessional errors, the result of the proceeding would have been different.'" *Kieser* v. *New York*, 56 F.3d 16, 18 (2d Cir. 1995) (quoting *Strickland*, 466 U.S. at 694).

As noted previously, the defendants do not argue that they have been ill-served by their counsel, nor do they assert that their attorneys are incompetent. The defendants' purported prejudice boils down to a complaint that a third party, namely KPMG, has failed to pay their legal bills. Once again, however, the law is clear that a defendant, whether "white-collar" or "blue-collar," has no right to spend a third party's money for legal services. *Caplin*, 491 U.S. at 626. "[T]here is [simply] no constitutional principle that gives one person the right to give another's property to a third party, even where the person seeking to complete the exchange wishes to do so in order to exercise a

constitutionally protected right." *Id.* at 628. The *Gagalis* case on which the defendants rely, while factually dissimilar, nonetheless suggested that:

> It is one thing for the government to interfere with a party's efforts to raise funds from sources — other sources that it does not have a right to, and it is another thing entirely for the government to interfere with a defendant's property right to use funds that he has a right to have for his defense. . . . And the cases that seem to me to be close to the point here, the forfeiture cases, draw a big distinction between a defendant's right to apply his or her own property to fund counsel of his or her choice and the nonexistent right to apply funds that are forfeitable to the counsel of choice.

Arkin Affirmation, Ex. 1 Part A at 4-5.

Accordingly, the defendants bear the burden to establish prejudice, a requirement that the defendants cannot meet in alleging a violation of their constitutional rights.

V.

Should The Court Determine That The Defendants Have Established A Violation Of Their Sixth Amendment Rights, And The Requisite Prejudice, The Appropriate Remedy Is To Have KPMG Reconsider Its Decision Concerning The Advancement Of Fees,

As explained above, it is the Government's position that, not only have defendants not been prejudiced by any action on the part of the Government, but that neither the defendants' Fifth nor Sixth Amendment rights were violated. Should this Court disagree, however, the Government respectfully submits that the appropriate remedy would be to have KPMG reconsider its decision to advance fees to the defendants without reference to the Thompson memo or fear that doing so would constitute a breach of KPMG's deferred prosecution agreement.

"Cases involving Sixth Amendment deprivations are subject to the general rule that remedies should be tailored to the injury suffered from the constitutional violation and should not unnecessarily infringe on competing interests." *United States* v. *Morrison*, 449 U.S. 361, 364 (1981); *United States* v. *Williams*, 372 F.3d 96, 112 (2d Cir. 2004) (citing *Morrison*). Here, all parties appear to agree that, assuming a violation and prejudice exists, dismissal of the indictment is unwarranted. (Deft's Fees Br. at 27). The debate remains, however, as to the scope and breadth of any order issued by this Court regarding the advance payment of legal fees.

During oral argument, the Court sought confirmation that the Government "has no objection whatsoever to KPMG exercising its free and independent business judgment as to whether to advance defense costs to these defendants and that if it were to elect to do so the government would not in any way consider that in determining whether [KPMG] had complied with the [deferred prosecution agreement]." (3/30/06 Tr. at 37). The Government responded, "That's always been the case, your Honor. That's fine. We have no objection to that." (*Id.*). The Government respectfully submits that the Court has, with this inquiry, correctly framed the remedy, should a Sixth Amendment violation and prejudice be found. If KPMG decides, for reasons separate and apart from the conduct or influence of the Government, to advance legal fees to the defendants, any prejudice the

defendants may have suffered would appear to be remediated. (Deft's Fees Br. at 27). If KPMG elects not to advance fees, by contrast, no Sixth Amendment violation on the part of the Government could be said to exist, because the decision was reached independent of any Government involvement.[4]

The defendants have previously argued that this "Court can remedy the violation . . . by directing that advancement of legal fees be provided to defendants in the defense of this criminal prosecution." (*Id.*). At oral argument on March 30, 2006, the Court expressed doubt that it could order KPMG, who is not a party to the instant proceeding, to pay money. (3/30/06 Tr. at 16). In response, a defense counsel suggested that defendants' fees could be paid out of the $256 million that KPMG has already paid the Government or money to be paid by KPMG in the future pursuant to the deferred prosecution agreement. (3/30/06 Tr. at 16). The Government disagrees.

As an initial matter, the Government agrees with the Court that it would be a constitutional violation to order KPMG, who is not a party to this action, to pay defendants' legal fees. However, there are at least two significant problems with the defendants' alternative argument of securing their legal fees from the United States. First, the Supreme Court has made clear that "there is no constitutional principle that gives one person the right to give another's property to a third party, even where the person seeking to complete the exchange wishes to do so in order to exercise a constitutionally protected right." *Caplin*, 491 U.S. at 628. This principle rings particularly true where, as here, KPMG, a defendant in a separate proceeding before the Honorable Loretta A. Preska, has relinquished property to the Government to pay fines, penalties, and restitution imposed to address KPMG's admitted criminal conduct. Thus, as in *Caplin*, the illegal funds recovered by the Government are the exclusive property of the Government, and "to hold that the Sixth Amendment . . . creates a right on [defendants] part to receive these assets, would be peculiar." *Id.* at 628.

Second, the defendants have cited no statutory or other authority under which the Court could permissibly order the Government to pay the defendants' legal fees. "[A] general rule inherent in the American constitutional system, [is] that, unless otherwise expressly provided or incidental to the powers conferred, . . . the judiciary cannot exercise either executive or legislative power." *Springer* v. *Government of Philippine Islands*, 277 U.S. 189, 201-02 (1928); *see also Missouri* v. *Jenkins*, 495 U.S. 33, 67 (1990) ("[T]he Judiciary is not free to exercise all federal power; it may exercise only the judicial power."). The appropriations power is a legislative power under the Constitution. *See* U.S. Const., Art. I, § 9, cl. 7 ("No Money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law"). The Supreme Court has cautioned that its cases "underscore the straightforward and explicit command of the Appropriations Clause. 'It means simply that no money can be paid out of the Treasury unless it has been

[4] In fact, KPMG's decision on this issue in light of the Government's prior and current representations should obviate the need for an evidentiary hearing, regardless of which course KPMG pursues.

appropriated by an act of Congress.'" *Office of Personnel Management* v. *Richmond*, 496 U.S. 414, 424 (1990).

Congress has enacted a statutory scheme for the payment of fees for "counsel and investigative, expert and other services" for criminal defendants. *See* 18 U.S.C. § 3006A (the Criminal Justice Act). That statute, which contains an Appropriations Clause cite, *see* 18 U.S.C. § 3006A(i), permits the Court to authorize such payments where "necessary for adequate representation," under certain circumstances set forth in the statute. The remedy suggested by defense counsel does not appear to be permitted under this statutory scheme. Thus, for the Court to order payments from the United States Treasury would, in essence, be enacting a method for Government payment of legal services independent of the scheme enacted by Congress. Accordingly, the Government respectfully submits that the defendants' proposal be denied.

CONCLUSION

For the reasons stated above, the Court should find that the defendants bear the burden of establishing prejudice to succeed on their motions, and that the defendants' Sixth Amendment rights have not been violated by KPMG's decision to advance legal fees to the defendants subject to certain conditions. Accordingly, the defendants' motion to remedy the supposed violation should be denied. In the alternative, if the Court were to conclude that the defendants' Sixth Amendment rights were violated by the Government's conduct, the Government respectfully submits that the appropriate remedy would involve allowing KPMG to reconsider its position concerning the advancement of legal fees exclusive of the Thompson memo.

Dated: New York, New York
April 27, 2006

Respectfully submitted,

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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

UNITED STATES OF AMERICA	:	
	:	**S1 05 Crim. 888 (LAK)**
-against-	:	
JEFFREY STEIN, et al.,	:	
Defendants.	:	

AMENDED MOTION OF THE SECURITIES INDUSTRY ASSOCIATION, THE ASSOCIATION OF CORPORATE COUNSEL, THE BOND MARKET ASSOCIATION, AND THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA FOR LEAVE TO FILE BRIEF *AMICI CURIAE*

The Securities Industry Association, the Association of Corporate Counsel, the Bond Market Association, and the Chamber of Commerce of the United States of America respectfully submit this amended motion for leave to file a brief as *amici curiae* to address the broad legal and policy issues raised by defendants' motion concerning advancement of legal fees. This amended motion incorporates by reference the previous motion of *amici*, which requested leave to file our brief by May 5, 2006, and attaches the brief as Exhibit A.

May 3, 2006

Respectfully Submitted,

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Exhibit A

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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

UNITED STATES OF AMERICA	:	
-against-	:	**S1 05 Crim. 888 (LAK)**
JEFFREY STEIN, et al.,	:	
Defendants.	:	

BRIEF FOR *AMICI CURIAE* THE SECURITIES INDUSTRY ASSOCIATION, THE ASSOCIATION OF CORPORATE COUNSEL, THE BOND MARKET ASSOCIATION, AND THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA

The Securities Industry Association, the Association of Corporate Counsel, the Bond Market Association, and the Chamber of Commerce of the United States of America submit this brief to address the broad legal and policy issues raised by defendants' motion concerning the advancement of legal fees.[1] Although *amici* do not address the factual issues presented by this particular case, *amici* can give the Court the business community's perspective on the Justice Department's disquieting policy of thwarting private arrangements for the legal representation of corporate officers and employees.

INTRODUCTION AND SUMMARY

Under the Department of Justice Internal Policy Guidelines for charging corporations (the "Thompson Memorandum"), the Department treats "a corporation's promise of support to culpable employees and agents . . . through the advancing of attorneys fees" as a potential basis for finding that the corporation itself has failed to "cooperat[e]" with a government investigation.[2] The government decides which unconvicted corporate employees the corporation should consider "culpable," and it coerces corporate counsel to withhold previously promised support for those employees' legal defense. The twin premises implicit in this policy are (i) that the employees in question are guilty, even though they have been convicted of no crime and (ii) that effective representation for targeted employees frustrates, rather than promotes, the cause of justice. The Thompson Memorandum's author summed up the essence of this policy when he explained that, in the government's view, employees subject to investigation "don't need fancy legal representation" unless they are guilty.[3]

As discussed below, the government's intervention in private fee arrangements subverts the basic principles of our adversarial justice system; it places corporate counsel in the untenable position of having to accept a prosecutor's "culpability" determinations at face value even during the early phases of an investigation; and it creates perverse incentives that threaten business efficiency. An enormous number of private businesses agree to advance attorneys' fees to employees under investigation for conduct arising from their employment. Such arrangements are necessary both to recruit talented individuals to work in industries subject to close governmental scrutiny and to ensure that those individuals, once hired, act in the interests of their employers rather than serving their own self-interest by erring on the side of extreme caution, lest they face personally ruinous legal fees. For these reasons and those discussed below, the Thompson Memorandum is wrong both as a matter of constitutional law and as a matter of sound business sense.

STATEMENT OF INTEREST

Amici are organizations that represent the interests of the business community and corporate counsel. All of them have a strong interest in preserving the discretion of their members to advance legal fees to officers and employees under investigation for acts committed in the course of employment.

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[1] *See* Motion to Remedy the Violation of Defendants' Constitutional Rights to Counsel and a Fair Trial Resulting From the Prosecutors' Wrongful Interference With Defendants' Ability to Obtain Advancement of Legal Fees from KPMG (filed Jan. 12, 2006). Defendants, all former partners of KPMG LLP, have moved for dismissal of the indictments, or other appropriate relief, on the ground that the government has interfered with their constitutional right to counsel and a fair trial. The Court has scheduled an evidentiary hearing for May 8, 2006, to consider "whether the government, through the Thompson memorandum or otherwise, affected KPMG's determination(s) with respect to the advancement of legal fees and other defense costs." Memorandum and Order (Corrected), *United States v. Stein*, No. 05-888 (S.D.N.Y. filed Apr. 13, 2006).

[2] Memorandum from Larry Thompson, Deputy Attorney General, on Principles of Federal Prosecution of Business Organizations to Heads of Dep't Components and United States Attorneys (Jan. 20, 2003), http://www.usdoj.gov/dag/cftf/corporate_guidelines.htm.

[3] *See* Laurie P. Cohen, *In the Crossfire: Prosecutors' Tough New Tactics Turn Firms Against Employees*, Wall St. J., June 4, 2004, at A1.

The Securities Industry Association ("SIA") brings together the shared interests of approximately 600 securities firms active in all U.S. and foreign markets and in all phases of corporate and public finance. SIA's members include leading investment banks, broker-dealers, and mutual fund companies. Employing nearly 800,000 individuals, the securities industry generated $236.7 billion in domestic revenue and an estimated $340 billion in global revenue in 2004.

The Association of Corporate Counsel ("ACC") represents the professional interests of attorneys who practice in the legal departments of corporations and other private sector organizations worldwide. The association has more than 19,000 members in over 50 countries who represent approximately 7,500 organizations. Its members represent 49 of the Fortune 50 companies and 98 of the Fortune 100 companies. Internationally, its members represent 42 of the Global 50 companies and 74 of the Global 100 companies. One of the primary missions of the ACC 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 employers.

The Bond Market Association ("TBMA") is a global trade organization that represents approximately 200 securities firms, banks, and asset managers that underwrite, sell, trade, and invest in debt securities and other credit products in the United States and in international markets. Its members include securities dealers and brokers that are large multi-product firms and those with special market niches, including all primary dealers in U.S. government securities and all major dealers in U.S. agency securities, mortgage- and asset-backed securities, corporate bonds, and money market and funding instruments, as well as asset management firms with nearly $9 trillion under management.

The Chamber of Commerce of the United States of America ("Chamber") is the largest business federation in the world. The Chamber's underlying membership includes more than three million companies and professional organizations of every size, in every industry sector, and from every region of the country. An important function of the Chamber is to represent the interests of its members in matters before Congress, the Executive Branch, and the courts. To that end, the Chamber regularly files *amicus curiae* briefs in cases that raise issues of vital concern to the nation's business community.

BACKGROUND

When they deem it appropriate, many companies provide for the advancement of legal fees to officers, directors, and (often at the company's discretion) employees who face legal problems arising from conduct within the scope of their employment.[4/] A survey of publicly available data reveals that 48 of the nation's largest 50 companies (in terms of annual revenue) provide for such fee advancement in their articles of incorporation, by-laws, or other organic documents. Large companies are hardly alone in this respect; for example, nine of *Forbes*' "Ten Best Small Companies" have also adopted such provisions. In addition, many states have formalized, through state legislation, an official policy endorsing each company's discretion to adopt such provisions.[5/] For example, "[r]ights to indemnification and advancement are deeply

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[4/] *See, e.g.*, Chevron Corporation, Restated Certificate of Incorporation, art. IX (May 9, 2005), http://www.chevron.com/investor/corporate_governance/docs/certificate_of_incorporation.pdf; Pfizer, Inc., By-laws, art. V (Feb. 24, 2005), http://www.pfizer.com/pfizer/download/investors/corporate/bylaws.pdf.

[5/] *See, e.g.*, Del. Code Ann. tit. 8, § 145(e); N.Y. Bus. Corp. Law § 723(c); *In re Republic Techs. Int'l, LLC*, 275 B.R. 508, 513 (Bankr. N.D. Ohio 2002); *see generally* Kurt A. Mayr, II, *Indemnification of Directors and Officers: The "Double Whammy" of Mandatory Indemnification Under Delaware Law*, 42 Vill. L. Rev. 223, 223-224 & n.4 (1997) (collecting statutes). Corporations face few state law *requirements* to adopt such policies against their will, and *amici* oppose any such legal compulsion.

rooted in the public policy of Delaware corporate law in that they are viewed less as an individual benefit arising from a person's employment and more as a desirable mechanism to manage risk in return for greater corporate benefits." *Kaung v. Cole Nat'l Corp.*, 884 A.2d 500, 509 (Del. 2003). For many years, this "deeply rooted" legal tradition has helped define the expectations and practices of the business community.

The Thompson Memorandum, issued in 2003, imperils this mainstay of corporate employment.[6/] It directs that "a corporation's promise of support to culpable employees and agents . . . through the advancing of attorneys fees . . . may be considered by the prosecutor in weighing the extent and value of a corporation's cooperation." Thompson Memorandum at 7-8. Put differently, this guidance encourages prosecutors to threaten businesses with indictment if they do not play ball by withdrawing prior commitments to advance legal fees to whatever employees those prosecutors deem "culpable" for some wrongdoing. The Thompson Memorandum thus encourages prosecutors to substitute their own judgment about an employee's culpability for the judgment of corporate counsel in determining whether to advance legal fees to that employee.

This policy is designed to, and does in fact, exert tremendous pressure on companies under investigation.[7/] While even a mere allegation of wrongdoing can drive down a company's stock price, companies and the government both know the ruinous practical consequences of indictment. "In the 212-year history of the U.S. financial markets, no major financial-services firm has ever survived a criminal indictment." Ken Brown et al., *Called to Account: Indictment of Andersen in Shredding Case Puts Its Future in Question*, Wall. St. J., Mar. 15, 2002, at A1. For example, Arthur Andersen LLP lost most of its clients soon after it was indicted and is now, for practical purposes, a dead firm, even though the Supreme Court later overturned its conviction.[8/] Indicted companies may also face an onslaught of lawsuits by shareholders who allege that the company's wrongdoing caused a decrease in its share price.[9/]

[6/] The Thompson Memorandum built on policies previously adopted by former Deputy Attorney General Eric Holder by "increas[ing] emphasis on and scrutiny of the authenticity of a corporation's cooperation." Thompson Memorandum at 1; *see* Memorandum from Eric Holder, Deputy Attorney General, on Bringing Criminal Charges Against Corporations to Component Heads and United States Attorneys, U.S. Department of Justice (June 16, 1999), http://www.usdoj.gov/criminal/fraud/policy/Chargingcorps.html; *see generally* Carmen Couden, Note, *The Thompson Memorandum: A Revised Solution or Just a Problem?* 30 J. Corp. L. 405, 413-416 (2005) (discussing the Thompson Memorandum's revision to previous DOJ guidance).

[7/] The government's efforts to suppress fee advancements are part and parcel of its broader program to weaken rights of legal representation for the subjects of its investigations. For example, the Thompson Memorandum states that "[i]n gauging the extent of the corporation's cooperation, the prosecutor may consider the corporation's willingness . . . to waive the attorney-client and work product protection." Thompson Memorandum at 6. Such demands are widespread. In a recent survey of more than 1,200 respondents, 30% of in-house counsel and 51% of outside corporate counsel who had recent experience with enforcement actions reported that the government had indicated an expectation that the company would waive the attorney-client privilege in order to engage in bargaining or to be eligible to receive more favorable treatment. *See* Association of Corporate Counsel et al., *The Decline of the Attorney-Client Privilege in the Corporate Context: Survey Results Presented to the United States Congress and the United States Sentencing Commission*, at 3, http://www.acca.com/Surveys/attyclient2.pdf (last visited May 2, 2006). The predictable result of such routine privilege waiver is to chill attorney-client communications in the long run and thus to frustrate the ability of corporate counsel to conduct effective internal investigations and to provide necessary legal advice to clients.

[8/] *See Arthur Andersen LLP v. United States*, 544 U.S. 696 (2005); *see generally* Cohen, *supra*, at A1 (describing the effect of criminal charges on Arthur Andersen and Drexel Burnham Lambert); Jonathan D. Glater, *Enron Holders in Pact with Andersen Overseas Firms*, N.Y. Times, Aug. 28, 2002, at C3 (describing effects of indictment on Andersen's operations).

[9/] *See, e.g.*, John C. Coffee, Jr., *Rescuing the Private Attorney General: Why the Model of the Lawyer as Bounty Hunter is Not Working*, 42 Md. L. Rev. 215, 223 (1983) (describing the frequency with which derivative lawsuits piggyback on government injunctive actions or indictments).

ARGUMENT

I. The Government's Policy Violates Key Criminal Justice Principles.

For centuries, criminal suspects have been presumed innocent until proven guilty, *see, e.g., Coffin v. United States*, 156 U.S. 432, 453 (1895), and effective representation for these suspects has been thought to serve, rather than thwart, the essential goals of the justice system, *see, e.g., Penson v. Ohio*, 488 U.S. 75, 84 (1988). The government's policy on fee advancements turns both principles on their heads.

First, it pressures corporate counsel to acquiesce in a prosecutor's unilateral conclusion that particular employees are guilty of wrongdoing, are "uncooperative" if they assert otherwise (or remain silent), and are undeserving of the high-quality legal representation that few employees can afford on their own. Corporate counsel are typically hard-pressed to present evidence of their own contradicting that conclusion. Culpability is particularly difficult for anyone to assess in the early phases of complicated financial or accounting-related investigations, given the complexity of the issues involved and the volume of documents to be reviewed.[10/] Implicating corporate counsel in a prosecutor's pretrial "culpability" determinations undermines the ethic of fairness needed for healthy employer-employee relationships and subverts the basic presumption that investigatory targets are presumed innocent until convicted of a crime.

Here, the terms of the Deferred Prosecution Agreement ("DPA") between the government and KPMG exemplify the government's hostility toward any effort to slow down its own rush to judgment. In the DPA, the government extracted a commitment from KPMG that "it shall not, through its attorneys, agents, partners, or *employees*, make any statement, in litigation or otherwise, contradicting the Statement of Facts or its representations in this Agreement."[11/] Such provisions present employees with a Hobson's choice: either "cooperate" and keep quiet about any information that may undermine the DPA's Statement of Facts; or speak up and risk causing corporate counsel, fearful of "violating" the DPA, to distance the company from the inconsistent statements by withdrawing the advancement of legal fees. This dynamic fosters a culture of silence that is as inimical to principles of good corporate governance as it is to the effective functioning of the adversarial system.

Second, the government's policy on fee advancements rests on a contemptuous and legally baseless view of the role of defense counsel in the judicial process. The author of the Thompson Memorandum summarized the government's attitude with the remark that if employees contest criminal liability in good faith, then "they don't need fancy legal representation." Laurie P. Cohen, *In the Crossfire: Prosecutors' Tough New Tactics Turn Firms Against Employees*, Wall St. J., June 4, 2004, at A1 (internal quotations omitted). Nothing could be further from the truth. Particularly in complex financial or accounting cases, all defendants, not just those with something to hide, benefit from effective legal representation. In fact,

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[10/] *See* Am. Coll. of Trial Lawyers, *The Erosion of the Attorney-Client Privilege and Work Product Doctrine in Federal Criminal Investigations*, 41 Duq. L. Rev. 307, 337-338 (2003). Indeed, even courts often find it challenging to differentiate between culpable and lawful behavior notwithstanding a full trial record. Under the Sherman Act, for example, it is "often difficult to distinguish" illegal conduct "from the gray zone of socially acceptable and economically justifiable business conduct." *United States v. U.S. Gypsum Co.*, 438 U.S. 422, 441 (1978); *see also* Pamela H. Bucy, *Indemnification of Corporate Executives Who Have Been Convicted of Crimes: An Assessment and Proposal*, 24 Ind. L. Rev. 279, 293 (1991).

[11/] Letter of David N. Kelley, United States Attorney, Southern District of New York, to Robert S. Bennett, Aug. 26, 2005, at 16, http://www.usdoj.gov/usao/nys/Press%20Releases/August%2005/KPMG%20dp%20AGMT.pdf (emphasis added).

employees whom the government considers culpable have an even greater need for high-quality legal representation than employees who have not been so prejudged, because they face more severe consequences.[12]

The government's antipathy toward effective representation of those it deems "culpable" for wrongdoing also runs headlong into basic constitutional principles. For example, when (as in this case) the government issues an indictment, the Sixth Amendment entitles the defendant not just to a competent lawyer, but to the defendant's lawyer of choice, precisely because the Framers understood that some lawyers are especially adept at defending individuals against particular types of charges.[13] Although the government need not itself subsidize the defendant's retention of his lawyer of choice, the government may not unilaterally interfere with his ability to secure such funding through private means.[14] The government's policy here thwarts the right to counsel in precisely that respect by encouraging prosecutors to obstruct private legal fee arrangements.

This case thus raises a fundamental question: With all the formidable resources it brings to any investigation of a major business, what interest could the government have in depriving individuals of the privately obtained financial resources needed for a level playing field? One commentator reasonably contends that the natural consequence of the government's policy is to "mov[e] the process governing the American system away from the form the Founders expressly meant it to take—an accusatorial system—and toward something they feared—an inquisitorial system." George Ellard, Essay, *Making the Silent Speak and the Informed Wary*, 42 Am. Crim. L. Rev. 985, 991 (2005). And the government has inflicted that choice on businesses because it believes that most of its targets are guilty and that most effective lawyers serve only to frustrate the search for truth. Again, each position violates the basic premises of our adversarial system of justice.

Finally, the government's policy may, if anything, *hinder* the search for truth over the long term, even if it proves expedient to the government in the short term. Employees with important information relevant to an investigation may be less willing to give complete (or any) information to investigators unless they are represented by counsel they trust. And, so long as

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[12] The role of defense counsel in white collar cases is all the more critical now that, according to the government, employees can be indicted for making false statements to private corporate counsel. *See, e.g.*, Indictment, *United States v. Kumar*, No. 04-846 (E.D.N.Y. filed May 17, 2004); *see generally* Lisa M. Fairfax, *Spare the Rod, Spoil The Director? Revitalizing Directors' Fiduciary Duty Through Legal Liability*, 42 Hous. L. Rev. 393, 437-438 (2005) (discussing enhanced penalties for securities fraud); Testimony of Gerald B. Lefcourt Before the ABA Task Force on Attorney-Client Privilege (Apr. 21, 2005), at 4-5 & n.10, http://www.abanet.org/buslaw/attorneyclient/publichearing20050421/testimony/lefcourt.pdf (discussing the case against former Computer Associates' executives).

[13] *See Powell v. Alabama*, 287 U.S. 45 (1932) ("It is hardly necessary to say that, the right of counsel being conceded, a defendant should be afforded a fair opportunity to secure counsel of his own choice."); *see also United States v. Gonzalez-Lopez*, 399 F.3d 924 (8th Cir. 2005), *cert. granted*, 126 S. Ct. 979 (Jan. 6, 2006) (addressing whether erroneous denial of counsel of choice is so inimical to our justice system that it invariably requires reversal of any ensuing conviction). Protection for a criminal defendant's right to choose his own counsel likely arose in part as a reaction to the infamous efforts of prosecutors in New York to deprive a newspaperman of the right to his choice of counsel in his trial on charges of seditious libel against the colonial governor. *See* Bruce J. Winick, *Forfeiture of Attorneys' Fees Under Rico and CCE and the Right to Counsel of Choice*, 43 U. Miami L. Rev. 765, 790-798 (1989). The newspaperman subsequently published an account of his trial that was widely read at the time. *See* James Alexander, *A Brief Narrative of the Case and Trial of John Peter Zenger, Printer of the New York Weekly Journal* (S. Katz, 2d ed. 1972).

[14] *See, e.g., United States v. Monsanto*, 924 F.2d 1186 (2d Cir.) (*en banc*) (government cannot prevent defendant from using private funds to pay defense fees absent showing of probable cause that the restrained funds derive from a crime), *cert. denied*, 502 U.S. 943 (1991); *United States v. Farmer*, 274 F.3d 800, 803 (4th Cir. 2001) (collecting cases); *United States v. Noriega*, 746 F. Supp. 1541, 1545-1546 (S.D. Fla. 1990) (holding that "where a criminal defendant's only assets available for payment of attorneys' fees have been placed out of reach by government action, due process mandates that the government be required to demonstrate the likelihood that the restrained assets are connected to illegal activity").

corporate counsel remain under pressure to acquiesce in a prosecutor's hasty determinations of culpability, even employees who *have* counsel will think twice before divulging all they know about alleged improprieties, lest their knowledge be turned on them and taken as a sign of complicity. The government's policy will likewise discourage some potential informants from seeking plea agreements with the government. Many people will negotiate plea bargains with the government only if they have faith in their counsel, and such individuals are less likely to come forward with information if they lack the means to hire trusted legal representation.

II. The Government's Attack on Fee Advancements Threatens the Integrity of the Employment Relationship and Efficient Corporate Operations.

Quite apart from its incompatibility with traditional legal principles, the government's fee advancement policy is bad for business. As an initial matter, it threatens to distort the economic marketplace. Companies routinely exercise their discretion to use indemnification and advancement policies as recruiting tools to attract the best-qualified directors and officers. *See Homestore, Inc. v. Tafeen*, 888 A.2d 204, 218 (Del. 2005). In addition to serving the interests of the company, indemnification provisions serve the interests of the public because they encourage highly skilled executives to serve in important corporate roles that expose them to a high risk of legal trouble. *Mooney v. Willys-Overland Motors*, 204 F.2d 888, 898 (3d Cir. 1953). If the government regularly coerces companies to deny fee advancement to employees the government deems "culpable" for some wrongdoing, many talented employees may well decide to avoid working in fields subject to detailed regulation, such as accounting or finance, for fear of incurring exorbitant legal fees in defending themselves against complex, document-intensive charges.

Even more troubling, the government's policy gives corporate managers perverse incentives to exalt their own self-interest over their company's interests. Companies function best when the interests of the company and its employees are aligned.[15] Fear of massive personal exposure to legal fees, however, can lead employees to err on the side of extreme caution in their daily work, even when doing so disserves their companies' interest in a more sensible approach. This divergence in individual and corporate interests is particularly pronounced in fields, such as accounting or finance, in which everyday decisions can carry complex and financially enormous consequences.

Fee advancement guarantees reduce that divergence in interests by giving employees the confidence they need to act assertively when the company's business interests so require. A fitting analogue is the business judgment rule, a mainstay of corporate law. This rule enables directors, for example, to make difficult but necessary and prudent business decisions by shielding them from liability for the later adverse results of those decisions. But for the business judgment rule,

> the entire advantage of the risk-taking, innovative, wealth-creating engine that is the Delaware corporation would cease to exist, with disastrous results for shareholders and society alike. That is why, under our corporate law, corporate decision-makers are held strictly to their fiduciary duties, but within the boundaries of those duties are free to act as their judgment and abilities dictate, free of *post hoc* penalties from a reviewing court using perfect hindsight.

In re Walt Disney Co. Derivatives Litig., No. Civ. A. 15452, 2005 WL 2056651, at *2 (Del. Ch. Aug. 9, 2005) (unpublished); *see also Unitrin, Inc. v. American Gen. Corp.*, 651 A.2d 1361, 1372-1373 (Del. 1995). Likewise, fee advancement guarantees permit managers to act with the security that, should the need arise, they will be able to defend themselves effectively against complex but ultimately unfounded allegations of wrongdoing. The government's policy here

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[15] *See, e.g., Restatement (Second) of Agency* § 387, cmt. b (2006) ("[A]n agent is subject to a duty to his principal to act solely for the benefit of the principal in all matters connected with his agency.").

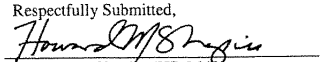
undermines that sense of security and thereby creates precisely the types of the perverse incentives these fee advancement guarantees are designed to preclude.

CONCLUSION

For the foregoing reasons, the relevant provisions of the Thompson Memorandum are unlawful.

May 3, 2006

Respectfully Submitted,



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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

UNITED STATES OF AMERICA,	
- against -	05 Cr. 888 (LAK) (ECF)
JEFFREY STEIN, et al.,	
Defendants.	

DEFENDANTS' (AMENDED) PRE-HEARING MEMORANDUM

INTRODUCTION

Defendants submit this Memorandum in advance of the hearing scheduled for May 8, 2006 (the "Hearing") in order to summarize and analyze for the Court voluminous documentary evidence produced to the defendants by KPMG LLP and the United States Attorney's Office for the Southern District of New York ("USAO").[1] The memorandum reviews: (1) the early stages of KPMG's dealings with the USAO on fee issues, in which the USAO made clear its expectations and KPMG moved swiftly to satisfy them; (2) the collaboration by KPMG and the USAO in enforcing the restrictions on fees established by KPMG; and (3) other aspects of KPMG's dealings with the USAO, including the manner in which KPMG repeatedly emphasized to the USAO its restrictions on payment of fees as a key aspect of its cooperation with the USAO's investigation.

[1] As of the time of this submission, documents have been produced by (1) KPMG with bates numbers KPMG17(c)-0001 through 0357, and (2) the government with bates numbers USAO 0001 through 0100. In this memorandum, KPMG documents will be cited as "KPMG ____", and government documents will be cited as "USAO ____".

As the Court will see from the discussion below, the documents produced by KPMG and the USAO leave no doubt that, through the Thompson Memo[2] and direct and specific communication with KPMG's counsel, the USAO compelled KPMG to abandon a decades-old practice of always advancing legal fees for its partners, principals, and employees (collectively, "employees"), no matter what, and to adopt a totally new approach for purposes of this case that severely restricted and eventually eliminated KPMG's payment of legal fees for its employees. We believe the testimonial evidence still to come at the Hearing will provide further proof that the USAO coerced KPMG to restrict and eliminate payment of legal fees for employees.

I. BACKGROUND

On February 9, 2004, the USAO sent letters to a large number of KPMG employees informing them that they were subjects of a grand jury investigation into so-called "tax shelter" activities at KPMG. An example of such a letter is attached as Exhibit A. (See also KPMG 0271). The sending of these letters set in motion a series of meetings and dealings between KPMG and the government (through its counsel, Skadden Arps Slate Meagher & Flom LLP ("Skadden")) that are illuminated by the documents produced by KPMG and the government.

As of early 2004, when the events at issue began to unfold, KPMG had a decades-old practice of always paying all legal fees for all present and former employees in all types of legal proceedings – literally without exception. In a letter to the Court dated April 25, 2006, the defendants, the government, and KPMG set out the following stipulation that they had entered into:

[2] Memorandum on Principles of Federal Prosecution of Business Organization, issued on January 20, 2003, by then-Deputy Attorney General Larry Thompson.

> 1. Prior to February 2004, notwithstanding the absence of a written policy, it had been the longstanding voluntary practice of KPMG to advance and pay legal fees, without a preset cap or condition of cooperation with the government, for counsel for partners, principals, and employees of the firm in those situations where separate counsel was appropriate to represent the individual in any civil, criminal or regulatory proceeding involving activities arising within the scope of the individual's duties and responsibilities as a KPMG partner, principal, or employee.
>
> 2. This practice was followed without regard to economic costs or considerations with respect to individuals or the firm.
>
> 3. With the exception of the instant matter, KPMG is not aware of any current or former partner, principal, or employee who has been indicted for conduct arising within the scope of the individual's duties and responsibilities as a KPMG partner, principal, or employee since [two partners] were indicted and convicted of violation of federal criminal law in 1974. Although KPMG has located no documents regarding payment of legal fees in that case, KPMG believes that it did pay pre- and post-indictment legal fees for the individuals in that case.

This practice was fully supported by the law of Delaware, under which KPMG operates as a registered limited liability partnership. (KPMG 0197; see generally Memorandum of Law in Support of Certain Defendants' Motion to Remedy the Violation of Defendants' Constitutional Rights to Counsel and a Fair Trial Resulting from the Prosecutors' Wrongful Interference with Defendants' Ability to Obtain Advancement of Legal Fees from KPMG, dated January 12, 2006, at pages 4-10).

However, as a result of the meetings and dealings between KPMG and the government, as well as the overbearing influence of the Thompson Memo, in a matter of weeks after the government had launched its attack on February 9, 2004, KPMG abandoned that decades-old practice. We will seek to prove at the Hearing that pressure by the government was the sole, or at least the predominant, reason why KPMG abandoned its previously inviolate rule and turned its back on its employees at a time when they most needed the support they had always assumed would be there for them.

II. EARLY STAGES OF KPMG'S DEALINGS WITH THE USAO

On February 25, 2004, lawyers from Skadden, as counsel for KPMG, held their first meeting with representatives of the government at the offices of the USAO in New York City. Five partners from Skadden, including Robert S. Bennett, Kenneth J. Bialkin, and Fred Goldberg (a former Commissioner of the IRS) attended the meeting. (KPMG 0001). Ten representatives of the government, including AUSA Shirah Neiman (Chief Counsel to the United States Attorney), AUSA Justin Weddle, AUSA Stan Okula, Special AUSA Kevin Downing, and various Special Agents from the Criminal Investigation Division of the IRS also attended. (Id.; USAO 0021; KPMG 0312). In advance of the meeting, the government apparently prepared an outline of issues it intended to raise with the Skadden lawyers. A redacted copy of that outline, bearing the handwriting of AUSA Neiman, was produced by the government. (USAO 6). The outline includes the following typed questions:

> Is KPMG paying/going to pay the legal fees of employees?
> Current or former?
>
> . . . .
>
> Who?
>
> • Any agreements or other obligations to do so?

As planned in advance, at the meeting the government expressly raised the issue of payment of fees. A typed Memorandum of Interview prepared by IRS Special Agent Laura Marcandetti states: "AUSA Weddle asked what KPMG's obligations were to pay the legal fees of its employees." (USAO 0021, 0024; see also KPMG 0313 ("Weddle – .... Are u paying fees

for partners/ees? Are you obligated[?]")). Mr. Bennett responded that it was KPMG's "common practice" to pay fees for its employees. (KPMG 0313; see also USAO 0024 ("Mr. Bialkin further stated that, generally, KPMG would pay the legal fees of a partner involved in legal proceedings")). According to Special Agent Mercandetti, Mr. Bennett told the government he "was still looking into this issue, but was ninety percent (90%) sure that if the result was that KPMG had to pay the legal fees then it would not pay the legal fees for anyone who was not cooperating with the government, i.e. taking the fifth amendment." According to the Special Agent, "Mr. Bennett stated that KPMG hoped that this would further show the government of [sic] its cooperation." (USAO 0024).

In the end, the Skadden lawyers told the government at the meeting that "KPMG has yet to make a determination about paying the legal expenses of former partners/employees of the firm." (Id.; see also KPMG 0313 (notes of Skadden lawyer Pilchin: "We have had discussions @ what the firm does in typical situations – but no final decisions made")). Special Agent Mercandetti's Memorandum of Interview states: "AUSA Weddle finally asked Mr. Bennett to find out what KPMG's obligations would be." (USAO 0025; see also USAO 0006 (AUSA Neiman handwritten notes on typed outline: "want partnership agr.")). AUSA Weddle also told Skadden that if KPMG had discretion regarding payment of fees, the government would "look at that under a microscope." (KPMG 0314 ("JW – if u have discretion re fees – we'll look at that under a microscope")). According to Special Agent Mercandetti, "Shirah Neiman further advised [Skadden] that under the federal guidelines misconduct can not be rewarded." (USAO 0025; see also KPMG 0313 ("SN – misconduct shdn't be rewarded"; reference by AUSA Neiman to "Principles of Fed. Prosecution")).

The government's pressure on KPMG regarding the payment of fees quickly bore fruit. On March 2, 2004, Mr. Bennett called AUSA Weddle to follow up on the February 25 discussion about fees. AUSA Weddle reported on the conversation in an email to several government colleagues, including AUSA Neiman and AUSA Okula:

> [Mr. Bennett's] preliminary view on legal fees was as follows: ....
>
> KPMG does not think it has any binding legal obligation to pay fees, but since this is a partnership it would be a big problem not to do it. They are planning on doing two things: (1) putting a cap on fees; and (2) conditioning fees on the person cooperating fully with the company and the government. I told him that I had had a bad experience in the past with a company conditioning payments on a person's cooperation, where the company did not define cooperation as "tell the truth" they [sic] way we define it. He said he understood and it would not be a problem.

(USAO 0030 (emphasis added)).

This astounding statement by AUSA Weddle – that the "truth" would be what the government said it was, and that anyone who disagreed with the government's version of the "truth" would be a liar, and, more significantly for present purposes, deemed not to be cooperating with the government and therefore not entitled to any payment of legal fees by KPMG – is truly Orwellian. That statement by itself demonstrates why a person pulled into this criminal investigation desperately needed an experienced and capable lawyer to protect him from an egregiously wrongful mindset on the part of the government.

There can be no doubt as to why KPMG reached its decision to severely limit fees and make them conditional on "cooperating" with the government. On March 4, 2004, a Skadden lawyer had a telephone conversation with counsel for KPMG partner Carol Warley (who had recently received one of the USAO's "subject" letters, and who has since been indicted) in which the Skadden lawyers explained KPMG's new, restrictive approach to the payment of fees.

(KPMG 0316). Mr. Pilchen of Skadden stated in the call: "[I am] upset by that policy, but this is Ashcroft." (Id.). The Skadden lawyers also told Ms. Warley's counsel that the government had "implied it'd prefer K[PMG] not to pay fees here." (KPMG 0317).

On March 11, 2004, five Skadden partners were back at the USAO to meet with AUSA Weddle and Okula, among other government representatives. Mr. Bennett told the government lawyers that KPMG was "being as cooperative as possible so you don't exercise discretion" (KPMG 0319) – presumably a reference to the government's ultimate discretion to indict KPMG. Mr. Bennett also argued that the cooperation KPMG was giving the government was "more than [the government had] ever gotten before." (KPMG 0319).

Though none of the documents we have received from KPMG or the government expressly say so, it seems likely that at that same March 11 meeting, the Skadden lawyers presented the prosecutors with a prototype letter formally setting out the approach KPMG had settled on regarding payment of fees to present and former employees who became involved in the investigation. (KPMG 0015). The prototype letter, on Skadden letterhead and addressed to a fictitious lawyer named "John Jones," purported to set out "the decision made by KPMG…regarding the payment of reasonable legal fees and related expenses for [your client's] representation by [you] in connection with the federal grand jury investigation of certain tax strategies commenced recently in the Southern District of New York (the 'investigation')." (Id.) The letter went on to say that KPMG had determined that it had "no legal obligation" to pay any of the KPMG employee's legal fees or expenses, but that, "[c]onsistent with its past practices," KPMG was prepared to pay legal fees and expenses "subject to the conditions set forth in this letter." Those conditions were as follows:

> *First,* [your client] must cooperate with the government and that cooperation must be prompt, complete, and truthful. KPMG is cooperating fully with the government in this investigation, and [your client] must do the same.
>
> *Second,* KPMG's payment of [your client's] legal fees and expenses in connection with the investigation … will be capped at $400,000….
>
> KPMG's payment of [your client's] legal fees and expenses will cease immediately if (i) [your client's] cooperation with the government is not prompt, complete, and truthful; (ii) the cap is reached; or (iii) [your client] is charged by the government with criminal wrongdoing.
>
> ….
>
> If [your client] wishes to have KPMG pay reasonable legal fees and related expenses in connection with his representation in this investigation, please have [your client] sign this letter below and return it to me.

We say it seems likely that the prototype letter was discussed with prosecutors at the March 11 meeting because, starting on March 11, Skadden began sending out letters identical to the prototype, but addressed to real lawyers representing real KPMG employees. (See, e.g., KPMG 0160-61 (Bickham); KPMG 0162-63 (DeLap), KPMG 0164-65 (Eischeid); KPMG 0166-67 (Gremminger); KPMG 0168-70 (Hasting); KPMG 0171-72 (Lanning); KPMG 0173-74 (Rivkin); KPMG 0175-76 (Rosenthal); KPMG 0177-78 (Smith); KPMG 0179-80 (Warley); KPMG 0181-82 (Watson); and KPMG 0183-84 (Wiesner)).

About this same time, the prosecutors and the lawyers from Skadden had a telling written exchange which demonstrates the depth of the government's intrusion into KPMG's dealings with its employees on the subject of representation by counsel. On March 12, the day after the March 11 meeting with the prosecutors, Skadden faxed to AUSAs Weddle and Okula an "Advisory Memorandum to KPMG Personnel Regarding Possible Contacts by Government

Investigative Personnel" (the "Advisory Memorandum" or "Memorandum"), which KPMG had already distributed to certain employees. (KPMG 0270-73). The fax to the USAO included (1) a cover letter to the two prosecutors, (2) a distribution memo from KPMG Deputy General Counsel Joseph Loonan briefly explaining the purpose of the Advisory Memorandum, and (3) the Memorandum itself. The cover letter began: "In response to your request, enclosed is a copy of a memorandum advising personnel of KPMG... – on their rights and responsibilities with regard to the government's investigation." (KPMG 0270). Mr. Loonan's distribution memo noted that in early February the USAO had sent letters to several individuals at KPMG and explained that the attached Advisory Memorandum addressed "possible contacts by government representatives." (KPMG 0271). The Loonan memo urged those on the "Distribution List" (the document does not indicate who was on that list) to "read [the Advisory Memorandum] carefully." (Id.).

The Advisory Memorandum generally informed the reader about the investigation by the USAO and described its own purpose as "answering potential questions that might arise in the event that government representatives seek to interview you regarding these matters." (KPMG 0272). The Memorandum provided the following information about the availability of counsel for an employee who was contacted by the government:

> In the event that you are contacted for an interview, the Firm has arranged for an independent attorney and law firm to be available to advise KPMG personnel on how to proceed and to be present with you at any interview with government representatives.... In addition, because the government representatives may wish to question you as a witness about matters that you dealt with in your capacity as a KPMG professional, KPMG has agreed to be responsible for the payment of reasonable fees and related expenses in connection with your legal representation regarding this investigation.

(KPMG 0273).

Among a list of things to "keep...in mind" if the reader of the Memorandum was contacted by the government, was the following sage advice:

> [R]egardless of when or where government representatives may approach you should [sic] remember that you always have the right to confer with counsel and have counsel with you at any interview by government representatives. Among other things, consultation with independent legal counsel may help you to better understand the nature of the investigation and to ensure that any interview is conducted in accordance with your legal rights. Counsel can also take notes on your behalf at the interview to avoid future misunderstandings of what was said.

(Id.).

When the prosecutors read the Advisory Memorandum, they were unhappy. By letter dated March 17, 2004, AUSA Weddle wrote to Skadden that the government was "disappointed with the tone of [the Memorandum] and its one-sided presentation of potential issues that may arise, as well as the substance of certain of its directives." (KPMG 0275). AUSA Weddle added:

> These problems must be remedied, and we propose that the firm send out a supplemental memorandum to do so. Attached please find our proposal. The proposal assumes that KPMG truly is committed to fully cooperating with the Government's investigation.

(Id.).

The government's attached proposal addressed KPMG's prior statements in its Advisory Memorandum regarding the availability of counsel. Apparently upset that KPMG's

Memorandum had stressed the importance of being represented by counsel, the government's proposal had KPMG presenting the concept of appearing without counsel as an equally attractive alternative. The relevant portion of the government's proposal read as follows:

> As described in our March 12, 2004 memorandum, the Firm has arranged for independent counsel to be available to assist employees in their discussions with Government investigators. Employees are not required to use this counsel, or any counsel at all. Rather, employees are free to obtain their own counsel, or to meet with investigators without the assistance of counsel. It is entirely your choice.

(KPMG 0276).

The actions by the prosecutors regarding the Advisory Memorandum provide a window into the dealings between KPMG and the government on the subject of legal representation for KPMG's employees. Like any thinking person of even modest experience, the leaders of KPMG knew that when federal criminal prosecutors approach an individual to question him about involvement in events under investigation by a grand jury, that individual should and must be represented by a qualified lawyer unless, in spite of the fact that such a lawyer has been made available free of charge, the individual refuses to accept the offer. The theory behind having a lawyer is not that the lawyer will impede the government's investigation. Rather, the theory is that the lawyer will make sure the individual's constitutional and other legal rights are protected in dealings with prosecutors who are likely to have an agenda that not only does not include concern for that individual, but may actually include trying to get words out of the individual that can be used to convict him of a crime. Thus, KPMG included this admonition in its list of things to "keep in mind" in the Advisory Memorandum: "[S]tatements made to government representatives may constitute legal admissions which can later be used as evidence against the individual, other individuals, or the Firm in a criminal, civil or administrative proceeding." (KPMG 0273). And this: "[I]t is improper for investigators to resort to threats or intimidation, whether express or implied." (Id.). And this: "[Y]ou retain the right to suspend or terminate an interview at any time." (Id.).

The USAO's alternative proposal, by contrast, sought to maximize the chance that the KPMG employees it contacted would be unrepresented by counsel, so that the prosecutors could deal with them without the intervention of a trained professional who was committed to protect the individual's rights. The undeniable preference on the part of the prosecutors to have the individuals it was investigating be unrepresented is fully consistent with their goal of depriving the defendants in this case of the financial resources they desperately need – and would have otherwise had – to fight what is, for many of them, the threat of life imprisonment.

The next recorded contact between the government and KPMG regarding the payment of attorneys fees was on March 29, 2004. Notes taken by a Skadden lawyer reflect a telephone conversation on that day between Skadden and government lawyers, including AUSA Weddle, AUSA Okula, and Special AUSA Downing. (KPMG 0320-21). In response to the government's unhappiness with KPMG's Advisory Memorandum, Mr. Bennett stated: "We've sent this out before [and] nobody had trouble [with] it." (KPMG 0321). Mr. Bennett added: "We're not even paying [attorneys] fees unless people agree to coop[erate]." (Id.). Bowing to the government's insistence that KPMG's statements to its employees in the Advisory Memorandum had been "one-sided," Mr. Bennett informed the prosecutors in the call that KPMG was "in the process" of preparing a new communication in Q&A format "to give a more balanced approach." (Id.).

Having learned its lesson about sending communications regarding the investigation to its employees without clearing the text first with the government, when KPMG was ready to send out its new communication, it sought prior approval from the government. (KPMG 0278-0293).

On May 10, 2004, Mr. Rauh of Skadden sent the new "Q&A" communication to the government with "DRAFT" stamped on every page. In his cover letter to AUSA Weddle, Mr. Rauh said the following:

> First, we informed you that KPMG wished to distribute to its personnel a series of Questions and Answers ("Q&As") relating to the government's investigation of KPMG, which we read to you. As we discussed, the Q&As were intended to amplify upon and clarify the [Advisory Memorandum] that KPMG sent to all of its Firm personnel on March 12, 2004. You asked us to send a copy of the draft Q&As to you for your further review. That document is attached at Tab A. Please let us know if you have any questions or concerns about the draft Q&As. As we discussed, the Firm wishes to send out the Q&A document soon in order to further emphasize to KPMG personnel the importance of fully cooperating with the government's investigation.

(KPMG 0278).

As with the Advisory Memorandum, the proposed communication was to be accompanied by a distribution memo from Deputy General Counsel Loonan. (KPMG 0282). The draft Loonan memo sent to the prosecutors with Mr. Rauh's letter on March 29 referenced the Advisory Memorandum sent earlier and explained that KPMG was now "set[ting] forth some additional information in question and answer form…in order to clarify and emphasize certain points." (Id.). The attached proposed Q&As were titled "Government Contact Questions & Answers." (KPMG 0283). Going right to the heart of the government's unhappiness with KPMG's prior attitude regarding the importance of having counsel, one of the questions posed was: "Do I have to be assisted by a lawyer?" The answer given was:

> No. Although we believe that it is probably in your best interests to consult with a lawyer before speaking to government representatives, whether you do so is entirely your choice. As we said in the March 12 OGC memorandum, you may deal directly with government representatives without counsel. In any event, the Firm expects you to cooperate fully with government representatives and provide complete and truthful information to them.

(KPMG 0284). Thus, as required by the force of the government's grip on it, KPMG retreated from its prior thoughtful admonition that its employees needed counsel if they became involved in the government's investigation, instead presenting the issue as a matter of rather indifferent personal "choice." (Id.).

The May 10, 2004 Rauh cover letter to AUSA Weddle, with the proposed Q&As attached, also contained a statement intended to communicate to the government the fullness of KPMG's commitment to try to please the government. On page two of the copy of the letter produced to defendants by KPMG, all of the text is redacted except for one sentence. (KPMG 0279). That sentence reads: "In this regard, if you believe that firm personnel have not cooperated with the investigation, please let us know."[3] (Id.). Exactly what KPMG meant by this ominous statement soon became painfully evident to those KPMG employees unfortunate enough to get caught up in the government's investigation.

III. COLLABORATION BETWEEN KPMG AND THE GOVERNMENT

As early as April 2004, the government bore down with a fury on the KPMG employees who had received "subject" letters in February. Among other things, the USAO insisted on days-long interviews of many of these individuals. Despite the fact that the accepted wisdom among criminal defense lawyers is that one should not permit a prosecutor to interview a client who has been described as a "subject" of a grand jury investigation – at least in the absence of a grant of immunity – KPMG's new practice regarding the payment of fees and "cooperation" with the

[3] This is but one example of the many instances where KPMG has improperly redacted portions of documents it produced. How can the sentence that precedes "In this regard…." not be relevant and responsive? We request the Court to direct KPMG to immediately produce this letter in its entirety. The letter reflects KPMG's abject submission to the government on all things large and small, and therefore defendants should be able to see it in its entirety and use it as evidence at the hearing.

government's investigation did not permit such a choice. Rather, any KPMG employee who chose to decline an interview by the government would have payment of his legal fees terminated immediately, leaving him to face a potentially very expensive proceeding completely on his own. Worse, any KPMG employee who declined an interview would be fired from his job at KPMG, even if that individual was a partner.

One KPMG employee at the time whom the government latched onto with a vengeance was Houston tax partner Carol Warley. On April 21, 2004, Ms. Warley had reluctantly gone with her lawyer, John Townsend, a Houston attorney experienced in criminal tax matters, to be interviewed by the government. (KPMG 0097). From Mr. Townsend's perspective, the way the meeting had been conducted was grossly unfair and the government representatives' behavior toward Ms. Warley had been outrageous. Accordingly, when the prosecutors contacted Mr. Townsend to demand that Ms. Warley return to the USAO to continue her interview, Mr. Townsend pushed back.

On April 25, 2004, AUSA Okula wrote to Mr. Townsend confirming a request he had made to have Ms. Warley return. (KPMG 0018). Mr. Okula stated: "Please advise us by Tuesday, April 27th, whether Ms. Warley will agree to return." (Id.) By letter dated April 29, Mr. Townsend responded to AUSA Okula's demand. (KPMG 0019-0027). In the earlier interview, Ms. Warley had steadfastly defended her actions in connection with the matters under investigation, an approach that was poorly received by the government. In his April 29 letter, Mr. Townsend stated:

> I want also to address an issue that you and I discussed that seems to be at the heart of the concerns I have about the process as your team has chosen to pursue it. As in the interview and in our telephone call today, I advise again that your team and my client were not communicating. She answered questions as to her knowledge in her words, not the words you sought to impose on her. In her opinion and in my opinion, she did not lie in the interview. Today, you repeated your team's conclusion that she did lie. If you believe that..., you are mistaken.

(KPMG 0021).

Because of the hostility the government had demonstrated towards his client in the prior interview, Mr. Townsend insisted that, before he would permit Ms. Warley to return for a further interview, he must have a "written representation" from the prosecutors that Ms. Warley "is a subject of the investigation" and "is not a target of the grand jury investigation." (KPMG 0019). Mr. Townsend described this request as "a necessary condition of further interviews." (KPMG 0019). Because of what he considered outrageous conduct by the prosecutors in the prior interview, Mr. Townsend made a further request:

> The next interview(s) will be recorded by an independent video court reporter with the following conditions:
>
> a. one camera on my client;
>
> b. one camera on inquisitor (this will have to move as the inquisitor changes);
>
> c. one camera from front side covering all of grand jury team (at least the attorneys on the team); and
>
> d. the cameras and audio recorders will be on at all times; no unrecorded conversations by anyone.
>
> This will insure an accurate record of what actually occurs; we will not need to rely upon the notes and recollections of persons on either side with an interest and perspective that might cause their notes and recollections to be suspect. My client is willing to stand on what she does and what she says. If you are truly interested in truth and justice, we don't think you can object to this condition. This is a necessary condition of any further interview.

(KPMG 0019-20).

AUSA Okula responded to Mr. Townsend's letter on May 5, 2004, writing:

> Please be advised that the conditions you set out are unacceptable. Unless Ms. Warley agrees to speak with us under the same conditions as the previous meeting – including the same proffer protection – we will conclude that she is no longer interested in cooperating with us in our investigation.

(KPMG 0034). Mr. Townsend wrote back on May 11, refusing to back off his stated requirements. (KPMG 0028-29).

A few days after the USAO received Mr. Townsend's May 11 letter, AUSA Weddle wrote to Mr. Rauh at Skadden to inform him of Mr. Townsend's refusal to return with Ms. Warley except under conditions. Mr. Weddle stated:

> At our meeting of March 29, 2004, you requested that we notify you if any current or former KPMG partner or employee refused to meet with us or otherwise failed to cooperate in our investigation. Pursuant to that request, please be advised that the following individual[] ha[s] refused to meet with us in an informal interview setting pursuant to this Office's standard proffer agreement, and ha[s] instead…proposed unacceptable and inappropriate conditions for any future meeting, as further detailed below:
>
> ….
>
> Carol Warley – met with us pursuant to our standard proffer agreement, but when requested to return for a continued meeting, refused to meet with us except subject to unacceptable conditions.

(KPMG 0030).

Thus prompted by AUSA Weddle, Skadden lawyers telephoned Mr. Townsend to discuss the government's claim that Ms. Warley was refusing to cooperate. After the phone call, Mr. Townsend sent an email to one of the Skadden lawyers with whom he had spoken, attaching the recent correspondence between AUSA Okula and himself and expressing his objection to the way he and his client had been treated by the prosecutors. (KPMG 0031-32). In the email, he called them "aggressive," "over-reaching," "overzealous," and "disingenuous." (Id.) The plucky Mr. Townsend also added: "I am sure Mr. Okula thinks he is doing the Lord's work, but I suspect so did many of the people involved in the Iraqi detainee interrogation abuses. The ends justify the means." (Id.).

On May 28, 2004, three days after Mr. Townsend sent his email to Skadden, Mr. Bennett wrote to him regarding his dispute with the prosecutors. Mr. Bennett referenced the fact that KPMG was "fully cooperating" with the investigation and had conditioned "its willingness to pay a limited amount of legal fees and expenses" upon Ms. Warley's "'prompt, complete, and truthful' cooperation with the government." (KPMG 0045). Mr. Bennett then noted that Skadden had received a letter from the government – the May 18 letter from AUSA Weddle to Mr. Rauh, discussed above – indicating that Ms. Warley was refusing to attend a second interview except on conditions rejected by the government, and that Mr. Townsend had informed Skadden lawyers that he believed the conditions were reasonable. (Id.). Mr. Bennett stated:

> We ask that you endeavor to resolve any disagreement or misunderstanding between your client and the government as to her level of cooperation. Absent an indication from the government within the next ten business days that your client no longer refuses to participate in a second interview except subject to conditions that the government deems unreasonable, KPMG will cease payment of Ms. Warley's fees.
>
> Finally, please note that KPMG will view continued non-cooperation as a basis for disciplinary action, including expulsion from the Firm.

(Id. (emphasis added)). Mr. Bennett sent this letter to AUSA Weddle the same day it went to Mr. Townsend. (KPMG 0294).

It is critical to note how KPMG, through counsel, empowered the prosecutors to define what was and was not "cooperation." Simply put, if the prosecutors said an individual was not

cooperating, then as far as KPMG was concerned, the person was not cooperating. (See USAO 0030 (AUSA Weddle's email to colleagues at the USAO dated March 2, 2004, reporting on a telephone conversation with Mr. Bennett of Skadden ("I told him that I had had a bad experience in the past with a company conditioning payments on a person's cooperation, where the company did not define cooperation as 'tell the truth' the[] way we define it. He said he understood and it would not be a problem.")).

Subjected to the threat of termination of payment of her legal fees and termination of her job, Ms. Warley – whose husband had been ill with severe heart disease and other illnesses for years, and who was the sole wage-earner for her husband, her daughter, and herself[4] – had no choice but to agree to return for a further interview, with none of the conditions on which her counsel had insisted. By letter dated June 15, 2004, AUSA Okula wrote to Mr. Rauh at Skadden that "since our May letter, Ms. Warley's counsel has indicated that she will no longer insist on the conditions that we found unacceptable, and that she will meet with us. We will advise you if she does not follow through promptly." (KPMG 0049).

Ms. Warley then returned to the USAO for a further interview on October 19, 2004. However, at this second interview, the prosecutors served Ms. Warley with a grand jury subpoena and insisted that they wanted to question her before the grand jury without her counsel present. (KPMG 0097). They also changed their designation of her from "subject" to "target." (Id.). Mr. Townsend would not permit her to appear before the grand jury, and on November 10, 2004, AUSA Weddle wrote to Skadden again, advising that "notwithstanding her counsel's representation that she would cooperate with the investigation, Carol Warley continues to refuse to cooperate with this investigation." (KPMG 0081). Five days later, on November 15, 2004, Mr. Rauh wrote to Mr. Townsend informing him that, because "we received another letter from the government...stating that Ms. Warley is not cooperating with the government's investigation," "effective [the date of that letter from the government], KPMG has ceased payment of Ms. Warley's attorney's fees." (KPMG 0093). The letter concluded with the following sentence:

> In addition, absent an indication from the government within the next ten business days that your client no longer refuses to cooperate with the investigation, KPMG will consider additional actions, including Ms. Warley's separation from the Firm.

(Id.). A few days later, Ms. Warley was terminated by KPMG. (See Warley Affidavit cited in note 3 above).

There are dozens of other documents among those produced by KPMG which demonstrate that other KPMG employees received identical treatment at the hands of the government and KPMG. (See KPMG 0160-161 (Bickham); KPMG 0162-163 (DeLap); KPMG 0030, 0037-39, 0042-43, 0164-165 (Eischeid); KPMG 0166-167 (Gremminger); KPMG 0168-170 (Hasting); KPMG 0171-172 (Lanning); KPMG 0269 (Larson); KPMG 0269 (Pfaff); KPMG 0055, 0059 (Ritchie); KPMG 0173-174 (Rivkin); KPMG 0175-176 (Rosenthal); KPMG 0030, 0040-41, 0044-44.1, 0177-178 (Smith); KPMG 0181-182 (Watson); KPMG 0183-184 (Wiesner); KPMG 0047, 0050-54, 0094-95 (Anonymous Individual 1); KPMG 0056-58, 0063-65, 0126 (Anonymous Individual 2); KPMG 0060-62 (Anonymous Individual 3); KPMG 0066, 0076-77, 0084-90 (Anonymous Individual 4); KPMG 0127-29 (Anonymous Individual 5); and KPMG 0134-141, 0186-190, 0268 (Anonymous Individual 6)).

[4] See the Affidavit of Carol Warley dated January 11, 2006, submitted with Ms. Warley's Memorandum of Law in Support of Her Motion for Severance, Change of Venue, Dismissal of Certain Counts of the Indictment, Bill of Particulars and Discovery, dated January 12, 2006.

IV. OTHER DEALINGS BETWEEN KPMG AND THE USAO

At various times during the government's investigation, KPMG had important meetings with the government, and prepared written advocacy pieces, to discuss the extent of its cooperation with the government. The record of these meetings and writings is significant for two reasons. First, it shows that the government continually questioned the fullness of KPMG's cooperation. This approach by the government had the effect of keeping KPMG insecure about its own status and eager to demonstrate its cooperation any way it could. Second, the record shows that KPMG frequently touted its restrictions on payment of legal fees as evidence of its total commitment to cooperation. KPMG knew how much importance the government placed on having KPMG hobble its employees in their efforts to defend themselves, and KPMG reminded the government frequently about how it had done so.

On August 4, 2004, five Skadden partners and KPMG Deputy General Counsel Loonan met with AUSA Neiman, AUSA Weddle, AUSA Okula, Special AUSA Downing, Special Agent Mercandetti, and the Chief of the Criminal Division of the USAO. (USAO 0042, 0069). The Chief of the Criminal Division noted that there were some "troubling issues" under the Thompson Memo. (USAO 0050; see also USAO 0072). She mentioned severance packages given to Mr. Stein and defendant Jeffrey Eischeid,[5] which she described as "rich," and complained that KPMG had granted the packages "without making statements to the public, or privately to its employees, of the wrongdoing that went on." (USAO 0072; see also USAO 0050). In the kind of twisted logic that had developed as a result of the Thompson Memo's requirements, the government referred to the severance packages given to Mr. Stein and Mr. Eischeid as KPMG's "lack of 'ferreting out' the wrong doing [sic]," and called it "not good corporate policy,...[that] serves to limit the USAO in its investigation." (USAO 0072; see also USAO 0051; compare USAO 0025 and KPMG 0313 (both noting AUSA Neiman's statement at the first meeting between the government and Skadden on February 25, 2004, referring to the payment of legal fees for employees as rewarding misconduct). Mr. Bennett of Skadden defended the severance packages and noted that "Skadden had no evidence to show that Stein or Eischeid committed a crime." (USAO 0072; see also USAO 0051).

This focus by the government on Mr. Stein's severance agreement may well have caused KPMG some anxiety because KPMG had not disclosed Mr. Stein's severance agreement to the prosecutors. Similarly, KPMG had not disclosed to the prosecutors that, in Mr. Stein's severance agreement, it had made an unqualified and open-ended contractual commitment to pay his legal fees for any and all legal proceedings relating to the performance of his duties at KPMG.[6] Obviously, this commitment was inconsistent with KPMG's representation to the USAO that all present and former employees were subject to the $400,000 cap and other restrictions relating to cooperation. Later, at the time when the discussions between KPMG and the government about possible indictment came to a head, KPMG abruptly repudiated Mr. Stein's severance agreement and terminated payment of his legal fees[7] – again, without disclosing anything about it to the government.

On November 2, 2004, for reasons unknown to the defendants, Mr. Bennett sent AUSA Weddle a seven-page letter. (KPMG 0067-73). When it produced this letter to defendants,

[5] Mr. Stein had entered into a severance agreement with KPMG on January 27, 2004.

[6] See the April 11, 2006 letter of AUSA Marc Weinstein to the Court, at p. 3 and p. 7 n.6.

[7] See the April 5, 2006 letter of David Spears to the Court, at pp. 3-4.

KPMG redacted all but one paragraph. That one paragraph shows KPMG emphasizing to the government how it had used its restrictions on fees to try to satisfy the government's desire:

> Fourth, KPMG has repeatedly directed all current and former personnel to cooperate with the investigation and has conditioned payment of attorney's fees upon prompt, complete, and truthful cooperation with the government's inquiry. Whenever your Office has notified us that individuals have not rendered prompt, complete, and truthful cooperation, KPMG has promptly and without question encouraged them to cooperate and threatened to cease payment of their attorney fees and (if applicable) to take personnel action, including termination. In certain instances, KPMG's action has led previously non-cooperating individuals to meet with your Office. In other instances, KPMG has ceased payment of fees and expenses.

(KPMG 0068).

By March 2005, KPMG was engaged in intensive discussions with the USAO about KPMG's fate. On March 2, five members of Skadden and three senior leaders of KPMG (including the then-Chairman, Eugene O'Kelly, and Mr. Loonan) went to the USAO to meet with the United States Attorney himself. Also present were the Chief of the Criminal Division, AUSA Neiman, AUSA Weddle, AUSA Okula, Special AUSA Downing, and three IRS Special Agents. A memo to the file prepared by one of the Skadden lawyers – once again, heavily redacted as produced to defendants – gives the following description of the discussion regarding cooperation:

> [The United States Attorney] interrupted at this point and said, with regard to cooperation, "Let me put it this way. I've seen a lot better from big companies." Bennett responded that KPMG has done a great deal to cooperate. He specifically mentioned the conditions placed on payment of fees and noted that KPMG had cut off fees for several individuals for non-cooperation and had terminated two partners for non-cooperation.

(KPMG 0336).

On March 18, 2005, the Skadden lawyers and KPMG executives were back meeting again with the United States Attorney and his colleagues. The (heavily redacted) memo to the file prepared by one of the Skadden lawyers reports that Mr. Bennett told the United States Attorney "that the Firm had been 'enormously cooperative.'" (KPMG 0342). The cooperation Mr. Bennett cited was "that KPMG had 'hinged attorneys fees on whether people would talk to [the prosecutors] and had waived privilege." (Id.).

On June 6, KPMG submitted a so-called "Whitepaper" setting out KPMG's arguments why it should not be indicted. (KPMG 0130). While this document is apparently more than 37 pages in length, KPMG produced to defendants only three paragraphs from pages 35 to 37. (KPMG 0131-133). Two paragraphs appear under the heading "KPMG Has Actively Assisted The Investigation." (KPMG 0132). The first paragraph framed the issue regarding cooperation:

> The Thompson Memorandum states that prosecutors should consider "whether the corporation appears to be protecting its culpable employees and agents" through actions such as advancing attorneys fees, providing information to the employees regarding the Department's investigation pursuant to a joint defense agreement, and failing to sanction the employees for their wrongful conduct. Thompson Mem. at 7-8.

(Id.). The next paragraph touted KPMG's restrictive approach to the payment of legal fees and its punishment of those who had refused to do exactly what the government said:

> KPMG understands that at least 40 current or former KPMG personnel have been interviewed by the U.S. Attorney's Office. KPMG has encouraged that cooperation by refusing to pay the attorneys' fees for its individual partners and employees, unless those partners and employees agree to cooperate fully with the Department's investigation. KPMG capped attorneys' fees for cooperating current and former personnel and has refused to pay attorney's fees in the criminal investigation for numerous former KPMG personnel, including [six named individuals]. KPMG demanded the resignation of two partners…for, respectively,

> refusing to meet with the prosecutors and asserting her Fifth Amendment right not to testify.

(KPMG 0132-133).

Finally, on June 13, 2005, with KPMG's fate still uncertain, a host of Skadden lawyers and KPMG executives met with Deputy Attorney General James Comey to make their case for a resolution that avoided indictment. (USAO 0082; KPMG 0347). In the discussion about KPMG's cooperation, Mr. Bennett stated that KPMG "had done something 'never heard of before' – conditioned the payment of attorney's fees on full cooperation with the investigation." (KPMG 0349-50). Mr. Bennett also told the Deputy Attorney General:

> We said we'd pressure – although we didn't use that word – our employees to cooperate. We told employees that attorney fees would not be paid unless they fully cooperated with the investigation.

(KPMG 0350). Finally, the memorandum to the file prepared by a Skadden lawyer attributes the following additional statements to Mr. Bennett:

> He noted that whenever an individual indicated he or she would not cooperate, "Justin [Weddle] or Stan [Okula] would tell us," and KPMG took action. He went on to note that "what played out" was that current and former personnel who otherwise would not have cooperated did cooperate, and those who did not had their fees cut off and, in two instances, were separated from the firm. This process exhibited "a level of cooperation that is rarely done."

(Id.).

Together, these various statements by KPMG emphasizing to the government how it had limited and withheld legal fees further confirm the importance the government attached to KPMG depriving its employees of legal fees as a demonstration of its cooperation.

CONCLUSION

Defendants look forward to presenting additional evidence at the Hearing.

Respectfully submitted,

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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

---------- X

UNITED STATES OF AMERICA :

- against - : S1 05 Cr. 888 (LAK)

JEFFREY STEIN, ET AL., :

Defendants. :

---------- X

GOVERNMENT'S POST-HEARING MEMORANDUM
ON ISSUES CONCERNING THE DEFENDANTS' RIGHT TO COUNSEL

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GOVERNMENT'S POST-HEARING MEMORANDUM
ON ISSUES CONCERNING THE DEFENDANTS' RIGHT TO COUNSEL

The Government respectfully submits this memorandum in opposition to defendants' motions for relief stemming from KPMG's decision to pay legal fees subject to certain conditions. In response to the defendants' motions, as well as to issues raised *sua sponte* by the Court, this brief addresses any claimed violations of the defendants' Sixth Amendment and statutory rights to counsel, and claimed violations of the defendants' Fifth Amendment rights to procedural and substantive due process. Under any of these frameworks, the defendants cannot mount a viable claim for relief. The expansive construction implicit in the defendants' original claim — that the Sixth Amendment extends to cover a defendant's efforts to obtain funds from third parties — is negated by several Supreme Court decisions, which confirm that a defendant's right to the counsel of his choice can be constrained by economic factors, and does not extend beyond a defendant's right to use his own funds to secure counsel. As detailed in the Statement of Facts, the Government does not believe that its conduct intentionally or impermissibly influenced KPMG's decision to condition the payment of legal fees for the defendants. Were the

Court to conclude otherwise, however, the conduct would not amount to a Sixth Amendment violation. Moreover, any Sixth Amendment claim would require the defendants to establish prejudice — a showing that they, having been consistently represented by competent counsel, cannot make.

Claims by the defendants under the Fifth Amendment would fare no better. The Government conduct alleged falls far short of that required to establish a violation of the defendants' substantive due process rights. Any claims of procedural due process violations would also fail, inasmuch as the defendants have not established that they have a protected property interest arising under the applicable statutes, their contract with KPMG, or common-law principles. The defendants have previously acknowledged the absence of a statutory or express contractual right to the advancement or indemnification of legal fees. The evidence presented during the hearing makes clear that they lack an implied-in-fact or common-law right to advancement or indemnification as well.

If this Court were ultimately to conclude, however, that the defendants had a constitutional right that was violated by Government conduct proven during the hearing (as distinct from being merely alleged in the moving papers), the proper remedy would be for KPMG to reconsider its decisions concerning the payment of legal fees without fear that paying such fees could amount to a violation of KPMG's deferred prosecution agreement ("DPA"). The scope of the Court's jurisdiction over KPMG, if any, is unclear. What is clear, however, is that the defendants' various arguments in favor of requiring the *Government* to pay their legal fees are unsupported by the relevant statutes and case law.

STATEMENT OF FACTS

There are numerous undisputed facts for purposes of this motion: (i) the United States Attorney's Office for the Southern District of New York ("USAO") and KPMG had its first meeting on February 25, 2004; (ii) prior to that meeting, KPMG considered placing conditions on the payment of legal fees; (iii) in response to the USAO's inquiry regarding KPMG's plan on legal fees at the February 25 meeting, lawyers from Skadden, Arps, Slate, Meagher & Flom LLP ("Skadden"), on behalf of KPMG, informed the USAO that, if KPMG had the discretion to do so, KPMG intended to pay for legal fees but condition payment on cooperation with the Government; (iv) KPMG's partnership agreement and by-laws do not provide for the advancement or indemnification of legal fees; (v) on March 2, 2004, Skadden informed the USAO that KPMG intended to place a monetary cap on the payment of legal fees; (vi) the USAO never commented on the placement of a monetary cap, and KPMG never discussed with the USAO the amount of such a cap prior to its implementation; (vii) KPMG never informed the USAO that it would cease paying legal fees upon an individual's indictment prior to implementing that decision; (viii) on March 11, 2004, by letter, KPMG informed its personnel of its decisions on the payment of legal fees; (ix) only one defendant received a letter from KPMG informing her that KPMG terminated her legal fees as a result of her failure to cooperate with the USAO's investigation; and (x) no defendant other than Jeffrey Stein had any written agreement with KPMG containing any provision addressing the payment of legal fees prior to March 11, 2004.

In this Statement of Facts, the Government sets forth what it believes to be the reasonable findings the Court can make based upon the facts before the Court, with respect to: (i) the

reference to legal fees in the January 2003 Principles of Federal Prosecution of Business Organizations (hereinafter, the "Thompson Memo"); (ii) the evidence, or the lack thereof, regarding the influence of the Thompson Memo's reference to legal fees on KPMG's decision to place three conditions on the payment of fees, and the evidence demonstrating whether KPMG's three separate conditions impacted on any particular defendant's receipt of legal fees; (iii) the USAO's limited conduct with respect to KPMG's decision to pay legal fees; and (iv) the evidence regarding any Government knowledge of or interference with the provisions in Stein's severance agreement regarding legal fees.

I. The Thompson Memo

As set forth in the Government's April 11 submission, one of the primary focuses of the Thompson Memo is to address how the Government should handle situations where a business organization, "while purporting to cooperate with a Department investigation, in fact takes steps to impede the quick and effective exposure of the complete scope of wrongdoing under investigation." (Thompson Memo Cover Page). Among the numerous factors that may be considered in deciding whether to charge an entity is the nature of the entity's cooperation, the authenticity of which may be scrutinized. In evaluating the authenticity of purported cooperation, the Thompson Memo provides a non-exhaustive list of steps that an entity might take as a means to truly assist in providing information to the Government, or steps an entity might take to guard the company's information regarding wrongdoing despite paying lip service to cooperation.

While "cases will differ depending on the circumstances," as noted in the Thompson Memo, the payment of legal fees to employees can be one aspect of a corporation impeding an investigation where the corporation "circles the wagons" by, among other things, essentially muffling relevant corporate witnesses and controlling the flow of information to the Government. To the extent a corporation seeks to shield the truth from the Government by, in part, paying the fees of its employees in order to keep its employees in line, the Government may consider that in weighing the authenticity of the entity's purported cooperation efforts. Thus, in circumstances where an entity seeks credit for assisting the Government's investigation, it is fair and appropriate for the Government to obtain information from the corporation that will aid in the Government's investigation of the matter and to conduct inquiries to ascertain the *bona fides* of the entity's cooperation efforts — just as the Government would do with individual defendants seeking to cooperate. Moreover, in the event it later becomes necessary to ascertain whether the Government's investigation has been hampered because an entity has "circled the wagons" or impeded the criminal investigation under the guise of cooperation, it is fair and appropriate for the Government to inquire into the entity's obligations and intentions concerning the payment of legal fees for culpable employees.

Significantly, neither the Thompson Memo's reference to the payment of fees, nor the identical reference in its predecessor, the Holder Memo, constitutes a blanket Government statement that a corporation's payment of legal fees will be weighed negatively in the charging decision. Shirah Neiman ("Neiman"), Chief Counsel to the United States Attorney and one of the authors of the Holder Memo, testified that had KPMG paid unlimited legal fees in this case without conditions, it would not have been considered a negative factor in determining whether

to charge the entity. (Tr. 280, 314).[1] Ms. Neiman testified that, under the Thompson Memorandum, the payment of legal fees is considered only when the Government believed such payments were part of an effort to "circle the wagons." (Tr. 293). In her view, the legal fees provision contained in both the Holder and Thompson Memos is relevant only where the entity is not really cooperating, but rather taking steps to prevent the Government from obtaining information. (Tr. 293-95, 315-16).[2] It has never been the view of the USAO that, if an entity is not legally obligated to pay fees, then the entity should not advance fees. (Tr. 303-04; *see also* Tr. 111).[3]

[1] References to "Tr. __" are to pages of the hearing and argument before the Court on May 8 through May 10, 2006. References to "K __" are to documents produced by KPMG and admitted at the hearing, and references to "U __" are to documents produced by the Government and admitted at the hearing. References to "DX __" are to defense exhibits admitted at the hearing.

[2] Not only do the Holder and Thompson Memos contain the identical provisions, but the Holder Memo itself was merely a codification of practices followed by the USAO for many years prior. *See* Shirah Neiman, "Hallmarks of an Effective Corporate Compliance Program and Waiver of the Privilege Under the Principles of Federal Prosecution of Business Organizations," White Collar Crime 2004 (ABA-CLE), at D-6. (Attached hereto as Exhibit A is a copy of Ms. Neiman's lecture, which she presented in 2003 at the ABA's White Collar Crime National Institute conference, and which was published in the ABA's White Collar Crime 2004 publication). The reference to legal fees in each of these Memos is not a separate factor to be considered, but is one of various factors to be considered in determining the authenticity of an entity's cooperation.

[3] At oral argument, the Court commented that, if that is the view of the Department of Justice, "it sure is not what they have said to the defense bar in the United States of America." (Tr. 410). The Government respectfully disagrees. There has been no evidence adduced at this hearing that entities believe the USAO looks disfavorably on the advancement of legal fees during an investigation. Even the *amicus* brief filed in this case failed to cite a single example of this. Moreover, during the hearing, the Government attempted a line of inquiry with Ms. Neiman regarding her experience in other cases, and the Court disallowed such testimony on relevance grounds. (Tr. 279-80). The Government maintains that it has not sent such a signal to corporations during its investigations, and its experience is that corporations do not interpret the

(continued...)

The defense suggested during oral argument on May 10, 2006, that the Government was trying to "distance itself" from the Thompson Memo. (Tr. 369). We are not. What the Government has sought to do in its submissions to the Court and the evidence it submitted in connection with the hearing, is to place the Thompson Memo, and the reference therein to the payment of legal fees, in their appropriate contexts, in order:

(i) to convey to the Court the legitimate Government interests that resulted in the preparation of the Thompson Memo, and its predecessor the Holder Memo;

(ii) to explain the circumstances under which the Government considers the payment of fees, among many other factors, in ascertaining whether a corporate target is in fact providing the Government with authentic cooperation, or impeding a criminal investigation under the guise of cooperation;

(iii) to detail what happened (primarily, but not exclusively from the Government's perspective) during the conversations between the Government and KPMG and its representatives in 2004 and 2005; and

(iv) to rebut the defense contentions that (a) the Government told or hinted to Skadden that KPMG should not advance fees at all if it had discretion; and (b) the Government approved or hinted its approval of KPMG's plan to condition fees on cooperation, impose a cap, and not pay fees post-indictment.

[3](...continued)
Thompson Memo in such a fashion. The USAO's experiences in other cases is relevant to the extent the defense suggests what a natural reading of the Thompson Memo's provision entails. In fact, Robert Bennett ("Bennett") of Skadden, acting as counsel for KPMG, in statements to the USAO and the Deputy Attorney General, stated that KPMG's decisions regarding the payment of legal fees were unprecedented (*see* K 349-51), which suggests that other companies have not viewed the Thompson Memo as an edict to cut off or otherwise condition the payment of attorney's fees. At the very least, absent proof of such a global effect and without an opportunity for the Government to rebut such an assumption, the Government requests that the Court not base any findings on the effect the Thompson Memo's reference to legal fees has on the rest of the defense bar.

A review of the evidence submitted during the hearing, which is discussed below, confirms that the Government acted properly, and in accordance with legitimate prosecutive interests, and, more importantly, that the defendants' constitutional rights were not violated.

There is no factual basis to conclude that the Government's consistent and long-held view regarding the relevancy of the advancement of legal fees in a corporate investigation varied with respect to this investigation. Nor has the defense posited any evidence that the USAO has taken inconsistent positions in other cases or with the defense bar in general. Thus, the Government has not distanced itself from the Thompson Memo. Rather, the Government does not share the defendants' views regarding its meaning or application in this context.

II. KPMG's Decision To Condition The Payment Of Legal Fees

By letters dated March 11, 2004, KPMG informed its personnel that, in connection with the criminal investigation, KPMG decided to pay legal fees for its personnel, subject to the following three conditions: (i) the individual must cooperate with the Government; (ii) KPMG capped payments at $400,000; and (iii) KPMG will cease paying fees if the individual is charged with criminal wrongdoing. (*See, e.g.*, K 15). The proof of Government influence on each of these conditions is limited or non-existent.

A. The Condition Of Cooperation

It is undisputed that, prior to any meeting between KPMG and the USAO, KPMG had been the subject of Senate hearings and a scathing Senate report regarding its tax shelter conduct; was the subject of an IRS audit; had been referred by the IRS to the Department of Justice ("DOJ") for summons enforcement in connection with the IRS audit (which enforcement action itself was unprecedented in KPMG's history (Tr. 226)); and had been named in various civil suits with hundreds of millions of dollars of potential exposure. In addition, in early February 2004, KPMG was informed that the USAO had begun a criminal investigation into these tax shelters. (Tr. 53-54, 268-69). Prior to February 25, 2004, KPMG had at least one internal meeting with its attorneys at Skadden, during which the issue of whether KPMG should pay legal fees was discussed. (Tr. 142-43). While no witness from KPMG or Skadden testified as to the substance of such discussions, it is clear that KPMG determined to pay legal fees subject to cooperation.

At the February 25 meeting, Skadden informed the USAO that KPMG intended to cooperate fully with the Government's investigation and was going to encourage its partners to cooperate as well. (Tr. 271; U 114). Mr. Bennett indicated that the Chairman of KPMG was concerned about how KPMG had been handling the IRS civil audit and the summons enforcement proceeding[4] and acknowledged that the results of the Senate hearings were very negative for KPMG. (Tr. 270; U 113-14). When later asked what KPMG's plan was with respect to the payment of legal fees, KPMG's attorneys informed the USAO that, although KPMG had not made any final decisions,[5] if KPMG had discretion over the payment of legal fees, KPMG would pay such fees subject to the individual's cooperation with the Government. (Tr. 272). No witness testified about the factors KPMG considered in arriving at that decision. While the

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[4] KPMG and Skadden had good reason to be concerned about the summons enforcement proceeding. In May 2004, Judge Hogan in the District of Columbia adopted a Special Master's Report and Recommendation issued in October 2003, concluding, among other things, that "KPMG has taken steps since the IRS investigation began that have been designed to hide its tax shelter activities," and that KPMG was "misrepresenting its unprivileged tax shelter marketing activities as privileged communications." *See United States* v. *KPMG LLP*, 316 F. Supp. 2d 30, 37, 44 (D.D.C. 2004).

[5] According to the notes of IRS Special Agent Laura Mercandetti ("Mercandetti"), KPMG was 90 percent sure that, if it had discretion, it would condition such fees upon cooperation. (*See* U 105, U 116).

Court can easily surmise that KPMG's attorneys either read or were familiar with the Thompson Memo prior to February 25, 2004, nothing in the record warrants a finding that KPMG made its fee decision based upon an interpretation of the reference to the payment of legal fees in the Thompson Memo, as opposed to its recognition that cooperation with the USAO investigation was critically important for an organization that believed its very existence was on the line, and that KPMG's cooperation was dependent upon its employees' willingness to cooperate. Moreover, even assuming KPMG's decision was based, at least in part, on its interpretation of that reference in the Thompson Memo, it is clear that KPMG determined to condition the payment of fees upon cooperation prior to any inquiry by or meeting with the USAO.[6]

Taking the defense argument a step further, even if KPMG's decision was influenced by both the defense reading of the reference to legal fees in the Thompson Memo and statements made by the USAO, there is no factual basis to conclude, with the possible exception of defendant Carol Warley, that this "influence" resulted in the cessation of legal fees. As part of its efforts at cooperation, KPMG informed the USAO that it would make its personnel available for interviews. In that context, KPMG asked the USAO to inform KPMG if any individual was not being "cooperative" with the Government. (Tr. 94, 317). While the USAO chose not to advise KPMG whether the USAO considered any individual to be less than forthcoming or honest in proffers,[7] the USAO did send letters to KPMG when, in the USAO's determination, an individual was not making himself/herself reasonably available for an interview pursuant to the USAO's standard proffer agreement. (*See* Tr. 119-20; *see, e.g.*, K 30, K 55). While the USAO understood that KPMG decided it was likely to cut off an individual's fees as a result (Tr. 318), the USAO did not send such letters in order to get fees cut off. (Tr. 105-06).

With respect to the indicted defendants, the USAO sent such letters only for four individuals: Carol Warley (K 30, K 81), Jeffrey Eischeid (K 30), Richard Smith (K 30), and Gregg Ritchie (K 55). In only one instance did KPMG apparently cut off legal fees for an indicted defendant (Warley) subsequent to receiving such a letter from the Government. (K 93). In fact, KPMG informed the Government that it had never paid the legal fees for Gregg Ritchie in connection with the criminal investigation.[8] (K 59). Thus, even assuming that KPMG decided to condition fees upon cooperation as a result of specific Government conduct, and assuming further that KPMG's partners had some legal right to the payment of legal fees, no defendant other than perhaps Warley can establish that such a right was infringed as a result of KPMG's decision to condition the payment of fees upon cooperation. Consequently, in the context of this motion, the defendants' claims cannot factually rest upon KPMG's decision to condition the payment of fees on cooperation.

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[6] In the Statement of Facts attached to KPMG's deferred prosecution agreement, KPMG stated that it determined to implement this condition "on its own initiative." (*See* DPA, Statement of Facts, ¶ 35).

[7] Our decision in this regard belies the defense theory that what the Thompson Memo or the USAO wants is for an entity under investigation to take actions based upon the Government's (continued...)

[7](...continued)
say-so.

[8] This fact regarding Ritchie's fees raises questions regarding the lack of evidence for many moving defendants concerning: (i) whether KPMG ever paid that particular defendant's legal fees; (ii) whether that particular defendant sought payment of legal fees from KPMG; and (iii) whether KPMG ceased paying that defendant's legal fees, and if so, when and for what reason. It also clearly demonstrates that KPMG's decisions to condition the payment of fees had no impact on Ritchie.

B. The $400,000 Cap

The subject of a cap on legal fees was not raised at the February 25 meeting. Rather, during one phone call on March 2, 2004 initiated by Robert Bennett, Mr. Bennett informed the USAO that KPMG had decided to place a cap on any legal fees paid to its personnel, without reference to any specific amount. (U 29-30). No member of the Government ever suggested such a monetary cap, nor is there any evidence that any member of the Government ever expressed any view on a cap. There is also no evidence to conclude that KPMG instituted this cap in response to its reading of the Thompson Memo's reference to legal fees. In fact, to the extent that the defense suggests that the Thompson Memo constitutes a blanket "objection" by the Government to the discretionary payment of fees, KPMG's decision to pay up to $400,000 per person runs counter to that.

Despite KPMG's history of paying legal fees without a cap or other conditions, it cannot seriously be disputed that, in early 2004, KPMG faced criminal, civil, and monetary exposure as a result of the subject tax shelters at a level unprecedented in KPMG's history. In addition, by February 25, 2004, KPMG was aware that at least 20 subject letters had been sent to KPMG personnel, and clearly knew from its lengthy involvement with the tax shelters, the IRS audit, the summons enforcement proceedings, and the Senate hearings and report, that many more personnel could be implicated in the investigation. While the Court did not permit the admission of KPMG's redacted insurance policies, KPMG's General Counsel Joseph Loonan ("Loonan") testified that KPMG's insurance did not cover costs associated with criminal investigations or inquiries. (Tr. 217). Thus, it is not unreasonable to conclude that economic factors played a role in the institution of a monetary cap. In fact, Mr. Loonan testified that, with respect to the amount of the cap, "the number was derived at for economic reasons." (Tr. 227).

Finally, even assuming the placement of a monetary cap on legal fees resulted in whole or in part from KPMG's reading of the reference to legal fees in the Thompson Memo, the defendants have not presented evidence that any defendant's fees were cut off as a result of having reached the $400,000 limit.[9] Thus, to the extent it is found that any defendant had a right to the payment of fees above $400,000, no defendant has established that such right was infringed as a result of KPMG's decision to cap fees at that amount.

C. The Cessation Of Fees Upon Indictment

The defendants urge the Court to find that, absent the reference to fees in the Thompson Memo and/or statements made by the USAO, KPMG would have paid legal fees to any partner indicted for criminal conduct. The defendants failed to carry their burden on this issue.

There is no evidence that, prior to sending letters to its personnel on March 11, 2004, KPMG informed the USAO of the decision not to pay fees post-indictment or invited the USAO to weigh in on this decision, or that the USAO raised the issue of post-indictment legal fees. Nor do any notes or memoranda reveal that KPMG ever sought "credit" for this condition as part of its cooperation efforts. No witness has testified that KPMG's decision regarding post-indictment payment of fees was related to any reference to fees in the Thompson Memo.

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[9] There is evidence that KPMG advanced defendant Stein's legal fees in excess of the cap (Tr. 185), and that, during a few months period prior to indictment, KPMG decided to cut off any further advancement of Stein's fees (*see* DX 7), as other KPMG partners did not believe Stein should have been treated differently from others. (Tr. 197).

Nor can the defendants rely upon any longstanding practice in this area. In only one other known instance, the Natelli case in the mid-1970s, were any KPMG partners indicted for conduct arising from work at KPMG. There is no evidence, or reason to believe, that in connection with that case, KPMG as an entity was facing potentially serious and extensive criminal liability, or that KPMG had any reason to believe that more than a handful of its personnel faced criminal exposure. Also in stark contrast to the Natelli case, here, by the time the Grand Jury returned the indictment, KPMG had already admitted substantial criminal wrongdoing and suffered other serious direct consequences to the firm (*e.g.*, a massive criminal fine, the imposition of a corporate monitor). In order for the Court to find any constitutional violation in this context, the Court must find not only that the Thompson Memo's reference to legal fees improperly interfered with KPMG's discretion at the time of its original decision on March 11, 2004, but also that, after KPMG signed the DPA, with its statement of wrongdoing and other consequences, KPMG's decision to not pay fees for subsequently indicted individuals continued to be driven by Thompson Memo concerns as opposed to a host of other obvious factors. Thus, one cannot draw from KPMG's scant history the inference that, when faced with the consequences to the firm as a result of criminal wrongdoing by many individuals, and where the firm itself admitted extensive criminal conduct,[10] the remaining partners at KPMG would choose to pay the legal fees for indicted defendants but for the Thompson Memo. Put another way, had KPMG decided to pay fees without conditions all along, there is no evidence that KPMG would have continued to pay fees post-indictment in the unique circumstances of this case.

[10] For example, KPMG admitted such criminal conduct was "deliberately approved and perpetrated at the highest levels of KPMG's tax management, and involved dozens of KPMG partners and personnel." *See* DPA, Statement of Facts, ¶ 3.

Charles Stillman's statement on behalf of KPMG at the close of the hearing is telling. Mr. Stillman, when addressing the issue of KPMG's decision not to pay legal fees for the indicted defendants, stated: "My client doesn't miss for a second how important it is, but they have made a conscientious business decision regarding the thousands of people that work for them, the work that they're doing. I don't know how many other partners there are who, thank God for them, are not involved in this, had no involvement with it, and they made that decision." (Tr. 428). The statement suggests that non-Thompson Memo factors drove KPMG's decision in this regard, if not as of March 11, 2004, certainly as of the date that any individual was indicted in this case. While the Court may choose not to make a factual finding based upon the non-testimonial statement of KPMG's agent on that point, at the very least the Court should not make a factual finding that KPMG's decision to cease paying fees for any indicted individual was motivated by the Thompson Memo's reference to legal fees when the record is bare on that point.

As of February 2004, KPMG faced circumstances unprecedented in its history. KPMG was the subject of Congressional hearings and a scathing report on its conduct, was under a contentious IRS audit, and was the subject of DOJ summons enforcement proceedings, faced numerous civil lawsuits by taxpayer clients, and faced the prospect of massive criminal liability. The defense has offered no evidence to establish that, in light of these circumstances, the non-culpable partners of KPMG, absent a reference to legal fees in the Thompson Memo, would have chosen to pay the legal fees for those partners and employees responsible for placing KPMG in the precarious position it had been placed, with the firm's existence on the line. Particularly in light of Mr. Stillman's comments to the Court in this context regarding KPMG's "conscientious business decision," the Court should find that the defendants have failed to establish that

KPMG's decision regarding the advancement of legal fees for indicted individuals resulted from any improper Government influence.

The defendants' failure to present sufficient evidence on this issue is significant for several reasons. First, as discussed below, the Sixth Amendment right to counsel arises only in the post-indictment context. Thus, absent evidence establishing that the Government wrongly caused KPMG to cease paying legal fees upon the indictment of an individual, no Sixth Amendment claim can be found. Second, if the Government did not improperly interfere with the payment of legal fees post-indictment, then at best the monetary remedy — to the extent one could possibly exist — sought by the defendants must be limited to unpaid fees between the date a given defendant's fees were cut off and the date of the indictment, assuming that a defendant's fees went unpaid during that limited time period as a result of the first two conditions KPMG placed on fee payments. Moreover, to the extent this Court proceeds to consider whether the defendants were prejudiced, the defendants will be hard-pressed to establish any adverse effect on trial preparation as a result of the non-payment of fees in the pre-indictment period.

III. The USAO's Conduct Regarding Fees

The defendants urge the Court to find that the USAO "intentionally, wrongfully, and without legitimate reason" interfered with KPMG's determination regarding the payment of legal fees. They have failed to establish any of those allegations.

The USAO did not intentionally interfere with or intend to influence KPMG's decision regarding the payment of legal fees. In support of its claim of intentional interference, the defendants can point to only two things: (i) statements made at the February 25, 2004 meeting; and (ii) letters sent by the USAO to KPMG, at KPMG's request, when certain KPMG personnel refused to interview with the Government pursuant to the USAO's standard proffer agreement. Neither establishes the alleged intentional interference.[11]

At the February 25 meeting, it is undisputed that the USAO inquired of KPMG's legal obligations to pay fees and KPMG's plan in this regard. (Tr. 272). In response to these inquiries, Skadden informed the USAO that (i) KPMG was still researching its legal obligations; (ii) if KPMG had discretion, KPMG intended to pay fees contingent upon an individual cooperating with the Government's investigation[12]; (iii) generally KPMG paid the fees of partners in legal proceedings, but that this was new ground; and (iv) if KPMG determined that a partner was involved in wrongdoing, KPMG would not pay that individual's fees, especially if that person "took the fifth amendment." (Tr. 70-71, 73, 76-77, 272-73; U 116). Stanley Okula ("Okula"), an Assistant United States Attorney in the USAO, and Ms. Neiman testified that no member of the Government expressed a view to Skadden regarding KPMG's plan. (Tr. 74-75, 273-74, 277). No witness testified to the contrary.

At the outset of the meeting, Skadden described the impact of the IRS audit, the Senate hearings and Senate report on KPMG, and said that among other things, KPMG had taken serious high level personnel action in response, and also determined to change the atmosphere of the firm. (Tr. 269-71; U 113-14). After the discussion of legal fees, Justin Weddle ("Weddle") turned to the subject of personnel action. (*See* Tr. 274; U 116). Mr. Bennett discussed the

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[11] The facts with respect to the letters sent by the USAO to KPMG were addressed in Section II.A. As described above, putting aside whether those letters caused individuals to proffer with the Government (an issue not pertinent to the instant motion), the letters had little if any effect on KPMG's actual termination of legal fees for the moving defendants.

[12] As mentioned previously, Mercandetti's notes reflect that KPMG was 90 percent sure regarding this plan. (*See* U 105; U 116).

personnel action against Jeffrey Stein, former Deputy Chairman at KPMG and head of the Tax Practice, and others. Skadden discussed whether KPMG had any specific information about individual wrongdoing, and the reasons for the personnel action to date. (*See* Tr. 274; U 116-17).

Mr. Bennett then briefly spoke about the kind of lawyers Skadden anticipated recommending for the investigation, and the notes of another Skadden lawyer, Saul Pilchen ("Pilchen"), reflect that Mr. Pilchen apparently said that no decision had been made and no lawyers had been recommended.[13] (Tr. 274-75; K 313). Ms. Neiman and Mr. Okula both testified that the USAO was concerned about the severance package of Mr. Stein (Tr. 114-15, 275), as the USAO had learned that he had been paid millions of dollars upon his "being shown the door" by KPMG . (Tr. 114-15). Ms. Neiman testified that after Skadden's discussion of personnel action and after Mr. Bennett's remarks about the selection of attorneys, she took the opportunity to remind Skadden that under the federal sentencing guidelines' provisions regarding effective corporate compliance programs, KPMG cannot reward misconduct. (Tr. 274-76; *see* U.S.S.G. § 8B2.1). Mr. Okula corroborated Ms. Neiman's testimony that her statement was associated with personnel action, not legal fees. (Tr. 80-81, 116-17). Ms. Neiman also testified that both she and Mr. Weddle were speaking around the same time, about two different subjects. (Tr. 275-76). Mr. Weddle took the opportunity to ask Skadden to get back to the USAO regarding KPMG's obligations with respect to legal fees. (Tr. 276). Ms. Neiman testified that her comments clearly related to the personnel action taken by KPMG and had nothing to do with Mr. Weddle's wrap-up comment about legal fees. (Tr. 275-76).

Mr. Okula testified unequivocally that it was not the USAO's intent to influence KPMG's decision to pay fees (Tr. 69-70, 104), and both Mr. Okula and Ms. Neiman testified that it would have been of no moment had KPMG determined to pay legal fees without conditions. (Tr. 67-68, 280, 314). In fact, Ms. Neiman repeatedly testified that KPMG's decision to pay fees had little or no impact on the eventual charging decisions. (Tr. 292-93, 315, 320, 326). Despite the unequivocal testimony on this subject, the defendants urge the Court to make adverse factual findings regarding the statements made by the prosecutors at this meeting, as well as their intent in making the statements. The defendants rely on their selective citations to and interpretations of certain notes — when one set of notes appears to support their claim, the defendants cite to them vociferously, and when that same set of notes does not support their argument, they cite to a portion of a different set of notes, all the while ignoring inconsistencies in the notes themselves and failing to call any witness from Skadden who had any recollection of the events.

For example, the defendants point to Mercandetti's notes, and argue that Ms. Neiman's statement regarding misconduct was juxtaposed with the word "fees" and a reference to the "federal guidelines." The defendants argue that, notwithstanding Ms. Neiman's and Mr. Okula's testimony to the contrary, those words in the notes demonstrate that Ms. Neiman's "misconduct" statement reflected a view she purportedly had that, in connection with the reference to legal fees in the Thompson Memo, KPMG should not reward those engaged in misconduct by paying their legal fees. First, it is not surprising that the word "fees" appears at this juncture of the notes because Mr. Weddle had returned to the topic of fees when requesting KPMG to provide

[13] The defendants argue that Mr. Pilchen's reference to "no decisions made" (K 313) related to fees. However, the statement in his notes directly follow a "redacted" portion, which in Mercandetti's notes reflects a discussion about personnel action, followed by a discussion about recommending lawyers. (U 106).

information regrading its obligations.[14] Second, as Ms Neiman testified, the reference to "federal guidelines" attributed to her was a reference to the Sentencing Guidelines, and she does not call the Thompson Memo the "federal guidelines."[15] Although the defendants seem skeptical that any prosecutor would refer to the Sentencing Guidelines at that stage, Ms. Neiman consistently refers to the Sentencing Guidelines when lecturing on the issues of corporate compliance programs and cooperation. For example, at the White Collar Crime Institute lecture, Ms. Neiman stated that "the guidance to prosecutors in Principles of Federal Prosecution uses a carrot and stick approach similar to the sentencing guidelines." *See* Neiman, "Hallmarks of an Effective Corporate Compliance Program and Waiver of the Privilege Under the Principles of Federal Prosecution of Business Organizations," at D-3. She further added, "I would like to start by discussing the guidelines, because in the area of cooperation the guidelines reflect the same values that the government considers in deciding whether to charge a corporation in the first place." *Id.* at D-4.

[14] Neither the notes nor any witness' recollection clarifies the specific order of the statements by Mr. Weddle and Ms. Neiman. (*Cf.* U 106, U 117, K 313-14). This is not surprising in a meeting such as this one, where there were numerous speakers, each with different agendas on his/her mind, and often speaking simultaneously on the subject he/she wished to raise or respond to.

[15] The defendants mismatch other aspects of the notes in a further effort to support this claim. For example, they state that one set of Skadden's notes (those of Saul Pilchen) had a reference to Ms. Neiman's statement, and has her referring to the Principles of Federal Prosecution (tellingly, not the "federal guidelines") in connection with the "misconduct" comment. (Tr. 349). The defense however is referring to notes taken by Mr. Pilchin at a different part of the meeting and in a different context. Indeed, Mr. Pilchin's notes simply state that Ms. Neiman said "misconduct shdn't be rewarded." (K 313). The notes do not refer either to "fees" or "legal fees," or to the Thompson Memorandum. Mr. Pilchen himself had no recollection of the context of Ms. Neiman's comment regarding rewarding misconduct. (Tr. 37). The reference to the Principles of Federal Prosecution relied upon by the defense appears in Mr. Pilchen's notes at the outset of the discussion on legal fees, when the Government inquired into KPMG's obligations and Mr. Bennett was explaining that research was still being done, although it appeared that KPMG was not obligated to pay fees. (K 313).

Thus, at the end of the day, it is irrelevant whether Ms. Neiman stated "federal guidelines," "federal sentencing guidelines," or "Thompson Memo," as both the Thompson Memo and the Sentencing Guidelines address the issue being addressed by Ms. Neiman — disciplining wrongdoers and rewarding misconduct as part of corporate compliance programs.

Ms. Neiman's testimony on the issue is also consistent with the position she has taken in addressing corporate compliance issues at lectures and other panels. For example, at the same lecture in 2003, Ms. Neiman emphasized as one of the six hallmarks of an effective compliance program, the issue of "discipline and rewards," remarking that:

> Built into every compliance program there have to be appropriate responses to violations of the program through an effective discipline and reward system. Those who engage in misconduct and criminal activities have to be appropriately punished. Supervisors who fail to enforce discipline or adherence to the compliance program have to be disciplined or even dismissed. Top level management who violate the compliance program, frankly in my view, should be booted out. On the other hand, employees or officers who report violations of the program have to be protected and rewarded. There can be no retaliation against employees who report misconduct.

Id. at D-3. Tellingly, the issue of legal fees is not mentioned by Ms. Neiman in the context of discipline and rewards. Similarly, neither the Thompson Memo nor the Sentencing Guidelines refer to the subject of legal fees in describing the need for a corporation to mete out appropriate discipline for misconduct.[16]

Further, as Ms. Neiman and Mr. Okula testified, such corporate decisions are considered only when the corporation has sufficient information to determine employee misconduct, not, as the defense suggests here, when the Government determines there has been employee

[16] *See* Thompson Memo, Sections VII(A), VIII(A), VIII(B); U.S.S.G. § 8B2.1.

misconduct. (*See* Tr. 109, 302). Thus, the true test of an effective corporate compliance program is what steps the company takes to root out misconduct *the company* has found and what disciplinary actions are meted out for such employees, not whether the company responds to the Government's determination of wrongdoing. Most importantly, such disciplinary action does not encompass withholding legal fees.

James B. Comey, when United States Attorney for the Southern District of New York, published relevant remarks on this topic in November 2003, in a discussion largely focusing on waiver of privileges under the Thompson Memo. *See* United States Attorney's USA Bulletin, "Corporate Fraud Issues II," Vol. 51, Number 6, November 2003, at 1. (Attached hereto as Exhibit B is a copy of the published Comey remarks). While Mr. Comey's remarks did not address the Thompson Memo's reference to legal fees, they did address the subject of alleged Government requests that corporations fire employees who refuse Government investigative interviews. Mr. Comey made clear that the Government does not request such personnel action. Instead,

> [w]hat the Government focuses on in evaluating corporate compliance programs is whether a corporation properly disciplines employees who have engaged in or facilitated serious misconduct, or who have committed serious crimes. If a company continues to employ an individual when *it has evidence in its possession* that establishes criminal activity, the Government will likely view that as a serious flaw in the corporation's compliance program, and reflective of a problematic corporate culture.
>
> Of course, if a corporation determines in good faith that an employee did not commit a crime or engage in serious misconduct, in evaluating the corporation's conduct and culture we would not "penalize" the corporation for not firing such an employee even where the employee declined to submit to a Government interview.

Id. at 4-5 (emphasis added).[17] Thus, as Ms. Neiman testified, the issue of "not rewarding misconduct" arises in the context of personnel action and corporate compliance programs, not in the context of the advancement of fees. The Court should reject the defense contention that Ms. Neiman's remarks were addressed to the subject of legal fees[18] and not personnel action and appropriate discipline.[19]

The other aspect of the notes from this meeting that the defense relies upon to allege that the USAO intended to influence KPMG's decision on payment of fees is Saul Pilchen's note regarding viewing fees "under a microscope." Mr. Pilchen has no independent recollection of this statement (Tr. 25-26), and twice stated that his notes included impressions of what he

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[17] Significantly, Comey acknowledged the "invaluable assistance of his Chief Counsel, Shirah Neiman, in the preparation" of the above-cited Comey remarks. *See id.* at 5.

[18] One defense counsel theorized that at the February 25 meeting, KPMG essentially "floated" the idea of conditioning fees to the USAO, and the USAO, through its comments, signaled the USAO's approval of such a plan. (Tr. 388-92). The defense, however, offered no testimonial evidence that Skadden, on behalf of KPMG, merely floated an idea rather than informed the USAO of its plan. Moreover, Ms. Neiman's testimony, consistent with her prior lecturing on this subject, rebuts any contention that the USAO intended to signal KPMG one way or another. In fact, the defense view of Ms. Neiman's "misconduct cannot be rewarded" comment would be inconsistent with a stated plan to pay fees.

[19] The defendants, by selectively relying on different notes for different characterizations of certain words, attempt to distort several other aspects of that meeting, and others. For example, the defense argues that, during the February 25 meeting, after a reference to legal fees, "Bennett pushes back on the Thompson memo and says, We don't even know if anyone committed a crime. . ." (Tr. 347). Here, the defendants simply ignore the very notes on which they rely. According to Agent Mercandetti's notes, Mr. Bennett discussed whether KPMG had knowledge of wrongdoing not in response to a reference to fees, but rather in response to Mr. Weddle's question regarding KPMG's purported strong personnel action (*see* U 116, ¶¶ 27-28), which KPMG touted at the onset of the meeting (*see* U 113, ¶ 1 ("Bennett further expressed that . . . KPMG had already taken serious personnel action against several high level employees")). The alleged "push back" comment had absolutely nothing to do with legal fees and the defense cannot point to anything at all to support that argument. And here again, the defense did not call Mr. Bennett to support the defense view of this meeting.

thought was said. (Tr. 19-20). No witness testified that this comment was made. Mr. Okula and Ms. Neiman both testified that they did not hear Mr. Weddle make such a statement (Tr. 83-84, 108, 276), and that in fact, nobody from the USAO expressed any view on KPMG's plan with respect to fees. Moreover, while the defendants cite to the agent's notes as being reliable and thorough when it suits their version of events, this purported remark does not appear in the agent's notes or typed memo. Agent Mercandetti has no recollection of such a comment being made. (Tr. 249). Nor does this comment appear in the handwritten notes of two other Skadden lawyers present at the meeting. (*See* K 309-11). Thus, taking all of the evidence together, it appears most likely that those specific words were not used. However, even if the comment were made, it is consistent with the principle that a company's discretionary payment of fees will be looked at closely if it appears the company, while purporting to provide corporate cooperation, is taking steps to keep employees toeing the company line. (*See* Tr. 295). In other words, such a statement says nothing more than what the Thompson Memo stands for. Indeed, there is no dispute that, at the outset of the meeting, in response to Skadden's request that the USAO handle the case delicately due to the potential collateral consequences to KPMG, the USAO told Skadden that the USAO would follow the Thompson Memo. (U 101).

The defendants also point to the placement of the fee issue on a pre-meeting USAO agenda as proof of some intentional interference. The defense suggests that the USAO prepared an agenda by combing through the Thompson Memo, that the placement of this item on the agenda establishes that the USAO intended to influence KPMG's decision on this issue, and that the USAO did so as a result of the Thompson Memo's purported directive. Even assuming that item was placed on the agenda with the Thompson Memo in mind, there is nothing improper in that issue being raised. In order to assess, at a later point during the investigation, whether KPMG was attempting to keep information from the USAO, the Government needed to know the lay of the land at the beginning. Inquiring about the information is not an expression of distaste as to the payment of fees. Rather, as with much other information asked about during that meeting, it was an effort to learn as much information about the entity upfront which might have relevance at some point in the investigation. (*See* Tr. 67-68, 310). Thus, while the entire agenda was not produced in discovery, it is clear that the USAO made other inquiries during this initial meeting that did not necessarily have a bearing on the Thompson Memo considerations, but did have relevance to how the investigation could proceed *vis-a-vis* KPMG and its partners. For example, the USAO inquired about the organizational structure of the firm, KPMG's document retention policy, and various conflicts of interest raised from KPMG's and Skadden's continued representation of taxpayers and others in the various investigations. (U 114-15, 117-18).

To rebut the testimony of Ms. Neiman and Mr. Okula that the concern regarding fees is a "circling of the wagons," the defense argues that if a company is taking such steps, then the company is "fighting with the government; they are not cooperating." (Tr. 354). They continue, "[i]f you circle the wagons, you're not even under the Thompson memo." (*Id.*). The defense appears to miss the point. First, February 25, 2004 was the initial meeting with KPMG at the beginning of a long investigation. While KPMG might have stated they wanted to cooperate, any potential cooperation could be evaluated only down the road, not at the first meeting or even soon after that meeting. Thus, at the initial meeting is where the Government attempts to obtain the information that may have relevance when evaluating a company's purported cooperation at a later time. Second, an effort to "circle the wagons" might evince an attitude of "fighting," but it

does not prevent a company from paying lip service to cooperation in an attempt to avoid prosecution. That is one of the very concerns the Thompson Memo is meant to address. In fact, Skadden clearly understood that concern, as it stated to the Deputy Attorney General that KPMG had not "circled the wagons" during this investigation. (*See* U 90; Tr. 228). Thus, to argue that a company's efforts to "circle the wagons" means that a company is not "under the Thompson memo" makes no sense.

Also supporting the USAO's testimony regarding the lack of intent to influence KPMG's decision on paying fees was Mr. Okula's testimony regarding HVB, another entity involved in this tax shelter investigation. Mr. Okula testified that, with respect to HVB, the Government made a similar inquiry regarding fees, and, after being informed that HVB was paying legal fees, did nothing more. HVB, like KPMG, was not legally obligated to pay legal fees, and similarly received a deferred prosecution agreement. (Tr. 111-13). Thus, as Mr. Okula stated, not only did he have no intention of influencing an entity's legal fee decisions, it is clear that with respect to HVB, his inquiry had no such influence. (Tr. 111-12).

The defense has also attempted to spin certain events after the February 25 meeting without calling a single witness to testify as to what actually happened at any of those events. For example, the defense points to a March 2, 2004 telephone call in which Mr. Bennett informed Mr. Weddle that KPMG decided to condition the payment of fees on cooperation and to place a cap on the payment of fees. Referring to an internal USAO e-mail regarding that call, the defense states that the Government insisted that KPMG condition fees upon truthful cooperation, and that the USAO "define[d] the truth" as it wanted, which, according to the defense, "shows the extent to which the government feels empowered under the Thompson memo . . . to dictate terms to a corporation that comes before it." (Tr. 356-57). This interpretation of events is nonsense. It is clear from the context of the e-mail that the antecedent for the pronoun in the phrase "as we define it" is "cooperation," not "truth." (*See* U 30). Thus, the e-mail reflects the innocuous proposition that cooperation, as the USAO defines cooperation, means to tell the truth.

This obvious reading of the document is corroborated by several facts. First, the Government did not propose or even suggest that KPMG condition fees on cooperation in the first place, much less dictate the terms of those conditions. Second, as explained in the April 11 Declaration of Justin Weddle, Mr. Weddle, upon hearing of KPMG's plan from Mr. Bennett, expressed a concern to Mr. Bennett that such "cooperation" has been misconstrued in another case he prosecuted, in which a defense attorney suggested that the company in that case, in the guise of "cooperation" with the Government, sought to have its employees frame others to benefit the company, rather than provide the truth. *See* Weddle Dec., ¶ 3c. The defense had this declaration prior to the hearing, and could have called either Mr. Weddle to cross-examine him on that, or Mr. Bennett to determine if he had a different recollection of the conversation. Instead, consistent with how they proceeded during the hearing, the defense chose not to call any witness who might have recalled the conversation, and created an interpretation of events that suited their needs. Third, the evidence clearly demonstrated that the USAO never shared its views with KPMG regarding the truthfulness of any individual's information provided during a proffer. (Tr. 119-20). Thus, even if the USAO imposed a condition of truthful cooperation,

which it did not, the issue of who determines what is "truthful" had no bearing on any individual's fees being cut off.[20]

The defendants further craft a story regarding correspondence between Skadden and the USAO even after KPMG made its decisions on fees through its March 11 letters to its partners and employees. For example, on March 12, 2004, Skadden forwarded to the USAO a memorandum sent to KPMG personnel on various issues relating to the investigation. The defense points to a March 17 letter from the USAO for the proposition that the USAO "didn't like" that KPMG "told people, you need a lawyer, and if the government contacts you you need a lawyer." (Tr. 358). First, this theory that the Government did not want KPMG having lawyers is belied by the fact that the Government's February 9 "subject letters" to various KPMG personnel, including the defendants in this case, advised those "subjects" to have a lawyer contact the Government. *See, e.g*, DX 401. Second, on the issue of obtaining a lawyer, KPMG's initial memo noted that each individual had a "right to deal directly with government representatives without counsel." (K 272). The Government's proposed version of a new memorandum reiterated that KPMG arranged for independent counsel for all employees, but that "[e]mployees are not required to use this counsel, or any counsel at all. Rather, employees are free to obtain their own counsel, or to meet with investigators without the assistance of counsel. It is entirely your choice." (K 276). While the Government's version combined related concepts contained in different parts of KPMG's memo, it did not add anything new on whether any individual had the right to counsel.[21] In fact, the true concerns of the USAO regarding KPMG's memo to its personnel focused on other issues. However, because the Court deemed these issues irrelevant to the proceedings during defense questioning on the first day of the hearing, the Government did not elicit testimony regarding the serious concerns raised by KPMG's memorandum. As a result, the defense should be precluded from offering such arguments out of context, and the Court should draw no inferences from these facts.

Having misinterpreted this series of correspondence, the defense then tries unsuccessfully to connect the issues of retention of counsel and legal fees to a statement made at a meeting in August 2004. At that meeting, Karen Patton Seymour, Chief of the USAO's Criminal Division at the time, reiterated the USAO's concern about the message KPMG sent to the public and its employees by rewarding with rich severance packages those they had touted as examples of strong

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[20] The defense relies upon this misinterpretation of the March 2 e-mail, along with an assertion that KPMG made blanket waivers of various privileges, as evidence that the Thompson Memo asks companies "how high can you jump," and KPMG responded by stating "we're jumping as high as we can." In this context, the aforementioned Comey remarks explain that, as with any issue to be considered under the Thompson Memo, there are no absolute requirements. Thus, in the privileges context, "[w]aiver is not required as a measure of cooperation." *See* Comey Remarks, at 2. The main issue is whether the Government gains access to necessary information. If the Government's investigation is "stymied," and the corporation also refuses to provide information gathered during internal investigations, then "the Government will probably not view this as cooperation in evaluating charging decision factors." *Id*. However, it does not mean that a corporation will be indicted as a result. There are no pre-conditions for a decision not to prosecute. Rather, a wide range of factors must be decided. *See id*.

Moreover, the defendants are simply wrong in their assertion that KPMG waived all privileges. Rather, KPMG waived privileges in limited circumstances (*see* K 374-75), and reserved all other privileges in connection with the criminal investigation and any civil litigation. (*See* DPA, ¶ 8(e)(I)).

[21] During oral argument, the Court, focusing on the paragraph marked "Fourth" in KPMG's memo appearing on K 273, appeared to believe that KPMG's memo made no reference whatsoever to the fact that employees were not required to meet with investigators with counsel, as the USAO's redraft did. (Tr. 402). However, KPMG informed its personnel that they did not require counsel on the first page of the memo. *See* K 272. The USAO's proposed redraft merely combined these issues in one paragraph.

personnel action. (*See* U 72). Thus, more than six months after the initial February 25 meeting, Ms. Seymour expressed the same concern as that expressed by Ms. Neiman on February 25 regarding rewarding misconduct. Putting aside certain mischaracterizations regarding this conversation, the defense argues that, as a result, "KPMG is reminded that it's got a big Stein legal fee problem," as KPMG contracted with Stein to pay all of his legal fees. (Tr. 359-60). The defense adds, "that is the form of payment of legal fees that the government hates the most under the Thompson memo." (Tr. 360). Despite the fact that the Government did not utter one word about legal fees at this meeting, the defense ignores the true concern regarding rewarding misconduct through personnel action and baldly asserts that KPMG has been reminded about Stein's "legal fee problem." Apart from the absurdity of this argument, and the undisputed fact that the Government knew nothing about Stein's legal fees, what the defense cannot answer is that, if the Stein "legal fee problem" was so apparent as of August 4, 2004, and it was so clear to KPMG that the Government detested the payment of such fees, why did it take a company that purportedly capitulated to every whim of the Government until May 2005 to address this glaring Thompson Memo problem?

Lastly, from this August 2004 meeting through August 2005, when KPMG signed the DPA, there is no evidence that the USAO made any mention or inquiry of KPMG's payment of legal fees during any meeting, conversation, or correspondence. The USAO never expressed any concern that KPMG was continuing to pay legal fees for the overwhelming majority of those involved in the criminal investigation.

IV. Defendant Stein's Severance Agreement

Unlike the other defendants, who must at this stage concede that they had no written contractual right to the advancement of legal fees, (*see* Tr. 348 (Spears stating that "I will represent to the court that [the partnership agreements] are completely silent on the issue of payment of fees or indemnification generally")), defendant Jeff Stein had a written severance agreement entered into in January 2004. Stein contends that his severance agreement, entered into before the onset of this criminal investigation, provides a contractual right to the advancement of his legal fees. KPMG, through the testimony of its General Counsel, Joseph Loonan, disputes Stein's claim. Regardless of whose interpretation of the various provisions of that agreement is correct, any dispute under that agreement must be resolved through arbitration. *See* DX 6B. More significantly in terms of Stein's Fifth and Sixth Amendment claims here, Stein concedes that KPMG never informed the USAO of the terms of that agreement with respect to legal fees, and it is undisputed that KPMG never sought credit as "cooperation" with the Government for its decision in May 2005 to cease paying Stein's legal fees.

Faced with this hole in his claim that the USAO intentionally interfered with his purported contractual right to the advancement of his legal fees, Stein creatively asserts that KPMG ceased paying his fees in the off-chance that the USAO might ask if KPMG has consistently cut off partners' fees for everyone, without exception. This novel theory misses the mark in several respects. First, even if KPMG did attempt to hide the Stein fee issue from the Government, as Stein suggests, the fact remains that the Government did not knowingly interfere with his contractual rights to fees, and Stein cannot establish that the Thompson Memo or the USAO influenced KPMG's decision in his case. Second, there is no basis in the record to believe that (i)

KPMG intentionally hid the payment of Stein's fees; or (ii) that KPMG believed that, as of May 2005, the USAO would ask whether KPMG had ceased paying fees for partners on a consistent basis. On the latter point, the evidence is to the contrary. Other than at the initial meeting in February 2004, the USAO never asked about KPMG's fee policy or plan at another meeting with KPMG or Skadden. In fact, Mr. Loonan testified that, at the meetings he attended, the USAO never inquired about the issue of legal fees, not only with respect to Stein, but for anybody. (Tr. 224-25). Despite efforts by the defense to suggest that the USAO focused on legal fees at a meeting with United States Attorney David Kelley, Mr. Loonan further testified that he did not recall a focus on a discussion of legal fees at a meeting with the United States Attorney in March 2005. (Tr. 188). As the various notes and memos from meetings demonstrate, other than the initial meeting, it was always Skadden who raised the issue of conditioning fees in support of their argument that KPMG had rendered cooperation. Moreover, there is no evidence that the USAO ever responded in any fashion to Skadden's raising this issue at these subsequent meetings. Thus, to suggest that KPMG ceased paying Stein's fees in May 2005, in case the USAO asked a general question about KPMG's implementation of its fees policy across the board, ignores reality. KPMG was given no reason to believe that the USAO would make such an inquiry at that point in time. Rather, what is clear is that KPMG cut off Stein's fees because its other partners were upset that Stein had been treated differently from the rest, and were further concerned about how the firm was handling the investigation. (Tr. 197).

In sum, other than Stein, no defendant can rely upon a contractual right to the payment of legal fees. And, even assuming Stein's severance agreement obligated KPMG to advance or even indemnify legal fees if he was charged with a crime, Stein cannot establish that KPMG breached such a contractual right to fees as a result of intentional and wrongful interference by the Government, through the Thompson Memo or otherwise.

ARGUMENT

I. The Defendants Cannot Allege A Sixth Amendment Claim

Nothing in the text, history, or policies underlying the Sixth Amendment supports the expansive construction of the right to counsel urged by the defendants on this Court. The text itself makes no mention of legal fees. What little case law there is on the specific issue in this case, *i.e.*, the defendants' ability to access third-party funds in mounting a defense,[22] provides no

[22] The Government originally analyzed the issue in terms of KPMG's decision to advance legal fees to the defendants subject to certain conditions. However, pursuant to this Court's instructions during the hearing and oral argument in this matter, the Government has also considered whether, regardless of whether the firm was obligated to advance fees, the defendants were ultimately owed a duty of indemnification from KPMG under statute, contract, or common law.

Courts in Delaware, where KPMG is registered as a limited liability partnership, distinguish indemnification from advancement. *See Senior Tour Players 207 Mgmt. Co., Ltd.* v. *Golftown 207 Holding Co., LLC*, 853 A.2d 124, 128 & nn.11-12 (Del. Ch. 2004) (collecting cases); *cf.* 8 Del. C. § 145(a)-(e) (distinguishing, under Delaware's General Corporation Law, indemnification of fees from the advancement of such fees). Among other things, these courts have found that a right to advancement is not dependent on a determination that the party seeking advancement will ultimately be entitled to indemnification. Conversely, a decision to advance fees does not constitute an acknowledgment of the ultimate duty to indemnify. *See Senior Tour Players*, 853 A.2d at 128 & n.11. In any event, viewing the issue from the perspectives of indemnification or advancement does not alter the legal analysis. With the possible exception of defendant Jeffrey Stein, discussed below, the defendants had no statutory, contractual, or common-law right either to the advancement of fees or to indemnification, apart from those rights set forth in the agreements they executed with KPMG for the conditional advancement of legal fees. Moreover, to the extent the defendants claim that the Government interfered with a right to indemnification, such a claim would be premature, inasmuch as the right to indemnification would not come into play until the conclusion of the criminal proceedings. Indeed, precisely because such a right would not arise until after the conclusion of the proceedings, Government interference with a right to indemnification would appear never to violate the Sixth Amendment.

support for the defendants' claims of a Sixth Amendment violation. To the contrary, the Supreme Court has indicated that the right to counsel of a defendant's choosing extends only insofar as the defendant's means will permit, and that a defendant cannot "bootstrap" a Sixth Amendment claim onto an inability — even an inability resulting from Government conduct — to obtain funds from a third party. Finally, the history of the Sixth Amendment, which began as a reaction to English laws forbidding the assistance of counsel in criminal cases, offers no support. In any event, even if the Court were to recognize a Sixth Amendment violation on these circumstances, the defendants would have to demonstrate prejudice. Given the acknowledged fact that each defendant has been consistently, and more than competently, represented by counsel, no such showing could be made.

A. The Defendants' Sixth Amendment Rights Did Not Attach Until The Time of Indictment

The Supreme Court has concluded that "the core purpose of the counsel guarantee was to assure 'Assistance' at trial, when the accused was confronted with both the intricacies of the law and the advocacy of the public prosecutor." *United States* v. *Ash*, 413 U.S. 300, 309 (1973). As a result, it is implicated only during "critical stages" of the criminal process. *Maine* v. *Moulton*, 474 U.S. 159, 170 (1986). Specifically, the right to counsel does not attach until the initiation of formal judicial proceedings, "whether by way of formal charge, indictment, preliminary hearing, information, or arraignment." *Kirby* v. *Illinois*, 406 U.S. 682, 689 (1972) (plurality opinion); *McNeil* v. *Wisconsin*, 501 U.S. 171, 175 (1991); *United States* v. *Gouveia*, 467 U.S. 180, 185-90 (1984); *United States* v. *Massiah*, 377 U.S. 201, 205-07 (1964); *United States* v. *Holmes*, 44 F.3d 1150, 1159-60 (2d Cir. 1995); *In re Doe*, 781 F.2d 238, 244 (2d Cir. 1986) (*en banc*).

These temporal restrictions are neither arbitrary nor discretionary. As Justice Stewart stated for the Court in *Kirby*:

> The initiation of judicial criminal proceedings is far from a mere formalism. It is the starting point of our whole system of adversary criminal justice. For it is only then that the government has committed itself to prosecute, and only then that the adverse positions of government and defendant have solidified. It is then that a defendant finds himself faced with the prosecutorial forces of organized society, and immersed in the intricacies of substantive and procedural criminal law. It is this point, therefore, that marks the commencement of the "criminal prosecutions" to which alone the explicit guarantees of the Sixth Amendment are applicable.

Kirby, 406 U.S. at 689-90. The Supreme Court subsequently explained that:

> The Sixth Amendment's intended function is not to wrap a protective cloak around the attorney-client relationship for its own sake any more than it is to protect a suspect from the consequences of his own candor. Its purpose, rather, is to assure that in any "criminal prosecutio[n]," U.S. Const., Amdt. 6, the accused shall not be left to his own devices in facing the "'prosecutorial forces of organized society.'" *By its very terms, it becomes applicable only when the government's role shifts from investigation to accusation.* For it is only then that the assistance of one versed in the "intricacies . . . of law," is needed to assure that the prosecution's case encounters "the crucible of meaningful adversarial testing."

Moran v. *Burbine*, 475 U.S. 412, 430 (1986) (internal citations omitted) (emphasis added).

Accordingly, the fact that "a person is the subject of a criminal investigation is not enough to trigger his Sixth Amendment right to counsel," *United States* v. *Vasquez*, 675 F.2d 16, 17 (2d Cir. 1982) (*per curiam*), even if the subject already has counsel at that time. *Moran*, 475 U.S. at 431 (1986); *see also Holmes*, 44 F.3d at 1160 (finding that unindicted target has no Sixth Amendment rights). The Government conduct alleged by the defendants in this motion took

place, if at all, at least seventeen months before the return of the indictment. At that time, no Sixth Amendment rights had attached, and none could be violated.[23]

During the hearing, the Court anticipated a defense argument that, where the Government conduct at issue had the "foreseeable consequence" (or, more pointedly, the "specific purpose") of interfering with a defendant's Sixth Amendment rights, *see* Tr. 332-33, a violation could be premised on this conduct. The Government respectfully submits that such an argument would be unavailing.

The Government's research has disclosed no case in which an "anticipatory" Sixth Amendment violation has been recognized by a court. The absence of case law is not surprising, however, because the rights guaranteed under the Sixth Amendment, including the right to counsel, are subject to temporal restrictions that correlate with what the Supreme Court has termed the "critical stages" of the prosecution after the initiation of formal judicial proceedings. For this reason, the Court has found that conduct that could amount to a Sixth Amendment violation *after* the initiation of formal judicial proceedings does not amount to a Sixth Amendment violation when undertaken *earlier* in the Government's investigation. *Cf. Massiah*, 377 U.S. at 205-07 (finding that a defendant's Sixth Amendment rights are violated when, acting through an undisclosed informant, the Government deliberately elicits incriminating statements from the defendant after indictment). To recognize "anticipatory" Sixth Amendment violations would run counter to those Supreme Court decisions and undermine the "critical stages" test. After all, a defendant could always claim, after his Sixth Amendment rights have attached, that prior Government conduct operated as a continuing violation of those rights.

Even if the Court were to find that a defendant could claim an "anticipatory" or "continuing" Sixth Amendment violation based on pre-indictment Government conduct, the Sixth Amendment does not extent to cover the conduct alleged in this case. That is, whatever the scope of a defendant's Sixth Amendment right to counsel, it does not encompass a defendant's "right" to access third-party funds to pay for his defense. Accordingly, even assuming that the defendants were correct that the Government anticipated or intended that the Thompson Memo or its communications with Skadden concerning legal fees would cause KPMG to advance legal fees subject to certain conditions — including the cessation of legal fees post-indictment — such conduct would not constitute a Sixth Amendment violation.

In fact, however, the defendants have failed to demonstrate that the Government anticipated or intended that KPMG would condition fees based on the Thompson Memo. As amply detailed above, the "legal fees" provision to which the defendants ascribe so much

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[23] Prior to the initiation of formal judicial proceedings, a defendant has a Fifth Amendment right, as part of his right against self-incrimination, to counsel during any custodial interrogation. *See Miranda* v. *Arizona*, 384 U.S. 436, 478-79 (1966). However, violations of the Fifth Amendment right to counsel are not cognizable unless and until statements obtained in violation of the right are sought to be introduced at trial. *See Chavez* v. *Martinez*, 538 U.S. 760, 766-67 (2003) (finding no Fifth Amendment violation where statements obtained in purported violation of the defendant's rights were not admitted as testimony against him in a criminal case).

In a pre-*Miranda* decision, *Escobedo* v. *Illinois*, 378 U.S. 478 (1964), the Supreme Court appeared to recognize a Sixth Amendment right to counsel in the context of custodial interrogations. Notably, however, in subsequent decisions, the Court recharacterized *Escobedo* as vindicating Fifth Amendment rights, and limited the decision to its facts, which involved a custodial interrogation without the presence of counsel. *See Gouveia*, 467 U.S. at 188 n.5 ("[W]e have made clear that we required counsel in *Miranda* and *Escobedo* in order to protect the Fifth Amendment privilege against self-incrimination rather than to vindicate the Sixth Amendment right to counsel."); *Kirby*, 406 U.S. at 689 ("[T]he Court in retrospect perceived that the 'prime purpose' of *Escobedo* was not to vindicate the constitutional right to counsel as such, but, like *Miranda*, 'to guarantee full effectuation of the privilege against self-incrimination.'") (citing *Johnson* v. *New Jersey*, 384 U.S. 719, 729 (1966)); *see also Michigan* v. *Tucker*, 417 U.S. 433, 438 (1974) ("As we have noted previously, *Escobedo* is not to be broadly extended beyond the facts of that particular case.").

significance is a sub-factor of one of many factors that the Government is permitted to consider in determining whether to prosecute a particular company. Even then, the payment of legal fees is not considered by the Government in a vacuum, but only to the extent that it is indicative of a company's efforts to shield culpable employees in order to "circle the wagons." Moreover, the evidence presented during the hearing demonstrated that the Government's purpose in inquiring about this information was *not* to signal to KPMG a preferred course of action, but rather to determine who or what entity was paying the fees of the subject employees. *See generally* Tr. 272-73, 277-79, 281-82, 292-93 (testimony of Shirah Neiman).

Despite the defendants' claims to the contrary, the Thompson Memo, its reference to the payment of fees, and the Government communications with KPMG and Skadden in early 2004 were not intended, individually or combined, to dissuade companies from paying legal fees for counsel, and the evidence does not suggest that they were perceived as such by KPMG. Nor was it perceived in that manner by companies such as HVB, which advised the Government early on that it *would* advance legal fees to its employees without conditions, despite the absence of a statutory or contractual obligation to do so. *See* Tr. 111-12 (testimony of Stanley Okula). To the extent that these Government statements were misperceived by KPMG, the record has been set straight by the Government's repeated representations in this case that it did not, and would not, consider a decision by KPMG to advance or indemnify legal fees to be a violation of the DPA.

B. The Defendants' Sixth Amendment Rights, To The Extent They Existed, Were Not Violated By The Government's Conduct

The defendants' Sixth Amendment claims are unusual because the defendants have consistently been represented by competent counsel since well before the Grand Jury returned the indictment. Indeed, they do not contend otherwise. Instead, the focus of the defendants' Sixth Amendment claim is legal fees — more specifically, who or what entity should pay their legal fees in this case. The defendants argue that Government conduct improperly influenced KPMG's decision to condition the payment of legal fees to the defendants, and thereby violated their rights to counsel. The few Supreme Court cases addressing this issue belie this argument.

Unlike the right of access to counsel, which is absolute, the right to counsel of one's choosing is subject to various limitations. In *Wheat* v. *United States*, the Supreme Court offered the following guidance on the scope of this right:

> The Sixth Amendment to the Constitution guarantees that "[i]n all criminal prosecutions, the accused shall enjoy the right . . . to have the Assistance of Counsel for his defence." In *United States* v. *Morrison*, 449 U.S. 361, 364 (1981), we observed that this right was designed to assure fairness in the adversary criminal process. Realizing that an unaided layman may have little skill in arguing the law or in coping with an intricate procedural system, *Powell* v. *Alabama*, 287 U.S. 45, 69 (1932); *United States* v. *Ash*, 413 U.S. 300, 307 (1973), we have held that the Sixth Amendment secures the right to the assistance of counsel, by appointment if necessary, in a trial for any serious crime. *Gideon* v. *Wainwright*, 372 U.S. 335 (1963). We have further recognized that the purpose of providing assistance of counsel "is simply to ensure that criminal defendants receive a fair trial," *Strickland* v. *Washington*, 466 U.S. 668, 689 (1984), and that in evaluating Sixth Amendment claims, "the appropriate inquiry focuses on the adversarial process, not on the accused's relationship with his lawyer as such." *United States* v. *Cronic*, 466 U.S. 648, 657, n.21 (1984). Thus, while the right to select and be represented by one's preferred attorney is comprehended by the Sixth Amendment, the essential aim of the

> Amendment is to guarantee an effective advocate for each criminal defendant rather than to ensure that a defendant will inexorably be represented by the lawyer whom he prefers. *See Morris* v. *Slappy*, 461 U.S. 1, 13-14 (1983); *Jones* v. *Barnes*, 463 U.S. 745 (1983).
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> The Sixth Amendment right to choose one's own counsel is circumscribed in several important respects. Regardless of his persuasive powers, an advocate who is not a member of the bar may not represent clients (other than himself) in court. Similarly, a defendant may not insist on representation by an attorney he cannot afford or who for other reasons declines to represent the defendant. Nor may a defendant insist on the counsel of an attorney who has a previous or ongoing relationship with an opposing party, even when the opposing party is the Government.

486 U.S. 153, 158-59 (1988); *see United States* v. *Perez*, 325 F.3d 115, 124-25 (2d Cir. 2003) (setting forth limitations on right to counsel of choice); *see also Morris*, 461 U.S. at 13-14 (finding that the Sixth Amendment does not include a right to a "meaningful" attorney-client relationship); *United States* v. *Schmidt*, 105 F.3d 82, 89 (2d Cir. 1997) ("Because the right to counsel of one's choice is not absolute, a trial court may require a defendant to proceed to trial with counsel not of defendant's choosing; although it may not compel defendant to proceed with incompetent counsel").

The *Wheat* decision confirmed that a defendant's right to counsel of his choosing was, and properly could be, circumscribed by economic constraints. In *Caplin & Drysdale, Chartered* v. *United States*, 491 U.S. 617 (1989), the Supreme Court considered the extent to which a defendant's Sixth Amendment rights encompassed the right to obtain fees from a third party. The Court concluded in that case, which involved the operation of the federal forfeiture laws, that

> [w]hatever the full extent of the Sixth Amendment's protection of one's right to retain counsel of his choosing, that protection does not go beyond "the individual's right to spend his own money to obtain the advice and assistance of . . . counsel." A defendant has no Sixth Amendment right to spend another person's money for services rendered by an attorney, even if those funds are the only way that that defendant will be able to retain the attorney of his choice.

Id. at 626 (citations and quotations omitted). Accordingly, the Court found "no constitutional principle that gives one person the right to give another's property to a third party, even where the person seeking to complete the exchange wishes to do so in order to exercise a constitutionally protected right." *Id.* at 628[24]; *see also id.* at 631-32 (rejecting suggestion that the "Government could never impose a burden on assets within a defendant's control that could be used to pay a lawyer"; noting that both taxes and "jeopardy assessments," by which the Internal Revenue Service (the "IRS") seized assets to secure potential tax liabilities, were found to be constitutional, even though they deprived a defendant of resources that could be used to hire an attorney); *United States* v. *Rogers*, 984 F.2d 314, 316 (9th Cir. 1993) (finding no Sixth Amendment violation in the IRS's use of jeopardy assessments).

In a decision issued the same day as *Caplin & Drysdale*, the Court further found that because the Government could obtain forfeiture of property that a defendant might otherwise have used to pay legal fees "without offending the Fifth or Sixth Amendment," a pretrial restraining order of such property did not "arbitrarily interfere with a defendant's fair opportunity to retain counsel." *United States* v. *Monsanto*, 491 U.S. 600, 616 (1989) (internal citations and quotation

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[24] The *Caplin & Drysdale* Court also rejected a Fifth Amendment due process challenge to the forfeiture statute. It observed, preliminarily, that such a claim might well be co-extensive with a Sixth Amendment claim, because "while '[t]he Constitution guarantees a fair trial through the Due Process Clauses . . . it defines the basic elements of a fair trial largely through the several provisions of the Sixth Amendment.'" 491 U.S. at 633 (citing *Strickland* v. *Washington*, 466 U.S. 668, 684-685 (1984)). Nonetheless, assuming that the Fifth Amendment "provide[d] some added protection not encompassed by the Sixth Amendment's more specific provisions," 491 U.S. at 633, the Court rejected the claim in the absence of prosecutorial misconduct. *Id.* at 634.

marks omitted).[25] Nothing in these cases indicates that a Sixth Amendment right would in fact arise if the third party was willing to pay the defendant's legal fees (a showing that, incidentally, was not made in this case). Indeed, as discussed in the following section, such a right would far exceed both the original intent of the Sixth Amendment and the legal principles advanced by the Supreme Court in the above-cited cases.[26]

A corollary to the defendants' argument is that the Government may not interfere with a third-party's decision to pay legal fees. Yet there are circumstances in which Government inquiry into third-party payment of legal fees is entirely appropriate. In *United States* v. *Locascio*, 6 F.3d 924, 931-34 (2d Cir. 1993), the Second Circuit affirmed a district court's decision to disqualify counsel to defendants Gotti and Locascio based, in part, on Gotti's transmission of "benefactor payments" to these attorneys to serve as "house counsel" to Gambino Crime Family members. In addition to the obvious concerns about the conflict of interest such payments raised, the Second Circuit also noted that evidence of Gotti's payment of legal fees could be used by the Government to prove the existence of the criminal enterprise. *Id.* at 932-33. The Government is in no way suggesting that KPMG and its partners and employees could be considered the equivalent of an organized crime family. Rather, the point is that if the Government can properly treat the payment of the legal fees of an associate as strong evidence of the existence of a criminal enterprise involving the payor and the associate, then surely the Government can do the significantly less intrusive act alleged in this case involving coordinated criminal activity, *i.e.*, treating such payments as a factor to consider in its discretionary charging decision concerning the payor.

The defendants' attempt to analogize this case to *United States* v. *Gagalis*, 04 Cr. 126 (D.N.H.), fails on a comparison of the facts. Significantly, the district court in *Gagalis* never found a Sixth Amendment violation in that case. In any event, *Gagalis* involved a situation in which the employer — unlike KPMG here — had expressly provided for advancement of legal fees to its employees in the company's by-laws. Thus, the court in that case expressly posed the issue as one of Government interference with a duty *imposed by law* to pay fees. Here, however, neither Delaware law nor written contract directs that KPMG pay the legal fees of its employees, with the possible exception of defendant Stein; even there, it is undisputed that the Government was unaware of the existence of any contractual obligations.

The defendants also ascribe undue importance to the Eighth Circuit's decision in *United States* v. *Gonzalez-Lopez*, 399 F.3d 924 (8th Cir. 2005), for which a writ of *certiorari* was granted and as to which arguments were recently held in the Supreme Court. That case involved a

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[25] At oral argument, the defense sought to distinguish *Caplin & Drysdale* by suggesting that, because KPMG was a partnership, the defendants' efforts to secure the advancement of legal fees by KPMG did not implicate "other people's money," because the defendants (as partners in KPMG) had a legal right to that money. This argument lacks merit. The Delaware Revised Uniform Limited Partnership Act ("DRULPA") makes clear that while a "partnership interest is personal property," an individual partner "has no interest in specific limited partnership property." 6 Del. C. § 17-701; *cf.* 6 Del. C. § 17-703(e) ("No creditor of a partner or of a partner's assignee shall have any right to obtain possession of, or otherwise exercise legal or equitable remedies with respect to, the property of the limited partnership."). Thus, while those defendants who were current partners of KPMG at the time of the events in question may have had an interest in the partnership, and could have brought an action on the partnership's behalf, they did not have a divisible interest in the assets of the partnership. *Cf. International Business Machines Corp.* v. *Comdisco, Inc.*, C.A. No. 91C-07-199, 1991 WL 269965, at *14 (Del. Super. Dec. 4, 1991) (relying on § 17-701 in concluding that plaintiff's partnership interest entitled it to bring a conversion action on behalf of the partnership, but did not entitle it to bring an action on its own behalf, because of the absence of an ownership interest in the partnership's property).

[26] The *Caplin & Drysdale* Court also rejected an argument advanced by *amicus curiae* American Bar Association that the complexity of the case was a factor to consider in determining whether a defendant could access funds subject to forfeiture. *See* 491 U.S. at 630 n.7 ("[W]e cannot say that the Sixth Amendment's guarantee of effective assistance of counsel is a guarantee of privately retained counsel in every complex case, irrespective of a defendant's ability to pay.").

situation in which the lower court erroneously denied permission for defendant's retained counsel to appear *pro hac vice*; to that end, it more closely approximates historical concerns that the Government could impermissibly prevent counsel from appearing. *Cf. Perez*, 325 F.3d at 125 (noting that a non-indigent defendant's "[c]hoice of counsel should not be unnecessarily obstructed by the court") (internal quotations and citations omitted). That case does not, however, implicate the issue presented here, namely, the extent to which the Sixth Amendment extends to cover a defendant's access to third-party funds for the payment of legal fees.

The defendants cannot circumvent the Supreme Court's finding in *Caplin & Drysdale* that "[w]hatever the full extent of the Sixth Amendment's protection of one's right to retain counsel of his choosing, that protection does not go beyond 'the individual's right to spend his own money to obtain the advice and assistance of . . . counsel.'" 491 U.S. at 626. Accordingly, even if the Court were to conclude that the Government had, unwittingly or otherwise, interfered with KPMG's decision to provide legal fees to the defendants, such conduct could not support a Sixth Amendment violation.

C. The History Of The Sixth Amendment Does Not Support The Defendants' Construction Of The Right To Counsel

Nor does the defendants' expansive theory of the right to counsel find any support in the history of the Sixth Amendment. The right to counsel was scarcely considered in pre-Revolutionary War England. In fact, during the latter half of the eighteenth century, English law forbade the assistance of counsel in criminal cases — other than in cases involving the polar opposites of treason and misdemeanors — and instead prescribed that a defendant should "appear before the court in his own person and conduct his own cause in his own words." *See Faretta* v. *California*, 422 U.S. 806, 823 (1974) (quoting 1 Frederick Pollack & Frederic W. Maitland, The History of English Law 211 (2d ed. 1909)).[27] Several theories have been offered for this ban on attorneys, including: (i) the fact that criminal prosecutions during that time were typically brought by private parties who represented themselves; (ii) the presence of an impartial arbitrator, who ostensibly served to level the playing field; or (iii) a monarchical fear that accused felons would be acquitted. *See generally* Pamela R. Metzger, Beyond the Bright Line: A Contemporary Right-to-Counsel Doctrine, 97 Nw. U.L. Rev. 1635, 1637-38 (2003) (collecting authorities).

Interest in permitting the assistance of counsel in criminal proceedings grew as several American colonies rejected the private prosecution system in favor of professional prosecutors. *Id.* at 1638-40; *see also Ash*, 413 U.S. at 307-08; *Powell* v. *Alabama*, 287 U.S. 45, 61-63 (1932). The impetus for the right to counsel, therefore, was the colonists' desire "to forbid laws, like those in England, which required criminal defendants to represent themselves." Bruce A. Green, Lethal Fiction: The Meaning of "Counsel" in the Sixth Amendment, 78 Iowa L. Rev. 433, 438-49 (1993).

The Judiciary Act of 1789 permitted criminal defendants to defend themselves in their cases "personally or by the assistance of such counsel . . . as by the rules of the said court . . . shall be permitted to manage and conduct causes therein." *See* Judiciary Act of 1789, § 35, 1 Stat. 73, 90, *quoted in* William M. Beaney, The Right to Counsel in American Courts 28 (1955) (hereafter, "Beaney"). The following day, the Sixth Amendment was proposed by Congress. The right to counsel, one of several rights contained in the amendment, appeared to reflect the same goals as the Judiciary Act. *See* Beaney at 28. A second statute, passed after the Sixth Amendment was

[27] The right of self-representation in federal court is codified at 28 U.S.C. § 1654.

proposed but prior to its ratification, provided for the appointment of counsel only in capital cases. *See* Act of April 15, 1790, § 29, 1 Stat. 112, 118-19.[28]

"No affirmative responsibilities either to provide counsel or to ensure his effectiveness were originally intended." Stephen G. Gilles, Effective Assistance of Counsel: The Sixth Amendment and the Fair Trial Guarantee, 50 U. Chi. L. Rev. 1380, 1388 & n.38 (1983). Beginning in the 1930s, however, after approximately 150 years of relative inaction, the right to counsel became the focus of several Supreme Court decisions. Even then, the principal concern was the appointment of counsel for indigent defendants. *See Powell*, 287 U.S. at 61 (requiring appointment of counsel in capital cases in which an indigent defendant was "incapable adequately of making his own defense because of ignorance, feeblemindedness, illiteracy or the like"); *Johnson* v. *Zerbst*, 304 U.S. 458, 462-463 (1938) ("The Sixth Amendment withholds from federal courts, in all criminal proceedings, the power and authority to deprive an accused of his life or liberty unless he has or waives the assistance of counsel."); *Gideon* v. *Wainwright*, 372 U.S. 335, 341 (1963) (holding that the Sixth Amendment right to appointed counsel was applicable to the states through the Fourteenth Amendment); *United States* v. *Wade*, 388 U.S. 218, 226-27 (1967) (holding that the right to counsel "in all criminal prosecutions" extended to pretrial proceedings where such assistance was necessary to guarantee a fair trial); *Kirby*, 406 U.S. at 689 (holding that the right to counsel attaches after the initiation of adversary criminal proceedings through "formal charge, preliminary hearing, indictment, information, or arraignment").

The Supreme Court has, conversely, afforded less attention to cases involving retained counsel. Thus, to the extent the relevant historical analysis sheds any light on the Sixth Amendment issues in the instant case, it undercuts the defendants' efforts to impute a Sixth Amendment violation to the Government's conduct. To be sure, the Supreme Court has recognized a defendant's right to be represented by the counsel of his choosing, a right that itself is broader than the text of the Sixth Amendment. The Court has made clear, however, that this right is not absolute, but rather may yield in circumstances including, for example, conflicts of interest or insufficient bar credentials. *See Wheat*, 486 U.S. at 159; *see also Perez*, 325 F.3d at 124-26 (collecting cases).

Nothing in the Supreme Court's decisions supports an extension of the Sixth Amendment right to counsel to a defendant's ability to obtain funds from a third party. To the contrary, as discussed above, the few Supreme Court cases on the issue have made clear that "[w]hatever the full extent of the Sixth Amendment's protection of one's right to retain counsel of his choosing, that protection does not go beyond 'the individual's right to spend his own money to obtain the advice and assistance of . . . counsel.'" *Caplin & Drysdale,* 491 U.S. at 626 (quoting *Walters* v. *National Assn. of Radiation Survivors*, 473 U.S. 305, 370 (1985) (Stevens, J., dissenting)).

D. The Defendants Are Required To Establish Prejudice

Assuming this Court were to find that the defendants' Sixth Amendment rights had been violated, the defendants would be required to present evidence of prejudice. In *Lainfiesta* v. *Artuz*, the Second Circuit observed that:

> The Supreme Court has held that violations of the Sixth Amendment right to counsel are *per se* reversible only when they amount to an "'[a]ctual or constructive denial of the assistance of counsel altogether,'" *Penson* v. *Ohio*, 488 U.S. 75, 88 (1988) (quoting *Strickland* [v. *Washington*, 466 U.S. 668, 692 (1984))], or when counsel was "prevented from assisting the accused during a critical stage of the proceeding," *United States* v. *Cronic*, 466 U.S.

[28] This act is codified in its present form at 18 U.S.C. § 3005.

> 648, 659 & n.25 (1984); *see also Geders* [v. *United States*, 425 U.S. 80, 91 (1976)] (bar on attorney-client consultation during overnight recess violated Sixth Amendment; no harmless error analysis). On the other hand, most Sixth Amendment violations that occur during the presentation of a case have been found to merit only harmless error analysis.

253 F.3d 151, 157 (2d Cir. 2001) (citations omitted); *cf. McKaskle* v. *Wiggins*, 465 U.S. 168 (1984) (finding that denial of a defendant's right to self-representation at trial is a *per se* violation).

Building on this Supreme Court precedent, the Second Circuit has, broadly speaking, recognized three categories of Sixth Amendment violations, which are distinguished by the severity of the deprivation and the concomitant showing of prejudice required of the defendant in order to succeed on his claim. *See generally United States* v. *O'Neil*, 118 F.3d 65, 70 (2d Cir. 1997). The first category encompasses circumstances so severe as to constitute *per se* violations of the Sixth Amendment. *Bellamy* v. *Cogdell*, 974 F.2d 302, 306 (2d Cir. 1992) (*en banc*). In the *O'Neil* decision, the Second Circuit stated that it had found *per se* violations only in cases where the attorney in question was: (i) not licensed to practice law because he failed to satisfy the substantive requirements of admission to the bar, or (ii) implicated in the defendant's crime. *O'Neil*, 118 F.3d at 70-71; *United States* v. *John Doe #1*, 272 F.3d 116, 125-26 (2d Cir. 2001) (same). In fact, the Second Circuit has also recognized a *per se* violation of the right to counsel in cases where an attorney has completely abandoned his client, *see Restrepo* v. *Kelly*, 178 F.3d 634, 640 (2d Cir. 1999) (collecting cases), and where an attorney has failed to file a notice of appeal after his client requests he do so, *see Campusano* v. *United States*, 442 F.3d 770, 772 (2d Cir. 2006).

The second category involves conflicts of interest between attorney and client that do not rise to the level of *per se* violations, but may jeopardize the adequacy of representation. *O'Neil*, 118 F.3d at 71; *United States* v. *Schwarz*, 283 F.3d 76, 92 (2d Cir. 2002). "In order to prevail on a conflict of interest claim, the defendant must establish an actual conflict of interest that resulted in a lapse of representation." *O'Neil*, 118 F.3d at 71 (quotation omitted). A defendant can prove a lapse in representation, in turn, by demonstrating "that some plausible alternative defense strategy or tactic might have been pursued, and that the alternative defense was inherently in conflict with or not undertaken due to the attorney's other loyalties or interests." *United States* v. *Levy*, 25 F.3d 146, 157 (2d Cir. 1994).

The third category entails ineffective assistance of counsel that is unrelated to a conflict of interest. *O'Neil*, 118 F.3d at 71. Claims of this type are analyzed under the familiar framework of *Strickland*, which requires a defendant to show "(1) that his attorney's performance fell below an 'objective standard of reasonableness,' and (2) that 'there is a reasonable probability that, but for counsel's unprofessional errors, the result of the proceeding would have been different.'" *Kieser* v. *New York*, 56 F.3d 16, 18 (2d Cir. 1995) (quoting *Strickland*, 466 U.S. at 694).[29]

The defendants argue that no showing of prejudice is required, because the Government's conduct amounts to a *per se* violation of their Sixth Amendment rights. (*See* Defendants' Supp. Mem. at 1-2). However, the cases on which they rely, while consistent with the Supreme Court decisions summarized in *Lainfiesta*, involve circumstances of egregious Government misconduct

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[29] The Second Circuit has also suggested that such claims could be analyzed under a "harmless error" standard, *see Lainfiesta*, 253 F.3d at 157, under which the reviewing court would consider whether the error had a "substantial and injurious effect or influence" on the outcome. *Kotteakos* v. *United States*, 328 U.S. 750, 764-65 (1946).

that are wholly inapposite even to the allegations in this case, much less the evidence actually presented to the Court. *See Via* v. *Cliff*, 470 F.2d 271 (3d Cir. 1972) (prison officials prevented defendant from meeting with counsel prior to and during his trial, and allowed police to interrogate defendant in the absence of counsel despite counsel's notice that he wished to be present for any interrogation); *Briggs* v. *Goodwin*, 698 F.2d 486 (D.C. Cir. 1983) (prosecutor lied under oath about whether co-defendant was confidential informant, which resulted in informant's participation in joint defense meetings)[30]; *Shillinger* v. *Haworth*, 70 F.3d 1132 (10th Cir. 1996) (deputy sheriff attended defendant's trial preparation sessions and reported information obtained during those sessions to the prosecutor); *United States* v. *Danielson*, 325 F.3d 1054 (9th Cir. 2003) (Government improperly obtained information concerning defendant's trial strategy by allowing informant to tape-record conversations with defendant in which that strategy was discussed). Even in *Danielson*, the Ninth Circuit required the defendant to establish that he was "substantially prejudice[d]" by the Government's intrusion into the attorney-client relationship. *Danielson*, 325 F.3d at 1069 (citations omitted). Notably, several of the cases cited by the defense arose in civil damage actions brought pursuant to 42 U.S.C. § 1983 and similar theories, which do not require a showing of prejudice.

The Government's conduct in this case did not result in the actual or constructive denial of the right to counsel, and cannot be considered a *per se* violation of the Sixth Amendment. Nor can the defendants demonstrate that their attorneys were hampered by an actual conflict of interest that resulted in any lapse in representation. Accordingly, the defendants are required to demonstrate prejudice under the *Strickland* standard. This Court has deferred receipt of evidence on the issue of prejudice. The Government submits that, for the reasons set forth in pages 14 through 17 of its Supplemental Memorandum, the defendants will be unable to meet their burden.

[30] The precedential force of this decision is lessened by the fact that, upon rehearing, the United States Court of Appeals for the District of Columbia concluded that the prosecutor who was the defendant in this civil litigation was subject to absolute immunity, as a witness in a judicial proceeding, for the false testimony he provided to the trial court. *See Briggs* v. *Goodwin*, 712 F.2d 1444, 1447 (D.C. Cir. 1983) (citing *Briscoe* v. *LaHue*, 460 U.S. 325 (1983)).

II. The Defendants Cannot Allege A Fifth Amendment Due Process Claim

This Court invited the parties to broaden the scope of the legal inquiry to include a review of the Fifth Amendment Due Process Clause. The law governing such claims makes plain that the defendants have no viable Due Process argument. The Government conduct alleged by the defendants falls far short of that required to satisfy the stringent requirements of a substantive due process violation. Moreover, the defendants can allege neither a cognizable liberty nor property interest of which they were deprived as a result of the Government's conduct.

A. The Government's Conduct Cannot Support A Substantive Due Process Violation

The defendants cannot claim that the Government's conduct amounted to a substantive due process violation under the Fifth Amendment. The substantive due process guarantee "prevents the government from engaging in conduct that shocks the conscience or interferes with rights implicit in the concept of ordered liberty." *United States* v. *Salerno*, 481 U.S. 739, 746 (1987) (quotations and citations omitted). Thus, the Supreme Court has repeatedly stressed that "only the most egregious official conduct can be said to be arbitrary in the constitutional sense," and that the actions "most likely to rise to the conscience-shocking level" are those "intended to injure in some way unjustifiable by any government interest." *County of Sacramento* v. *Lewis*, 523 U.S. 833, 846 (1998). The Second Circuit has likewise instructed courts that "[s]ubstantive

due process protects against government action that is arbitrary, conscience shocking, or oppressive in a constitutional sense, but not against government action that is incorrect or ill-advised." *Lowrance* v. *Achtyl*, 20 F.3d 529, 537 (2d Cir.1994).

What constitutes "a demonstrable level of outrageousness" cannot be identified with precision, but "the due process claim, in the rare instances when successful, has prevailed to restrain law enforcement activities that involve coercion . . . or outrageous violation of physical integrity," *United States* v. *Myers*, 692 F.2d 823, 837 (2d Cir. 1982), or psychological integrity. *United States* v. *Cuervelo*, 949 F.2d 559, 565 (2d Cir. 1991); *see Rochin* v. *California*, 342 U.S. 165, 172-73 (1952) (finding a violation of substantive due process in case involving law enforcement officers breaking into suspect's bedroom, forcibly attempting to pull capsules from his throat, and pumping his stomach without his consent); *see also Chavez*, 538 U.S. 760, 787 n.1 (Stevens, J., concurring in part and dissenting in part) (collecting cases where coercive police interrogation procedures were held to violate the Due Process Clause). "Especially in view of the courts' well-established deference to the Government's choice of investigatory methods, the burden of establishing outrageous investigatory conduct is very heavy." *United States* v. *Rahman*, 189 F.3d 88, 131 (2d Cir. 1999) (internal citations omitted). The defendants have alleged nothing even remotely similar to the factual circumstances that have resulted in the rare findings of a substantive due process violation. Accordingly, the Court should give short shrift to any arguments of substantive due process.

B. The Defendants' Procedural Due Process Rights Were Not Violated

Nor can the defendants allege a violation of their right to procedural due process. The Due Process Clause of the Fifth Amendment protects not only "substantive" rights; it also requires that the Government act with adequate or fair procedures when it deprives a person of life, liberty, or property. *Mullane* v. *Central Hanover Bank & Trust*, 339 U.S. 306, 313 (1950). To determine whether there has been a deprivation of property without due process of law, the protected interest involved must first be identified. *O'Connor* v. *Pierson*, 426 F.3d 187, 196 (2d Cir. 2005). Next, a determination must be made as to whether a constitutionally adequate process has been received in the course of the deprivation. *Harhay* v. *Town of Ellington Bd. of Educ.*, 323 F.3d 206, 211-12 (2d Cir. 2003); *see also Logan* v. *Zimmerman Brush Co.*, 455 U.S. 422, 428 (1982). Here, however, because defendants cannot establish a deprivation of a cognizable property interest, a procedural due process claim under the Fifth Amendment necessarily fails.

Identifying a relevant property interest is a two-step process. *See Ciambriello* v. *County of Nassau*, 292 F.3d 307, 313 (2d Cir. 2002). First, a court must determine whether some source of law other than the Constitution, such as a state or federal statute, confers a property right upon the claimant. *O'Connor*, 426 F.3d at 196. In this regard, the Supreme Court has instructed as follows:

> Property interests, of course, are not created by the Constitution. Rather, they are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law — rules or understandings that secure certain benefits and that support claims of entitlement to those benefits.

Board of Regents of State Colleges v. *Roth*, 408 U.S. 564, 577 (1972). Once such a property right is found, a court must next determine "whether that interest rises to the level of a legitimate claim of entitlement protected by the Due Process Clause." *Town of Castle Rock* v. *Gonzales*, 545 U.S. ___, 125 S.Ct. 2796, 2804 (2005) (internal quotation and citation omitted). Here, the defendants assert that the Government prevented a third party, namely KPMG, from providing its partners

and employees with paid representation without certain conditions, including a cap on the aggregate amount of fees advanced.[31] Because defendants have no recognized legal interest in the advancement or the indemnification of their legal fees by KPMG, no property interest cognizable under the Fifth Amendment is present and, accordingly, any such claim must fail.

The defendants concede that they have neither a statutory nor an express contractual right to the advancement or the indemnification of their legal fees. *See* Defendants' Opening Mem. at 4 (citing 6 Del. C. § 17-108, the DRULPA provision that entrusts the limited partnership with the discretion to decide for itself whether to indemnify legal fees and, by extension, to advance such fees); Tr. 348 ("I will represent to the court that both documents [the KPMG By-Laws and the KPMG Partnership Agreement] are silent on the issue of payment of fees or indemnification generally.") (argument of David Spears). Instead, KPMG is a limited liability partnership registered in Delaware, a state that permits, but does not require, that partnerships advance legal fees for employees and partners in connection with civil and criminal investigations and prosecutions that arise out of the employee or partner's work on behalf of the partnership. *See* 6 Del. C. § 17-108 ("Subject to such standards and restrictions, if any, as are set forth in its partnership agreement, a limited partnership *may*, and shall have the power to, indemnify and hold harmless any partner or other person from and against any and all claims and demands whatsoever.") (emphasis added).

Delaware courts have emphasized the expansive discretion accorded to limited partnerships under Section 17-108. "In fact, Section 17-108 defers completely to the contracting parties to create and delimit rights and obligations with respect to indemnification and advancement of expenses." *Delphi Easter Partners Ltd. Partnership* v. *Spectacular Partners, Inc.*, Civ. A. No. 12409, 1993 WL 328079 (Del. Ch. Aug. 6, 1993); *see also Senior Tour Players*, 853 A.2d at 127 n.5 ("Limited liability companies, like limited partnerships, are governed by a statute that gives the contracting parties broad authority in setting their indemnification provisions."). To this end, DRULPA announces that "[i]t is the policy of this chapter to give maximum effect to the principle of freedom of contract and to the enforceability of partnership agreements." 6 Del. C. § 17-1101(c).

Delaware courts are also uniform in concluding that "[t]he statute itself creates no rights to indemnification." *Delphi*, 1993 WL 328079, at *2. During the relevant time period, KPMG had no by-law or other written undertaking to advance or indemnify legal fees. Accordingly, there is no basis in law or contract to confer such a property right upon the defendants here. *See O'Connor*, 426 F.3d at 196.[32]

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[31] Defendant Jeffrey Stein stands in a different factual footing than the other defendants, inasmuch as he had entered into a severance agreement in January 2004, before the commencement of the federal investigation, which Stein alleges specified KPMG's obligations to provide for advancement of legal fees. *See* Stein Letter dated April 5, 2006. Stein asserts that KPMG continued to pay his legal fees until May 2005, which fees exceeded the $400,000 cap imposed by KPMG on others. *See id.* at 3. It is undisputed, however, that the Government was not aware of the fee provisions of Stein's severance agreement, and in fact had no communications with KPMG concerning the advance of fees for Stein. *See* KPMG Letter dated April 19, 2006 at 5. Where "a government official's act [purportedly] causing injury to life, liberty, or property is merely negligent, 'no procedure for compensation is constitutionally required," and no due process violation can lie. *Daniels* v. *Williams*, 474 U.S. 327, 333 (1986) (quotation omitted). Here, since the Government was concededly unaware of Stein's severance agreement, the defense could establish, at best, that the Government acted negligently, and any Fifth Amendment claims as to Stein would therefore fail.

[32] The defendants overstate the significance of the statement in *Active Asset Recovery, Inc.* v. *Real Estate Asset Recovery Svcs., Inc.*, Civ. A. No. 15478, 1999 WL 743479, at *16 (Del. Ch. Sept. 10, 1999), that a partnership can elect to indemnify persons "even in the absence of a provision in the partnership agreement contemplating that result." (*See* Defendants' Opening (continued...)

This Court invited the parties to consider whether a contractual right could be implied in fact from KPMG's longstanding-but-unwritten practice of advancing fees in civil and criminal investigations. *See* Order of May 11, 2006. No such right, however, can be implied. An implied-in-fact contract is a contract that can be formed through the parties' conduct. Unlike written and orally expressed contracts, however, the parties' intent and mutual assent to an implied-in-fact contract is proven through conduct rather than words. "An agreement implied in fact is founded upon a meeting of minds, which although not embodied in an express contract, is inferred, as a fact, from conduct of the parties showing, in light of the surrounding circumstances, their tacit understanding." *Hercules* v. *United States*, 516 U.S. 417, 424 (1996) (quotation omitted); *see also Chase Manhattan Bank* v. *Iridium Africa Corp.*, 239 F. Supp. 2d 402, 408-09 (D. Del. 2002); *Maas* v. *Cornell Univ.*, 94 N.Y.2d 87, 93-94 (1999). Accordingly, the elements required to form an implied-in-fact contract are identical to those required for an express agreement, that is, offer, acceptance, and consideration. *In re Penn Cent. Transport Co.*, 831 F.2d 1221, 1228 (3d Cir. 1987); *In re Phillips Petroleum Secs. Litig.*, 697 F. Supp. 1344, 1354 (D. Del. 1988).

An implied-in-fact contract requires a meeting of the minds. More to the point, to be a legally binding implied-in-fact contract, the parties' mutual assent to the contract terms must be *objectively* manifest or shown. In this setting, mutual assent can be neither a subjective nor a personal understanding. *Creditors' Comm. of Essex Builders, Inc.* v. *Farmers Bank*, 251 A.2d 546, 548 (Del. 1969). "Implied contractual obligations are terms which 'clearly would have been included had the parties negotiated with respect to them.'" *Chaplake Holdings Ltd.* v. *Chrysler Corp.*, No. Civ. A. 94C-04-164-JOH, 1999 WL 167834, at *19 (Del. Super. Jan. 13, 1999) (citations omitted)

The parties have stipulated to the existence and the generalities of KPMG's prior practice of advancing legal fees. (*See* DX 4). The terms of the KPMG Partnership Agreement to which the defendants agreed to be bound, however, foreclose the possibility of an implied-in-fact contract. First, Section 19.7 of the Agreement contains an integration clause that provides, in pertinent part, that "[t]his Agreement . . . constitutes the entire agreement, and supersedes all prior agreements and understandings, both written and oral, among the Members with respect to the subject matter hereof." Section 19.1 of the Agreement, in turn, provides that the Agreement "may only be amended upon the written consent of not less than Two-thirds of the Members Voting."

Where a party has entered into an agreement that contains an unambiguous integration clause, he may not later rely on external documents to allege a breach of an undertaking not contained in the integrated agreement. *See Chrin* v. *Ibrix Inc.*, C.A. No. 20587, 2005 WL 2810599, at *5 (Del. Ch. Oct. 19, 2005), *citing H-M Wexford LLC* v. *Encorp, Inc.*, 832 A.2d 129, 141 (Del. Ch. 2003). Similarly, parol evidence cannot be introduced to interpret a contract that facially is unambiguous. *Chrin*, 2005 WL 2810599, at *5, *citing Highlands Ins. Group, Inc.* v. *Halliburton Co.*, Civ. A. No. 17971, 2001 WL 287485 (Del. Ch. Mar. 21, 2001).

As of October 1, 2003, the date of the relevant Partnership Agreement, the defendants may have been aware of the firm's informal practice of advancing legal fees in civil and criminal investigations. Nonetheless, neither the defendants nor the partnership as a whole made any effort to enshrine that practice as a contractual right. Given the existence of an unambiguous integration

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[32](...continued)
Mem. at 4). The court in that case went on to conclude that limited partnerships had only "the power but not the duty to indemnify." 1999 WL 743479, at *17. The Government disagrees with neither of these propositions.

clause, there can be no implied-in-fact contract. *See Burgess* v. *Manufactured Housing Concepts, L.L.C.*, No. Civ. A. 06-02-025, 1997 WL 364038, at *1 (Del. Super. Jun. 17, 1997) ("where two parties have executed a written contract to which they both have assented as the complete integration of the agreement, all other evidence of antecedent understanding and negotiation will be inadmissible for the purpose of varying or contradicting the writing").[33] In point of fact, to imply a contract based on past practice would contravene KPMG's choice *not* to include an obligation to advance or indemnify, and thus would fly in the face of Delaware law's explicit policy of "giv[ing] maximum effect to the principle of freedom of contract and to the enforceability of partnership agreements." 6 Del. C. § 17-1101(c).

Finally, this Court invited the parties to consider whether the defendants possessed any common-law rights that could support a Fifth Amendment procedural due process claim. Once again, the answer is no. The common law recognized a right to "indemnity," by which "a tort-feasor 'passes through' his entire liability to a third party whom the tort-feasor alleges is the real party responsible for injury." 42 C.J.S. *Indemnity* § 2 at 73 (1991). While some courts have termed this duty a duty of "indemnification," *see, e.g.*, *Levy* v. *Hayes Lemmerz Int'l, Inc.*, Civ. A. No. 1395-N, 2006 WL 985361, at *11 (Del. Ch. Apr. 5, 2006), that duty is not implicated by this case. Rather, the defendants seek a common-law right to the advancement or indemnification of fees by a statutorily-created entity to its directors, officers, partners, and employees. Significantly, however, "[n]o common law right to indemnification existed." *Merritt-Chapman & Scott Corp.* v. *Wolfson*, 264 A.2d 358, 360 (Del. Super. 1970) (citing Corporate Responsibility for Litigation Expenses of Management, 40 Calif. L. Rev. 104 (1952)). Indeed, the *Merritt-Chapman* court noted, the absence of any such common-law rights is what led states such as Delaware to enact indemnification statutes. As such, the defendants cannot claim a property interest in the indemnification or advancement of their legal fees based in the common law.

The defendants, to the extent they were partners in KPMG during the relevant time period, would have a mutual duty of good faith and fair dealing with KPMG. However, this right was not violated by the conduct alleged. The Delaware Supreme Court has found that:

> [T]he implied covenant [of good faith and fair dealing] requires "a party in a contractual relationship to refrain from arbitrary or unreasonable conduct which has the effect of preventing the other party to the contract from receiving the fruits of the bargain." Thus, parties are liable for breaching the covenant when their conduct frustrates the "overarching purpose" of the contract by taking advantage of their position to control implementation of the covenant's terms

Dunlap v. *State Farm Fire and Cas. Co.*, 878 A.2d 434, 442 (Del. 2005) (citations omitted). As detailed above, the defendants had no contractual right — express or implied — to the advancement or indemnification of legal fees. Thus, KPMG's decision to advance fees subject to certain conditions could not, by definition, prevent the defendants from receiving the fruits of their bargain with the firm, nor could it frustrate the "overarching purpose" of the contract they *did* have, which is fully set forth in the Partnership Agreement.

Because the defendants cannot identify a property interest of which they were deprived as a result of the Government's conduct, the procedural due process inquiry ends there, without need

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[33] While the Government has focused on the law of Delaware, the state in which KPMG has registered, it notes that New York law affords comparable treatment to integration clauses, *see Gebbia* v. *Toronto-Dominion Bank*, 306 A.D.2d 37, 38 (N.Y. App. Div. 2003), and comports with Delaware's treatment of the parol evidence rule. *See South Rd. Assocs., LLC* v. *IBM*, 4 N.Y.3d 272, 278 (2005).

to inquire whether any process the defendants received was adequate. For all of these reasons, the defendants cannot allege a viable claim under the Due Process Clause of the Fifth Amendment.[34]

III. The Appropriate Remedy Is To Have KPMG Reconsider Its Position Regarding The Advancement Or Indemnification Of Legal Fees

Should the Court find, despite the absence of supporting law, that the Government's conduct (be it the Thompson Memo standing alone, and/or this Office's communications with KPMG and its representatives on the subject of advancing attorney fees) resulted in a violation of the defendants' constitutional rights and, further, that the defendants have demonstrated the requisite prejudice, the remaining issue is one of remedy.

In its supplemental memorandum on Sixth Amendment issues, the Government agreed with the Court's suggestion that an appropriate remedy would be to afford KPMG an opportunity to reconsider its decision to advance or indemnify legal fees to the defendants in connection with the instant criminal proceeding. The Government further outlined, in broad terms, the significant constitutional issues that were implicated by the defendants' suggestion that fees could be paid from the funds paid to the Government by KPMG pursuant to the DPA. In the remainder of this section, the Government will address, in greater detail, the various remedy arguments proffered by the defense, which arguments, the Government submits, are premised on fundamental misconstructions of the relevant statutes and case law.

A. Any Remedy Should Be Tailored To The Injury Suffered

Preliminarily, the Government agrees with the defense that the starting point for any Sixth Amendment remedy inquiry is the Supreme Court's decision in *United States* v. *Morrison*, 449 U.S. 361 (1981). There, the Court found that "[c]ases involving Sixth Amendment deprivations are subject to the general rule that remedies should be tailored to the injury suffered from the constitutional violation and should not unnecessarily infringe on competing interests." *Id.* at 364. The Court described its approach as tailoring relief "to assure the defendant the effective assistance of counsel and fair trial." *Id.* at 365. Significantly, however, the Court found that, except in the rarest of circumstances involving the existence of a "demonstrable prejudice, or substantial threat thereof" that could not be remedied by any other means, "dismissal of the indictment is plainly inappropriate, even though the violation may have been deliberate." *Id.*; *see generally United States* v. *Rubio*, 709 F.2d 146, 152 (2d Cir. 1983) ("It is well established that dismissal of an indictment on grounds of governmental misconduct is an 'extreme' and 'drastic' sanction . . . .") (citations omitted).[35]

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[34] The Supreme Court decisions in *Caplin & Drysdale* and *Monsanto* do not alter this analysis. First, as discussed above, the Court in *Caplin & Drysdale* observed that the protections afforded under the Fifth Amendment's Due Process Clause appeared to be co-extensive with those afforded under the Sixth Amendment. 491 U.S. at 633. Moreover, the procedure established by the Court in *Monsanto* presupposed that the defendant had a cognizable property interest in the money seized by the Government. 491 U.S. at 615-16. No such interest, however, is present in the instant case.

Moreover, to the extent the defendants allege that the Government violated a protected *liberty* interest, this argument, too, must be rejected. Because the defendants have not previously asserted a protected liberty interest that has been violated, and courts continue to find difficulty in determining "whether what a [defendant] calls a liberty interest falls within the constitutional concept of liberty," *Baden* v. *Koch*, 799 F.2d 825, 829 (2d Cir. 1986), the Government believes any such liberty claim would be problematic. Nevertheless, the liberty interests currently recognized by the courts have no application here. *Id.* (recognizing that "liberty" encompasses the right "to engage in any of the occupations of life, to acquire useful knowledge, to marry, establish a home and bring up children, [and] to worship God"). *But see West Coast Hotel* v. *Parrish*, 300 U.S. 379, 391-93 (1937) (overruling *Lochner* v. *New York*, 198 U.S. 45 (1905), and holding that there is no fundamental right to contract under the Constitution).

[35] Violations of the Fifth Amendment are subject to similarly tailored remedies. *Cf.* *United States* v. *Chitty*, 760 F.2d 425, 431 n.3 (2d Cir. 1985) ("The remedy afforded for the (continued...)

Clearly, dismissal of the indictment is inappropriate in this case, because no one disputes that the defendants are seeking monetary relief. To the extent there is a cognizable violation in this case, the violation is that the Thompson Memo improperly influenced KPMG's decisions concerning the provision of legal fees in this case. *Morrison* teaches that, in this setting, the appropriate remedy would be to have KPMG consider again — this time without reference to the Thompson Memo or any prior discussions with the Government — whether to pay the legal fees of the defendants.

It is unclear that the Court has ancillary jurisdiction over KPMG, or that it would elect to exercise such jurisdiction if it did.[36] However, the Court can instruct the Government to advise KPMG more formally, in accordance with the Government's prior representations to this Court, *see* 3/30/2006 Tr. 37, that the Government would not consider a decision by KPMG to advance or indemnify the defendants' legal fees to be a violation of the DPA. If KPMG elects to pay the legal fees without conditions, any supposed prejudice suffered by the defendants would be remediated. If, however, KPMG elects not to pay the fees, or elects to pay them subject to certain conditions, no constitutional violation can be said to exist, because KPMG has made its decision independent of any alleged Government interference. The defendants may have a civil claim against KPMG; clearly, however, they would have no claim against the Government.[37]

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[35](...continued)
violation of his Fifth Amendment rights is the same remedy to which he would be entitled in this case for any violation of his Sixth Amendment rights."). Violations of the Fifth Amendment protection against self-incrimination are typically remedied by exclusion of the evidence obtained as a result of such a violation. *See, e.g., United States* v. *Rivieccio*, 919 F.2d 812, 816 (2d Cir. 1990) (finding, in case involving use of immunized testimony, "generally the remedy for the violation is the suppression of the tainted evidence at trial, not a dismissal of the indictment"). Violations of the Fifth Amendment Due Process Clause are typically addressed by equitable remedies, although civil damage actions are sometimes permitted. *Compare Davis* v. *Passman*, 442 U.S. 228, 248-49 (1979) (implying right of civil action under the equal protection component of the Due Process Clause in the context of alleged gender discrimination in employment) *with Schweiker* v. *Chilicky*, 487 U.S. 412, 429 (1988) (refusing to imply an action for alleged due process violations in the denial of Social Security disability benefits, finding that damages remedy was not included in the elaborate remedial scheme devised by Congress). As set forth later in this section, there is no basis for a civil damages action.

[36] *Garcia* v. *Teitler*, 443 F.3d 202 (2d Cir. 2006), suggests that the Court may have ancillary jurisdiction to hear the claim. However, *Garcia* involved a fee dispute among defendants before the court and the lawyer who represented them before that court. Here, by contrast, KPMG is not a party, and the issue is not a fee dispute *per se*, but rather a civil claim for money damages against the Government. Moreover, other courts have taken contrary positions. *Compare United States* v. *Weissman*, No. S2 94 Cr. 760 (CSH), 1997 WL 334966, at *9 (S.D.N.Y. Jun.16, 1997) (finding ancillary jurisdiction to compel employer to continue to advance legal fees, where employer ceased advancing fees only after the defendant's conviction), (continued...)

[36](...continued)
with United States v. *Polishan*, 19 F. Supp. 2d 327, 333 (M.D. Pa. 1998) (finding no ancillary jurisdiction, and criticizing *Weissman* for failing to "address the constitutional limitations of ancillary jurisdiction"). Of course, this Court is not required to exercise such jurisdiction. *See Fermin* v. *Moriarty*, No. 96 Civ. 3022 (MBM), 2003 WL 21787351, at *6 (S.D.N.Y. Aug. 4, 2003) (finding that a district court may exercise ancillary jurisdiction over a fee dispute arising out of a criminal case, but declining to exercise such jurisdiction). If this Court were to exercise jurisdiction over the defendants' claims against KPMG, such claims would be subject to all limitations that would otherwise apply, including, in particular, the arbitration clause contained in the Partnership Agreement.

[37] At page 5 of their Supplemental Memorandum, the defendants assert that to have the Government inform KPMG of its indifference to the company's payment of their legal fees is "not sufficient," because the Government caused KPMG to depart from its "longstanding practice of paying legal fees, and the bell cannot simply be 'unrung.'" (Defendants' Supp. Mem. at 5 n.3). To the contrary, because any violation related to the Government's purported interference with the payment of legal fees, removing that interference would in fact, to borrow the defendants' metaphor, "unring" the bell. The defendants may be concerned that KPMG might freely exercise its discretion now (as it exercised its discretion in 2004) and elect *not* to pay the legal fees for a group of individuals that brought the firm to the brink of indictment and cost it $456 million in criminal penalties, and several hundred million dollars in actual and contemplated civil penalties, exclusive of legal fees and other business losses. For this reason, the defendants devote the bulk of their remedies analysis in their Supplemental Memorandum to arguments in favor of ordering the Government to pay for their fees.

B. The Court Should Not Compel The Government To Pay The Defendants' Legal Fees From The DPA Money

In their Supplemental Memorandum, the defendants propose that the Court compel the Government "to instruct KPMG to deposit monies that are due the Government on June 30, 2006 into the registry of the Court, which may then be administered by the Court for payment of defendants' legal fees." (Defendants' Supp. Mem. at 5).[38] Such an order would plainly contravene the Supreme Court's decision in *Caplin & Drysdale*, which found that "there is no constitutional principle that gives one person the right to give another's property to a third party, even where the person seeking to complete the exchange wishes to do so in order to exercise a constitutionally protected right." *Caplin & Drysdale*, 491 U.S. at 628. As in *Caplin & Drysdale*, the funds recovered by the Government here as penalties, disgorgement, and restitution are the exclusive property of the Government, and "to hold that the Sixth Amendment . . . creates a right on [defendants'] part to receive these assets, would be peculiar." *Id.* at 628. Moreover, adopting the defendants' suggestion would require this Court effectively to amend the DPA, which is an agreement entered into in a separate criminal proceeding before a different judge.

Ordering the Government to pay the defendants' legal fees from the DPA monies would also violate the separation of powers between the executive, legislative, and judicial branches, by effectively requiring the Government to fund the defense costs in a system separate from that set forth in the Criminal Justice Act ("CJA"), 18 U.S.C. § 3006A. The appropriations power is a legislative power under the Constitution. *See* U.S. Const., Art. I, § 9, cl. 7 ("No Money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law"). The Supreme Court has cautioned that its cases "underscore the straightforward and explicit command of the Appropriations Clause. 'It means simply that no money can be paid out of the Treasury unless it has been appropriated by an act of Congress.'" *Office of Personnel Management* v. *Richmond*, 496 U.S. 414, 424 (1990). The Second Circuit has likewise instructed that a district court ought not "put itself in the difficult position of trying to enforce a direct order . . . to raise and allocate large sums of money, . . . steps traditionally left to appropriate executive and legislative bodies responsible to the voters." *New York State Ass'n for Retarded Children, Inc.* v. *Carey*, 631 F.2d 162, 165 (2d Cir. 1980) (citation omitted).

Congress enacted the CJA for the payment of fees for "counsel and investigative, expert and other services" for criminal defendants. 18 U.S.C. § 3006A. That statute, which contains an Appropriations Clause cite, *see* 18 U.S.C. § 3006A(i), permits the Court to authorize such payments where "necessary for adequate representation," under certain circumstances set forth in the statute. The remedy suggested by defense counsel here is not permitted under this statutory scheme. Thus, for the Court to order payments from the United States Treasury would, it is submitted, impermissibly establish a method for Government payment of legal services independent of the scheme enacted by Congress and unsupported by Congressional appropriation.[39]

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[38] As noted in the Government's Supplemental Memorandum, KPMG, as a defendant in a separate criminal proceeding before the Honorable Loretta A. Preska, has relinquished and agreed to relinquish certain funds to the Government to pay fines, penalties, and restitution imposed as a result of KPMG's admitted criminal conduct.

[39] The defendants' proposal would also appear to violate the Anti-Deficiency Act, 31 U.S.C. § 1341, which bars a federal agency from entering into a contract for future payments in excess of an existing appropriation. The Act states, in pertinent part, that "officers or employees of the United States may not: (A) make or authorize an expenditure or obligation exceeding an amount available in an appropriation or fund for the expenditure or obligation; or (B) involve [the] government in a contract or obligation for the payment of money before an appropriation is

(continued...)

C. The Court Should Not Award Damages In The Amount Of The Defendants' Legal Fees

The defendants' alternative suggestion — that the Court "award monetary damages against the United States in the amount of the defendants' legal fees" (Defendants' Supp. Mem. at 6) — is equally problematic. The defendants concede that sovereign immunity may bar the Court from exercising its inherent powers to impose sanctions against the Government. (Defendants' Supp. Mem. at 4 & n.2).[40] However, they argue that various statutory waivers of sovereign immunity would permit the Court to award such damages. A review of these purported "waivers" only underscores their inapplicability to this case.

1. There Has Been No Waiver Of Sovereign Immunity

The doctrine of sovereign immunity generally provides that the United States cannot be sued without its consent. *See United States* v. *Mitchell*, 463 U.S. 206, 212 (1983); *Robinson* v. *Overseas Military Sales Corp.*, 21 F.3d 502, 510 (2d Cir. 1994) ("Because an action against a federal agency . . . is essentially a suit against the United States, such suits are also barred under the doctrine of sovereign immunity."). Congress can waive the United States' sovereign immunity only through unequivocal statutory language, and may impose conditions on such a waiver. *United States* v. *Dalm*, 494 U.S. 596, 608 (1990); *United States* v. *Mottaz*, 476 U.S. 834, 841 (1986). If the United States has not waived its sovereign immunity, or if the conditions under which the United States has agreed to waive that immunity have not been met, federal subject matter jurisdiction does not exist. *FDIC* v. *Meyer*, 510 U.S. 471, 474-75 (1994); *United States* v. *Sherwood*, 312 U.S. 584, 586 (1941); *Morales* v. *United States*, 38 F.3d 659, 660 (2d Cir. 1994) (claimant may not sue United States without complying with all statutory and regulatory

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[39](...continued)
made unless authorized by law."

[40] In this regard, it is worth noting that the cases on which the defendants rely provide scant support for their position. In fact, in only one of those cases did the court suggest (in *dicta*) that sovereign immunity would not bar a district court from imposing monetary sanctions pursuant to its supervisory powers. *United States* v. *Woodley*, 9 F.3d 774, 781-82 (9th Cir. 1993) (reversing monetary sanctions imposed pursuant to Fed. R. Crim. P. 16; noting, in discussing exercise of supervisory powers, that "alternatives to monetary sanctions . . . are the more proper remedies"); *but see United States* v. *Horn*, 29 F.3d 754 (1st Cir. 1994) (overturning monetary sanctions imposed against the United States for prosecutorial misconduct, finding no basis for imposing same under the district court's supervisory powers; terming *Woodley dicta* "both gratuitous and unsupported"). Research has disclosed no Second Circuit decision concerning the interplay of the doctrines of sovereign immunity and the court's supervisory powers. In *United States* v. *Prince*, No. CR 93-1073 (RR), 1994 WL 99231 (E.D.N.Y. Mar. 10, 1994), then-District Judge Raggi withdrew a previous sanctions order compelling the U.S. Attorney's Office for the Eastern District of New York (the "E.D.N.Y.") to pay one day's jury costs because of delay in complying with certain disclosure obligations; Judge Raggi expressly declined to address the sovereign immunity arguments raised by the E.D.N.Y. *Id.* at *1. She noted, however, that because 28 U.S.C. § 1871 authorized the public treasury to compensate jurors for time spent attending court, Appropriations Clause issues were not implicated. There is no analogue for the instant case.

The ability of a district court to impose sanctions pursuant to its supervisory powers was further called into doubt by the 1998 passage of the so-called "Hyde Amendment," enacted as part of the Commerce, Justice and State, the Judiciary, and Related Agencies Appropriations Act of 1998. *See* Pub. L. No. 105-119, § 617, 111 Stat. 2440, 2519 (1998); 18 U.S.C. § 3006A (statutory note); *see generally United States* v. *Schneider*, 395 F.3d 78, 85-86 (2d Cir. 2005). In pertinent part, the Hyde Amendment provides for the award of "a reasonable attorney's fee and (continued...)

[40](...continued)
other litigation expenses, where the court finds that the position of the United States was vexatious, frivolous, or in bad faith, unless the court finds that special circumstances make such an award unjust." Pub. L. No. 105-119, § 617, 111 Stat. 2440, 2519; *see generally United States* v. *Knott*, 256 F.3d 20, 29 (1st Cir. 2001) (noting a Congressional intent "to limit Hyde Amendment awards to cases of affirmative prosecutorial misconduct rather than simply any prosecution which failed"), *cited in Schneider*, 395 F.3d at 88; *see also Knott*, 256 F.3d at 29 ("We hold that a determination that a prosecution was 'vexatious' for the purposes of the Hyde Amendment requires both a showing that the criminal case was objectively deficient, in that it lacked either legal merit or factual foundation, *and* a showing that the government's conduct, when viewed objectively, manifests maliciousness or an intent to harass or annoy.") (emphasis added).

prerequisites). Moreover, waivers of sovereign immunity and their conditions, whether substantive, procedural, or temporal, must be strictly applied against the claimant. *Lane* v. *Pena*, 518 U.S. 187, 192 (1986); *Millares* v. *United States*, 137 F.3d 715, 719 (2d Cir. 1998).

A fundamental procedural flaw imperils each of the defendants' sovereign immunity arguments. Specifically, the defendants proffer hypothetical bases of waiver, such as those contained in the Administrative Procedure Act (the "APA"), 5 U.S.C. § 701, *et seq.*, and the Federal Tort Claims Act (the "FTCA"), 28 U.S.C. §§ 1346(b), 2671-80 . Notably, however, such waivers would come into play, if at all, in civil lawsuits filed pursuant to the particular statute. They are *not* appropriately considered in the context of pretrial motions filed pursuant to Fed. R. Crim. P. 12. *Cf. Presidential Gardens Assoc.* v. *United States*, 175 F.3d 132, 140 (2d Cir. 1999) ("Whether ancillary jurisdiction exists, however, has no impact whatsoever on the issue of sovereign immunity or its waiver. ").

2. The APA Provides No Basis For Relief

In any event, the defendants' proffered claims of statutory waiver fail on the merits. The defendants first suggest that they could recover their legal fees pursuant to the APA because they seek "'relief other than money damages.'" (Defendants' Supp. Mem. at 4 (citing 5 U.S.C. § 702)). This claim, however, misconstrues the limited waiver of sovereign immunity contained in that provision, as well as the seminal Supreme Court case on the issue.

In pertinent part, the APA provides that:

> A person suffering legal wrong because of agency action, or adversely affected or aggrieved by agency action within the meaning of a relevant statute, is entitled to judicial review thereof. An action in a court of the United States seeking relief other than money damages and stating a claim that an agency or an officer or employee thereof acted or failed to act in an official capacity or under color of legal authority shall not be dismissed nor relief therein be denied on the ground that it is against the United States or that the United States is an indispensable party.

5 U.S.C. § 702. "Section 702 waives sovereign immunity in an action seeking equitable relief from wrongful agency action, except where (i) the action also seeks monetary relief; (ii) there is an adequate remedy at law; or (iii) the action is precluded from judicial review by statute or committed by law to agency discretion." *Polanco* v. *U.S. Drug Enforcement Admin.*, 158 F.3d 647, 652 (2d Cir. 1998).

The defendants misstate the relief they seek in an effort to shoehorn their hypothetical claim into the permitted bases of suit under the APA. In *Bowen* v. *Massachusetts*, 487 U.S. 879 (1988), the Supreme Court distinguished "money damages," which were "intended to provide a victim with monetary compensation for an injury to his person, property, or reputation," from equitable actions for specific relief, "which may include . . . the recovery of specific property or monies, ejectment from land, or injunction either directing or restraining the defendant officer's actions." *Id.* at 893 (quoting *Larson* v. *Domestic & Foreign Commerce Corp*, 337 U.S. 682, 688 (1949)); *see also id.* at 894-95 ("'Damages are given to a plaintiff to *substitute* for a suffered loss, whereas specific remedies are not substitute remedies at all, but attempt to give the plaintiff the very thing to which he was entitled.'") (quoting *Maryland Dept. of Human Resources* v. *Department of Health and Human Services*, 763 F.2d 1444, 1446 (D.C. Cir. 1985) (emphasis in original) (internal quotation omitted)). Only the latter were found by the Court to be cognizable under the APA. *See Aetna Cas. & Sur. Co.* v. *United States*, 71 F.3d 475, 479 (2d Cir. 1995) (explaining *Bowen* distinction as one between "money damages, which seeks to compensate for

governmental failure to perform a legal duty, and injunctive relief requiring that the duty be performed") (cited in Defendants' Supp. Mem. at 5).

A careful read of the defendants' claims in this case confirms that what they are seeking from the Government is money damages, which would be precluded if a claim were brought under the APA. While the defendants maintain that they are seeking "the 'very thing' to which they are entitled: payment of their legal fees" (Defendants' Supp. Mem. at 5), the *only* party from which the defendants could be entitled to receive such fees is KPMG, a non-party to this action. The money deposited by KPMG with the Government pursuant to the DPA is in no way related to legal fees, but rather represents restitution to the IRS and fines to the Government. Thus, while the defendants may purport to seek specific performance of a contractual right, the contractual relationship exists (if at all) with KPMG, and specific performance may only be sought against that entity.

As to the Government, the defendants principally seek money damages for purported violations of their constitutional rights, which damages are clearly precluded under the APA. The defendants have not claimed that the Government would have any duty to pay legal fees absent the predicate Government action identified as the Thompson Memo. Any requests for equitable relief as against the Government have already been satisfied by the Government's statement to KPMG that it could reconsider the payment of legal fees without concern that such payment would violate the DPA.[41] Moreover, any order by the Court that the Government pay prospectively for the defendants' fees would have no statutory or appropriations basis except under the CJA, and thus would be subject to the limitations of that statute.

[41] The defendants suggest that the Government divert a portion of the fines and restitution recoverable pursuant to the DPA in order to establish a fund for the payment of their legal fees; thereafter, the defendants suggest that the Court hear argument from "the interested parties" concerning the ultimate apportionment of the defendants' legal fees between KPMG and (continued...)

3. The FTCA Provides No Basis For Relief

Defendants fare no better with their hypothetical claims under the FTCA, which governs

> claims against the United States, for money damages . . . for injury or loss of property, or personal injury or death caused by the negligent or wrongful act or omission of any employee of the Government while acting within the scope of his office or employment, under circumstances where the United States, if a private person, would be liable to the claimant in accordance with the law of the place where the act or omission occurred.

28 U.S.C. § 1346(b)(1). The FTCA provides the exclusive avenue for common-law tort claims against the federal government, and only permits such suits against the United States. *See* 28 U.S.C. §§ 1346(b)(1), 2679(a). In other words, the FTCA expressly precludes common-law tort suits against individual federal employees acting within the scope of their employment. *See* 28 U.S.C. §§ 1346(b)(1), 2679(b)(1); Federal Employees Liability Reform and Tort Compensation Act of 1988, Pub. L. No. 100-694, § 2(b), 102 Stat. 4563, 4564 (1988) (noting that purpose of the Act is to protect federal employees from personal liability for state law torts committed within scope of their employment).

The FTCA provides that "[a]n action shall not be instituted upon a claim against the United States . . . unless the claimant shall have first presented the claim to the appropriate federal agency . . . ." 28 U.S.C. § 2675(a). Thus, the FTCA "requires that a claimant exhaust all

[41](...continued)
the Government. (Defendants' Supp. Mem. at 6 n.5). This proposal, however, does not transmute the defendants' claims against the Government from damage claims to equitable ones, nor does it avoid the above-described Appropriations Clause problems.

administrative remedies before filing a complaint in federal district court. This exhaustion requirement is jurisdictional and cannot be waived." *Celestine* v. *Mount Vernon Neighborhood Health Ctr.*, 403 F.3d 76, 82 (2d Cir. 2005); *see also Johnson* v. *Smithsonian Inst.*, 189 F.3d 180, 189 (2d Cir. 1999) ("Unless a [claimant] complies with the [exhaustion] requirement, a district court lacks subject matter jurisdiction over a [claimant's] FTCA claim."). "The burden is on the [claimant] to both plead and prove compliance with the statutory requirements." *In re "Agent Orange" Prod. Litig.*, 818 F.2d 210, 214 (2d Cir. 1987). The defendants do not, and cannot, suggest that they have exhausted their remedies in this case. In large measure, this is because the remedy for any constitutional violation has already been achieved — the Government has represented that it will not consider KPMG's decision to pay legal fees to be a violation of the DPA.

The defendants' putative FTCA claims would also be felled by the "discretionary function" exception to the statute, which bars recovery for

> [a]ny claim based upon an act or omission of an employee of the Government, exercising due care, in the execution of a statute or regulation, whether or not such statute or regulation be valid, or based upon the exercise or performance or the failure to exercise or perform a discretionary function or duty on the part of a federal agency or an employee of the Government, whether or not the discretion involved be abused.

28 U.S.C. § 2680(a). Designed "to prevent judicial 'second guessing' of legislative and administrative decisions grounded in social, economic and political policy through the medium of an action in tort," *see United States* v. *S.A. Empressa Viacao Aerea Rio Grandense*, 467 U.S. 797, 814 (1984), the discretionary tort exception applies when the challenged acts (i) involve an element of judgment of choice, and (ii) are based on considerations of public policy. *See United States* v. *Gaubert*, 499 U.S. 315, 322-23 (1991).

"Prosecutorial decisions as to whether, when and against whom to initiate prosecution are quintessential examples of governmental discretion in enforcing the criminal law, and, accordingly, courts have uniformly found them to be immune under the discretionary function exception." *Gray* v. *Bell*, 712 F.2d 490, 513 (D.C. Cir. 1983) (collecting cases). Among other things, "[t]he discretionary function exception to the FTCA bars claims of malicious prosecution against government prosecutors who, in their discretion, decide to prosecute an individual, as well as against investigative and law enforcement agents aiding in the investigation to determine whether to prosecute." *Morales* v. *United States*, Nos. 94 Civ. 4865 (JSR) & 94 Civ. 8773 (JSR), 1997 WL 285002, at *1 (S.D.N.Y. May 29, 1997) (collecting cases).

Finally, the defendants' hypothetical FTCA claims would be barred by the "intentional tort" exception, which bars recovery for tort claims "arising out of libel, slander, misrepresentation, deceit, or interference with contract rights." 28 U.S.C. § 2680(h); *see also United States* v. *Neustadt*, 366 U.S. 696, 701 (1961). The scope of this "intentional torts exception" is broad. *See Dorking Genetics* v. *United States*, 76 F.3d 1261, 1264 (2d Cir. 1996) (citing *Neustadt*). In fact, the Second Circuit has specifically held that "the FTCA does not authorize suits for intentional torts based upon the actions of Government prosecutors." *Bernard* v. *United States*, 25 F.3d 98, 104 (2d Cir. 1994). Accordingly, whether the Government's conduct in this case is construed as an interference with the defendants' contractual rights (*see* Defendants' Opening Mem. at 14) or "knowing inducement" of KPMG's breach of a fiduciary duty (*see* Defendants' Supp. Mem. at 6), it falls outside of the scope of the FTCA.

4. *Bivens* Is Inapposite Here

In a footnote, the defendants suggest that liability may extend to the individual prosecutors pursuant to *Bivens* v. *Six Unknown Named Agents of Federal Bureau of Narcotics*, 403 U.S. 388 (1971), and its progeny. (*See* Defendants' Supp. Mem. at 8 n.6).[42] The defendants, however, are simply wrong. The United States has not waived its sovereign immunity for *Bivens* claims against itself, its agencies, or its officers acting in their official capacities. *See Meyer*, 510 U.S. at 476-79 (holding that there is no subject matter jurisdiction over *Bivens* claim seeking damages from United States agency); *Dotson* v. *Griesa*, 398 F.3d 156, 177 (2d Cir. 2005) (same).

Similarly, the defendants cannot, by attempting to bring a civil *Bivens* claim against the prosecutors in the guise of a motion under Fed. R. Crim. P. 12, sidestep the obvious bars to such an action, including, in particular, the immunity with which the prosecutors would be shielded. "The nature of a prosecutor's immunity depends on the capacity in which the prosecutor acts at the time of the alleged misconduct. Actions taken as an advocate enjoy absolute immunity, while actions taken as an investigator enjoy only qualified immunity." *Zahrey* v. *Coffey*, 221 F.3d 342, 346 (2d Cir. 2000) (internal citations omitted); *see Buckley* v. *Fitzsimmons*, 509 U.S. 259, 273 (1993) ("acts undertaken by a prosecutor in preparing for the initiation of judicial proceedings or for trial, and which occur in the course of his role as an advocate for the State, are entitled to the protections of absolute immunity"); *Imbler* v. *Pachtman*, 424 U.S. 409, 420 (1976) ("The Courts of Appeals . . . are virtually unanimous that a prosecutor enjoys absolute immunity from § 1983 suits for damages when he acts within the scope of his prosecutorial duties.").

In *Imbler*, the Supreme Court confirmed that "the duties of the prosecutor in his role as advocate for the State involve actions preliminary to the initiation of a prosecution and actions apart from the courtroom." 424 U.S. at 431. However, the Court later suggested in *Buckley* that a prosecutor should not consider himself "an advocate before he has probable cause to have anyone arrested." 509 U.S. at 273; *see also Zahrey*, 221 F.3d at 347 n.2 (noting, in *dicta*, the temporal restriction "suggest[ed]" in *Buckley*).

To the extent that the defendants theorize a *Bivens* claim based on purported Sixth Amendment violations, absolute immunity would apply. This is so because the protections of the Sixth Amendment would attach only after the initiation of formal judicial proceedings; as such, any violation would be similarly restricted temporally, and, pursuant to *Buckley*, would result in the prosecutors being deemed to have acted as advocates rather than investigators. To the extent the prosecutors were found to be acting as investigators, however, a *Bivens* claim would still be barred by the prosecutors' qualified immunity. "The doctrine of qualified immunity offers protection for 'government officials performing discretionary functions . . . .'" *McClellan* v. *Smith*, 439 F.3d 137, 147 (2d Cir. 2006) (quoting *Harlow* v. *Fitzgerald*, 457 U.S. 800, 818 (1982)). "Qualified immunity 'serves important interests in our political system,'" *Sound Aircraft*

[42] The law is unclear on the issue of whether a *Bivens* action for damages can lie for alleged violations of the Sixth Amendment right to counsel. In *Higazy* v. *Millenium Hotel and Resorts, CDL, et al.*, 346 F. Supp. 2d 430 (S.D.N.Y. 2004), which involved a civil action brought by an individual who was mistakenly detained on a material witness warrant after the terrorist attacks of September 11, 2001, Judge Buchwald reviewed existing case law and concluded that there was no Sixth Amendment claim on the facts of that case. *See id.* at 451 (citing *O'Hagan* v. *Soto*, 523 F. Supp. 625, 630 (S.D.N.Y. 1981) ("Admittedly, this court is unaware of any case in which money damages have been awarded for deprivation of the right to counsel."). Judge Buchwald went on to observe that the plaintiff's claim could readily be couched as a Fourth or Fifth Amendment violation, and that any Sixth Amendment injury could be remedied by means other than money damages. As such, she declined to "treat as a 'stand-alone violation subject to compensation' an alleged Sixth Amendment deprivation of counsel." *Id.* at 452 (quoting *Chavez*, 538 U.S. at 778-79 (Souter, J., concurring)). The plaintiff's appeal of that decision is presently pending before the Second Circuit. *See Higazy* v. *Millenium Hotel*, Dkt. No. 05-4148-cv.

Servs., Inc. v. *Town of East Hampton*, 192 F.3d 329, 334 (2d Cir. 1999), chief among them to ensure that damages suits do not 'unduly inhibit officials in the discharge of their duties' by saddling individual officers with 'personal monetary liability and harassing litigation.' *Anderson* v. *Creighton*, 483 U.S. 635, 638 (1987)." *Provost* v. *City of Newburgh*, 262 F.3d 146, 160 (2d Cir. 2001).

"'In general, public officials are entitled to qualified immunity if (1) their conduct does not violate clearly established constitutional rights, or (2) it was objectively reasonable for them to believe their acts did not violate those rights.'" *Id.* (quoting *Weyant* v. *Okst*, 101 F.3d 845, 857 (2d Cir. 1996)). "A right is sufficiently clearly established if 'it would be clear to a reasonable officer that his conduct was unlawful in the situation he confronted.'" *Kerman* v. *City of New York*, 374 F.3d 93, 108 (2d Cir. 2004) (quoting *Saucier* v. *Katz*, 533 U.S. 194, 202 (2001)).

There can be no doubt that qualified immunity would attach in the instant case. After all, there are very few cases discussing the scope of Sixth Amendment rights in the context of access to third-party funds for legal fees, and those that exist support the conclusion that there is no Sixth Amendment right to have a third party pay a defendant's legal fees. Similarly, there are no cases finding the Thompson Memo, its predecessor, the Holder Memo, or any of their provisions to be violative of a defendant's constitutional rights. There was, therefore, no basis for any reasonable prosecutor (and certainly any of the prosecutors involved in this case) to believe that consideration of the Thompson Memo, and, more generally, inquiry into KPMG's obligations and intentions concerning legal fees, would ever been deemed unlawful. For all of these reasons, there would be no basis for holding the prosecutors individually liable under a *Bivens*-type theory.[43]

Thus, the remedy initially proposed by this Court is the appropriate remedy, were the Court to find that the defendants' constitutional rights had been violated: Ask KPMG to reconsider its decisions concerning the provision of legal fees in this case without regard to the Thompson Memo and with regard to the Government's confirmation that whatever KPMG's decision is, it would not constitute a violation of the DPA. In addition to violating the doctrine of sovereign immunity and various statutes, and in addition to being inconsistent with the decisions cited above, any order directing the Government to pay these legal fees would give the defendants more than they were entitled to under their agreements with KPMG. This Court should not countenance that result.

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[43] Moreover, contrary to the defendants' claims, there is no basis for holding KPMG or any of its representatives liable under *Bivens* for acting "in concert with" the Government. *See Correctional Services Corp.* v. *Malesko*, 534 U.S. 61, 74 (2001) (declining to recognize *Bivens* action for private entities that engaged in conduct under color of federal law); *John Street Leasehold, LLC* v. *Capital Mgmt. Resources, LLP*, 283 F.3d 73, 75-76 (2d Cir. 2002) (upholding dismissal of *Bivens* action against private actors working along with FDIC).

CONCLUSION

For the reasons set forth above, the Court should deny the defendants' motions alleging constitutional violations stemming from KPMG's decision to pay legal fees subject to certain conditions.

Dated: New York, New York
May 22, 2006

Respectfully submitted,

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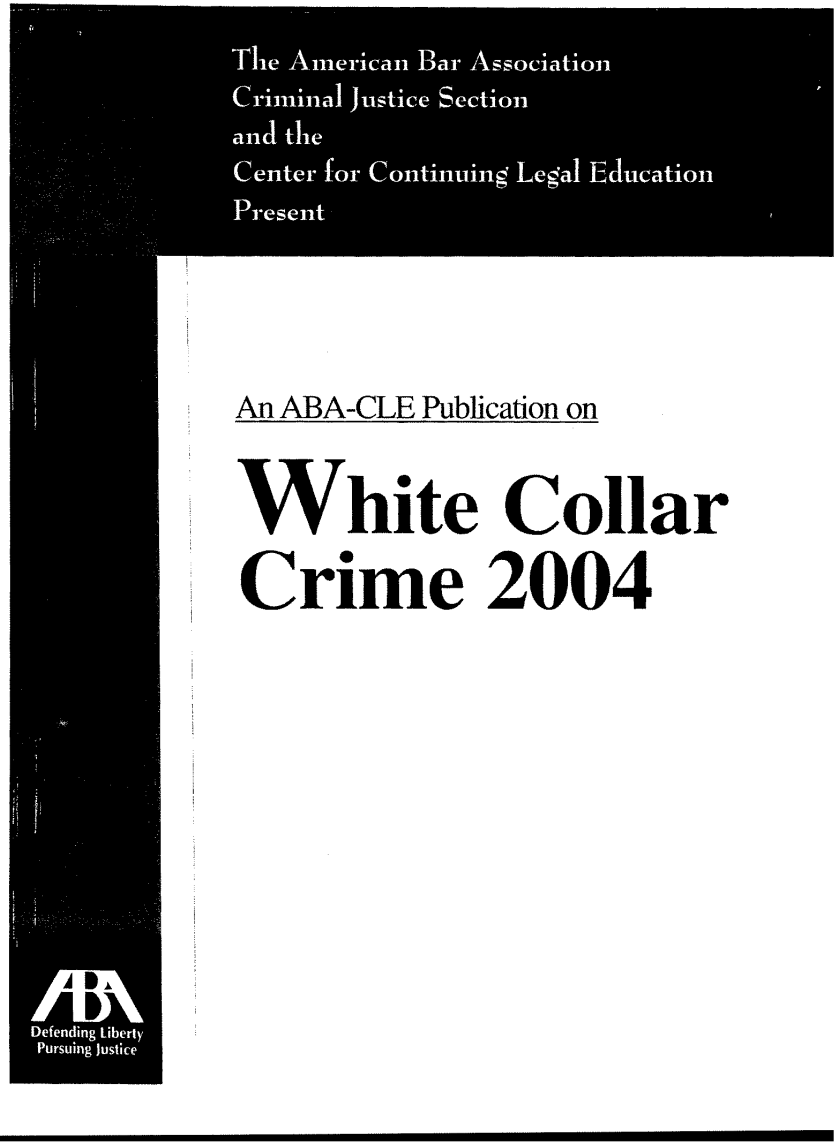

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COMPLIANCE—WHAT CONSTITUTES AN EFFECTIVE CODE OF CONDUCT

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Hallmarks of an Effective Corporate Compliance Program and Waiver of the Privilege Under the Principles of Federal Prosecution of Business Organizations[1]

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Southern District of New York
New York, New York

Good morning everyone. Let me begin by saying I am going to assume that a crime has been committed that could result in a proper criminal charge against a corporation. The most important point you should take away from my remarks this morning about what the government considers to be an effective corporate compliance program, in my view, is this—and you have heard it before. The corporation cannot just have a paper compliance program. That it exists on paper, and a corporation paid a lot of money for someone to design it, is not the point. It must be effective. And the second important point is that it can only be effective—and not just a paper program—if the top corporate officers really want it to be effective and are not just going through the motions. What is the government's objective? The answer in my view is simple. The government wants corporations to be good corporate citizens. Corporations enjoy privileges such as limited liability. Although run by individuals and owned by shareholders, they are inanimate entities, so if they commit crimes they do not go to jail. Corporate misconduct has enormous negative consequences on all of our lives. Take just two examples: investor fraud and environmental misconduct. An obvious corollary is that good corporate behavior has enormous positive effect on all our lives. The government believes that it is in the public's interest to require corporations to be scrupulously honest in all aspects of their business, and that it is also in the corporation's business interest to be honest. The government strongly believes that good business and good ethics go together. Therefore the purpose of government actions in the arena of corporate misconduct is to foster programs that deter and detect misconduct. And so the guidance to prosecutors contained in the Principles of Federal Prosecution uses a carrot and stick approach similar to the sentencing guidelines. An approach which encourages corporations to self-police and self-report misconduct. If a prosecutor is at the stage of evaluating a compliance program, that means someone in the corporation committed a crime to benefit the corporation, and the compliance program, if there was one, did not deter or possibly even detect the crime. As a result, one of several factors a prosecutor would have to assess in deciding whether to charge the corporation or whether to accord leniency to the corporation by not filing charges, is whether the corporation has in place an effective albeit obviously not fool proof compliance program. If the corporation had an effective compliance program in place, that would tell the prosecutor a lot about the corporation's culture, and it is a very positive factor to be considered in weighing whether to file charges. Related factors are whether the corporation voluntarily disclosed the misconduct at issue by immediately reporting it to the authorities. And, whether the corporation responded to the misconduct appropriately, by enhancing the compliance program to plug any loop holes that were discovered, by disciplining the employees who engaged in the misconduct, and by instituting stepped up and enhanced training on how to deal with the problem.

Let me list the three situations which implicate compliance programs. The first is what we have been talking about—deciding whether to charge a corporation. Second, when a corporation is found guilty whether by plea or after trial, the existence of an effective compliance program is a factor that can reduce or mitigate the sentence mated out to the corporation. (And as you all know self reporting will also mitigate the sentence.) Third, if a corporation is found guilty, at sentencing the government may request a federal monitor and an order requiring the implementation of a permanent effective compliance program during a period of federal probation. This can also be worked out by the government and the corporate defendant in a plea agreement prior to sentencing, which the judge would then need to adopt.

What is an effective compliance program? I can't describe the specifics of what an effective program should look like because every corporation and every industry will have different issues to address, and compliance programs will have to be tailored to each corporation's unique structure and unique problem areas. Some corporations may have to have several different programs to address different aspects of their business. For example, a corporation may need a program that ensures honesty to consumers and another program that ensures compliance with environmental laws. The cruise ship industry which has been the subject of some prosecutions comes to mind as requiring at least two very distinct programs. Even though I cannot get into specifics, I believe I can highlight for you six hallmarks of effectiveness that I believe the government is looking for in all compliance programs.

First, an effective program should be crafted to deter crime and detect crime and so it should clearly set forth all the laws and regulations applicable to the industry, how they are to be complied with, what are the dos and don'ts without ambiguity, what procedures are to be followed when there is an issue that has to be clarified. There must be effective checks and balances throughout the program to ensure compliance and particularly on the discretion of individuals who operate in areas at very high risk for violations. The rules should also include clear document retention policies, a subject of a lot of recent publicity, that are designed to preserve rather than destroy documents that are likely to be relevant to impending investigations. One way to look at it, is that a program should be just as effective as any program that is instituted by a corporation to make sure that its employees don't rob it blind.

Second, an effective program will need a compliance department, which can be configured in many different ways and which may or may not be totally centralized. But there will have to be a single compliance officer and that compliance officer will have to have overall responsibility for all compliance. Compliance has to be a high level priority of the top level management and the board of directors, so the compliance officer should be an integral part of top level management. This job can't be relegated to an unimportant spot on the corporate pecking order, because that would send a clear signal to employees that the corporation views compliance as a necessary evil, which the corporation has to tolerate but does not embrace. The compliance officer obviously must be very well qualified for the job and must have an adequate staff to perform the job. The compliance officer has to have direct access to the highest corporate officers and to the board, and it is vital that there be mechanisms in place which allow the compliance officer to bypass anyone, no matter how highly placed, who is involved in suspected misconduct.

Third, training and communication. Management's commitment to compliance must be strongly communicated to all employees. Sometimes, especially in a company that has had a corporate culture of disregarding or skirting the law, the head of the corporation may have to personally and directly address employees to make sure they get it... that the corporation is now truly committed to obeying the law and strictly adhering to the compliance program, that

the culture really has to change and that change will be rewarded, failure to change and misconduct will be punished. Employees must be adequately trained and regularly trained on the ins and outs of the program. Training has to be more than just handing out a booklet. Meetings have to be held and attendance must be mandatory. A dialogue has to develop so that employees understand the importance to the corporation of complying with the law and so that they understand that training is not just lip service to appease the government. And very important, there has to be an end to the traditional dichotomy of "the compliance part of the firm" has one viewpoint and "the business side of the firm" has a different viewpoint on ethical issues.

Fourth, independent auditing. There have to be procedures to conduct regular internal or external audits of the compliance program to check that everyone from top to bottom is following the procedures stipulated in the program including the compliance folks. This will require the commitment of additional resources. It will also require that the auditors (like the compliance officer and his staff) are independent and have a method of reporting problems and misconduct to management and the board of directors, while at the same time being able to bypass any highly placed person or official who is failing to carry out the compliance program. The auditing function should also provide for implementation of changes to the program as loop holes are detected. If, for example, it is obvious from the audit that the corporate culture is not changing, that mid-level management continues to believe that the bottom line is more important than complying with the law: immediate steps will have to be taken to fix that problem, to let all employees know that top level management demands change and demands compliance with the law or else there will be consequences.

Fifth, discipline and rewards. Built into every compliance program there have to be appropriate responses to violations of the program through an effective discipline and reward system. Those who engage in misconduct and criminal activities have to be appropriately punished. Supervisors who fail to enforce discipline or adherence to the compliance program have to be disciplined or even dismissed. Top level management who violate the compliance program, frankly in my view, should be booted out. On the other hand, employees or officers who report violations of the program have to be protected and rewarded. There can be no retaliation against employees who report misconduct. We encounter retaliation all the time. Employees who are punished, demoted, ostracized, not promoted, and who fear for their jobs if they report misconduct. To ensure that employees can report misconduct anonymously or without fear of retaliation, it may, in certain corporations make sense to created an ombudsman to whom employees can report and the ombudsman might establish a hotline to which employees can anonymously report what they believe to be misconduct.

Sixth, the last hallmark of an effective compliance program is internal investigations and reporting misconduct to the authorities. Every compliance program should have guidelines and procedures for when it is appropriate to conduct an internal investigation and guidelines for the timely self-reporting of misconduct to the regulators, and law enforcement, were appropriate.

Let me conclude my remarks on compliance programs with one general comment, with which I started. First and foremost and last and foremost, is always the issue of corporate culture. Top level management has to be committed to obeying the law and to want all employees to obey the law. If the bottom line is more important than complying with the law, that will inevitably filter down through the corporate structure to all employees, and the best drafted compliance program in the world would not be effective.

When I was initially invited to speak, I was told that the topic would be Corporate Compliance, which it is. In the first phone conference with the panelists, suddenly the topic of Waiver of the Privilege was put on my plate. I naively asked, "what does that have to do with an effective compliance program"? One of the panelists responded in substance: "if the government is going to ask us to waive the privilege all the time the corporation will conduct a different kind of investigation of misconduct. For example, we might not investigate too thoroughly or probe too deeply". Well imagine my shock and horror to hear that a corporation might not really investigate possible misconduct brought to its attention because of a concern that prosecutors might ask for the results of its investigation. My reaction was then, and is now: that kind of corporate response will likely guarantee prosecution of a corporation. Now, I did ask the ABA for a set of bodyguards for the topic of waiver, but unfortunately I have to be satisfied that Irv Nathan has personally guaranteed my security. The problem with that is that Irv is the person most likely to attack me (laughter).

Much has been written and spoken about prosecutors' requests that a corporation waive the privilege in order to supply the government with full information about activity under criminal investigation. In my view, the discussion has generated a good deal of heat and very little light. I hope that whether you agree with me or not, I can at least shed some light on the issue. The issue of waiver comes into play at two stages of a criminal investigation. First, under the Principles, cooperation of a corporation is one factor to consider in deciding whether to prosecute. And in assessing the timeliness, completeness and adequacy of that cooperation, whether the corporation waived the privilege may be a relevant consideration. Second, under the sentencing guidelines, cooperation can reduce the corporation's culpability score which determines the level of the fine.

I would like to start by discussing the guidelines, because in the area of cooperation the guidelines reflect the same values that the government considers in deciding whether to charge a corporation in the first place. As in the case of individuals, the guidelines encourage and reward full and meaningful cooperation with the government. Cooperation, like self-reporting, reflects a decision by the corporation to clean house and begin to change what may be a bad corporate culture. It enables the government to gather the facts before they are stale, assists the government in fully investigating the wrongdoing and wrongdoers so it can prosecute and hold accountable those responsible for the criminal activity, and assists in minimizing victims losses and maximizing restitution. The guidelines lower a corporate defendant's culpability score if the corporation timely and thoroughly discloses all pertinent information—that is the language in the guidelines—and they go on to say, specifically, information that is sufficient for the government to identify the nature and the extent of the offense and the individuals responsible for the criminal conduct. What constitutes full and thorough cooperation will necessarily vary in every case and the guidelines do not prescribe the specifics. The guidelines also do not refer to waiver of the privilege. However, the guidelines expressly recognize that if a corporation has learned precisely what has happened and who is responsible, this must be disclosed to the government, if the corporation is to earn credit for cooperation. That is the same cooperation that the government expects if a company is to earn leniency in the government's charging decision. The government wants to know as soon as possible: what happened? who did it? and how did they do it?

Now, how a corporation cooperates (if they chose to cooperate) will vary and the government does not require any particular method so long as all the pertinent facts are disclosed, including the identification of all culpable individuals, all witnesses with relevant information and all relevant documents. Depending on the nature of the disclosure, some attorney-client work product protection may have to be waived because, frequently although not always, the corporation has gathered the pertinent facts through an investigation conducted by counsel including witness interviews which are protected by privileges. While a corporation may be able to provide the government with a thorough briefing of all the relevant facts without waiving the privilege, realistically, a corporation that has chosen to cooperate will likely have to make some limited or partial waiver of its privileges in order to supply the government with thorough information about the criminal activity that it has learned

during protective interviews.

I would like to make several additional points. First, as you all know, a corporation does not have to cooperate. It is the corporation's decision and the corporation's alone to seek leniency by cooperating with the government's investigation. Cooperation is only one factor the government considers in deciding whether to file charges, although, to be sure, it can be a very important factor and possibly even a dispositive factor in a close case. But, plainly the government should not be charging a corporation where all the other factors militant clearly against charging, just because the corporation did not cooperate in an investigation. Second, the government does not require a corporation to waive its privileges. Whether in relation to the charging decision or the guidelines, if the facts can be fully disclosed without a waiver of any privileges, DOJ policy does not require a waiver as a measure of full cooperation. I personally believe that prosecutors can and should work with defense counsel to try to avoid waivers, if possible, or at least minimize any intrusion into work product, yet still have the corporation promptly provide the government with the answers to the questions: what happened? who did it? and how did they do it? But, if the full facts are only available through access to protected items such as the information contained in detailed notes taken during interviews of witnesses who are unavailable to the government, the corporation will simply have to decide whether to waive in order to thoroughly cooperate. Neither cooperation nor waiver is a fitmus test for charging decisions. Proof of that is apparent from cases in which corporations were not charged even though they did not cooperate, or if they did cooperate, did not waive. And, you are all familiar with cases in which corporations have cooperated and waived yet were still charged. Every case is unique.

I would like to give you some concrete examples of how a corporation can provide information to the government. Let's say that a corporation comes into the Southern District of New York and tells us: "we have uncovered an accounting fraud, we have understated expenses by a billion dollars, we know exactly what happened, how it happened, and who is responsible. But we know this from interviews we have conducted that are covered by the attorney-client privilege and work product and we don't want to waive so we are not prepared to tell you anything more". I hope everyone in this room would agree that this disclosure does not constitute the full and thorough cooperation which the guidelines do, and I believe should, require in order for a corporation to be rewarded with credit. And in my view, this is certainly insufficient to qualify for much credit at all in consideration of the charging decision. Now, some of you may say "but wait a minute, the corporation has self disclosed criminal activity, and when you serve subpoenas we will produce documents promptly and without motion practice (thank you very much), and, when you figure out who to talk to, we will make them available, so we will be completely cooperative". There may be some small credit for self disclosure albeit, I imagine in a case like this the law probably required it, and subpoena compliances is required by law. But at a minimum in my view, to get full credit for cooperation, a corporation has to promptly find a way to tell the government what it knows about: what happened, who did it and how did they do it.

Let's look at a different scenario where a corporation does not have to waive but has found a way to fully cooperate. A company comes in and says, "we've uncovered a crime, there was a gross understatement of expenses, it happened in the Widget department, we have conducted an internal investigation but we don't want to turn over the notes or the report, but we will promptly identify and bring in all the witnesses you will need to figure out exactly what happened and who is responsible and we will make sure that the witnesses make full disclosures and provide you with all the facts". So as long as the corporation follows through on it promises, the government will more than likely view that as full cooperation worthy of earning consideration in the charging decision as well as guidelines credit if the corporations ends up being charged. But, what if it turns out that several of the witnesses who the corporation tells you they will bring in decline to be interviewed and/or go into the grand jury and take the Fifth Amendment. If the government can't fully reconstruct the crime or gather sufficient information and evidence to prosecute those who are culpable, the government may turn back to the corporation and seek the information imparted when those particular employees were interviewed. Now some of you may say, "why not just immunize those employees"? The answer is, because the government does not want to immunize those who may be culpable and perhaps who are even the most culpable, and we will look to the corporation to provide the missing information. The corporation will then have to decide whether to waive its privileges. If it does not and the investigation is stymied, or certain high-level officials have to be immunized and go scot-free, the government will probably view this as significantly undercutting the cooperation already provided.

These examples highlight something else I think is important. That is the kind of information the government is seeking. We are generally only seeking the facts: We are not seeking attorney analysis or attorney strategy, we are not seeking advice to the client, we are not seeking to know the discussion between counsel and the board about what has been found and what the options are. But what we are seeking is essentially fact work product. And all of you and members of the defense bar in general and in-house counsel know how to disclose the facts to the government, and you know how to take notes of what a witness says without incorporating your own mental impressions, evaluations, editorial comments and legal advice. Now I certainly recognize that notes of interview reflect the questions asked by the attorney and to some extent the attorney's focus during the interview. But disclosure of the notes or the facts contained in the notes is really a minimal intrusion on the privilege and it simply may sometimes be necessary if the corporation makes the decision to earn leniency through cooperation.

I would like to conclude with one last observation. There is really nothing at all new in the Principles of Federal Prosecution of Business Organizations just like there was nothing new in the Holder Memo in 1999. The factors set forth in those documents are just codifications, if you will, of the practices followed by prosecutors for decades. As many of you know, the Southern District of New York played a big role in drafting the factors. They simply reflect the reality of how we had been making charging decisions for decades including the factors of cooperation and waiver. In the early 80's, Salomon and Kidder Peabody (taken over by GE at the time), set the standards for corporate cooperation. Those standards really have not changed at all.

ENDNOTES

1. The views set forth herein do not necessarily reflect the views of the U.S. Department of Justice or any U.S. Attorney's Office and are not binding on those entities.

2. Shirah Neiman is Chief Counsel to the United States Attorney in the Southern District of New York. This paper was presented at the 2003 White Collar Crime National Institute.

Interview with United States Attorney James B. Comey Regarding Department of Justice's Policy on Requesting Corporations under Criminal Investigation to Waive the Attorney Client Privilege and Work Product Protection

Q: Mr. Comey, the white collar defense bar is agitated about requests to corporations under criminal investigation to waive the attorney client privilege and work product protection. Can you explain DOJ's policy?

A: As you know, the *Principles of Federal Prosecution of Business Organizations* govern this issue by providing guidance to prosecutors making the very important decision of whether to criminally charge a corporation. The *Principles* set forth many factors to consider, one of which is whether and to what extent the corporation cooperated with the Government's investigation. In evaluating cooperation, the *Principles* tell prosecutors that they can consider whether the corporation turned over any internal investigation it may have conducted, and waived privileges.

In my view, for a corporation to get credit for cooperation, it must help the Government catch the crooks. Sometimes a corporation can provide cooperation without waiving any privileges. Sometimes, in order to fully cooperate and disclose all the facts, a corporation will have to make some waiver because it has gathered the facts through privileged interviews and the protected work product of counsel.

Q. What exactly are prosecutors looking for when they ask a corporation to waive privileges?

A: Prosecutors are generally seeking the facts: what happened, who did, how they did it. Although the facts gathered by an attorney providing advice to a corporation may be covered by both the attorney client privilege and work product doctrine (*Upjohn v. United States*, 449 U.S. 383 (1981)), prosecutors are not generally seeking legal advice or opinion work product; they are just seeking the facts, including factual attorney work product. Of course, disclosure of interview notes or the facts contained in the notes reflects the questions asked by the attorney, which may result from prior research, as well as the attorney's focus during the interview. The disclosure, however, involves a minimal intrusion on the privilege, and may be necessary if the corporation chooses to earn leniency through cooperation.

Q. Don't you sometimes ask the corporation to provide information that is classic attorney client privilege, i.e. counsel's advice to the corporation?

A: Yes, but rarely. For example, where the corporation is claiming it engaged in the conduct in good-faith reliance on advice of counsel, such disclosure may be requested. Or, where employees may have disregarded advice of counsel that a particular course of conduct would violate the law, or be of questionable legality, successful prosecution of those employees may require Government access to that advice of counsel, and the information would also be highly relevant to making the charging decision on the corporation.

Q: What about the defense bar complaint that DOJ *requires* waivers?

A: The *Principles* do not *require* waiver, and do not even require cooperation. Rather, all relevant factors need to be assessed in making a charging decision. Moreover, if a corporation that chooses to cooperate can do so fully without waiving any privileges, that is fine. Waiver is not required as a measure of cooperation.

For example, assume a corporation comes to us to report that they have discovered a billion dollar accounting error. Their lawyers have conducted an internal investigation and the corporation has learned exactly what happened. Further assume that when they meet with us, they explain that they do not wish to waive privileges, but will immediately provide a briefing on what they have learned and will bring in all the witnesses the government will need to figure out exactly what happened. If the corporation does that, we would likely consider that to be cooperation worthy of earning credit in the charging decision (as well as under the Sentencing Guidelines), even though there was no waiver, because the corporation timely told us what it knows about what happened, who did it, and how it was done. (Of course, in our experience, many corporations choose to go farther in order to demonstrate their commitment to cooperation by voluntarily waiving privileges and forging a much closer relationship with Government investigators in order to uncover wrongdoing.)

On the other hand, if critical witnesses won't consent to interviews and, therefore, the government cannot fully reconstruct the crime, or gather sufficient evidence to prosecute those who are culpable, the Government may turn to the corporation and seek the information imparted when those particular employees were interviewed. The corporation will then have to decide whether to waive its privileges. If it does not, and the investigation is stymied, or certain high level officials have to be immunized and go free, the Government will probably not view this as cooperation in evaluating charging decision factors.

Q: Does that mean that if a corporation does not waive or fully cooperate it will be indicted?

A: Absolutely not. A prosecutor must consider a wide range of factors in making a charging decision. There is no litmus test. For example, in situations where all the other factors militate against charging, failure to cooperate and/or waive should certainly not lead to filing charges. Looking at the other extreme, all the cooperation and waivers in the world may not obviate the need to charge a corporation that has engaged in very serious misconduct, involving high level management, over a long period of time. So, cooperation will not guarantee non-prosecution; and cooperation and waiver are not pre-conditions for a decision not to prosecute.

Q: But what about the repeated complaints by the defense bar that prosecutors routinely ask for waiver?

A: I have heard the complaints, but I don't see evidence of such a widespread practice. If defense counsel mean that prosecutors routinely ask corporations to cooperate and to furnish the Government with all the information known to them about the criminal activity, I certainly hope that is going on. Corporations are unique entities that enjoy many privileges. The Department expects them to conduct their affairs in a scrupulously honest fashion and maintain effective compliance programs that deter and detect any misconduct. When misconduct is discovered, the Department expects corporations to self-report to law enforcement, including any regulators, to investigate the misconduct, to discipline any wrongdoers, and to cooperate fully with government investigations. Cooperation doesn't just mean complying with subpoenas. It means–and I hate to sound like a broken record–telling the Government what the corporation knows about what happened, who did it, and how they did it. In short, we expect cooperating corporations to help us catch the bad guys.

If a corporation can do that without waiver, prosecutors should give them the opportunity to do that. If the questions are fully answered without a waiver, prosecutors should consider that to be meaningful cooperation in evaluating all factors in making the charging decision. If a corporation wishes to go farther and share work product and privileged materials in order to enhance the Government's investigation, so much the better. Whether a corporation's failure to cooperate at all, or failure to waive if necessary to answer those questions, will result in a charge, is a separate issue that can only be answered by evaluating all the factors.

Q: What do you think about the defense bar's contention that waivers will interfere with their ability to investigate the wrongdoing

because employees won't agree to be interviewed if they know the information they provide or their "statement" is likely to be turned over to the Government.

A: I don't agree, and we have not seen that happen. Experienced attorneys routinely advise an employee that the interview is covered *only* by the corporation's attorney client privilege and that the corporation could decide to waive it. Indeed, many corporations have regulatory obligations to make disclosure of information learned in such interviews. A corporation also has the ability to require an employee to cooperate with its counsel on pain of dismissal. On many occasions, employees who have stolen from corporations willingly confess when confronted by counsel, even though they realize that the consequences will likely be loss of employment, and possible referral to the authorities. To be sure, employees who have engaged in criminal activity may decline to be interviewed. But the fear that the interview might be disclosed to the Government (as opposed to getting the employee in trouble with the corporation) has little impact. In any event, that possibility does not change the fact that, in order to fully cooperate, a corporation has to help the Government solve the crime.

Corporations self-report and waive the privilege all the time without being requested to do so by the Government. When corporations are victimized by employees, they conduct an internal investigation and frequently decide to voluntarily furnish the evidence to the authorities and seek prosecution. There is no parade of horribles conjured up by the defense bar when, on their own initiative, they waive the attorney client privilege or work product protection.

Q: What do you think about the defense contention that requests for waiver will discourage corporations from conducting internal investigations?

A: We have been actively investigating and prosecuting corporations for decades, and seeking corporate cooperation throughout that time period. We have seen no evidence at all that corporations refrain from conducting internal investigations because, in order to obtain leniency for cooperating, they might be asked to waive a privilege. Many corporations have regulatory obligations to investigate and find out the facts. In some instances there may also be a fiduciary obligation to investigate. If the corporation is under criminal investigation, its attorneys need to uncover and learn the facts in order to adequately represent the corporation, as they will also have to do, given the likelihood of related civil litigation. In addition, one must remember that waiver of the privilege is voluntary and may only be necessary if the corporation chooses to cooperate in order to obtain leniency from the Government and/or the Court. In short, I have a hard time imagining that a corporation would refrain from conducting an internal investigation because of some fear that they might wish to share the results of it with the government.

There are also those who contend that the "requirement"–and there is none–that corporations waive the privilege, will discourage implementation of compliance programs, and aggressive efforts to deter and detect fraud. I cannot believe that a corporation will not seek to prevent criminal activity–for which it will be liable–because, if it does occur, and it is discovered by the Government, the corporation might seek to waive the privilege to obtain leniency from the Government or the Court.

Q: Doesn't the corporation's relationship of trust with its employees sour if the employees understand that the corporation will report misconduct to the Government, and won't that also undermine the self-reporting the Government is trying to encourage?

A: A corporation must explain to its employees the premium it puts on obtaining full information about misconduct of any kind and that reporting wrongdoing to the authorities, including the regulators and where appropriate criminal investigators, is a good thing to do, and is part and parcel of good corporate citizenship. The message has to be sent that disclosure of misconduct will be rewarded, and failure to disclose will be punished. Employees who have only made mistakes will understand; employees who have information about others will also understand, especially when the corporation protects them from retaliation; employees who have committed crimes, have no trust to undermine.

Q: Doesn't waiver of the privilege allow the Government to piggy-back on the investigation conducted by the corporation?

A: Yes, and there is nothing wrong with that. This is about the public's interest in uncovering corporate crime in a timely fashion, not only to prosecute the wrongdoers, but also to minimize additional losses and maximize restitution. Some internal investigations cost millions of dollars and analyze hundreds of thousands of documents. Federal prosecutors don't have funds for that, and would be unable to replicate that work. They can, however, work with a report of such an internal effort in order to conduct a thorough and complete Government investigation. Ultimately, however, we go back again to the core issue, which is whether a corporation wants to earn leniency in the charging decision and under the Guidelines. If it does, then it will have to figure out a way to tell the Government what is knows about the misconduct and to help us catch the wrongdoers.

No corporation can be forced to cooperate. But isn't cooperation what good corporate citizenship is all about? If a corporation prefers that the Government *not* find out the true facts, or take a longer time to gather the same facts the corporation has gathered, then it won't provide full and timely disclosure. How that will affect the charging decision, which is based on numerous factors, will vary in every case. If the corporation is charged, it will obviously have a negative effect on the Guidelines calculation.

Q: Doesn't waiver of the privilege cause collateral problems with civil litigants who will argue that the waiver entitles them to the same information as the Government?

A: While there is varying case law in this area, it is true that courts have held that waiver to the Government during a criminal investigation can result in a waiver with respect to civil litigants. There is pending litigation about the enforceability of Government agreements to keep privileged information confidential and there have also been legislative proposals to protect information disclosed via waivers to the SEC. So the landscape in this area may be changing.

B: What if a corporation enters into a joint defense agreement claiming it is the only way employees will speak to it, and so the corporation can't waive the privilege even if it would otherwise want to?

A: It is hard for me to understand why a corporation would ever enter into a joint defense agreement because doing so may prevent it from making disclosures it either must make if it is in a regulated industry, or may wish to make to a prosecutor.

In any event, how a joint defense agreement will affect a corporation's ability to cooperate will vary in every case. If the joint defense agreement puts the corporation in a position where it is unable to make full disclosure about the criminal activity, then no credit for cooperation will be factored into the Government's charging decision, and it will get no credit for that cooperation under the guidelines. On the other hand, a corporation may learn only some things pursuant to a joint defense agreement and still be able to make a full disclosure to the Government of all relevant information in a sufficient manner to qualify for cooperation credit.

Q: Isn't the Government's desire to obtain interview notes of employees just an end run around the Fifth Amendment? You know the employee has to talk to the corporation on pain of dismissal, and you expect the corporation to fire employees who won't speak, so you indirectly force employees to relinquish their Fifth Amendment rights by putting them between a rock and a hard place. Is that fair?

A: If you are suggesting that a corporation should not have a policy of firing an employee who won't consent to be interviewed by the corporation about possible misconduct, I'm not sure that's a corporation acting in its shareholders' interests. Should the Government request the results of interviews conducted under pain of dismissal? Yes, of course. The Government needs to find out what happened. And interviews with employees are usually the source of the corporation's knowledge. It is obviously up to the corporation to decide whether it wants to cooperate or supply the details of the interviews.

Q: Don't you ask corporations to fire employees who refuse to be interviewed by the Government, or who formally invoke the Fifth Amendment?

A: Certainly with respect to the Fifth Amendment, the Government is not permitted to disclose the invocation of the Fifth in the Grand Jury and should not be discussing that topic at all with anyone other than the witness's counsel.

Moreover, the Government does not ask corporations to fire employees who refuse to be interviewed by the Government. What the

Government focuses on in evaluating corporate compliance programs is whether a corporation properly disciplines employees who have engaged in or facilitated serious misconduct, or who have committed crimes. If a company continues to employ an individual when it has evidence in its possession that establishes criminal activity, the Government will likely view that as a serious flaw in the corporation's compliance program, and reflective of a problematic corporate culture.

Of course, if a corporation determines in good faith that an employee did *not* commit a crime or engage in serious misconduct, in evaluating the corporation's conduct and culture we would not "penalize" the corporation for not firing such an employee even where the employee declined to submit to a Government interview.

Q: Mr. Comey, overall, how do you think the *Principles* are working?

A: I think they work very well. They have served the function of educating all DOJ attorneys about the need to give careful consideration to charging corporations, whose conduct can cause immense harm, and whose prosecution can result in enormous benefits, not only in restitution to victims, but in being a catalyst for tremendous changes for the good in many industries. They also instruct prosecutors to carefully consider a variety of critical mitigating factors, such as cooperation, collateral damage, and alternative remedies. In short, they provide a balanced framework for DOJ attorneys to make difficult decisions. In the process, they also greatly assist private counsel and corporations by spelling out the kinds of things that matter to prosecutors.❖

Mr. Comey wishes to acknowledge the invaluable assistance of his Chief Counsel, Shirah Neiman, in the preparation of this Q & A.❖

Revised Principles of Federal Prosecutions of Business Organizations: An Overview

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Northern District of Iowa

I. Introduction

The decision whether to charge a business organization with a criminal offense can be one of the most complex charging decisions that federal prosecutors face. Recognizing this, on June 16, 1999, then-Deputy Attorney General Eric Holder issued a memorandum entitled *Federal Prosecution of Corporations* (the Holder memo), Memorandum from Deputy Attorney General Eric Holder to the United States Attorneys' Offices (June 16, 1999) (on file with the Department of Justice). This nonbinding memorandum was based on the Principles of Federal Prosecution in the United States Attorney's Manual, § 9-27.000, and contained a number of general principles, with accompanying commentary, designed to assist federal prosecutors in evaluating corporate charging decisions.

Now more than ever, federal prosecutors are faced with difficult charging decisions involving corporate subjects and targets. As a result of the Department of Justice's (the Department) ever increasing number of corporate criminal investigations, on January 20, 2003, Deputy Attorney General Larry D. Thompson issued a new memorandum concerning corporate charging decisions. *Federal Prosecutions of Business Organizations* (the Thompson memo), Memorandum from Deputy Attorney General, Larry D. Thompson to the United States Attorneys' Offices (January 20, 2003) (on file with the Department), *available at* www.usdoj.gov/usao/eousa/foia_reading_room/usam/title9/crm00162.htm. This new memo drew on the combined efforts of the Department's Corporate Fraud Task Force and the Attorney General's Advisory Committee, and replaced the Holder memo of June 1999. While retaining the general principles and commentary enunciated in the Holder memo, the Thompson memo increases federal prosecutors' emphasis on, and scrutiny of, the authenticity of a corporation's professed cooperation. It addresses more specifically the

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

UNITED STATES OF AMERICA,	
- against -	S1 05 Crim. 888 (LAK)
JEFFREY STEIN, et al.,	
Defendants.	

BRIEF OF *AMICI CURIAE*
OF THE NEW YORK COUNCIL OF DEFENSE LAWYERS AND THE NATIONAL ASSOCIATION OF CRIMINAL DEFENSE LAWYERS

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acted to stack the adversarial deck to weaken the hand of the defense in order to strengthen its own. That interest is anathema to the founding principles of this society and should not be sanctioned by this Court.

STATEMENT OF FACTS

We base this brief on the following facts, which we assume to be true for the purposes of our argument.[1]

On January 23, 2003, the United States Department of Justice, through its Deputy Attorney General Larry D. Thompson, issued a memorandum describing the "Principles of Federal Prosecution of Business Organizations" (hereinafter the "Thompson Memorandum").[2] The Thompson Memorandum promulgated "a revised set of principles" intended to guide the exercise of prosecutorial discretion when determining whether to file criminal charges against corporate entities. Ex. A at 1. In Part II, "Charging a Corporation: Factors to be Considered," five of the nine enumerated "factors" explicitly presume individual criminal culpability: "1. the nature and seriousness of the offense"; "2. the pervasiveness of wrongdoing within the corporation"; "3. the corporation's history of similar conduct"; "4. the corporation's timely and voluntary disclosure of wrongdoing"; and, additionally, in the eight factor, the Thompson Memorandum advises prosecutors to consider "the adequacy of the prosecution of individuals responsible for the corporation's malfeasance." Ex. A at 2-3.

In further discussion of the cooperation and voluntary disclosure factor, the Thompson Memorandum instructs as follows:

> Another factor to be weighed by the prosecutor is whether the corporation appears to be protecting its culpable employees and agents. Thus, while cases will differ depending on the circumstances, a corporation's promise of support to *culpable employees and agents*, either through the advancing of attorneys[']fees, through retaining the employees without sanction for their misconduct, or through providing information to the employees about the government's investigation pursuant to a joint defense agreement, may be considered by the prosecutor in weighing the extent and value of a corporation's cooperation.

Ex. A at 5 (italics added; footnote omitted).

In this case, the United States Attorneys' Office for the Southern District of New York applied these principles in a manner that forced the accounting firm KMPG LLP ("KPMG") to cut off attorneys' fees to its employees and partners who were subsequently indicted.

KMPG had a longstanding practice to advance and pay legal fees, without a preset cap or condition on cooperation with the government, for counsel for partners, principals, and employees of the firm in those situations where separate counsel was appropriate to represent an individual in a proceeding involving activities arising within the scope of the individual's duties, including any criminal or regulatory proceeding. Prior to February 2004, when KPMG cut off fees in this case, this practice was unwavering and was followed without regard to economic costs or considerations with respect to the individual counsel or firm chosen for representation.[3]

The one and only time KMPG has not followed this practice is in this case. In statements made to KPMG and its lawyers in February 2004, prosecutors, relying on and

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1 In assembling this brief statement of facts, we rely on our review of the motion papers submitted regarding this issue by both the KPMG defendants and the prosecution, on the transcripts of the May 8, 9, and 10, 2006, hearing on this issue before the Court and on the letter to the Court from David Spears dated April 25, 2006.

2 A copy of the Thompson Memorandum is attached to the Declaration of Lewis J. Liman as Exhibit A, and will be referenced in this brief as such.

3 Adapted from Letter of David Spears to the Court dated April 25, 2006.

referring to the Thompson Memorandum, made clear that KPMG would face indictment if it continued its policy of paying attorneys' fees for employees and partners the prosecution believed were "culpable."

At the time of those demands, KPMG and its partners and employees had been the subject of intensive civil and criminal investigations by the government. Indeed, the firm and its principals had been the subject of IRS litigation and a congressional investigation.[4] Criminal charges, against both the firm and individuals, were clearly on the prosecution's mind. The prosecution made KPMG believe that the only way to avoid its own indictment, which most certainly would have meant the death knell for the organization, was to accede to the prosecution's demands and abandon its longstanding practice of advancing attorneys' fees.

At the time the attorneys' fees practice was abandoned, KPMG itself had conducted no internal investigation and made no determination of its own that any of its partners or employees were "culpable." In fact, the prosecution made the only assertion with respect to culpability against partners and employees who had not even been charged by a grand jury, let alone convicted. This assertion rested entirely on the prosecution's definition of culpability and its oversight of the way in which individuals interacted with the investigation.

As a result of the prosecution's demands, KPMG took the action that the prosecution wanted it to take and that it virtually had to take: it initially placed a $400,000 cap on legal fees and conditioned legal fees on the cooperation of its employees and partners with the prosecution's investigation, and then ultimately, at the prosecution's urging, cut off fees to the KPMG defendants altogether. The prosecution thereby ensured, as the natural and inevitable effect of its actions, that such employees and partners would be deprived of the resources to hire counsel of choice to proceed through what would be an exceedingly complex and lengthy litigation when (and not just if) the prosecution brought charges against them.

By exerting irresistible pressure on KPMG to cut off payment of legal fees, the prosecution not only interfered with KPMG's longstanding practice of advancing such fees, but also sought to circumvent the constitutional protections afforded by the Sixth Amendment right to counsel and the Fifth Amendment right to due process by hobbling the defense of KPMG's former partners and employees facing prosecution.

ARGUMENT

I. THE PROSECUTION'S CONDUCT VIOLATES THE SIXTH AMENDMENT

The Sixth Amendment to the U.S. Constitution guarantees that "[i]n all criminal prosecutions, the accused shall enjoy the right . . . to have the Assistance of Counsel for his defense." U.S. Const. Amend. VI. The right to counsel is a cornerstone of our criminal justice system, for "it is through counsel that all other rights of the accused are protected" and "'[o]f all the rights that an accused person has, the right to be represented by counsel is by far the most pervasive, for it affects his ability to assert any other rights he may have.'" Penson v. Ohio, 488 U.S. 75, 84 (1988) (quoting Walter V. Schaefer, Federalism and State Criminal Procedure, 70 Harv. L. Rev. 1, 8 (1956)).

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[4] "In mid-November 2003, the minority staff of the Senate permanent subcommittee on investigation published a report about so-called tax shelter activities, in which it was partially critical of KPMG's tax group. This followed highly publicized hearings carried on TV where certain employees of KPMG testified and were really roughed up by the senators who questioned them. At the same time, KPMG was embroiled in really hostile and difficult litigation with the IRS, which was doing an audit of KPMG and also subpoenaing information from KPMG investigating tax shelters . . . ." Transcript of May 10, 2006 Hearing at 343:23-25 and 344:1-7.

For this reason, "the right to select and be represented by one's preferred attorney is comprehended by the Sixth Amendment," Wheat v. United States, 486 U.S. 153, 159 (1988),[5] and a defendant should "be afforded a fair opportunity to secure counsel of his own choice," Powell v. Alabama, 287 U.S. 45, 53 (1932). The right to counsel of one's choice may not be abridged by the Court or the prosecution, except in extraordinary circumstances, such as where an accused person's choice of counsel threatens to harm the judicial process, see Wheat, 486 U.S. at 159 (a defendant may not select as his attorney "an advocate who is not a member of the bar" or "who has a previous and ongoing relationship with an opposing party"), or where abrogation is a mere byproduct of the government's exaction of a proper criminal penalty, such as seizure of illegally obtained assets, Caplin & Drysdale, Chartered v. United States, 491 U.S. 617, 626 (1989) (Blackmun, J., dissenting). It follows that the prosecution is not permitted to seize property from the accused, absent a duty of criminal forfeiture or some other lawful pretext, with the naked intention of depleting funding reserved for payment of attorneys' fees, thereby restricting the accused person's choice of counsel. [6]

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[5] Accord United States v. Curcio, 694 F.2d 14, 22 (2d Cir. 1982) (Friendly, J.), disapproved on other grounds in Flanagan v. United States, 465 U.S. 259, 263 n.2 (1984).

[6] Indeed, even where asset forfeiture may be appropriate, the potential consequences of such forfeiture on a defendant's Sixth Amendment rights require strict procedural protections. See, e.g., United States v. Unimex, Inc., 991 F.2d 546, 551 (9th Cir. 1993) ("right to counsel under the Sixth Amendment and to Due Process under the Fifth Amendment were violated by taking away all of [defendant's] assets, denying it an opportunity to show cause prior to its criminal trial that an amount it could have used for attorneys' fees was nonforfeitable, and then forcing it to trial without counsel"); United States v. Moya-Gomez, 860 F.2d 706, 724 (7th Cir. 1988) ("[T]he pretrial, post indictment restraint of a defendant's assets without affording the defendant an immediate, post restraint, adversary hearing at which the government is required to prove the likelihood that the restrained assets are subject to forfeiture violates the due process clause to the extent it actually impinges on the defendant's qualified sixth amendment right to counsel of choice."). For example, in Payden v. United States (In re Grand Jury Subpoena Duces Tecum dated January 2, 1985 (Simels)), 767 F.2d 26, 29 (2d Cir. 1985), the Court of Appeals rejected the government's assertion that the defendants' Sixth Amendment right to continue with counsel of his choice was secondary to the government's ability, through an investigation by the grand jury, to seek forfeiture of the funds used to retain the attorney.

It is the very fact that individuals charged with serious and complicated offenses can retain skilled counsel to challenge the prosecution's proof that protects the government's interest in securing convictions that are both procedurally and substantively, which is the hallmark of a free society. Whatever the consequences for a particular prosecution, the government can have no legitimate interest in an individual having other than the best and most skillful counsel. "[T]o refuse to recognize the right to counsel for fear that counsel will obstruct the course of justice is contrary to the basic assumptions upon which [the Supreme Court] has operated in Sixth Amendment cases." United States v. Wade, 388 U.S. 218, 237-38 (1967). The Supreme Court has repeatedly stated that only through defense counsel's testing of the prosecution's proof may the public, and the government, gain comfort that a conviction, once obtained, is just and that the proceedings have reached the correct substantive and procedural result. See, e.g., Penson, 488 U.S. at 84 ("[our criminal justice] system is premised on the well-tested principle that truth – as well as fairness – is best discovered by powerful statements on both sides") (quotation marks and citations omitted); Wade, 388 U.S. at 238 ("law enforcement may be assisted by preventing the infiltration of taint in the prosecution's identification evidence" and "[t]hat result . . . can only help insure that the right man has been brought to justice"). For this reason, "when the government's role shifts from investigation to accusation," the assistance of counsel "is needed to assure that the prosecution's case encounters 'the crucible of meaningful adversarial testing.'" Moran v. Burbine, 475 U.S. 412, 430 (1986) (quoting United States v. Cronic, 466 U.S. 648, 656 (1984)).

The prosecution's use of the Thompson Memorandum furthers no legitimate governmental interest and violates these Sixth Amendment principles. This is not a case in

which the corporate target has acted on its own volition, without pressure by the prosecution. Nor is it a case in which the corporation has conducted its own internal investigation and, on that basis, identified particular culpable employees and determined that it no longer wished to retain them or associate with them. Such cases would present different facts not present here. Nor does the record support the conclusion that KPMG advanced attorneys' fees to culpable employees or partners for fear that, absent such advancement, the employees or partners would testify or provide evidence against KPMG. The prosecution's threat came *after* the prosecution had already formed the conclusion that sufficient evidence existed to bring a charge against KPMG as evidenced by their focus on the Thompson Memorandum. Rather, this is a case where the prosecution, following to the letter the policy undertaken in the Thompson Memorandum, appears to have acted to further the naked interest in depriving individuals whom it contemplated bringing charges against from hiring the most skillful attorneys those individuals could hire with the use of KPMG's resources.

Whatever the outcome should be of those other hypothetical cases,[7] the government can have no legitimate interest in depriving an individual of counsel of choice. To the contrary, the legitimate interest of the government – indeed, its only legitimate interest – is ensuring that defendants' receive the best counsel possible. See supra at 5-7. The choice of an appropriate defense attorney may affect both the quality and the nature of the defense, due to differences in the competence and expertise of counsel and the heavy degree to which defendants come to rely upon their counsel to assist them in navigating the intricacies of criminal proceedings. Profound consequences may flow from this choice, for "[l]awyers are not fungible, and often 'the most important decision a defendant makes in shaping his defense is his selection of an attorney.'" United States v. Mendoza-Salgado, 964 F.2d 993, 1014 (10th Cir. 1992) (citations omitted). Furthermore, "once a lawyer has been selected 'law and tradition may allocate to the counsel the power to make binding decisions of trial strategy in many areas.'" United States v. Laura, 607 F.2d 52, 56 (3d Cir. 1979) (quoting Faretta v. California, 422 U.S. 806, 820 (1975)), aff'd, 667 F.2d 365 (3d Cir. 1981).[8]

The prosecution cannot shield its actions or its policy from constitutional scrutiny based on the fact that, at the time that it succeeded in blunting KMPG's long-standing practice of advancing attorneys' fees through indictment and trial, the KPMG defendants had not yet been formally charged with any crime, particularly here, where the withholding of such fees continued post-indictment. If the prosecution's actions had occurred only post-indictment, the Sixth Amendment right to counsel would most certainly have been implicated. But, the return of a felony indictment itself is not a magical moment without which no Sixth Amendment violation could exist. In determining when the Sixth Amendment right to counsel attaches, the focus should not be on the filing of a particular paper, but on the character of the prosecution's relationship to the individual at the specific time in question. Acknowledging the focus on form over substance that such a constitutional doctrine based on the filing of an indictment would sanction, the courts have recognized that the true question in assessing when a defendant's Sixth

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[7] The NYCDL and NACDL take no position in this case with respect to a case involving those facts.

[8] Moreover, "[t]he selected attorney is the mechanism through which the defendant will learn of the options which are available to him. It is from his attorney that he will learn of the particulars of the indictment brought against him, of the infirmities of the government's case and of the range of alternative approaches to oppose or even cooperate with the government's efforts." Laura, 607 F.2d at 56. Equally important, as Justice Scalia has recently commented from the bench in consideration of this very issue, the Sixth Amendment right to counsel embodies a fundamental respect for the autonomy of individuals such that "if you have funds with which you can hire someone to speak for you . . . [y]ou should be able to use all of your money to get the best spokesman for you as possible." United States v. Gonzalez-Lopez, No. 05-352, Oral Argument Tr. 5-6, Apr. 18, 2006.

Amendment right to counsel attaches is whether the prosecutor has crossed the constitutional divide between investigator and adversary, even before the defendant has been formally charged. See, e.g., Escobedo v. Illinois, 378 U.S. 478, 490-91 (1964) (upholding the right to counsel where "the investigation is no longer a general inquiry into an unsolved crime but has begun to focus on a particular suspect" and the government "carr[ies] out a process of interrogations that lends itself to eliciting incriminating statements"); Matteo v. Superintendent, SCI Albion, 171 F.3d 877, 892-93 (3d Cir. 1999) (en banc) (defendant enjoyed a right to counsel during jailhouse telephone conversations with an informant made prior to preliminary hearing, filing of information, or arraignment, having only surrendered himself into custody pursuant to an arrest warrant). The accused bears the right to the assistance of counsel at any "critical" stage of criminal prosecution when "the accused [is] confronted . . . by the procedural system, or by his expert adversary, or by both, in a situation where the results of the confrontation might well settle the accused's fate and reduce the trial itself to a mere formality." United States v. Gouveia, 467 U.S. 180, 189 (1984) (quotation marks and citations omitted).

Although the initiation of adversarial proceedings triggering application of the right to counsel is normally signaled "by way of formal charge, preliminary hearing, indictment, information, or arraignment," Kirby v. Illinois, 406 U.S. 682, 689 (1972), the right to counsel "also may attach at earlier stages" where circumstances of procedural complexity or adversarial confrontation so require, Matteo, 171 F.3d at 892. Thus, in practical terms "the right to counsel attaches . . . when 'the government has committed itself to prosecute,'" Roberts v. Maine, 48 F.3d 1287, 1290 (1st Cir. 1995) (quoting Moran, 475 U.S. at 430-32), or when "'the government's role shifts from investigation to accusation.'" Id. (quoting Moran, 475 U.S. at 430); see also United States v. Hamad, 858 F.2d 834, 839 (2d Cir. 1988) ("Moreover, we resist binding the [Disciplinary] Code's applicability to the moment of indictment. The timing of an indictment's return lies substantially within the control of the prosecutor. Therefore, were we to construe the rule as dependant upon indictment, a government attorney could manipulate grand jury proceedings to avoid its encumbrances."); United States v. Larkin, 978 F.2d 964, 969 (7th Cir. 1992) (citing Bruce v. Duckworth, 659 F.2d 776, 783 (7th Cir. 1981), for the proposition that "government may not intentionally delay formal charges for purpose of holding lineup outside presence of defense counsel"); United States v. Dobbs, 711 F.2d 84, 85 n.1 (8th Cir. 1983) (noting that intentional delay by the prosecution in seeking indictment until after an adversarial interview had taken place in order to prevent the defendant from obtaining advice of counsel may cause the right to counsel to attach "before judicial proceedings have been formally initiated"). Cf. United States v. Day, 969 F.2d 39, 43 (3d Cir. 1992) (vacating sentence on the ground that defendant's trial counsel failed to adequately represent defendant at the plea bargain stage); Matteo, 171 F.3d at 892 (emphasizing that the moment of subjection to the "'prosecutorial forces of organized society'" represents the "crucial point" at which the constitutional right to counsel attaches, and that this may occur at a stage prior to the formal charge or indictment) (citation omitted).

There could be no conduct that more centrally implicates the Sixth Amendment than a prosecutor's direction to a corporation to cut off the payment of attorneys' fees to individuals whom the prosecution believes to be criminally culpable. The very purpose and effect of such conduct is to weaken the defense when and if the prosecution brings criminal charges. There would be no reason for the prosecution to take such action but for its contemplation that it will bring criminal charges – what other reason could the prosecution have for cutting off attorneys' fees in circumstances such as these other than that counsel might be

necessary. This truth is highlighted by the very fact that the prosecution, by directing the corporation not to pay fees, itself has designated the employees or partners as "culpable" – terminology that, when used by the Department of Justice, can only mean criminally culpable.

Thus, whether measured according to whether the government had "committed itself to prosecute," Moran, 475 U.S. at 432 (internal quotation marks and citations omitted), whether "the adverse positions of government and defendant have solidified," Kirby, 406 U.S. at 689, whether the government's demand is an improper interference with counsel akin to Larkin, or whether simply there is a continuing constitutional violation, there should be little question that the Sixth Amendment is implicated (and violated) where the prosecution compels a corporation cut off attorneys' fees to its employees and partners for the naked purpose of depriving them of the most skilled criminal counsel if indicted and then, having succeeded in that demand, turns around and indicts those employees and partners.

Here, the prosecution had no reason to coerce KPMG to withhold advancement of the KPMG defendants' attorneys' fees – and no tactical interest in doing so -- unless the prosecution intended to face those defendants in court.[9] At this stage in the development of its case, having categorized the KPMG defendants as "culpable" the prosecution was actively in the process of interviewing them with the intention to elicit admissions and other inculpatory evidence. Under these circumstances, the "adverse positions of the prosecution and the defendants had solidified," see Kirby, 406 U.S. at 689, and the KPMG defendants had arrived to face difficulties both substantive and procedural which, if they failed to navigate efficiently, may have prejudiced their cases at trial or even rendered trial a "mere formality," see Gouveia, 467 U.S. at 189 (quotation marks and citation omitted). The prosecution's conduct accordingly violated the Sixth Amendment.

II. THE PROSECUTION'S CONDUCT VIOLATES THE FIFTH AMENDMENT

As set forth above, the prosecution's conduct in this matter, as sanctioned and insisted upon by the Thompson Memorandum, served no other purpose than to thwart the KMPG defendants from defending themselves against the Government and to further tip an already uneven playing field into the prosecution's favor. Such conduct reflects a contempt for the function of defense counsel and for the KPMG defendants' undeniable interest in their own defense and cuts at the very heart of the principles of liberty embodied in the Due Process Clause.

A. The Illegitimate And Irrational Deprivation By The Government Of Fundamental Liberty Interests Violates The Fifth Amendment Due Process Clause

The Due Process Clause of the Fifth Amendment provides that "[n]o person shall be . . . deprived of life, liberty, or property without due process of law." U.S. Const. Amend. V.

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[9] See infra at 16-17, n.12 (addressing the prosecution's argument that it has a legitimate tactical interest here to prevent "circling the wagons"); see also Peter J. Henning, Overcriminalization: The Politics of Crime, Targeting Legal Advice, 54 Am. U. L. Rev. 669, 702 (2005) ("In the name of investigating corporate crime, the DOJ has given expression to a mistrust of lawyers as little more than hindrances to the protection of society from wrongdoing. We are told [by the Thompson Memorandum], in effect, that lawyers cannot be trusted because their ethical rules permit them to obstruct justice, and their advice to clients to assert their constitutional rights make it appreciably more difficult to investigate and to prosecute economic crimes committed by corporations and their officers and employees. However, the DOJ's suspicion of lawyers and the targeting of legal advice as something to be limited or eliminated if possible from corporate crimes investigations are steps toward viewing all such allegations of misconduct as proven unless--and until--determined otherwise. I submit that this approach takes the issue of overcriminalization to a new level by making the provision of proper legal advice an indicia of criminality and an instrumentality to be removed from the hands of those subject to a criminal investigation in much the same way an officer would take a weapon or contraband from a suspect."). The Thompson Memorandum, accordingly, stands in stark contrast to the view, embodied in Supreme Court jurisprudence, that skilled defense counsel should be employed to test the prosecution as it tries to meet its burden. See, e.g., Polk County v. Dodson, 454 U.S. 312, 318 (1984) ("The system assumes that adversarial testing will ultimately advance the public interest in truth and fairness."); Herring v. New York, 422 U.S. 853, 862 (1975) ("The very premise of our adversary system of criminal justice is that partisan advocacy on both sides of a case will best promote the ultimate objective that the guilty be convicted and the innocent go free.").

Heightened protection against government interference is warranted under the Due Process Clause when certain fundamental rights and liberty interests are at stake. Washington v. Glucksberg, 521 U.S. 702, 719-20 (1997) (quoting Collins v. Harker Heights, 503 U.S. 115, 125 (1992) (further quoting Daniels v. Williams, 474 U.S. 327, 331 (1986))). Fundamental liberty interests cannot be subjected to government interference unless such interference bears a reasonable relationship to a legitimate state interest. Washington, 521 U.S. at 719-20. Absent a fundamental liberty interest, the prosecution, however, is still not unhindered in its discretion. The Due Process Clause protects defendants from outrageous government conduct that impairs their protected right to be treated in a fair, evenhanded manner such that an imbalance of forces is created between the accused and the accuser. See United States v. Cuervelo, 949 F.2d 559, 565 (2d Cir. 1991); see also Rochin v. California, 342 U.S. 165, 174 (1952).

B. The KPMG Defendants Have Substantial Liberty Interests At Stake

The liberty interest at issue here could not be more fundamental.[10] In essence, the prosecution is attempting to take away the defendants' very freedom in this case. Implicit in a defendants' unquestionable right to defend against the prosecution's efforts is the notion that individuals, when faced with the force and resources of the prosecutorial arm of the Government seeking to take away personal freedom, have a fundamental interest in planning the defense of their liberty without undue interference, including choosing their own attorney. See Powell, 287 U.S. at 53; United States v. Kikumura, 947 F.2d 72, 78 (3d Cir. 1991) ("Due process demands that a defendant be afforded an opportunity to obtain the assistance of counsel of his choice to prepare and carry out his defense."). This interest arises not only when an individual is subject to indictment, but, particularly in the case of complex investigations, arises whenever it is clear that the Government is the individual's adversary. See Walters v. Nat'l Ass'n of Radiation Survivors, 473 U.S. 305, 368-71 (1985) (Stevens, J., dissenting) ("What is at stake is the right of an individual to consult an attorney of his choice in connection with a controversy with the Government. In my opinion that right is firmly protected by the Due Process Clause of the Fifth Amendment . . . . [T]he citizen's right of access to the independent, private bar is itself an aspect of liberty that is of critical importance in our democracy."). An individual subjected to an investigation by the prosecution has an interest in setting up his possible defenses and strategizing without prosecutorial interference. Where a defendant's pre-indictment strategy includes arranging to have counsel fees advanced in the event of prosecution, the government cannot institute an illegitimate policy to carte blanche circumvent that strategy.

C. The Government Has No Legitimate Interest In Interfering With The KPMG's Defendants' Interests In Pursuing Their Counsel Of Choice

We are deeply concerned about the prosecution's trailblazing employment of the Thompson Memorandum here to cripple the defense before the trial has even started. With only the prosecution's assertion that the KPMG defendants were "culpable" or "uncooperative"[11], the prosecution coerced KPMG into revoking its long-standing policy of advancing attorneys' fees to employees. The notion that the prosecution may legitimately use the Thompson

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[10] To the extent the interest at stake here is more narrowly characterized as an economic interest in the advancement of counsels' fees or the liberty to agree to such an arrangement, these too are fundamental interests deeply rooted in our Nation's history, and, in this case, in the laws of the State under which KPMG is organized. Delaware law specifically recognizes the rights of partners in a partnership to agree to indemnify one another, and the Delaware courts have interpreted this right to include an agreement to advance counsel fees. Delaware Revised Uniform Limited Partnership Act § 17-108; Morgan v. Grace, C.A. No. 20430, 2003 Del. Ch. LEXIS 113, at *9 (Del. Ch. Oct. 29, 2003).

[11] We believe that the record demonstrates that no internal investigation was conducted by KMPG, and KPMG, consequently, made no findings with respect to the culpability of the KPMG defendants.

Memorandum to pressure KMPG to deprive the KPMG defendants, before they were even indicted, of the power to retain their counsel of choice is deeply unsettling. Caplin & Drysdale, 491 U.S. 617, 640 n.7 (1989) ("The notion that the Government has a legitimate interest in depriving criminals--before they are convicted--of economic power, even insofar as that power is used to retain counsel of choice is more than just somewhat unsettling, as the majority suggest. That notion is constitutionally suspect.") (quotation marks and citations omitted).

In Caplin & Drysdale, the Court was confronted with a challenge to forfeiture statutes that allowed the Government to seize certain assets of a defendant; the petitioner argued that the seizure of funds that the defendant would have used to retain counsel of choice was constitutionally impermissible. Caplin & Drysdale, 491 U.S. at 632-34. Although the Court upheld the forfeiture statutes, it did so on the basis of the government's strong property interest in the money at issue (as expressed in an act of Congress). Id. at 627. Here, the government has no such interest in the money that was to be advanced to the KPMG defendants. Absent this governmental interest, it is our position that this case falls squarely into the kind of interference with the retention of counsel that the majority in Caplin & Drysdale found constitutionally suspect. The Court, addressing the petitioner's Fifth Amendment due process claims, noted that a rule that by its very terms upsets the balance of forces between the accused and the accuser would be unconstitutional. Id. at 633 (quoting Wardius v. Oregon, 412 U.S. 470, 474 (1973)). For the reasons we have articulated, the Thompson Memorandum's implicit requirement that a company, which the prosecution perceives as the situs of "wrongdoing" and "malfeasance", cease advancement of attorneys' fees to individuals that the prosecution deems culpable is an unconstitutional rule that upsets the balance between defendants and the prosecution.

The prosecution's contempt for the role of defense counsel as embodied in the Thompson Memorandum cannot, should not and must not be sanctioned, as it is repugnant to the very core values of an adversarial system of justice. The government has no legitimate interest in increasing the chances of convicting a person by diminishing the quality of his counsel.[12] To the contrary, in any situation where a person's liberty is at stake, the courts have recognized that defense counsel's role is paramount--aiding in identifying legal questions, presenting arguments and, most importantly, challenging the prosecution's proof. See Gagnon v. Scarpelli, 411 U.S. 778, 786-87 (1973); see also Walters, 473 U.S. at 329-30 (acknowledging that in complex factual situations involving significant interests advice of counsel is essential once an adversary is present). The prosecutor's interest in having defendants with less than the best lawyer they can afford is not a legitimate government interest, as it is the existence of skilled defense counsel testing the prosecution's evidence that gives society comfort that a conviction, once obtained, is

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[12] The prosecution asserts that the Thompson memorandum stands for the proposition that a company is not cooperating when it provides attorneys' fees to culpable employees in an effort to "circle the wagons." Transcript of May 10, 2006 Hearing at 409:20-25. This assertion is disingenuous. The Thompson Memorandum's assessment of whether a company is cooperating with the prosecutor's investigation includes an examination of whether "the corporation, while purporting to cooperate, has engaged in conduct that impedes the investigation" and, separately, whether "the corporation appears to be protecting its culpable employees . . . through the advancing of attorneys['] fees . . . ." Ex. A at 5-6. The Thompson Memorandum defines "impeding an investigation" to include "inappropriate directions to employees or their counsel, such as directions not to cooperate openly and fully with the investigation including, for example, the direction to decline to be interviewed." Id. at 6. The Thompson Memorandum does not suggest that the prosecution only consider the issue of advancement of attorneys' fees if the company is engaged in impeding the investigation/"circling the wagons" as the prosecution asserts. In fact, if the prosecution's interpretation of the Thompson Memorandum were true, that the issue of attorneys' fees would only be raised when a company is impeding the investigation by discouraging employees from being interviewed, then the advancement issue would not have been raised in this case, as it is more than clear from the record that KPMG was fully encouraging its employees to cooperate with the prosecution. Rather, the factors are to be considered separate and apart, the import of which is that the prosecution believes it has an interest, separate from the "circling of the wagons," in ensuring that employees of a company under investigation not be advanced attorneys' fees. It is evident, then, that the Thompson memorandum's focus on the advancement of counsel fees is nothing more than a reflection of the belief that the mere presence of a well-financed lawyer frustrates the government's prosecutorial efforts. This naked interest in ensuring that defendants have less effective counsel is wholly illegitimate.

a just conviction—the substantively correct outcome of a fair process. Wilson v. Mintzes, 761 F.2d 275, 279 (6th Cir. 1985) ("[T]he accused's right to retain counsel of his choice is necessary to maintaining a vigorous adversary system and the objective fairness of the proceeding in which the accused is prosecuted."). The government's true and legitimate interest in all criminal proceedings is not to secure convictions, but, through a fair process, to achieve a just result. See Brady v. Maryland, 373 U.S. 83, 87 (1963) ("Society wins not only when the guilty are convicted but when criminal trials are fair; our system of the administration of justice suffers when any accused is treated unfairly. An inscription on the walls of the Department of Justice states the proposition candidly under the federal domain: 'The United States wins a point whenever justice is done its citizens in the courts.'"). It is particularly imperative that in increasingly complex investigations into business crimes defendant's counsel be a skilled advocate. Such skilled advocacy is necessary to enhance the reliability of litigation outcomes involving directors and officers by assuring a level playing field. Ridder v. CityFed Fin. Corp., 47 F.3d 85, 87-88 (3d Cir. 1995); see also Caplin & Drysdale, 491 U.S. at 646 (Allowing counsel of choice ensures "equality between the Government and those it chooses to prosecute.").

Further, the prosecutor's unreasonable interference in the advancement of attorneys' fees to the KMPG defendants is an affront to Due Process. The Supreme Court has recognized in a related context that "for an agent of the state to pursue a course of action whose objective is to penalize a person's reliance on his legal rights is 'patently unconstitutional.'" Bordenkircher v. Hayes, 434 U.S. 357, 363 (1978) (quoting Chaffin v. Stynchcombe, 412 U.S. 17, 32-33 (1977)). The prosecution could not coerce a defendant into taking on a less-skilled counsel by threatening to bring additional charges if he hired a more-skilled counsel. Such an action of prosecutorial vindictiveness would unconstitutionally "up the ante" based solely on a defendant's constitutionally protected exercise of his rights. See, e.g., Thigpen v. Roberts, 468 U.S. 27, 33 (1984) (holding that prosecuting a defendant for manslaughter following his invocation of his statutory right to appeal his misdemeanor convictions was unconstitutional); North Carolina v. Pearce, 395 U.S. 711 (1969) (holding that prosecutor may not seek imposition of a stiffer sentence after reversal and reconviction). Additionally, such interference would constitute improper and unconstitutional interference with the attorney-client relationship. See United States v. Marshank, 777 F. Supp. 1507, 1518-20 (N.D. Cal. 1991) ("Government misconduct which subverts a defendant's relationship with his [attorney] may be judged under the standards of both the Fifth and Sixth Amendments;" the government cannot be a "knowing participant" in circumstances that interfere with a defendant's right to counsel.); see also United States v. Ofshe, 817 F.2d 1508, 1516 (11th Cir. 1987) (holding that government interference in an attorney-client relationship that offends the "universal sense of justice" violates the Due Process Clause of the Fifth Amendment).[13]

Here, the prosecution should not be allowed to do indirectly what it could not do directly. See Marshank, 777 F. Supp at 1525 ("We . . . have made clear that, at the very least, the prosecutor and police have an affirmative obligation not to act in a manner that circumvents and thereby dilutes the protection afforded by the right to counsel.") (quoting Maine v. Moulton,

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[13] As stated in another, similar context -- the ascertainment of intent under 18 U.S.C. §1503, the statute which criminalizes obstruction of the administration of justice: "The likely result and attendant circumstances define the context in which the defendant acts . . . . The defendant's design is irrelevant; if the natural result of his plan is to interfere with judicial processes, justice will be obstructed whether he hopes it is or not." United States v. Neiswender, 590 F.2d 1269, 1273-74 (4th Cir. 1979) (18 U.S.C. § 1503 applied to obstruction of the defense); see also United States v. Buffalano, 727 F.2d 50, 53-54 (2d Cir. 1984) (false claim by defendant that he could "fix" the case); United States v. Gage, 183 F.3d 711, 718 (7th Cir. 1999) (Posner, J., concurring) (referring to the Buffalano and other decisions as plausibly reading two Supreme Court cases, Pettibone v. United States, 148 U.S. 197 (1893) and United States v. Aguilar, 515 U.S. 593 (1995), as holding that obstructive conduct is culpable "if the obstruction was the natural and probable consequence of the conduct. It need not have been the intended consequence").

474 U.S. 159, 170-71 (1985)). Those cases involving prosecutorial misconduct in violation of the Fifth Amendment do not turn upon the identity of the recipient of the illegitimate prosecutorial demand, but on an assessment of the effect of the prosecution's conduct and the legitimacy of the government's interest in that effect. Here the prosecution's interests were wholly illegitimate. The prosecution acts unlawfully when its design is solely to further its own chances at trial. That is clearly the natural, inevitable and foreseeable result of the prosecution's conduct here: by threatening KPMG with indictment were it not to cease advancing attorneys' fees to the KPMG defendants, the prosecution has no less effectively or nakedly interfered with those defendants rights to hire the best counsel available than were the prosecution to have threatened a lengthier jail sentence if a defendant hired a particular lawyer. In both circumstances, the prosecution's conduct would run afoul of Fifth Amendment principles central to our society.

CONCLUSION

Accordingly, we urge the Court to find that the prosecution's invocation of the Thompson Memorandum to thwart KMPG defendants' choice of counsel violates the Fifth and Sixth Amendments.

Date: New York, New York
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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

UNITED STATES OF AMERICA	
-against-	**S1 05 Crim. 888 (LAK)**
JEFFREY STEIN, et al.,	
Defendants.	

SUPPLEMENTAL BRIEF FOR *AMICI CURIAE* THE SECURITIES INDUSTRY ASSOCIATION, THE ASSOCIATION OF CORPORATE COUNSEL, THE BOND MARKET ASSOCIATION, AND THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA

In light of the Court's request for further briefing concerning the Thompson Memorandum,[1/] *amici curiae* Securities Industry Association, the Association of Corporate Counsel, the Bond Market Association, and the Chamber of Commerce of the United States of America submit this brief to supplement the previous brief they filed on May 3, 2006 ("5/3/06 Br.").

Our previous brief explained why the Thompson Memorandum's attack on private fee advancement policies is as bad for business as it is inimical to basic constitutional principles. As a business matter, the Justice Department's policy subverts the private sector's efforts (i) to recruit talented individuals to work in highly scrutinized industries and (ii) to prevent the threat of ruinous legal bills from causing employees to serve their own self-interest, rather than their employers' interests, by erring on the side of unreasonable caution in their business affairs. *See* 5/3/06 Br. 11-12.

The Justice Department's policy is just as problematic from a legal perspective. Although no one is entitled to *government* funding of attorneys' fees for his counsel-of-choice, an investigatory target does have a protected liberty and property interest, before and after indictment, in governmental non-interference with existing *private arrangements* for such funding. *See* NACDL Br. 13-20. Even if that right must sometimes yield to countervailing government interests, there can be no such interest here. The government's rationale for undermining corporate-funded fee arrangements is that effective legal representation for criminal suspects would frustrate the government's efforts to convict its investigatory targets and, for that reason alone, would harm the public interest. But our adversarial system, rooted in hundreds of years of Anglo-American jurisprudence, presumes the exact opposite: "that truth—as well as fairness—is best discovered by powerful statements on *both* sides[.]" *Penson v. Ohio*, 488 U.S. 75, 84 (1988) (emphasis added) (quotation marks and citations omitted); *see* 5/03/06 Br. 7-10.

1/ Memorandum from Larry Thompson, Deputy Attorney General, on Principles of Federal Prosecution of Business Organizations to Heads of Dep't Components and United States Attorneys (Jan. 20, 2003), http://www.usdoj.gov/dag/cftf/corporate_guidelines.htm.

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The briefs for the defendants and *amici* NACDL *et al.* address these doctrinal issues in detail, and we will not repeat that discussion here.

We nonetheless wish to supplement our earlier brief to address the practical dimensions of the distinction, raised at the May 10 hearing, between (i) advancements of attorneys' fees to employees from the outset of an attorney-client relationship and (ii) indemnification of attorneys' fees to employees that are exonerated of wrongdoing at the conclusion of an investigation or legal proceeding. *See, e.g.*, 5/10/06 Tr. 426. Companies often choose to advance attorneys' fees (and not simply indemnify employees after the fact) because they recognize that many employees cannot otherwise front the amounts needed for effective legal representation in complex accounting or financial investigations.[2/]

Without an advancement of fees, the mere prospect of indemnification offers little support for investigatory targets of limited means. Financial institutions may be reluctant to loan large amounts to a targeted employee given the risk that the employer will refuse to make indemnification if the employee is later found liable or strikes a plea bargain to gain closure. For the same reason, criminal defense attorneys—particularly the busiest and most effective ones—will be reluctant to represent such employees under a deferred-payment arrangement. In short, the Thompson Memorandum's suppression of privately negotiated fee advancements is designed

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[2/] *See generally Ridder v. Cityfed Fin. Corp.*, 47 F.3d 85, 87 (3d Cir. 1995) ("The [Delaware] statutory provisions authorizing the advancement of defense costs, conditioned upon an agreement to repay if a right of indemnification is not later established, plainly reflect a legislative determination to avoid deterring qualified persons from accepting responsible positions with financial institutions for fear of incurring liabilities greatly in excess of their means, and to enhance the reliability of litigation-outcomes involving directors and officers of corporations by assuring a level playing field"); *United States v. Wittig*, 333 F. Supp. 2d 1048, 1054 (D. Kan. 2004) (the presumption of innocence justifies advancement of legal fees by corporation to accused employees, subject to their acknowledgement "that their ultimate right to keep those payments depends on whether their . . . underlying conduct is indemnifiable").

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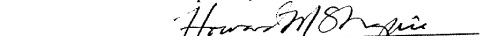
[2/] *See generally Ridder v. Cityfed Fin. Corp.*, 47 F.3d 85, 87 (3d Cir. 1995) ("The [Delaware] statutory provisions authorizing the advancement of defense costs, conditioned upon an agreement to repay if a right of indemnification is not later established, plainly reflect a legislative determination to avoid deterring qualified persons from accepting responsible positions with financial institutions for fear of incurring liabilities greatly in excess of their means, and to enhance the reliability of litigation-outcomes involving directors and officers of corporations by assuring a level playing field"); *United States v. Wittig*, 333 F. Supp. 2d 1048, 1054 (D. Kan. 2004) (the presumption of innocence justifies advancement of legal fees by corporation to accused employees, subject to their acknowledgement "that their ultimate right to keep those payments depends on whether their . . . underlying conduct is indemnifiable").

CONCLUSION

For the foregoing reasons, and those addressed in our May 3 brief, the relevant provisions of the Thompson Memorandum are unlawful.

May 22, 2006

Respectfully submitted,



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CONCLUSION

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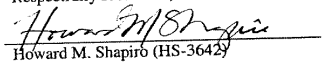

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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

UNITED STATES OF AMERICA, v. JEFFREY STEIN, ET AL., Defendants.	05 CR 888 (LAK)

MEMORANDUM OF NON-PARTY KPMG LLP SUBMITTED AT THE INVITATION OF THE COURT REGARDING CERTAIN ISSUES RELATING TO DEFENDANTS' FEE ADVANCEMENT MOTION

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MEMORANDUM OF NON-PARTY KPMG LLP SUBMITTED AT THE INVITATION OF THE COURT REGARDING CERTAIN ISSUES RELATING TO DEFENDANTS' FEE ADVANCEMENT MOTION

At the invitation of the Court, non-party KPMG LLP ("KPMG") hereby submits this memorandum of law addressing certain issues relating to a motion filed by certain defendants on January 12, 2006 entitled "Motion to Remedy the Violation of Defendants' Constitutional Rights to Counsel and a Fair Trial Resulting from the Prosecutors' Wrongful Interference with Defendants' Ability to Obtain Advancement of Legal Fees from KPMG" (the "Fees Advancement Motion" or the "Motion").

KPMG's only role in the Fees Advancement Motion is as a non-party witness. KPMG does not seek and has never sought to intervene in this matter, and KPMG takes no position here, and has never taken a position, regarding the merits of defendants' claim that the government, through the Thompson memorandum or otherwise, wrongfully interfered with the defendants' ability to obtain advancement of legal fees from KPMG. Nor does KPMG substantively address the merits of any potential and unspecified legal claim by any defendant against KPMG itself because no process has been commenced against the firm putting those claims at issue. In any event, as set forth below, this is not the proper forum for such legal claims. Rather, KPMG submits this memorandum as a response to this Court's informal invitation for "a chance to be heard" on whether any defendant may pursue a remedy against non-party KPMG in this case, and in response to this Court's request that it be provided with "the benefit of whatever learning I can get on what I acknowledge are difficult, cutting-edge questions." (Hrg. Tr. 430:17-19 (May 8-10, 2006).)[1] In asking for KPMG's input, this Court also recognized that KPMG is "not a party here." (*Id.* at 430:1.)

Several important and basic principles support the conclusion that this Court, in ruling on the Motion, cannot legally fashion a remedy against KPMG, which is a non-party to this criminal proceeding. Thus, this Court cannot exercise jurisdiction over KPMG, either through ancillary jurisdiction or in reliance upon a *pro hac vice* motion filed by counsel. Furthermore, any potential claim against KPMG for advancement of legal fees would be subject to the mandatory arbitration provision in the Partnership Agreement, which binds each of the KPMG defendants. Additionally, KPMG cannot be compelled to pay money to the defendants or otherwise be directed to assume significant financial obligations unless it receives due process under the Constitution, including the opportunity to call and examine witnesses (including the KPMG defendants), and introduce evidence to develop a factual record.

BACKGROUND

I. KPMG'S HISTORICAL FEES-ADVANCEMENT PRACTICE AND ITS FEES-ADVANCEMENT POLICY DETERMINATION IN THIS CASE.

KPMG is not and never has been contractually obligated to advance legal fees to its partners, principals, or employees. KPMG is a Delaware limited liability partnership, and Delaware partnership law provides that KPMG may, but is not required to, advance or indemnify its personnel for legal costs. Specifically, Section 15-110 of the Delaware Revised Uniform Partnership Act provides: "Subject to such standards and restrictions, if any, as are set forth in its partnership agreement, a partnership may, and shall have the power to, indemnify and hold

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[1] This Court also informed counsel that KPMG could "make whatever reservation of rights you want in submitting" documents. (Hrg. Tr. 430:20-22 (May 8-10, 2006)). To that end, KPMG hereby reserves all rights, and its submission of this memorandum of law at the invitation of this Court should not be construed or relied on in derogation of any and all of KPMG's rights.

harmless any partner or other person from and against any and all claims and demands whatsoever." 6 Del. C. §15-110. Neither KPMG's Partnership Agreement nor its By-Laws, both of which were produced by KPMG in response to the Rule 17(c) subpoena, obligate KPMG to advance or pay legal costs for its personnel. (*See* KPMG17(c)-0192 -0256.) The Partnership Agreement contains an integration provision, which provides that the agreement "constitutes the entire agreement, and supersedes all prior agreements and understandings, both written and oral, among the Members with respect to the subject matter hereof." (KPMG17(c)-0249 (§ 19.7).) The Partnership Agreement also contains an arbitration provision, which mandates that "Any dispute between the Firm and any Member or Separated Member . . . arising out of or relating to the Firm . . . or the rights or liabilities of a Member or Separated Member . . . shall be submitted for resolution by arbitration." (KPMG17(c)-0247 (§ 17) ("Arbitration").)

Although KPMG had no legal obligation to advance legal costs, KPMG historically exercised its discretion to do so, as stipulated by the government and the defendants.[2] KPMG faced the situation of paying for an indicted partner or other professional only once, some thirty years ago. Prior to February 2004, KPMG never needed to determine a policy with respect to whether it would advance legal fees for a large number of its current or former personnel who were identified as subjects of a criminal investigation. Consequently, in late February and early March of 2004, KPMG faced a question of first impression: Whether, upon being informed that both the firm and more than 25 current or former firm personnel were subjects of a grand jury investigation, the firm should exercise its discretion voluntarily to advance or pay legal costs of these individuals. In response to this unprecedented situation, KPMG made the considered business judgment to advance legal fees and expenses for certain current and former partners and employees, subject to the following conditions: (i) the individual was required to "cooperate with the government and that cooperation must be prompt, complete, and truthful"; (ii) the amount advanced by KPMG would be limited to $400,000; and (iii) advancement of legal fees would cease if the individual was charged by the government with criminal wrongdoing. (*See* KPMG17(c)-0015-0016.)

Pursuant to this case-specific determination, KPMG advanced legal fees to the following defendants: Randy Bickham, Larry DeLap, Steve Gremminger, Carl Hasting, John Lanning, Richard Rosenthal, Richard Smith, Carol Warley, Mark Watson, and Philip Wiesner. (*See* KPMG17(c)-0159-0184.) Each signed a letter agreeing with or acknowledging KPMG's position that it had no legal obligation to pay any of their legal fees in connection with the grand jury investigation. (*Id.*) In addition, KPMG advanced certain legal fees to defendant Jeff Stein pursuant to the terms of a severance agreement with Mr. Stein entered into on January 27, 2004. (*See* Exh. A to letter from David Spears to Hon. Lewis A. Kaplan of 4/5/06.) KPMG paid no legal fees for the defense of any of the other defendants. For various reasons and at various times prior to the commencement of court proceedings in this criminal action, KPMG ceased payment of legal fees for these individuals in accordance with the conditions of the letters that they signed.

II. THE FEES ADVANCEMENT MOTION AND KPMG'S ROLE IN THE MOTION.

Defendants filed the Fees Advancement Motion on January 12, 2006. Until the Court's April 12, 2006 Order authorizing issuance to KPMG of a non-party Rule 17(c) subpoena, KPMG had no involvement whatsoever in the Motion. The Motion and the accompanying brief alleged that the government engaged in prosecutorial misconduct and asked the Court to "rectify

[2] Notably, the defendants stipulated that KPMG's prior practice of advancing and paying legal fees was a "voluntary practice," which is inconsistent with any notion that KPMG had a legal obligation to advance legal fees for current or former personnel.

the prosecution's interference with their constitutional rights to counsel and a fair trial." (Def. Jan. 12, 2006 Mem. at 1.) The Motion did not ask the Court to have KPMG joined as a party; nor did the motion seek payment of additional monies by KPMG to the defendants for their legal expenses or otherwise seek any affirmative relief from KPMG. Instead, the motion's only reference to payment of funds by KPMG contemplated a disgorgement of sums KPMG already had paid or committed to pay.

> We note that given the unconstitutional interference by the prosecutors in the context of the KPMG deferred prosecution agreement, and the substantial funds paid (256 million dollars) and to be paid (another 200 million dollars) by KPMG to the government under the deferred prosecution agreement, this remedy can be accomplished in the context of this case by an order directing that advance payment of defendants' legal fees be made from the funds paid or that otherwise would be paid by KPMG under the deferred prosecution agreement.

(*Id.* at 27 n.3.)

Counsel for the defendants on the Motion, Ronald DePetris, made it clear at the March 30, 2006 hearing that the defendants sought no remedy from KPMG:

> The Court: What's the narrow relief you are seeking?
>
> Mr. DePetris: A direction that the legal fees of the KPMG defendants be advanced.
>
> The Court: How can I possibly do that when the party you are seeking to have pay the money is not even a party to the lawsuit?
>
> Mr. DePetris: Your Honor can do that for two reasons. What you are trying to remedy here is the constitutional violation arising from the government's misconduct.
>
> The Court: That may be. But don't you think that there would be a constitutional violation if a court in the United States ordered somebody who is not a party to the action, was never served with process, has had no opportunity to appear or resist the order, and is simply ordered to pay money? Do you think that would be a small problem?
>
> Mr. DePetris: That direction, your Honor, can be made to the government because the government is receiving, has already received $256 million from KPMG, I believe that's the correct figure, and are to receive an additional $200 million from KPMG.
>
> The Court: So you want me to order the government to pay it?
>
> Mr. DePetris: So the direction can be that it be paid out of that money, your Honor. That's one way to remedy the violation. If you can't remedy it in that fashion, then the court can take further steps such as dismissal of the indictment, but there has to be a remedy for the violation.

(Hrg. Tr. 15:21-16:24 (March 30, 2006).)

In an April 27, 2006 supplemental brief, the defendants reiterated that the Court should order the government to pay attorney's fees. In that same brief, however, the defendants raised for the first time the notion that the Court could consider directing relief against KPMG by exercising ancillary jurisdiction over it. (*See* Def. Suppl. Br. at 7.) The defendants opined that through the exercise of ancillary jurisdiction KPMG could be held liable "on state law tort claims" or under *Bivens v. Six Unknown Fed. Narcotics Agents*, 403 U.S. 388 (1971). *Id.* at 7, 8 n.6.

As noted above, KPMG played no role in the Motion until this Court's Order of April 12, 2006, which authorized issuance of a non-party subpoena to KPMG. That Order stated that "limited discovery and an evidentiary hearing are appropriate for the proper resolution of this aspect of the motions" and that the "issues for consideration" would be "whether the government, through the Thompson memorandum or otherwise, affected KPMG's determination(s) with respect to the advancement of legal fees and other defense costs to present or former partners and employees with respect to the investigation and prosecution of this case and such subsidiary issues as relate thereto." (Mem. and Or. 1-2 (April 12, 2006).) In furtherance of that purpose, the Order provided: "Defendants may serve a Rule 17(c) subpoena

on KPMG seeking production, on or before April 21, 2006, of documents described in Section B [of an attachment to defendants' April 5 letter to the Court], although this order is without prejudice to any objections that KPMG may interpose." (*Id.* at 3.)

On April 17, this Court issued an order authorizing issuance of the defendants' proposed Rule 17(c) subpoena. (Or. 1 (April 17, 2006).) The order directed that "KPMG shall make any objections as quickly as possible." On April 20, counsel for KPMG submitted objections to the subpoenas, a request for modification of the subpoenas, and a proposed protective order. Counsel made clear that KPMG was responding solely to a "non-party subpoena issued pursuant to Federal Rule of Criminal Procedure 17(c)." (Letter from Carl S. Rauh to the Honorable Lewis A. Kaplan of 4/20/06, at 1.) On April 21, 2006, KPMG produced documents in response to the subpoena and counsel for KPMG specifically identified KPMG as a "non-party." (Letter from Carl S. Rauh to the Honorable Lewis A. Kaplan of 4/21/06, at 1.)

KPMG completed its document production along with a privilege log over the next ten days. In each letter responding to the Rule 17(c) subpoena, counsel for KPMG referred to KPMG as a "non-party." (*See* Letter from Carl S. Rauh to the Honorable Lewis A. Kaplan of 4/21/06; Letter from Joseph L. Barloon to the Honorable Lewis A. Kaplan of 4/24/06; Letter from Joseph L. Barloon to the Honorable Lewis A. Kaplan of 4/27/06; Letter from Carl S. Rauh to the Honorable Lewis A. Kaplan of 4/28/06; Letter from Joseph L. Barloon to the Honorable Lewis A. Kaplan of 5/1/06.)

On May 8-10, 2006, this Court held a hearing at which KPMG's General Counsel testified, pursuant to a subpoena, along with several other witnesses. Although counsel for KPMG was present during the hearing to raise any objections on behalf of non-party KPMG, defendants never served KPMG with or provided notice of specific claims against the firm, and KPMG was not offered an opportunity to call or question witnesses, did not receive copies of exhibits, and was not consulted regarding in-court stipulations among the parties. On May 10, only after counsel for the parties summarized the factual testimony developed during the previous two days, this Court asked counsel for KPMG, who was present in the courtroom, to approach the bench. During the ensuing discussion, while noting that KPMG was "not a party here" (Hrg. Tr. 430:1 (May 8-10, 2006)), the Court apprised counsel that "a remedy is being sought against your client" and "[y]ou will have a chance to be heard on that if you want it." (*Id.* at 426:24-427:2.)

ANALYSIS

I. THERE IS NO FACTUAL BASIS UPON WHICH THE COURT CAN EXERCISE JURISDICTION OVER KPMG TO ORDER THE FIRM TO ADVANCE LEGAL COSTS TO ANY DEFENDANT.

A. The Facts Do Not Support The Exercise Of Ancillary Jurisdiction Over Any Potential Claims By Any Defendant Against KPMG.

As noted above, the defendants' Supplemental Memorandum raised, for the first time, the notion that the Court "may order KPMG to pay defendants' legal fees through the exercise of ancillary jurisdiction." Def. Suppl. Br. at 7. In support of this notion, the defendants cited *Garcia v. Teitler*, 443 F.3d 202 (2d Cir. 2006), which held that "resolving a fee dispute after an attorney withdraws following a *Curcio* hearing is within a district court's ancillary powers, as it relates to the court's ability to 'function successfully.'" *Id.* at 208, quoting *Kokkonen v. Guardian Life Ins. Co. of America*, 511 U.S. 375, 380, 114 S.Ct 1673, 1676 (1994). As set forth below, neither *Garcia* nor any other cases applying ancillary jurisdiction in a criminal matter supports exercise of such jurisdiction over any potential claims for payment of money by KPMG to any of the defendants in this criminal case.

1. The Purpose And Limits Of Ancillary Jurisdiction.

As *Garcia* notes, "ancillary jurisdiction is aimed at enabling a court to administer 'justice within the scope of its jurisdiction.'" *Id.* at 202. *Garcia* characterizes the "major purpose of ancillary jurisdiction" as to "insure that a judgment of a court is given full effect; ancillary orders will issue when a party's actions, either directly or indirectly, threaten to compromise the effect of the court's judgment." *Id.* (quoting *Morrow v. District of Columbia*, 417 F.2d 728, 740 (D.C. Cir. 1969)). To fulfill this purpose, as *Garcia* notes, "the Supreme Court has instructed that ancillary jurisdiction may be exercised 'for two separate, though sometimes related, purposes: (1) to permit disposition of claims that are, in varying respects and degrees, factually interdependent by a single court, and (2) to enable a court to function successfully, that is, to manage its proceedings, vindicate its authority, and effectuate its decrees.'" *Id.* at 208 (quoting *Kokkonen*, 511 U.S. at 379-80, 114 S.Ct. at 1676). The party asking a court to assert ancillary jurisdiction over another claim bears the burden of establishing that the claim is amenable to inclusion under ancillary jurisdiction; indeed, the presumption is that ancillary jurisdiction will not lie for such claims. *Kokkonen*, 511 U.S. at 377, 114 S. Ct. at 1675 (1994) (internal citations omitted).

Furthermore, the Constitutional requirement that a federal court hear only "cases and controversies" limits application of ancillary jurisdiction to matters involving the same common nucleus of operative fact as the claim that conferred the original jurisdiction on the trial court. *City of Chicago v. Int'l Coll of Surgeons*, 522 U.S. 156, 164-65, 118 S. Ct. 523, 529 (1997); *see also Peacock v. Thomas*, 516 U.S. 349, 358-59, 116 S.Ct. 862, 869 (1996) (reversing exercise of ancillary jurisdiction because the ancillary claims "all involved new theories of liability not asserted in the ERISA suit" that conferred original jurisdiction).

In criminal cases, courts have exercised ancillary jurisdiction in circumstances where the defendant seeks to have his arrest record expunged following dismissal of an indictment, or a defendant files a post-conviction motion for the return of seized property. *See Garcia*, 443 F.3d at 207 and cases cited therein. In addition, under certain circumstances, as explained in *Garcia*, courts have exercised ancillary jurisdiction over fee disputes during an ongoing criminal case "to avoid the possibility of defendants becoming indigent and requiring the appointment of counsel." *Id.* at 209.

For a number of reasons, this case is clearly distinguishable from cases in which the court chose to exercise ancillary jurisdiction over a claim relating to payment of attorney's fees. First, the defendants in this case either never had any of their legal fees paid by KPMG, had their fees cut off more than a year ago, or had their fees cut off when they were indicted, some 6 to 8 months ago. In fact, with the exception of defendant Stein, each of the potential claimants here was informed more than 26 months ago that their fees would not continue to be paid if: they did not cooperate with the investigation; their fees reached $400,000; or they were indicted. Mr. Stein himself was informed over a year ago that KPMG had ceased payment of fees and was informed of the basis for that action. Second, although they were informed more than two years ago of KPMG's fees-advancement policy determination for this criminal case, none of the defendants has filed a claim against KPMG seeking payment of legal fees, with the exception of Carl Hasting, who filed a claim in September 2005 based solely upon a California labor statute. That claim was referred by the court to arbitration, and the parties are currently engaged in active litigation of the claim before an arbitration panel. Third, as that case shows, any claim by a defendant would be subject to the mandatory arbitration provision of the KPMG Partnership Agreement. Fourth, resolution of any claim would require a full factual record.

Fifth, asserting jurisdiction over potential claims by defendants against KPMG is not necessary "to enable [the] Court to manage its proceedings," *id.* at 208, and exercise of such jurisdiction would run afoul of the constitutional limits of the ancillary jurisdiction doctrine.

2. **Garcia *And* Weissman.**

As explained in Judge Gleeson's memorandum opinion, *Garcia v. Teitler*, No. 04 CV 832 (JG), 2004 WL 1636982 (E.D.N.Y., July 22, 2004), upon which the Second Circuit heavily relied, *Garcia* involved a claim by two criminal defendants that their former defense attorney wrongfully withheld their retainer after he was fired. Garcia and his co-defendant hired Stanley A. Teitler after they had been arrested on drug charges. Teitler persuaded the co-defendants to allow him to represent them both and pay him a $40,000 retainer. Teitler represented them at a status conference and at their arraignment and he negotiated bail terms. Teitler and his clients then appeared at a *Curcio* hearing, after which Judge Gleeson determined that Teitler could not represent both defendants. Within days of the hearing, Teitler was fired by both clients, who asked that he return the retainer. Teitler then prepared a time statement to justify keeping the $40,000 retainer and sought $27,250 in additional fees. *Id.* at *1-4; *Garcia*, 443 F.3d at 205-06.

Garcia's new defense counsel asked Judge Gleeson to schedule an evidentiary hearing to determine whether the retainer paid to Teitler should be returned. *Garcia*, 2004 WL 1636982, at *1. Under New York law, an attorney dismissed by a client for cause is not entitled to fees. *Garcia*, 443 F.3d at 211. Accordingly, the only question the court had to determine at the hearing, and the only question it decided, was whether Teitler had been dismissed for cause. After hearing testimony from several witnesses, including Teitler and his former clients, Judge Gleeson determined that Teitler's "efforts to account for his work" were "fraudulent," a "fabrication" and a "crude attempt to justify the retention of funds Teitler has not earned." *Garcia*, 2004 WL 163982, at *4, *7. The court found that Teitler was "dismissed by both of his clients for cause," and "[t]hus, he is not entitled to any fee." *Id.* at *7. Accordingly, he ordered Teitler to return his former clients' money to them.

In explaining why he exercised ancillary jurisdiction over the fee dispute, Judge Gleeson stated that he relied upon the following "four factors":

> (1) my familiarity with the subject matter of the criminal case and the work performed by Teitler in that case; (2) my responsibility to protect officers of the court and their clients in such matters; (3) the convenience to the parties of litigating in federal court as opposed to state court; and (4) considerations of judicial economy.

Id. at *4 (citing *Cluett, Peabody & Co. v. CPC Acquisition Co.*, 863 F.2d 251, 256 (2d Cir. 1998)). Judge Gleeson also noted the "need for a swift resolution of this matter in light of the fact that the plaintiffs here may need any funds wrongfully withheld by Teitler to pay their new attorneys in their criminal case." *Id.* at *5.

On appeal, the Second Circuit held that "that resolving a fee dispute after an attorney withdraws following a *Curcio* hearing is within a district court's ancillary powers, as it relates to the court's ability to 'function successfully.'" *Garcia*, 443 F.3d at 208. The Court of Appeals reached this narrow holding because the "genesis of the present dispute was a *Curcio* hearing, which is itself ancillary to the underlying criminal action." *Id.* at 209. The Court's language makes clear the narrowness of its holding in the case, which required only a simple determination whether a lawyer who had appeared several times before the district court in a criminal proceeding had been dismissed for cause by the defendants in that proceeding.

Garcia cites the limited holding of an unpublished decision by Judge Haight, *United States v. Weissman*, No. 94-CR-760, 1997 WL 334966 (S.D.N.Y. June 16, 1997), with

regard to "exercising ancillary jurisdiction to decide whether, under an indemnity agreement, a company was required to continue to advance funds for defendant's legal proceedings as 'resolution of [the] dispute might impact . . . the conduct of the matter that gives rise to the court's original jurisdiction.'" *Garcia*, 443 F.3d at 209-10. *Weissman*, the only case of which we are aware in which a judge has exercised ancillary jurisdiction over a non-party employer in a fee dispute relating to a criminal matter, presented several unique facts.

Weissman was chief financial officer of Empire Blue Cross/Blue Shield, whose by-laws explicitly required Empire to indemnify its employees and to advance their expenses, including reasonable attorneys' fees, until an adverse "judgment or other final adjudication." *Weissman*, 1997 WL 334966, at *1. Empire had advanced Weissman's expenses during a four-year criminal investigation and subsequent trial, but ceased all payments immediately upon Weissman's conviction by a jury and before he was sentenced. Weissman then asked Judge Haight to compel Empire to "continue to advance the fees necessary for his defense" during sentencing and to pay past-due fees pending a final adjudication of his case. Empire resisted on the grounds that: (a) the court had no jurisdiction over it as a non-party; and (b) Empire was "no longer required to advance the funds which defendant requests" because his jury conviction terminated Empire's indemnification obligations under the by-laws. *Id.* at *1, *2.

The *Weissman* court decided to adjudicate Weissman's straightforward claim that Empire's cessation of fees contravened its by-laws provision because a conviction did not represent a "final adjudication." *See id.* at *9 ("the instant dispute boils down to a single question"). In choosing to decide this narrow issue, the Court noted the following: first, given Empire's prior advancement of funds for Weissman's defense and its negotiation of a discount from Weissman's counsel, Empire "cannot claim to be a stranger to the present proceedings." *Id.* Second, Empire's "actions in this regard may have an impact on the conduct of Weissman's defense, and on the Court's oversight of the case." *Id.* Third, the question of the "propriety of . . . indemnification has now been briefed." *Id.* at *7. Fourth, Empire had a clear obligation to advance legal fees to Weissman, and had done so throughout the proceeding and through trial.

3. Application Of The Law To The Facts Of This Case.

The relevant facts in this criminal action are fundamentally different from the situations presented by *Garcia* and *Weissman*.

None of the four factors that Judge Gleeson relied upon in deciding to exercise ancillary jurisdiction in *Garcia* are present here. First, Judge Gleeson was familiar with the "work performed by Teitler," which was the basis of the claim before him – that Teitler was dismissed for cause. Here, little or no evidence has been put before the Court relating to the factual basis of any potential claims by defendants for payment of legal fees by KPMG. Second, exercise of ancillary jurisdiction in *Garcia* was necessary for Judge Gleeson to exercise his "responsibility to protect officers of the court and their clients." No such concerns are implicated here. Third, Judge Gleeson determined that the "conveniences to the parties of litigating in federal court as opposed to state court" weighed in favor of exercising jurisdiction over Garcia's claim. Here, the former KPMG partners and KPMG have agreed to adjudicate any claims the former partners could file in an arbitration proceeding.

Fourth, Judge Gleeson determined that "considerations of judicial economy" favored resolution of the claim by Judge Gleeson rather than in a separate proceeding. Here, by contrast, resolution of potential claims against KPMG by 11 or more defendants based on various inchoate theories, as well as the counterclaims by KPMG for the former partners' breach of fiduciary duty and the offset claims by KPMG against the defendants arising out of their own

misconduct, could take many months to resolve. Resolution of the claims, counter-claims, and offset claims would therefore necessitate delay of the criminal trial for all defendants, whether they had any potential claim against KPMG or not. Finally, the sole issue to be decided in the ancillary proceeding – whether Teitler was dismissed "for cause" – was straightforward and clearly related to the Court's ability to "function successfully, that is, to manage its proceedings, vindicate its authority, and effectuate its decrees." *Garcia*, 443 F.3d at 208. By contrast, the potential claims against KPMG by defendants here (whether based on *Bivens*, New York state tort law, or contract law) are neither straightforward nor related to the Court's ability to vindicate its authority.

The factors that Judge Haight relied upon in *Weissman* are also not present here. First, unlike in *Weissman*, defendants have not moved for relief against KPMG and instead merely mentioned it in passing in a post-motion brief. Second, there are no by-laws or partnership agreements obliging KPMG to indemnify or advance fees. Accordingly, the question *Weissman* addressed -- whether to assert jurisdiction over an employer "bound by agreement" to indemnify one of the parties to the litigation -- is not present here. Third, Empire cut off fees after the jury verdict but before sentencing. Here, by contrast, KPMG ceased the advancement of legal fees to the 11 defendants upon their indictment or earlier, and informed all potential claimants except Stein more than 26 months ago that it would advance fees only subject to certain conditions. Each was told that no fees would be advanced if criminal charges were filed. (Similarly, KPMG informed Mr. Stein that it would cease payment of fees to him more than a year ago.) As such, the disruption and potential delay caused by the cessation of fee advancement contemplated in *Weissman* is not present here. Fourth, unlike Empire, which filed a declaratory judgment motion seeking an order that it had no obligation to advance any further fees to Weissman's counsel, KPMG has been treated throughout this proceeding as a witness and has been given no opportunity to present evidence on this point, no opportunity to cross-examine witnesses, and has in no way addressed the merits of any claim by any party regarding advancement of fees. Fifth, there was no provision mandating arbitration of Weissman's claim.

Finally, we are aware of no cases that have followed *Weissman* in asserting ancillary jurisdiction over a non-party employer. To the contrary, the courts that have considered *Weissman* have declined to follow its reasoning and limited it to its precise factual circumstances.

Most instructive on this point is *United States v. Polishan*, 19 F. Supp. 2d 327 (M.D. Pa. 1998). In *Polishan*, the indicted defendant's former employer, Leslie Fay, was required under its by-laws to advance defense costs, but (after Leslie Fay's bankruptcy) its insurer stopped doing so during the course of the criminal proceeding. Polishan then sought an order directing the company's insurer either to advance his defense costs directly or to reimburse Leslie Fay for its advancement. *Id.* at 329. Neither Leslie Fay nor the insurer was a party to the *Polishan* criminal case.

After considering the Supreme Court's limitations on ancillary jurisdiction, the *Polishan* court declined to assert ancillary jurisdiction over Leslie Fay or its insurer with respect to the advancement of fees dispute. It found that there was no "common nucleus of operative fact" between the criminal accusations against Polishan and the issues relating to Leslie Fay's by-laws or the policy insuring the company. *Id.* at 332. Although there was admittedly a "peripheral" relationship because the pending criminal case generated the fees for which Polishan sought payment, the court held that the "alleged criminal conduct is separate and distinct from Polishan's state law claims against Leslie Fay" and its insurer. *Id.*

The *Polishan* court noted that the "only support" for the defendant's claim to ancillary jurisdiction over non-parties was *Weissman*, whose reasoning the court found "not persuasive." *Id.* at 333. First, the *Polishan* court criticized *Weissman* for looking to civil cases instead of criminal cases for guidance

> I believe that resort to *civil* cases for purposes of delineating the contours of ancillary jurisdiction in a criminal case is unsound. Federal criminal cases involve an action by the United States against a private citizen for allegedly unlawful acts. Unlike the civil arena, there is no room for cross claims, counterclaims, third party action, or wide-ranging discovery.

Id. (emphasis in original). But the "major flaw" in the *Weissman* decision was the failure to "address the constitutional limitations of ancillary jurisdiction." *Id.* The *Polishan* court emphasized that it is necessary to determine whether there is "a common nucleus of operative facts, court control over property, or the presence of parties to a fee dispute" to ensure that "federal judicial power is exercised only in a case or controversy within a federal court's limited subject matter jurisdiction." *Id.* The court also emphatically rejected the notion that ancillary jurisdiction could rest on the theory that a non-party's failure to advance fees impairs the ability to defend the criminal case. Noting that inability to afford counsel and experts of one's choice in a criminal case is not uncommon, the court stated: "The fortuity of a potential third-party source for payment of fees here does not justify interrupting the progress of this matter to adjudicate a collateral controversy." *Id.* at 334. As the Court found, Polishan retained the right to seek court-appointed counsel and also retained any remedies he might have vis-a-vis the non-party insurer. *Id.*[3]

[3] In *United States v. Buhler*, 278 F.2d 1297 (M.D. Fla. 2003), the court likewise distinguished and declined to follow *Weissman*. 278 F.3d at 1299-1300. The *Buhler* court noted that the property in dispute was not before the court and that the defendant "will not be without remedies if the Court declines to intervene." *Id.* Similarly, in *Fermin v. Moriarty*, No. 96-Civ-3022, 2003 WL 21787351, at *7 (S.D.N.Y. Aug. 4, 2003), *(cont'd)*

* * * *

In sum, to assert jurisdiction here over potential claims of 11 or more defendants – each of whom presents unique factual circumstances and each of whom signed an agreement mandating arbitration for all claims against KPMG – would be an unprecedented and unwarranted extension of the ancillary jurisdiction doctrine. Whatever claims the various defendants may wish to assert against KPMG, they cannot satisfy their burden of demonstrating that their contentions are "factually interdependent" with the tax fraud charges before the Court or that the resolution of any such claims is necessary to enable the Court to "manage its proceedings, vindicate its authority, and effectuate its decrees." *Garcia*, 443 F.3d at 208. Finally, the exercise of jurisdiction over these potential claims would go well beyond the "constitutional limitations of ancillary jurisdiction." *Polishan*, 19 F. Supp.2d at 333.

B. The Filing Of A *Pro Hac Vice* Motion By An Attorney For A Non-Party Witness Does Not Confer Jurisdiction Over The Client.

During the May 8-10, 2006 hearing, this Court raised the possibility that KPMG's counsel's motion for admission *pro hac vice* might give the Court jurisdiction over KPMG that it otherwise did not have. Such is not the case. First, counsel for KPMG has not taken any action that would waive KPMG's right to assert lack of personal jurisdiction as a defense should the Court actually consider making KPMG a party to this proceeding. Second, counsel for KPMG explicitly limited his appearance before this Court to KPMG's role as a non-party witness responding to defendants' Rule 17(c) subpoenas and to orders entered by the Court relating to KPMG's role as a non-party witness. Third, the Court has recognized that KPMG is not a party to this criminal proceeding. (Hrg. Tr. 430:1 (May 8-10, 2006).) For these reasons, as more fully

(cont'd from previous page)
Judge Mukasey declined to assert ancillary jurisdiction in a fee dispute between a criminal defendant and his counsel.

explained below, KPMG has not submitted to the jurisdiction of this Court, nor have any objections to personal jurisdiction over KPMG been waived.[4]

1. Counsel's Filing Of A **Pro Hac Vice** *Motion Does Not Alter The Non-Party Status Of The Witness-Client Nor Waive The Jurisdictional Objections Of The Witness-Client.*

The motion of KPMG's counsel for admission *pro hac vice* on behalf of "non-party KPMG LLP" did not waive any objection to this Court's exercise of personal jurisdiction over KPMG. To the extent that the proceeding before the Court is being viewed as defendants' effort to perfect a civil monetary claim against KPMG, the Federal Rules of Civil Procedure require a litigant to challenge personal jurisdiction at the time the litigant "makes his first *significant* defensive move." *Transaero, Inc. v. La Fuerza Aerea Boliviana*, 162 F.3d 724, 730 (2d Cir. 1998) (emphasis added) (quoting 5A Charles Alan Wright & Arthur R. Miller, Federal Practice and Procedure § 1391 (1990)); *see also* Fed. R. Civ. P. 12.[5] Counsel for KPMG has made no moves, defensive or otherwise, warranting a finding that KPMG cannot now challenge this Court's jurisdiction over it. As several courts have held, "counsels' filing of initial appearances or motions for admission *pro hac vice* are not the defensive moves in which a waiver of personal jurisdiction can occur." *Springer v. Balough*, 96 F. Supp. 2d 1250, 1256 (N.D. Okla. 2000); *accord United States v. 51 Pieces of Real Property*, 17 F.3d 1306, 1314 (10th Cir. 1994) (stating that defendant's "initial appearance and motion for extension of time in which to file a claim were not defensive moves"); *Flock v. Scripto-Tokai Corp.*, No. Civ.A.H-00-3794, 2001 WL 34111630, at *4 (S.D. Tex. July 23, 2001) (holding that motion for *pro hac vice* admission "cannot be construed as an affirmative action that impliedly recognizes this court's jurisdiction over the foreign defendants").

Thus, KPMG's counsel has not done anything whatsoever that could waive KPMG's jurisdictional objections. Indeed, as the Seventh Circuit has noted, "admission *pro hac vice* is a formality, so long as the courts of some jurisdiction have approved the attorney as having the requisite skill and integrity to practice law." *Cole v. United States*, 162 F.3d 957, 958 (7th Cir. 1998). It relates not to the Court's jurisdiction over the attorney's client, but to the Court's authority and responsibility to manage its proceedings and the officers that appear before it. *See In re Starr*, 986 F. Supp. 1144, 1150-51 (E.D. Ark. 1997) (noting local rules relating to admission *pro hac vice* stem from court's inherent power to "control admission to its bar and discipline attorneys who appear before it."). As in *Flock*, counsel's request for admission *pro hac vice* "differs from situations where defendants contesting service actively defend the action, request affirmative relief, or participate in discovery." *Flock*, 2001 WL 34111630, at *4. In its limited role representing KPMG in this proceeding as a non-party witness, counsel has done nothing more than address issues relating to a non-party subpoena, which included filing and responding to filings regarding document subpoena issues and producing documents to facilitate the discovery process for the parties. (*See* Rauh Decl. ¶¶7-9.) (Exh. A.) Consistent with *Flock*, *Spinger*, and *51 Pieces of Real Property*, counsel's motion for admission *pro hac vice* cannot be construed to waive anything.

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4 Indeed, the only court to exercise jurisdiction over a non-party payor of legal fees, *Weissman*, specifically concluded that the party did not insert itself into the present proceedings "by reviewing the defense's litigation strategy, monitoring defense preparation of witnesses, observing the trial, *and moving to quash subpoenas*. I do not believe that a non-party subjects itself to the jurisdiction of a court merely because . . . it seeks the court's aid in other collateral matters." 1997 WL 334966, at *5 n.4 (emphasis added). Rather, it was "the fact that *Empire's actions may impact on the conduct of the proceedings*" that was determinative of the jurisdictional question. *Id.* (emphasis added).

5 A defendant's obligation to object on jurisdictional grounds is triggered by formal notice of the action against it. A non-party has no reason to object to jurisdiction. Aside from Mr. Hasting, no defendants have filed or served a complaint naming KPMG as defendant. Indeed, as explained below, because each relevant defendant entered into binding arbitration agreements with KPMG with respect to all claims between them, they are precluded from filing a complaint against KPMG. *See Hasting v. KPMG*, No. BC340378, slip op. (Cal. Feb. 8, 2006) (staying Hasting's state action and granting KPMG's petition to arbitrate claim that KPMG is required under state law to indemnify Hasting's attorney's fees in criminal matter) (attached).

2. ***The Conduct Of Counsel For KPMG In This Proceeding Was At All Times Consistent With KPMG's Limited Role As A Non-Party Witness And Nothing More.***

KPMG's counsel's actions in this proceeding began and ended with addressing defendants' Rule 17(c) subpoenas for the production of certain documents. In its April 12, 2006 Order, the Court permitted defendants to serve Rule 17(c) subpoenas on KPMG, and specifically stated its order was "without prejudice to any objections that KPMG may interpose." (Mem. and Or. 3 (April 12, 2006).) Upon issuing the subpoenas in its April 17 Order, the Court directed that KPMG "shall make any objections [to the Rule 17(c) subpoenas] as quickly as possible." (Or. 1 (April 17, 2006).) In response to the Court's invitation for objections, counsel to KPMG submitted a filing stating KPMG's objections to the "non-party subpoena," moving to quash paragraph six of the subpoena, and seeking permission to produce certain documents under a protective order. (*See* Letter from Carl S. Rauh to the Honorable Lewis A. Kaplan of 4/20/06.) Shortly thereafter, counsel for KPMG asked the Court for admission *pro hac vice*. (Rauh Decl. ¶8.)

In this motion, counsel specifically emphasized that his appearance was on behalf of "non-party KPMG" and that admission was sought "for the limited purpose of responding to Federal Rule of Criminal Procedure 17(c) subpoenas issued by this Court in the above captioned matter, and for any purposes relating to this matter that the Court may so order." The phrase "and for any purposes relating to this matter that the Court may so order" must be read to refer to any order of the Court relating to KPMG's role as a non-party witness. Such orders would include appearing at the telephonic hearing on May 5, 2006 regarding two defense motions pertaining to the Rule 17(c) subpoenas, and complying with the Court's May 8, 2006 Order requiring additional production under the Rule 17(c) subpoenas. Counsel's motion did not seek to enter an appearance in order to address or seek relief on the merits of the matter before the Court. Counsel's motion was straightforward, limited to the issue at hand, and not intended to enter an appearance on behalf of a party or to waive any objection to the Court treating KPMG as a party. (*See id.* at ¶¶9-11.)

After providing the Court with its objections to the Rule 17(c) subpoenas, KPMG produced documents responsive to the subpoenas on May 3. (*See* Letter from Carl S. Rauh to the Honorable Lewis A. Kaplan of 5/3/06.) Subsequently, KPMG was called upon to respond to issues relating to the Rule 17(c) subpoenas: defendants' motions to compel production of the unredacted portions of two documents and to eliminate the confidential designation of certain attorney notes and memoranda. On May 5, the Court's chambers contacted counsel for KPMG with respect to counsel's presence at a telephonic hearing to address these two motions by defendants. Counsel complied, and appeared and argued with respect to these issues. In addition, on May 8, the court issued an order directing KPMG to produce additional portions of two documents, and counsel again complied. Thus, the full extent of counsel's conduct in this proceeding was and is consistent with the status of KPMG as a non-party witness responding to the issues related to the Rule 17(c) subpoenas. None of these actions could conceivably convert KPMG from a witness to a party.

KPMG is aware of no authority where a non-party witness has been held subject to the court's jurisdiction through counsel's motion to appear *pro hac vice* to address a non-party subpoena and took no action to address the merits in the underlying action. KPMG has not sought to intervene or otherwise take part in this action on the merits; nor has it acted as if it were a party. It has made no arguments concerning defendants' pending motion to dismiss nor has it sought any relief with respect to the merits of this proceeding. Nothing in counsel's motion

for admission *pro hac vice*, or any other action taken by KPMG's counsel in responding to defendants' Rule 17(c) subpoenas, provides a basis for the Court to convert KPMG into a party against whom a remedy could be ordered.[6]

II. ANY PURPORTED CLAIM AGAINST KPMG BY ANY OF THE DEFENDANTS IS SUBJECT TO THE MANDATORY ARBITRATION PROVISION OF THE KPMG PARTNERSHIP AGREEMENT AND MUST BE ADJUDICATED PURSUANT TO THAT PROVISION.

Any claim by a defendant seeking to have KPMG pay his or her legal fees is subject to the mandatory arbitration provision in KPMG's Partnership Agreement and cannot, therefore, be adjudicated by this Court. Every defendant who has asked KPMG to pay some or all of his legal costs for the criminal matter is a former partner or principal of KPMG, and each of them signed KPMG's Partnership Agreement.[7] Section 17 of the Partnership Agreement provides that any claim by a KPMG partner or principal "shall be submitted for resolution by arbitration":

> Any dispute between the Firm and any Member or Separated Member or between or among Members or Separated Members arising out of or relating to the Firm or the accounts or transactions thereof or the dissolution or winding up thereof, the construction, meaning or effect of any provision of this Agreement, or the rights or liabilities of a Member or Separated Member or such Member's or Separated Member's representatives ("Disputes"), shall be submitted for resolution by arbitration in accordance with the procedures set forth in this Section 17. All arbitrations hereunder shall be held either in the State and City of New York or in Wilmington, Delaware.

(KPMG17(c)-0247.)[8]

Where parties have agreed to resolve issues by arbitration, their respective rights and responsibilities are governed by the Federal Arbitration Act, codified at 9 U.S.C. §§ 1-16 ("FAA"). *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24-25, 103 S. Ct. 927, 941 (1983). The FAA embodies a "liberal federal policy favoring arbitration agreements." *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 25, 111 S.Ct. 1647, 1651 (1991) (internal quotation marks omitted). As a result, "*any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration*, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability." *Moses H. Cone Mem'l Hosp.*, 460 U.S. at 24-25, 103 S. Ct. at 941 (emphasis added). Thus, for example, any concerns that a contract with an arbitration provision is void or voidable must be consigned to arbitration in the first instance. *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. ___, 126 S.Ct. 1204, 1209 (2006). Indeed, "the existence of a broad agreement to arbitrate creates a presumption of arbitrability." *WorldCrisa Corp. v. Armstrong*, 129 F.3d 71, 74 (2d Cir. 1997) (internal quotation marks omitted).

Given the foregoing presumption, any claim by the defendants against KPMG is subject to arbitration, provided that (i) the "parties agreed to arbitrate," and (ii) "scope of [that] agreement encompasses the claims" at issue. *Bank Julius Baer & Co., Ltd. v. Waxfield Ltd.*, 424 F.3d 278, 281 (2d Cir. 2005) (internal quotation marks omitted). As noted above, each defendant

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6 This is quite different from situations where an entity becomes a "*de facto* intervenor" by voluntarily coming into court to seek relief on the merits of a matter. For example, in *TWA, Inc. v. Mattox*, the Fifth Circuit held that thirty-three state attorneys general became *de facto* intervenors when they filed a motion to dismiss on the merits and participated in the temporary restraining order hearing. 897 F.2d 773, 786 (5th Cir. 1990), *overruled on other grounds, Morales v. TWA, Inc.*, 504 U.S. 374 (1992). According to the Fifth Circuit, "[a]t that point it was irrelevant that the thirty-three attorneys general had not been sued or served; *they chose to take part in the pending action as if they were parties*." *Mattox*, 897 F.2d at 786-87 (emphasis added). The court emphasized that its holding was grounded on two key points. First, that the attorneys general "sought affirmative relief." *Id.* at 786. Second, that "they came voluntarily into court" when they were not required to do so. *Id.* at 787. No such facts exist here.

7 Both "partners" and "principals" (*i.e.*, non-accountant Members of KPMG LLP), are bound by the terms of the Partnership Agreement that they signed. (*See* KPMG17(c)-0227 (§ 1.41).)

8 Paragraph 24 of the Stein Severance Agreement states as follows: "Any dispute arising under this Agreement shall be resolved in accordance with the provisions of Section 17 of the Partnership Agreement, which provisions hereby are incorporated herein by reference."

seeking payment of legal fees signed the Partnership Agreement, which mandates that any dispute between a member and the firm "arising out of or relating to the Firm . . . shall be submitted for resolution by arbitration." The Supreme Court and appellate courts have consistently found arbitration provisions that include language such as the phrase "arising out of or relating to" to be broad and all-encompassing. *See Long v. Silver*, 248 F.3d 309, 316 (4th Cir. 2001) (citing *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 398, 87 S.Ct. 1801, 1803 (1967)). In addition, by defining the scope of issues subject to arbitration with the words "any dispute . . . relating to . . . the construction, meaning or effect of any provision of this Agreement," the Partnership Agreement confers the threshold issue of arbitrability to an arbitrator. *See PaineWebber Inc. v. Bybyk*, 81 F.3d 1193, 1199 (2d Cir. 1996); *cf. Bradford Scott-Data Corp. v. Physician Computer Network, Inc.*, 136 F.3d 1156, 1157-58 (7th Cir. 1998) (contrasting narrowness of provision requiring arbitration of "any payment dispute" with expansive "arising out of or relating to" language). Consequently, the defendants cannot advance a claim or theory here that would fall outside the scope of the arbitration provision in KPMG's Partnership Agreement.

Indeed, in the only case to date in which a defendant has filed any claim against KPMG seeking payment of legal fees, the court held that the claim was subject to the Partnership Agreement's mandatory arbitration provision. Specifically, in September 2005, defendant Carl Hasting filed a complaint in California state court asserting that KPMG was obligated to pay his legal fees in this criminal matter and seeking injunctive relief. That court concluded that the scope of the arbitration provision in KPMG's Partnership Agreement was "broad" and "encompassing" and included Mr. Hasting's claim that KPMG was obligated to advance legal fees for Mr. Hasting's defense in this criminal action. The court accordingly ordered that "[t]his entire action [be] stayed pending arbitration."[9] *Hasting v. KPMG*, No. BC 340378, slip op. at 15 (Sup. Ct. Cal. Feb. 08, 2006) (unpublished) (attached).

In light of the foregoing, defendants' suggestion that the Court could order KPMG to advance or pay their legal expenses must be rejected because such claims "shall be submitted for resolution by arbitration" and therefore are outside the jurisdiction of this Court. The defendants here should not be allowed to circumvent the mandatory arbitration clause – and established precedent on this precise issue – by asking the Court in this criminal matter to order relief for them against a non-party without allowing that non-party the benefit of the mandatory arbitration provision agreed to by the defendants.[10]

III. ANY CLAIM AGAINST KPMG FOR ADVANCEMENT OF LEGAL FEES WOULD REQUIRE PROVIDING KPMG CONSTITUTIONAL PROTECTIONS, INCLUDING A FULL PROCESS TO DEVELOP A FACTUAL RECORD.

A. To Order KPMG To Advance Legal Fees Without Affording It Due Process Would Violate The United States Constitution.

To the extent any defendant requests a remedy from the Court that would impose upon KPMG responsibility to pay all or part of his or her legal fees in this action, such an order would be constitutionally infirm. The procedural safeguards for civil litigants enshrined in the

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9 Mr. Hasting and KPMG have proceeded with discovery in the arbitration proceeding. The parties recently exchanged requests for documents and other discovery, which are necessary to develop a factual record that would enable the arbitrators to adjudicate Mr. Hasting's claims.

10 In the event this Court were to disregard the mandatory arbitration clause and determine to hear defendants' claims, the factual issues underlying those claims would have to be tried to a jury. *See GTFM, LLC. v. TKN Sales, Inc.*, 257 F.3d 235, 244-45 (2d Cir. 2001) (finding that, if breach of contract claim did not fall within arbitrator's jurisdiction, the defendant would enjoy right to jury trial in federal court). The Seventh Amendment provides that "[i]n Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved." U.S. CONST. amend. VII. Contract and tort claims, such as those postulated by the defendants, fall within the Seventh Amendment's ambit. *Germain v. Conn. Nat'l Bank*, 988 F.2d 1323, 1328-29 (2d Cir. 1993). Consequently, if an arbitrator is not permitted to resolve the defendants' claims against KPMG, as the Partnership Agreement requires, KPMG is entitled to have its liability to defendants for legal fees determined by a jury.

Constitution create insurmountable barriers to any resolution of defendants' purported remedy against KPMG by this Court. The Supreme Court has held that a court could not amend a judgment to hold a sole shareholder, who was not a party to the initial suit, liable to pay a judgment of attorney's fees imposed on the shareholder's corporation. "Judicial predictions about the outcome of hypothesized litigation cannot substitute for the actual opportunity to defend that due process affords every party against whom a claim is stated." *Nelson v. Adams USA, Inc.*, 529 U.S. 460, 471, 120 S. Ct. 1579, 1587 (2000).

The Due Process Clause of the Fifth Amendment guarantees that "[n]o person shall . . . be deprived of life, liberty, or property, without due process of law." U.S. CONST. amend. V. The Supreme Court has consistently held that this protection ensures notice and an opportunity to be heard before a deprivation of property occurs. *See, e.g.*, *United States v. James Daniel Good Real Prop.*, 510 U.S. 43, 48, 114 S. Ct. 492, 498 (1993) (collecting cases). The "right to be heard before being condemned to suffer grievous loss of any kind, even though it may not involve the stigma and hardships of a criminal conviction, is a principle basic to our society." *Joint Anti-Fascist Comm. v. McGrath*, 341 U.S. 123, 168, 71 S. Ct. 624, 646-47 (1951) (Frankfurter, J., concurring). Fundamentally, what due process requires is the opportunity to be heard "at a meaningful time and in a meaningful manner." *Armstrong v. Manzo*, 380 U.S. 545, 552, 85 S. Ct. 1187, 1191 (1965).

Nelson involved resolution of a patent infringement claim by a company whose only shareholder was Nelson. The case was dismissed, and Nelson's company was ordered to pay the defendant's attorney's fees. Nelson's company had made it clear that it would be liquidated and would not have the resources to pay the attorney's fees. Accordingly, the defendant moved to add Nelson as a third-party defendant, and also "sought simultaneously an amended judgment, subjecting Nelson to liability as soon as he was made a party." 529 U.S. at 464, 120 S.Ct. at 1583. The district court granted the motion and altered the judgment. In upholding the trial court's decision, the Court of Appeals for the Federal Circuit reasoned that Nelson had not shown that "anything different or additional would have been done" to stave off the judgment had Nelson been a party, in his individual capacity, from the outset of the litigation." *Id.* at 465, 120 S.Ct. at 1583. A unanimous Supreme Court reversed, holding that the Due Process Clause requires that a prospective defendant be given adequate, formal notice of the legal and factual allegations against it, for "[b]eyond doubt, . . . a prospective party cannot fairly be required to answer [a] pleading not yet permitted, framed, and served," even where the prospective party already has knowledge of the litigation. *Id.* at 467, 120 S.Ct. at 1585. Here, of course, KPMG has never been given formal notice of the legal claims and factual allegations against it.

Moreover, a defendant must be afforded the opportunity to cross-examine witnesses against it. *See Guttman v. CFTC*, 197 F.3d 33, 38-39 (2d Cir. 1999) ("It is undisputed that denial of the opportunity to cross-examine a witness whose testimony forms the basis for adverse findings can constitute grounds for reversal."); *Gen. Signal Corp. v. MCI Telecomm. Corp.*, 66 F.3d 1500, 1508 (9th Cir. 1995) (noting severe limitations on or complete denial of cross-examination violates due process). Defendants' motion to dismiss presents the Court with an inadequate procedural context in which to properly protect these due process rights. Indeed, for the Court to hold KPMG liable to any defendant would offend even the minimum standards attendant to the entry of a default judgment; as such, any interest in a summary adjudication cannot outweigh KPMG's due process interest. The Second Circuit has repeatedly held that "[a] default judgment may be considered void if the judgment has been entered in a manner

inconsistent with due process of law." *State St. Bank & Trust Co. v. Inversiones Errazuriz Limitada*, 374 F.3d 158, 178 (2d Cir. 2004) (internal quotations omitted).

Here, although KPMG was afforded the opportunity to object to the defendants' Rule 17(c) subpoena, KPMG was never given formal notice of the defendants' specific substantive claims nor afforded the opportunity to develop evidence regarding the merits of such claims. *See Nelson*, 529 U.S. at 471, 120 S. Ct. at 1587 (holding that "the right to contest on the merits [defendant's liability] for fees . . . is just what due process affords . . . ."). Nor could those claims be addressed without factual discovery. In light of the foregoing, any order by the Court imposing any liability or imposing any restriction upon KPMG would offend well-established notions of procedural due process.

B. In Any Arbitration Proceeding, KPMG Would Have A Right To Develop Factual Evidence.

Although among the defendants only Carl Hasting has filed any claim against KPMG seeking payment of legal fees (and that claim was based solely on a California labor statute), the defendants in their April 27 supplemental memorandum suggested two theories in support of obtaining payment from KPMG: (i) imposing liability on the basis of "state law tort claims" for conspiring with the government to interfere with defendants' attorney-client relationships, (Def. Suppl. Br. at 7-8); and (ii) imposing liability under *Bivens*, to the extent that any KPMG official violated any defendant's constitutional rights under color of federal authority, (*id.* at 8 n.6.) In addition, defendant Jeff Stein has asserted an individualized breach of contract claim. (*See* Letter from David Spears to the Honorable Judge Kaplan of 4/5/06.) Finally, in its May 11 Order, the Court asked the government and the defendants "to address the question whether there was a contract implied in fact between KPMG and those defendants who were partners or employees of KPMG with respect to the advancement of or indemnification for legal fees and related expenses and the terms of any such contract." (Or. 1 (May 11, 2006).)

As KPMG is not a party to this action and has not been given an opportunity to develop a factual record that would be necessary to consider any of these theories, this memorandum does not address the merits of such theories. Further, as explained above, to the extent that any of the defendants wish to pursue such theories, he or she must do so in an arbitration proceeding. In any such arbitration proceeding, KPMG would have the right to develop (through discovery, testimony, and cross-examination) a complete factual record on a number of open issues, including the following:

KPMG has a right to develop a record to determine whether each individual potential claimant violated his or her own fiduciary duties to KPMG by engaging in wrongful or criminal conduct. Such evidence, which KPMG is pursuing in the Hasting arbitration proceeding, would be relevant to KPMG's potential counter-claims as well as potential offset claims against each individual to determine whether he or she engaged in fraudulent or otherwise wrongful conduct that was a proximate cause of the decision by the government to require a payment by KPMG of $456 million pursuant to the terms of its Deferred Prosecution Agreement.

KPMG has a right to develop a record showing the myriad different factual circumstances with respect to fees advancement for each defendant. KPMG should be able to present evidence regarding how much it paid for certain defendants, when and why it stopped paying for certain defendants, and other circumstances that would be relevant to determining whether it had or has any obligation to make any further payments to the potential claimants. It

would also be necessary to examine claimants as to their knowledge of and reliance upon any relevant voluntary past practice of KPMG with respect to advancement of legal fees.[11]

KPMG has a right to develop a record relevant to any potential claim asserting the existence of a contract implied in fact. Any such claim would require the development of evidence (including testimony from the defendants) regarding the course of conduct between KPMG and each claimant. Of course, any such claim would likely be foreclosed because the Partnership Agreement, which has an integration clause, sets forth all of the rights that a KPMG partner or principal can exercise.

KPMG has a right to submit evidence as to ten defendants showing that he or she signed a letter in which he or she agreed or acknowledged that KPMG had no obligation to pay any legal fees for the grand jury investigation.

KPMG has a right to develop a record with regard to various other defenses, including but not limited to statute of limitations, laches, and unclean hands.

KPMG has been given no opportunity to develop such a factual record here. In the absence of such a record, the Court cannot adjudicate potential claims by any of the defendants against KPMG.

CONCLUSION

For the foregoing reasons, non-party KPMG respectfully submits that the Court cannot exercise jurisdiction over KPMG so as to require KPMG to advance or pay legal costs for any defendants, or impose any other legal obligation upon KPMG.

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[11] *See Weissman*, 1997 WL 334966, at *3 (Weissman submitted affidavit claiming that he "would not have accepted the position of Chief Financial Officer if [] indemnification" had not been provided for in company's by-laws).

Dated: New York, New York
May 25, 2006

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STATE OF NEW YORK)
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CHARLES A. STILLMAN, being duly sworn, deposes and says that deponent is not a party to this action, is over 18 years of age and resides at 45 East 85th Street, Apt. 6B, New York, NY 10028, that on the 22nd day of May, 2006, attorneys for non-party KPMG served the within Memorandum to the following e-mail addresses designated by counsel for the purpose of receiving a copy of this Memorandum.

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Charles A. Stillman

Sworn to before me this
25th day of May, 2006

Notary Public

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Commission Expires July 14 2006

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK
----------x
UNITED STATES OF AMERICA,

-against-

S1 05 Crim. 0888 (LAK)

JEFFREY STEIN, et al.,

Defendants.
----------x

OPINION

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LEWIS A. KAPLAN, *District Judge.*

The issue now before the Court arises at an intersection of three principles of American law.

The first principle is that everyone accused of a crime is entitled to a fundamentally fair trial.[1] This is a central meaning of the Due Process Clause of the Constitution

The second principle, a corollary of the first, is that everyone charged with a crime is entitled to the assistance of a lawyer.[2] A defendant with the financial means has the right to hire the best lawyers money can buy. A poor defendant is guaranteed competent counsel at government expense.[3] This is at the heart of the Sixth Amendment.

The third principle is not so easily stated, not of constitutional dimension, and not so universal. But it too plays an important role in this case. It is simply this: an employer often must reimburse an employee for legal expenses when the employee is sued, or even charged with a crime, as a result of doing his or her job. Indeed, the employer often must advance legal expenses to an employee up front, although the employee sometimes must pay the employer back if the employee has been guilty of wrongdoing.

This third principle is not the stuff of television and movie drama. It does not remotely approach *Miranda* warnings in popular culture. But it is very much a part of American life. Persons in jobs big and small, private and public, rely on it every day. Bus drivers sued for accidents, cops sued for allegedly wrongful arrests, nurses named in malpractice cases, news reporters sued in libel cases, and corporate chieftains embroiled in securities litigation generally

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1 U.S. CONST. amend. V (Due Process Clause).

2 U.S. CONST. amend. VI.

3 *Gideon v. Wainwright*, 372 U.S. 335 (1963).

have similar rights to have their employers pay their legal expenses if they are sued as a result of their doing their jobs. This right is as much a part of the bargain between employer and employee as salary or wages.[4]

Most of the defendants in this case worked for KPMG, one of the world's largest accounting firms. KPMG long has paid for the legal defense of its personnel, regardless of the cost and regardless of whether its personnel were charged with crimes. The defendants who formerly worked for KPMG say that it is obligated to do so here. KPMG, however, has refused.

If that were all there were to the dispute, it would be a private matter between KPMG and its former personnel. But it is not all there is. These defendants[5] (the "KPMG Defendants") claim that KPMG has refused to advance defense costs to which the defendants are entitled because the government pressured KPMG to cut them off. The government, they say, thus violated their rights and threatens their right to a fair trial.

Having heard testimony from KPMG's general counsel, some of its outside lawyers, and government prosecutors, the Court concludes that the KPMG Defendants are right. KPMG refused to pay because the government held the proverbial gun to its head. Had that pressure not been brought to bear, KPMG would have paid these defendants' legal expenses.

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4 The existence of this right is not a product of charitable instincts. The law long has recognized that litigation can be expensive and that it could prove difficult to obtain the services of competent employees unless they are protected against the cost of lawsuits that arise out of the employers' business. *E.g., Homestore, Inc. v. Tafeen*, 888 A.2d 204, 218 (Del. 2005) (advancement of legal expenses "is actually a desirable underwriting of risk by the corporation in anticipation of greater corporate-wide rewards for its shareholders. The broader salient benefits that the public policy . . . seeks to accomplish . . . will only be achieved if the promissory terms of advancement contracts are enforced by courts even when corporate officials . . . are accused of serious misconduct") (internal quotation marks and footnote omitted).

5 All defendants previously employed by KPMG joined in the motion.

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.

Facts

The Thompson Memorandum

In June 1999, then-U.S. Deputy Attorney General Eric Holder issued a document entitled *Federal Prosecution of Corporations* (the "Holder Memorandum") to provide "guidance as to what factors should generally inform a prosecutor in making the decision whether to charge a corporation in a given case."[6] He took pains to make clear that the factors articulated in the memorandum were not "outcome-determinative" and that "[f]ederal prosecutors [we]re not required to reference these factors in a particular case, nor [we]re they required to document the weight they accorded specific factors in reaching their decision." Nevertheless, the language that plays a central role in the present controversy first was found in the Holder Memorandum.

The Holder Memorandum set forth some common sense considerations. Prosecutors, in deciding whether to indict a company, should pay attention to things like the nature and seriousness of the offense, the pervasiveness of wrongdoing within the entity, the company's efforts to remedy past misconduct, the adequacy of other remedies, and the like. It mentioned also:

> "the corporation's timely and voluntary disclosure of wrongdoing *and its willingness to cooperate in the investigation of its agents*, including, if necessary, the waiver of the corporate attorney-client and work product protection . . ."[7]

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6 http://www.usdoj.gov/criminal/fraud/policy/Chargingcorps.html (last visited June 23, 2006).

7 Holder Memorandum § II, ¶ 4 (emphasis added).

Section VI elaborated on what was meant by cooperation. The general principle was that "[i]n gauging the extent of the corporation's cooperation, the prosecutor may consider the corporation's willingness to identify the culprits within the corporation, including senior executives, to make witnesses available, to disclose the complete results of its internal investigation, and to waive attorney-client and work-product privileges."[8] The memorandum then set out several paragraphs of commentary, the most relevant for present purposes being this:

> "Another factor to be weighed by the prosecutor is whether the corporation appears to be protecting its culpable employees and agents. Thus, while cases will differ depending upon the circumstances, a corporation's promise of support to culpable employees and agents, either *through the advancing of attorneys fees,* through retaining the employees without sanction for their misconduct, or through providing information to the employees about the government's investigation pursuant to a joint defense agreement, may be considered by the prosecutor in weighing the extent and value of a corporation's cooperation."[9]

A footnote to the comment concerning the advancing of attorneys' fees read:

> "Some states require corporations to pay the legal fees of officers under investigation prior to a formal determination of their guilt. Obviously, a corporation's compliance with governing law should not be considered a failure to cooperate."[10]

Thus, the Holder Memorandum made clear that advancing of attorneys' fees to personnel of a business entity under investigation, except where such advances were required by law, might be viewed by the government as protection of culpable individuals and might contribute to a government decision to indict the entity.

The Court, with the consent of the parties, takes judicial notice of the Holder Memorandum.

8 *Id.* § VI, ¶ A.

9 *Id.* ¶ B (emphasis added).

10 *Id.* ¶ B, n.3.

As noted, the Holder Memorandum was not binding. Federal prosecutors were free to take it into account, or not, as they saw fit. But the corporate scandals of the earlier part of this decade changed that.

In late 2001, Enron, Global Crossing, Tyco International, Adelphia Communications and ImClone, among other companies, found themselves in worlds of trouble, much of it apparently of their own making. Bankruptcies and criminal prosecutions followed including, notably, the indictment of Enron's auditors, Arthur Andersen LLP – an indictment that resulted in the collapse of the firm, well before the case was tried.[11] And on July 9, 2002, the President issued Executive Order 13271, which established a Corporate Fraud Task Force (the "Task Force") headed by United States Deputy Attorney General Larry D. Thompson.

On January 20, 2003, Mr. Thompson issued a document entitled *Principles of Federal Prosecution of Business Organizations* (the "Thompson Memorandum") which, in many respects, was a modest revision of the Holder Memorandum. Indeed, the language concerning cooperation and advancing of legal fees by business entities was carried forward without change. Unlike its predecessor, however, the Thompson Memorandum is binding on all federal prosecutors.[12] Thus, all United States Attorneys now are obliged to consider the advancing of legal fees by business entities, except such advances as are required by law, as at least possibly indicative

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11 *Amici* point out that no major financial services firm has ever survived a criminal indictment. Brief for The Securities Industry Ass'n *et al.* at 6 [docket item 470] (quoting Ken Brown, *et al., Called to Account: Indictment of Andersen in Shredding Case Puts Its Future in Question,* WALL. ST. J., Mar. 15, 2002, at A1).

12 U.S. DEP'T OF JUSTICE, CRIMINAL RESOURCE MANUAL § 163 (2005) ("The Thompson Memorandum sets forth nine factors that federal prosecutors must consider in determining whether to charge a corporation or other business organization.") (available online http://www.usdoj.gov/usao/eousa/foia_reading_room/usam/title9/crm00163.htm) (last visited June 23, 2006).

of an attempt to protect culpable employees and as a factor weighing in favor of indictment of the entity.[13]

KPMG Gets Into Trouble and "Cleans House"

While all of this was going on, the Internal Revenue Service ("IRS") began investigating tax shelters, including a number that are subjects of the indictment in this case. In early 2002, it issued nine summonses to KPMG, which was less than fully compliant. Accordingly, on July 9, 2002, the government filed a petition in the United States District Court for the District of Columbia to enforce them.[14]

A few months later, the Permanent Subcommittee on Investigations of the Senate Committee on Governmental Affairs "began an investigation into the development, marketing and implementation of abusive tax shelters by accountants, lawyers, financial advisors, and bankers."[15] This led to public hearings in November 2003 at which several senior KPMG partners or former partners – three of them now defendants here – testified.[16]

The firm's reception at the hearing was not favorable. Senator Coleman, the subcommittee chair, for example, opened the hearing by saying that "the ethical standards of the legal and accounting profession have been pushed, prodded, bent and, in some cases, broken, for enormous monetary gain."[17] At another point, Senator Levin, the ranking minority member, in obvious exasperation at a KPMG witness, suggested that the witness "try an honest answer."[18]

Eugene O'Kelly, then KPMG chair,[19] was concerned about the Senate hearing and the IRS proceedings.[20] He retained Skadden Arps Slate Meagher & Flom ("Skadden"), and particularly Robert S. Bennett, "to come up with a new cooperative approach."[21] One aspect of that new approach was a decision to "clean house" – a determination to ask Jeffrey Stein, Richard Smith, and Jeffrey Eischeid, all senior KPMG partners who had testified before the Senate and all now defendants here – to leave their positions as deputy chair and chief operating officer of the firm, vice

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13 Mr. Thompson was quoted in the press as having defended pressuring companies to cut off payment of defense costs for their employees on the ground that "they [the employees] don't need fancy legal representation" if they do not believe that they acted with criminal intent. Laurie P. Cohen, *In the Crossfire: Prosecutors' Tough New Tactics Turn Firms Against Employees,* WALL. ST. J., June 4, 2004, A1. Naturally, the Court does not consider it in deciding this matter, as it is not in evidence. It notes, however, that such a view, whether held by Mr. Thompson or anyone else, would be misguided, to say the least.

The innocent need able legal representation in criminal matters perhaps even more than the guilty. In addition, defense costs in investigations and prosecutions arising out of complex business environments often are far greater than in less complex criminal matters. Counsel with the skills, business sophistication, and resources that are important to able representation in such matters often are more expensive than those in less complex criminal matters. Moreover, the need to review and analyze frequently voluminous documentary evidence increases the amount of attorney time required for, and thus the cost of, a competent defense. Thus, even the innocent need substantial resources to minimize the chance of an unjust indictment and conviction.

14 *United States v. KPMG LLP,* 316 F. Supp.2d 30, 31-32 (D. D.C. 2004).

It appears that the IRS was conducting also a penalty promoter audit of KPMG. Tr. (Neiman) 270:8-11.

15 STAFF OF THE PERMANENT SUBCOMM. ON INVESTIGATIONS OF THE S. COMM. ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS, THE ROLE OF PROF. FIRMS IN THE U.S. TAX SHELTER INDUS. 1 (Comm. Print 2005) ("SENATE REPORT").

16 *Id.* at 1-2.

17 *U.S. Tax Shelter Industry: The Role of Accountants, Lawyers, and Financial Professionals, Hearings Before the Permanent Subcomm. on Investigation of the S. Comm. on Governmental Affairs,* 108th Cong. 2 (2003).

18 *Id.* at 43.

19 Mr. O'Kelly is deceased.

20 Tr. (Neiman) 270:8-16.

21 *Id.*

chair – tax services, and a partner in personal financial planning, respectively.[22]

Given Mr. Stein's senior position and his relationship with Mr. O'Kelly,[23] his departure was cushioned substantially, although many of the facts have come to light only recently. He "retired" from the firm with a $100,000 per month, three-year consulting agreement. He agreed to release the firm and all of its partners, principals, and employees from all claims.[24] He and KPMG agreed also that Mr. Stein would be represented, at KPMG's expense, in any suits brought against KPMG or its personnel and himself, by counsel acceptable to both him and the firm or, if joint representation were inappropriate or if Mr. Stein were the only party to a proceeding, by counsel reasonably acceptable to Stein.[25]

Despite KPMG's effort to stave off trouble by "cleaning house," much damage already had been done. In the early part of 2004, the IRS made a criminal referral to the Department of Justice ("DOJ"), which in turn passed it on to the United States Attorney's Office for this district ("USAO").[26]

KPMG's Policy on Payment of Legal Fees

KPMG's policy prior to this matter concerning the payment of legal fees of its partners and employees is clear. While KPMG's partnership agreement and by-laws are silent on the subject, the parties have stipulated as follows:

> "1. Prior to February 2004, . . . it had been the longstanding voluntary practice of KPMG to advance and pay legal fees, without a preset cap or condition of cooperation with the government, for counsel for partners, principals, and employees of the firm in those situations where separate counsel was appropriate to represent the individual in any civil, criminal or regulatory proceeding involving activities arising within the scope of the individual's duties and responsibilities as a KPMG partner, principal, or employee.

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22 U113, ¶¶ 8, 28-29; *see* SENATE REPORT 2.

Mr. Eischeid was placed on administrative leave and Mr. Smith transferred. Tr. (Neiman) 274:16-20.

23 Mr. O'Kelly had selected Mr. Stein as deputy chair of KPMG. *See* Tr. (Loonan) 169:17-21. Although he felt compelled to ask Mr. Stein to retire, he personally negotiated the very generous terms of the severance. *Id.* 167:16-21; 169:23-170:7. Mr. Loonan, who worked out the terms of the written agreement with Mr. Stein's counsel (whose fee for doing the agreement ultimately was borne by KPMG), described the negotiation as "very friendly." *Id.* 168:23-169:16.

24 DX 6A, ¶¶ 7, 9(a).

There were limited exceptions that are not relevant here.

25 DX 6, ¶ 13.

The agreement provided also that, "[n]otwithstanding any other provision of [the] Agreement," if Mr. Stein were named as a defendant in any action based on his activities with the firm, KPMG would indemnify him "(through its Professional Indemnity Insurance Program)," except as to "wilful or intentional unlawful acts," to the same extent it would have done had he remained with KPMG. DX 6B, ¶ 22.

26 The United States Attorneys' Manual explains the process as follows:

"The IRS' Criminal Investigation Division (CID) is responsible for investigating violations of the criminal provisions of the internal revenue laws, including cases falling within the General Enforcement Plea Program . . . and related violations of the criminal provisions of 18 U.S.C. CID special agents are responsible for conducting administrative investigations . . . of alleged criminal violations arising under the internal revenue laws.

"Upon concluding an administrative investigation, a special agent recommending prosecution must prepare a special agent's report (SAR) that details the investigation and the agent's recommendations. After review within CID, the SAR, together with the exhibits, is reviewed by District Counsel. . . When prosecution is deemed warranted, District Counsel prepares a criminal reference letter (CRL) and refers the matter . . . either to the Tax Division or, in those circumstances when direct referral of certain classes of cases is authorized, to the United States Attorney. . . The CRL discusses the nature of the crime(s) for which prosecution is recommended, the evidence relied upon to prove it, technical aspects and anticipated difficulties of prosecution, and the prosecution recommendations themselves." U.S. DEP'T OF JUSTICE, UNITED STATES ATTORNEYS' MANUAL § 6-4.110 (1997) (hereinafter "UNITED STATES ATTORNEYS' MANUAL"). *See also id.* § 6-4.122. It appears that the decision whether to prosecute complex tax matters referred by the IRS is made by the Tax Division of the DOJ. *Id.* 6-4.212, subd. 1.

> "2. This practice was followed without regard to economic costs or considerations with respect to individuals or the firm.
>
> "3. With the exception of the instant matter, KPMG is not aware of any current or former partner, principal or employee who has been indicted for conduct arising within the scope of the individual's duties and responsibilities as a KPMG partner, principal, or employee since [two partners] were indicted and convicted of violation of federal criminal law in 1974. Although KPMG has located no documents regarding payment of legal fees in that case, KPMG believes that it did pay pre- and post-indictment legal fees for the individuals in that case."

The Court infers and finds that KPMG in fact paid the pre- and post-indictment legal fees for the individuals in the 1974 criminal case. Moreover, the extent to which KPMG has gone is quite remarkable. In one recent situation involving KPMG's relationship with Xerox Corporation, it paid over $20 million to defend four partners in a criminal investigation and related civil litigation brought by the Securities and Exchange Commission.[27]

The Initial Discussion between the USAO and Skadden

When the referral reached the USAO on February 5, 2004, it came under the supervision of Shirah Neiman, who was chief counsel to the United States Attorney, the USAO's liaison to the IRS, a participant in the drafting of the Holder Memorandum, and a very experienced prosecutor.[28] The USAO notified Skadden of the referral, and a meeting was scheduled for February 25, 2004.

In the meantime, on February 9, 2004, the USAO prepared "subject" letters – letters advising the recipient that he or she "is a person whose conduct is within the scope of [a] grand jury's investigation"[29] – to between 20 and 30 KPMG partners and employees, including all but five of the defendants in this case.[30]

In preparation for the meeting, Ms. Neiman, Assistant United States Attorneys ("AUSA") Weddle and Okula, and other members of the prosecution team conferred. They decided to ask Skadden whether KPMG was paying the legal fees of individuals under investigation.[31] Accordingly, the government prepared a document headed "Skadden Meeting Points" setting forth matters that the government intended to discuss at the meeting.[32] The first page of the three-page list contained an item that read:

> "● Is KPMG paying/going to pay the legal fees of employees? Current or former?
> What about taxpayers?
>
> Who?
>
> ♦ Any agreements or other obligations to do so? What are they?"[33]

The meeting was attended by Mr. Bennett, Ms. Neiman, and many others on both sides. Mr. Weddle began by telling Skadden that the government was there to hear what Skadden had to say and that it had a few questions. Mr. Bennett explained that Skadden had been hired in view of Mr. O'Kelly's concern about the controversy with the IRS and the Senate hearings and that

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27 Tr. (Loonan) 129:23-130:18.

28 Tr. (Neiman) 264:9-266:6, 268:3-9.

29 UNITED STATES ATTORNEYS' MANUAL § 9-11.151.

30 Tr. (Okula) 85:22-25, 92:25-93:12; K159-84; Docket item 524 (letter, Stanley J. Okula, May 22, 2006). It appears that the letters were hand-delivered between February 18 and 26, 2004, with most delivered by February 20, 2004. *Id.*

31 Tr. (Okula) 66:15-19.

32 *Id.* 63:23-64:21; *see id.* (Neiman) 282:17-283:16.

33 U6; U98.

KPMG had decided to clean house and change the atmosphere at the firm. He reported that the firm had taken high-level personnel action already, that it would cooperate fully with the government's investigation, and that the object was to save KPMG, not to protect any individuals. In an obvious reference to the fate of Arthur Andersen, he said that an indictment of KPMG would result in the firm going out of business.[34]

After a discussion of the structure of KPMG and of potential conflicts of interest, Mr. Weddle "got to the subject of legal fees and asked whether KPMG was obligated to pay fees and what their plans were."[35] Mr. Bennett tested the waters to see whether KPMG could adhere to its practice of paying its employees'[36] legal expenses when litigation loomed. He asked for government's view on the subject.[37] Ms. Neiman said that the government would take into account KPMG's legal obligations, if any, to advance legal expenses, but referred specifically to the Thompson Memorandum as a point that had to be considered.[38]

At or about that point, Messrs. Bennett and Bialkin told the USAO that KPMG's "common practice" had been to pay legal fees. They added that the partnership agreement was vague and that Delaware law gave the company the right to do whatever it wished, but said that KPMG still was checking on its legal obligations. It would not, however, pay legal fees for employees who declined to cooperate with the government, or who took the Fifth Amendment, as long as it had discretion to take that position.[39]

The conversation then shifted briefly to a discussion of the personnel changes that KPMG had made.[40] Mr. Bennett reported that Messrs. Stein, Eischeid, and Smith had been asked to leave, but explained that neither KPMG nor Skadden had done an internal investigation to determine who were "bad guys" or whether any crime had been committed.[41] Almost immediately, Mr. Weddle reverted to the subject of attorneys' fees, asking Mr. Bennett to determine KPMG's obligations in that regard.[42] Ms. Neiman then said that "misconduct" should not or cannot "be rewarded" and referred to federal guidelines.[43]

There is no dispute, and the Court finds, that this comment came immediately on the heels of a statement by Mr. Bennett relating to lawyers for KPMG partners.[44] There are disputes, however, about precisely what Ms. Neiman said about "guidelines" and what she meant by it.[45] The

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34 *Id.* (Neiman) 269:19-271:12.

35 *Id.* 271:13-272:10.; *id.* (Pilchen) 23:4-7, 32:25-33:2; U113 ¶ 23.

Mr. Weddle asked also for copies of KPMG's partnership agreement and by-laws. K313; U105.

36 The Court includes KPMG partners in the term "employees" for ease of expression.

37 *Id.;* Tr. (Pilchen) 23:8-12; K313.

38 *Id.* 23:12-15; *id.* (Okula) 75:20-76:1.

39 K313; U105; U116 ¶¶ 24-25; Tr. (Neiman) 273:13-17; *id.* (Pilchen) 24:6-19.

40 U116, ¶¶ 27-30; Tr. (Neiman) 274:4-25.

41 Tr. (Neiman) 274:3-8; *id.* (Okula) 110:3-5; U106, ¶ 26; U116, ¶ 28.

42 U117, ¶ 31; K313.

43 U117, ¶ 31; U106, ¶ 27; K313

44 *E.g.,* Tr. (Neiman) 275:3-10; *id.* (Pilchen) 21:12-23:16: *id.* (Okula) 114:13-115:2.

45 According to Ms. Neiman, she said "that the federal sentencing guidelines specifically address in its corporate compliance section the issue of providing discipline for people who engage in misconduct, and [that KPMG] can't reward misconduct and you have to be mindful of that." (Tr. (Neiman) 275:3-10) The Court assumes that this was what went through her mind and does not question the sincerity of the testimony. The contemporaneous notes and subsequent memorandum of the government's designated note taker and the contemporaneous notes of a Skadden partner, however, do not refer to corporate compliance and contain the word "guidelines" without specifying sentencing guidelines or the Thompson Memorandum. U106, ¶ 28; U117, ¶ 31; K313. The Court is not

parties have focused in particular on whether Ms. Neiman intended her remark to be directed to the legal fee issue – *i.e.*, to be a statement to the effect that payment by KPMG of employee legal fees could be viewed as rewarding misconduct – or to be directed instead at any severance arrangements between KPMG and Messrs. Stein, Eischeid, and Smith. Ms. Neiman testified that her intent was the latter.[46] But the Court finds it unnecessary to decide Ms. Neiman's subjective purpose in making the remark because what is more important is how her comment was understood.

As Ms. Neiman's remark came immediately after a statement concerning whether KPMG would be paying for lawyers for its personnel, it would have been quite natural to understand the comment as having been directed at payment of legal fees. And that is exactly what happened:

- The IRS agent's handwritten notes, taken at the meeting, state:

  "BB - [illegible] Skadden may recommend lawyers for this. Wants lawyers who understand cooperation is the best way to go in this type of case.

  He feels it is in the best interests of KPMG for its people to get attorneys that will cooperate with Go[vt]. Want to save the firm.

  "Per SN

  Fees – under Federal Guideline
  – Misconduct C/N Be rewarded.

  JW - figure out firms obligations ~~and~~ [illegible]"[47]

- The IRS agent's typewritten memorandum, prepared from her notes, state:

  "31. AUSA Weddle finally asked Mr. Bennett to find out what KPMG's obligations would be. Shirah Neiman further advised them that under the federal guidelines misconduct can not be rewarded."[48]

- Skadden's Mr. Pilchen recorded:

  "SP - No decisions made. No counsel have been recommended – we have had discussions @ what the firm does in typical situations - but no final decisions made.

  "SN - misconduct shdn't be rewarded."[49]

- Not long afterward, Mr. Pilchen told a lawyer for a KPMG employee that the government had implied that it preferred that KPMG not pay employee legal

persuaded that Ms. Neiman, whatever she had in mind, referred to the sentencing guidelines or to corporate compliance. She said, without elaboration, that misconduct cannot or should not be rewarded under federal guidelines. It is no stretch to conclude that this remark was taken by those who heard it as a reference to the Thompson Memorandum. In fact, KPMG's present chief legal officer, former U.S. District Judge Sven Erik Holmes, referred in a different context to the Thomson Memorandum as the "Thompson Guidelines" in a civil deposition. Docket item 544, Ex. B, at 74-75.

[46] The government's post-hearing brief attempts to support Ms. Neiman's claim that she referred to the federal sentencing guidelines, not to the Thompson Memorandum, and that she was speaking at the time of corporate compliance programs. It maintains that "Ms. Neiman consistently refers to the Sentencing Guidelines when lecturing on the issues of corporate compliance programs and cooperation" and appends a copy of a lecture she gave on the subject that referred to the sentencing guidelines. Docket item 510 at 20; *id.* Ex. A. It attaches also a copy of an interview with former Deputy Attorney General Comey regarding waiver of privileges by corporate entities under the Thompson Memorandum. In light of these materials, it maintains, the Court should find that Ms. Nieman referred to the sentencing guidelines and that her warning against rewarding misconduct was intended to encourage KPMG to take appropriate personnel actions against culpable employees and not as a reference to payment of legal fees. *Id.* at 21-23; *id.* Ex. B.

The Court declines to consider the appended material. The government could have sought to examine Ms. Neiman about her lecture at the hearing and could have called Mr. Comey as a witness. It did neither. To consider these materials, first submitted after the conclusion of the hearing, would deprive the KPMG Defendants of the right to cross-examine. Even more important, the documents are not probative, and at least no strongly so, of what Ms. Neiman said to KPMG in the February 25, 2004 meeting and what KPMG understood from her comment. Accordingly, they would not alter the result even if the Court considered them.

[47] U106.

[48] U117.

[49] K313.

fees.[50]

- AUSA Okula testified:

"Q In response to the topic of cooperation, isn't it a fact that Shirah Neiman goes back to the fees and says, well, remember, we're looking at that under federal guidelines. Yes or no?

"A Yes.

"Q And that was about fees, wasn't it?

"A Fees, yes, that's what it says.

"Q It wasn't about terminating Eischeid or Stein or anybody else. It was about paying fees and cooperation. Correct?

"A Correct."[51]

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[50] K316-17; *cf.* Tr. (Michael) 44:9-45:17.

[51] Tr. (Okula) 124:24-125:13.

This testimony was given with respect to the IRS agent's note of Ms. Neiman's remark to the effect that misconduct should not be rewarded. U106. That note came immediately after a note of a statement by Mr. Bennett that he felt it was "in the best interests of KPMG for it's [*sic*] people to get attorneys that will cooperate with Go[vt]" and that he wanted to "save the firm." *Id.*

Elsewhere in his testimony, Mr. Okula implied that he believed that Ms. Neiman's remark was a comment on the fact that Mr. Stein had been "let go with a severance package that exceeded $8 million or $10 million," which Mr. Okula thought inconsistent with an attempt by Skadden to claim credit for taking aggressive personnel action. Tr. (Okula) 115:3-13. This testimony, the Court finds, was mistaken.

The parties have stipulated that KPMG did not produce Mr. Stein's severance agreement to the government until recently. Tr. 181:18-24; *see also* Weddle Decl. [docket item 435] ¶ 7. Moreover, at an August 4, 2004 meeting, Karen Seymour, chief of the criminal division of the USAO, told Skadden that "KPMG's employment actions to grant rich severance packages without making statements to the public, or privately to its employees, of the wrongdoing that went on" was a "troubling issue under the 'Thompson Memo.'" U72; *see* Tr. (Loonan) 154:22-155:20. Notes of the meeting produced by the government indicate that Mr. Weddle was "very upset about this." U51.

It is difficult to see why the size of Mr. Stein's severance package would have provoked such a response in August 2004 if, as Mr. Okula suggested, its terms had been disclosed in February. In all the circumstances, the Court finds that the government was unaware at the time of the February 25, 2004 meeting of the financial arrangements between Mr. Stein and KPMG.

In sum, Ms. Neiman's comment that "misconduct" cannot or should not "be rewarded" under "federal guidelines," whatever went through her mind when she said it, was understood by both KPMG and government representatives as a reminder that payment of legal fees by KPMG, beyond any that it might legally be obligated to pay, could well count against KPMG in the government's decision whether to indict the firm. And if there were any doubt that this was the message conveyed, the doubt quickly was dispelled by Mr. Weddle. As Mr. Pilchen's notes recorded, he followed up Ms. Neiman's comment by saying:

"JW – if u have discretion re fees – we'll look at that under a microscope."[52]

Thus, while the USAO did not say in so many words that it did not want KPMG to pay legal fees, no one at the meeting could have failed to draw that conclusion.[53]

KPMG Gets the Message

Shortly after the February 25, 2004 meeting, Mr. Bennett got back to Mr. Weddle on the legal fee issue. He reported that KPMG did not think it had any binding legal obligation to pay

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[52] K314 (emphasis in original).

This comment appears only in Mr. Pilchen's notes, and no witness at the hearing had any present recollection of it. Nevertheless, Mr. Pilchen testified that his notes were an effort "to record [his] impressions and recollections of what was being said." Tr. 19:16-17. The notes specifically attribute the remark to Mr. Weddle, which is not consistent with their being a recordation of a subjective thought by Mr. Pilchen. Mr. Pilchen underlined them. In light of the memorable language and these additional circumstances, the Court finds that Mr. Weddle made the comment.

[53] Mr. Okula frankly admitted that it was his personal view that KPMG should not pay the fees. Tr. (Okula) 69:1-4.

legal fees,[54] but that "it would be a big problem" not to do so because the firm was a partnership. He said that KPMG was planning on putting a cap, or limit, on fees and conditioning their payment for any given partner or employee on that individual "cooperating fully with the company and the government."[55] Apparently satisfied with the government's response, KPMG began to implement the policy.

On March 4, 2004, Mr. Pilchen of Skadden spoke to Mr. Townsend, an attorney for defendant Carolyn Warley. He told Townsend that KPMG would pay his fees so long as Ms. Warley cooperated with the government. For example, he said, no fees would be paid if Ms. Warley invoked her privilege against self-incrimination under the Fifth Amendment.[56]

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[54] KPMG was blatantly self-interested on this point. While the Thompson Memorandum countenances compliance with legal obligations to advance fees, KPMG had an interest in avoiding advancement of fees if its legal obligation to do so might be questioned, as the government might view advancement of fees as protecting culpable personnel. Those of its partners and employees who were or might become subjects of the investigation, on the other hand, had an interest in taking the broadest possible view of KPMG's legal obligations.

In these circumstances, it is of more than passing interest that the government, which knew or at least was chargeable with knowledge of this obvious fact, appears to have made no effort to verify KPMG's claim beyond asking for and presumably reading the partnership and by-laws. There is no evidence, for example, that it ever inquired into exactly what KPMG's practices had been in this regard.

Nor did the government question the obvious conflict of interest manifest in Skadden's offer to recommend as counsel to targeted KPMG employees "law firms that were familiar with these types of proceedings and who understood that cooperation with the government was the best way to proceed." U119, ¶ 56; U106. Cooperation may have been the best way for KPMG to proceed, but it was not necessarily best for its employees. Skadden's effort to curry favor with the government by offering to seek to compromise the interests of KPMG's employees by inducing them to retain counsel who would serve KPMG's interest in cooperating and the government's apparent failure to take issue with it both are quite disturbing.

[55] U30.

[56] U316-17; Tr. (Michael) 41:16-44:8.

On March 11, 2004, the Skadden team had a conference call with the USAO. Mr. Bennett assured the USAO that KPMG would be "as cooperative as possible" so that the office would not exercise its discretion to indict the firm. Mr. Weddle urged that KPMG tell its people that they should be "totally open" with the USAO, "even if that [meant admitting] criminal wrongdoing." He commented that this would give him good material for cross-examination,[57] a statement that strongly indicates that at least the lead line AUSA on the case expected, even at this stage, to prosecute individuals.

The actions of the USAO, coupled with the Thompson Memorandum, had the desired effect. On the same date, Skadden's Mr. Rauh wrote to the USAO, enclosing among other things a form letter that Skadden was sending to counsel for the KPMG Defendants then employed by KPMG who had received subject letters from the government or otherwise appeared to be under suspicion.[58] The form letter stated that KPMG would pay an individual's legal fees and expenses, up to a maximum of $400,000, on the condition that the individual "cooperate with the government and . . . be prompt, complete, and truthful."[59] Importantly, however, it went even further. It made clear that *"payment of . . . legal fees and expenses will cease immediately if . . . [the recipient] is charged by the government with criminal wrongdoing."*[60] In addition, on March 12, 2004, Joseph Loonan, then KPMG's deputy general counsel, sent an advisory memorandum to a broader audience

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[57] U318-19; Tr. (Michael) 45:22-50:12.

[58] K5-16.

[59] *Id.* at15-16.

[60] *Id.* at 16 (emphasis added).

of KPMG personnel regarding potential contacts by the government.[61] The memorandum urged full cooperation with the investigation. But it advised also that recipients had a right to be represented by counsel if they were contacted by the government, mentioned some advantages of consultation with counsel, and stated that KPMG had arranged for independent counsel for those who wished to consult them.[62]

The USAO took no issue with KPMG's announcement that it would cut off payment of legal fees for anyone who was indicted and that it would condition the limited preindictment payments on cooperation with the government. The advisory memorandum, on the other hand, upset Mr. Weddle and Kevin Downing, another member of the prosecution team.[63] They immediately advised Skadden that it was "disappointed with [its] tone" and allegedly "one-sided presentation of potential issues" and demanded that KPMG send out a supplemental memorandum in a form they proposed.[64] The only significant point of difference between the memorandum that the government demanded and Mr. Loonan's original memorandum was the language in the government's proposal italicized below:

> "Employees are not required to use this counsel, or any counsel at all. Rather, employees are free to obtain their own counsel, *or to meet with investigators without the assistance of counsel.* It is entirely your choice."[65]

In due course, KPMG capitulated to the USAO demand. It put out in "Q & A" format a document containing the following language:

> *"Do I have to be assisted by a lawyer?*
>
> **"Answer:** No. Although we believe that it is probably in your best interests to consult with a lawyer before speaking to government representatives, whether you do so is entirely your choice. *As we said in the March 12 OGC [Office of General Counsel] memorandum, you may deal directly with government representatives without counsel.* In any event, the Firm expects you to cooperate fully with the government representatives and provide complete and truthful information to them."[66]

This exchange is revealing. No one suggests that either the original KPMG advice or the government's subsequent proposal misstated the law. The difference was one of emphasis. But it is entirely plain that the government's purpose in demanding the supplement was to increase the chances that KPMG employees would agree to interviews without consulting or being represented by counsel, whether provided by KPMG or otherwise.

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61 Skadden sent a copy to the government on the same day. K270.

62 K271-73; Tr. (Loonan) 145:2-149:22.

The memorandum indicated also that KPMG would "be responsible for the payment of reasonable fees and related expenses in connection with . . . representation regarding this investigation." K271-73, at 272. The failure to indicate that payment of legal fees would cease if the recipient were charged or to refer to the $400,000 cap apparently is attributable to the fact that those limitations were contained in letters sent to counsel for persons who already had received subject letters from the government while the advisory memorandum went to a broader group.

63 Tr. (Loonan) 149:23-150:1.

64 K275-77.

65 U276 (emphasis added).

66 U294-308, at U299 (emphasis added).

The USAO's demand was a focus of a meeting or telephone call with Skadden on March 29, 2004. Mr. Bennett protested that it had sent out memoranda such as those that had been sent on behalf of KPMG in other matters without objection. He emphasized that KPMG would not even pay attorneys' fees unless its personnel agreed to cooperate and that it would cut off payments to KPMG personnel who invoked the Fifth Amendment. Nevertheless, he ultimately acquiesced in the government's demands, stating that KPMG was in the process of sending out in "Q & A format" a "more balanced approach." K321.

The Government Presses Its Advantage

The KPMG lawyers met again with the USAO on March 29, 2004. In an effort to demonstrate that KPMG was cooperating, Skadden asked the government to notify it if any current or former KPMG employee refused to meet with prosecutors or otherwise failed to cooperate.[67]

From that point forward, the government took full advantage. It repeatedly notified Skadden when KPMG personnel failed to comply with government demands.[68] In each case, Skadden promptly advised the attorney for the individual in question that the payment of legal fees would be terminated "[a]bsent an indication from the government within the next ten business days that your client no longer refuses to participate in an interview with the government."[69] In some cases, the individuals in question relented under pressure of the threats from KPMG and submitted to interviews with the government. In others, they did not, whereupon KPMG terminated their employment and cut off the payment of legal fees.[70]

The Conclusion of the Investigation, KPMG's Stein Problem and the Deferred Prosecution Agreement

As the matter unfolded, meetings between KPMG and its counsel and the USAO continued, with KPMG seeking a resolution short of an indictment of the firm and the government pressing for admissions of extensive wrongdoing, a great deal of money, and changes in KPMG's business.

On August 4, 2004, the KPMG executives and lawyers met with Karen Seymour, then chief of the criminal division of the USAO, and other prosecutors. In the course of the meeting, Ms. Seymour said that the government had learned that KPMG had granted rich severance packages to certain executives and that this raised a "troubling issue under the 'Thompson Memo.'"[71] Mr. Bennett deflected the issue, agreeing that severance packages were "high in one or two cases" but reiterating that KPMG's "expectation" was that legal fees of individuals would be paid only up to $400,000 and only on condition that recipients cooperated with the government.[72] But the Stein severance agreement was not produced.

As time went by, KPMG came to view the Stein severance agreement as something of a ticking bomb. For one thing, KPMG had not adhered in Mr. Stein's case to the $400,000 pre-indictment legal fee cap that it had adopted in response to government pressure. It passed that figure by late October 2004,[73] and so was at odds with its representation to the government.[74] For another,

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67 U32; *see also, e.g.,* K30; K43.

68 *See, e.g.,* K30; K43; K44.1; K47; K49; K55; K56; K60; K66; K81; K127; K268; *see also* K68.

69 *See, e.g.,* K42-43; K44-44.1; K45; K51; K57-58; K61-62; K68; K76-77; *see also* K129 (suspending payment of legal fees and warning that payment would be discontinued entirely absent indication of cooperation from the government); K134 (same).

70 *See, e.g.,* K54; K68; K93; K126; K132-33; K186-90.

71 U69-77, at U72.

72 *Id.*

73 Docket item 512, Att. A, ¶ 6.

74 KPMG sought to explain this by suggesting that it had paid $646,000 in fees for both the criminal investigation and for civil litigation and that its representations to the government therefore may not have been inaccurate. Tr. (Loonan) 182:19-185:13. In fact, however, the parties later stipulated that KPMG paid $646,757.80 in Mr. Stein's legal fees for the criminal investigation alone. Docket item 512, Att. A, ¶ 5.

it had known since August 2004 that the USAO was unhappy that rich severance packages had been given to senior executives.[75]

Notwithstanding this problem, KPMG repeatedly tried to convince the USAO not to indict the firm, touting its cooperation with the investigation and its limitation of attorneys' fees for individuals. In meetings in March 2005 with David N. Kelley, then United States Attorney, however, this approach did not yield the desired result. Indeed, On March 2, 2005, Mr. Kelley interrupted Mr. Bennett's claim that the firm had cooperated by saying, "Let me put it this way. I've seen a lot better from big companies."[76] That meeting, in the words of KPMG's Mr. Loonan, was "not particularly encouraging,"[77] and a subsequent meeting in New York went no better.

With the scene about to shift to Washington and a last ditch effort to prevent an indictment by an appeal at the highest levels of the Justice Department, 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."[78] It concluded that the Stein situation involved too great a risk. So on May 5, 2005, eight days before KPMG was to meet with U.S. Deputy Attorney General James Comey to plead its case, KPMG unilaterally terminated the consulting services portion of the severance agreement and cut off payment of Mr. Stein's attorneys' fees.[79] It did so, as Mr. Loonan candidly admitted, "because [KPMG] thought it would help [the firm] with the government."[80]

Having dealt, as best it could, with the Stein problem, KPMG turned to attempting to persuade Deputy Attorney General Comey not to indict the firm. The meeting took place on June 13, 2005. Once again, Mr. Bennett relied upon KPMG's cooperation with the government, in addition of course to other arguments. A Skadden memorandum of the meeting recounts some of his remarks as follows:

> "In addition, it [KPMG] had done something 'never heard of before' – conditioned the payment of attorney's fees on full cooperation with the investigation. 'We said we'd pressure – although we didn't use that word – our employees to cooperate. We told employees that attorney fees would not be paid unless they fully cooperated with the investigation.' He noted that whenever an individual indicated he or she would not cooperate, 'Justin [Weddle] or Stan [Okula] would tell us,' and KPMG took action. He went on to note that 'what played out' was that current or former personnel who otherwise would not have cooperated did cooperate, and those who did not had their fees cut off and, in two instances, were separated from the firm. This process exhibited 'a level of cooperation that is rarely done.'
>
> * * *
>
> "He noted that what was really 'precedent-setting' about the case was the conditioning of payment of legal fees on cooperation."[81]

This time, KPMG was more successful.

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[75] The record is unclear as to exactly when the government learned the economic terms of the severance packages with Messrs. Stein and others, although it certainly was aware by August 2004 of the fact that they were sizeable. KPMG's Mr. Loonan testified that the government at some point was told the size of Mr. Stein's package, but he did not say when. In any case, his testimony leaves considerable doubt as to whether he had personal knowledge of the facts. Tr. (Loonan) 180:17-25.

[76] U334-36, at 336.

[77] Tr. (Loonan) 187:15-17.

[78] Docket item 544, Ex. B, at 74-75.

This civil deposition was received in evidence in this matter. Docket item 558.

[79] DX 7; Tr. (Loonan) 190:22-191:4.

[80] *Id.* 196:13-23.

KPMG unpersuasively sought to explain the payment of almost $650,000 in legal fees as an oversight and the termination of payments as consistent with the severance agreement. It has offered no justification for terminating the consulting payments. Nor does the Court credit its benign excuses for cutting off payment of the legal fees. It did so purely to create a response for use in the event the government were to discover that KPMG had exceeded the cap on legal costs that it had told the government it had imposed.

[81] U347-51, at 349-51.

The Deferred Prosecution Agreement and the Indictment in This Case

On August 29, 2005, KPMG and the government entered into a Deferred Prosecution Agreement ("DPA"). KPMG agreed, among other things, to waive indictment, to be charged in a one-count information, to admit extensive wrongdoing, to pay a $456 million fine, and to accept restrictions on its practice. The government agreed that it will seek dismissal of the information if KPMG complies with its obligations.[82] In a nutshell, KPMG stands to avoid a criminal conviction if it lives up to its part of the bargain.

One additional aspect of the DPA is noteworthy in the present context. The DPA obliges KPMG to cooperate extensively with the government, both in general and in the government's prosecution of this indictment. It provides in part:

> "7. KPMG acknowledges and understands that its cooperation with the criminal investigation by the Office [USAO] is an important and material factor underlying the Office's decision to enter into this Agreement, and, therefore, *KPMG agrees to cooperate fully and actively with the Office, the IRS, and with any other agency of the government designated by the Office ('Designated Agencies') regarding any matter relating to the Office's investigation about which KPMG has knowledge or information.*
>
> "8. KPMG agrees that its continuing cooperation with the Office's investigation shall include, *but not be limited to,* the following:
>
> "(a) Completely and truthfully disclosing all information in its possession to the Office and the IRS about which the Office and the IRS may inquire, including but not limited to all information about activities of KPMG, present and former partners, employees, and agents of KPMG;
>
> * * *
>
> "(d) Assembling, organizing, and providing, in responsive and prompt fashion, and, upon request, expedited fashion, all documents, records, information, and other evidence in KPMG's possession, custody, or control as may be requested by the Office or the IRS;
>
> "(e) Not asserting, in relation to the Office, any claim of privilege (including but not limited to the attorney-client privilege and the work product protection) as to any documents, records, information, or testimony requested by the Office related to its investigation . . . [; and]
>
> "(f) Using its reasonable best efforts to make available its present and former partners and employees to provide information and/or testimony as requested by the Office and the IRS, including sworn testimony before a grand jury or in court proceedings, as well as interviews with law enforcement authorities . . .
>
> "9. KPMG agrees that its obligations to cooperate will continue even after the dismissal of the Information, and *KPMG will continue to fulfill the cooperation obligations set forth in this Agreement in connection with any investigation, criminal prosecution or civil proceeding brought by the Office* or by or against the IRS or the United States relating to or arising out of the conduct set forth in the Information and the Statement of Facts and relating in any way to the Office's investigation."[83]

The cooperation provisions of the DPA thus require KPMG to comply with demands by the USAO in connection with this prosecution, with little or no regard to cost. If it does not comply, it will be open to the risk that the government will declare that KPMG breached the DPA and prosecute the criminal information to verdict. Anything the government regards as a failure to cooperate, in other words, almost certainly will result in the criminal conviction that KPMG has labored so mightily to avoid, as the admissions that KPMG now has made would foreclose a successful defense.

At about the same time, the government filed the initial indictment in this case. True to its word, KPMG cut off payments to the defendants of legal fees and expenses.

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[82] *United States v. KPMG LLP,* 05 Crim. 0903 (LAP), docket item 4 (filed Aug. 29, 2005).

[83] *Id.* ¶¶ 7-9 (emphasis added).

The Present Motion

The Government's Initial Response

On January 19, 2006, the KPMG Defendants moved to dismiss the indictment or for other relief on the ground that the government had interfered improperly with the advancement of attorneys' fees by KPMG in violation of their constitutional and other rights.

The government filed its memorandum in opposition to this and other motions on March 3, 2006.[84] It represented:

> "With respect to the facts[,] KPMG, which determined that it had no obligation under either Delaware partnership law or contract to advance legal fees at all, *decided of its own volition* that it would in fact advance such fees, but subject them to certain limitations. That KPMG, an entity that by its own admission engaged in a breathtaking tax fraud conspiracy with and through the defendants and others, may have made that decision as a matter of good partnership governance and in order to better position itself with prosecutors, does not detract from the fact that *it was KPMG's decision alone.* Tellingly, the defendants have not – and indeed cannot – point to any evidence supporting their spurious claims that the United States 'coerc[ed]' or 'bull[ied]' KPMG into making its decision to limit the advancement of fees."[85]

The motion was heard on March 30, 2006. In the course of the argument, the government, for the first time, took the position that it had "no objection whatsoever to KPMG exercising its free and independent business judgment as to whether to advance defense costs . . . and that if it were to elect to do so the government would not in any way consider that in determining whether [KPMG] had complied with the DPA."[86] Nevertheless, the Court expressed concern about the impact of the Thompson Memorandum on KPMG's decision with respect to the payment of legal fees and ultimately invited the defendants to make a written submission as to the precise factual issue(s) as to which they sought an evidentiary hearing.[87]

The government sought to avoid a hearing. It responded to the defendants' submission with a declaration by Mr. Weddle and a letter brief.

Mr. Weddle's declaration stated in relevant part:

> "2. On February 25, 2004, legal counsel for KPMG met with me and other representatives of the United States Attorney's Office for the first time in connection with this investigation. At this meeting, among other things:
>
> * * *
>
> "d. KPMG's lawyers stated that they were looking into the issue of their obligations to pay fees, and indicated that if it was within KPMG's discretion whether to pay fees, KPMG would not pay fees for individuals who do not cooperate.
>
> "e. *The Government did not instruct or request KPMG to implement that plan or to implement a contrary plan.*
>
> "3. * * * *Once again, in this call [March 2, 2004], the Government did not tell KPMG's counsel that KPMG's decision to pay legal fees was improper, nor did we instruct or request KPMG to change its decision about paying fees, capping the payment of fees, or conditioning of fees on an employee's or a partner's cooperation.*"[88]

The letter brief[89] stated:

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[84] The memorandum bore the names of Messrs. Weddle and Okula and two other AUSAs, in that order.

[85] Docket item 346, at 164 (emphasis added).

[86] Tr., Mar. 30, 2006, at 37.

[87] Tr., Mar. 30, 2006, at 128:19-129:7.

[88] Weddle Decl., docket item 435 (emphasis added).

[89] Docket item 432. The letter brief was signed by Mr. Weinstein. As he was not present at the February 25, 2004 meeting with Skadden and there is no evidence that he was involved in the later communications with Skadden described above, the Court assumes that his letter brief simply repeated the facts set out in Mr. Weddle's declaration and prior submissions.

> *"The Government did not instruct or request KPMG to implement that plan* [*i.e.*, KPMG's plan to advance fees subject to a cap and a requirement of cooperation with the government] *or to implement a contrary plan.*
>
> * * *
>
> "Once again, the Government did not tell KPMG that its decision to pay legal fees was improper. *Nor did the Government instruct or request KPMG to change its decision about paying fees, capping the payment of fees, or conditioning the payment of fees on an employee's or a partner's cooperation.*
>
> * * *
>
> "In sum, during the course of its dealings with KPMG, *the United States Attorney's Office did not instruct KPMG whether KPMG should pay legal fees, whether KPMG should cap the payment of legal fees, or whether KPMG should condition the payment of legal fees."*[90]

Prehearing Proceedings

On April 12, 2006, the Court ordered an evidentiary hearing and limited discovery on the motion and, particularly, on "whether the government, through the Thompson Memorandum or otherwise, affected KPMG's determination(s) with respect to the advancement of legal fees and other defense costs to present or former partners and employees with respect to the investigation and prosecution of this case and such subsidiary issues as relate thereto."[91] The order granted the KPMG Defendants leave to serve a Rule 17(c) subpoena on KPMG for documents.

Without getting into unnecessary detail, it is fair to say that KPMG's participation from that point on was more extensive than simply responding to the subpoena. It sought to block or, at least, delay issuance of the subpoena while it tried to broker stipulations between defendants and the government in an effort to limit the scope of discovery from KPMG and testimony by its personnel.[92] It sought and obtained, for its own convenience, a delay of the hearing.[93] And it obtained leave for its counsel appear not only for the purpose of responding to the subpoena "in this matter," but "for any purposes relating to this matter that the Court may so [*sic*] order."[94]

The Hearing

The Court conducted an evidentiary hearing on May 8-10, 2006. Counsel for KPMG were present throughout. At the conclusion of argument by other counsel, the Court addressed counsel for KPMG: "You certainly have notice that a remedy is being sought against your client, and I'm now making it clear in words of one syllable. You will have a chance to be heard if you want it."[95] It went on to emphasize that it would welcome any submission on behalf of KPMG and that KPMG could "make whatever reservation of rights [it wished] in submitting."[96]

KPMG ultimately submitted a memorandum of law. It did not seek to offer any evidence, to question any witnesses, or to make any offer of proof.

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90 Docket item 432, at 2, 3 (emphasis added).

91 Docket item 436, at 2.

92 Docket item 547.

93 Docket item 448.

94 Docket item 450, 455.

95 Tr., May 10, 2006, at 426:24-427:2.

96 *Id.* at 427:15-430:23.

Ultimate Factual Conclusions

Several broad conclusions follow from the foregoing.

First, the Thompson Memorandum caused KPMG to consider departing from its long-standing policy of paying legal fees and expenses of its personnel in all cases and investigations even before it first met with the USAO. As a direct result of the threat to the firm inherent in the Thompson Memorandum, it sought an indication from the USAO that payment of fees in accordance with its settled practice would not be held against it.

Second, the USAO did not give KPMG the comfort it sought. To the contrary, it deliberately, and consistent with DOJ policy, reinforced the threat inherent in the Thompson Memorandum. It placed the issue of payment of legal fees high on its agenda for its first meeting with KPMG counsel, which emphasized the prosecutors' concern with the issue. Mr. Weddle raised the issue and then repeatedly focused on KPMG's "obligations," thus clearly implying – consistent with the language of the Thompson Memorandum – that compliance with legal obligations would be countenanced, but that anything more than compliance with demonstrable legal obligations could be held against the firm. Ms. Neiman's statement, in response to a comment about payment of legal fees by KPMG, that misconduct should not be rewarded quite reasonably was understood in the same vein, whatever its intent. And Mr. Weddle's colorful warning that the USAO would look at any discretionary payment of fees by KPMG "under a microscope" drove the point home.

Third, the government conducted itself in a manner that evidenced a desire to minimize the involvement of defense attorneys. This objective arguably is inherent, to some degree, in the Thompson Memorandum itself. But there is considerably more proof, specific to this case, here. The *contretemps* with KPMG over its Advisory Memorandum demonstrated the government's desire, wherever possible, to interview KPMG witnesses without their being represented by lawyers. The USAO's ready acceptance of KPMG's offer to cut off payment of legal fees for anyone who was indicted speaks for itself. It speaks even more eloquently when one considers that the USAO accepted KPMG's assurance that it had no legal obligation to pay legal fees, knowing that (1) KPMG's "common practice" had been to make such payments, (2) KPMG was extremely anxious to curry favor with the USAO by demonstrating how cooperative it could be, and (3) KPMG had an obvious conflict of interest with its present and former personnel on the question whether it had a legal obligation to pay fees. Had the government been less concerned with punishing those it deemed culpable right from the outset, it would not have accepted KPMG's word on this point.

Fourth, KPMG's decision to cut off all payments of legal fees and expenses to anyone who was indicted and to limit and to condition such payments prior to indictment upon cooperation with the government was the direct consequence of the pressure applied by the Thompson Memorandum and the USAO. Absent the Thompson Memorandum and the actions of the USAO, KPMG would have paid the legal fees and expenses of all of its partners and employees both prior to and after indictment, without regard to cost.[97]

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[97] In a brief on another motion, filed after this one was taken under submission, the government points to the Statement of Facts attached to the DPA as evidence that KPMG made the decision concerning legal fees "on its own initiative" and argues that "this decision [w]as one reached by the firm for its own reasons, not at the request or direction of the Government." Docket item 569, at 15 n.5. Even if one put aside the fact that the government failed to offer this in evidence or make this argument on the present motion, the argument would be without merit. There is no inconsistency between KPMG making the decision "for its own reasons" and the decision having been a product of government pressure. The government pressure in fact was the reason that KPMG made the decision.

Discussion

I. The Relationship Between KPMG and its Personnel With Respect to Advancement of Legal Fees and Defense Costs

A. Indemnification and Advancement Generally

The issue of employer payment of legal expenses incurred by their employees as a result of doing their jobs arises in a context that dates back many years.

In the nineteenth century, Justice Story stated what already was an established proposition: "if an agent has, without his own default, incurred losses or damages in the course of transacting the business of his agency, or in following the instructions of his principal, he will be entitled to full compensation therefor" from the employer.[98] The modern common law rule is the same. And it extends to payment of expenses incurred by an employee or other agent in defending a lawsuit on a claim with respect to which the employee is entitled to indemnity.[99]

The success of the corporation as a business form brought growing pains. Lawsuits against corporate directors became ever more common. By the early part of the last century, the situation had become what one commentator described as "open season on directors."[100] The question whether directors who successfully defended such suits were entitled to be reimbursed for the expenses of defending such suits despite the fact that they often were not employees began to arise.

98 JOSEPH STORY, STORY ON AGENCY § 339, at 413 (Charles P. Greenough ed. 1882).

99 *E.g.*, RESTATEMENT (SECOND) OF AGENCY § 438(2) & cmt. e (1958).

100 Joseph W. Bishop, Jr., *Current Status of Corporate Directors' Right to Indemnification,* 69 HARV. L. REV. 1057, 1058 (1956) (hereinafter "Bishop").

At least one early decision favored reimbursement, commonly called indemnification.[101] In the 1930s, however, courts in Ohio and New York came to the opposite conclusion.[102] These decisions gave rise to a "not unnatural cry for legislation."[103] Taking the view that "[i]ndemnification encourages corporate service by capable individuals by protecting their personal financial resources from depletion [as a result of] . . . litigation that results by reason of that service,"[104] legislatures all over the country responded.

Today, all states have statutes addressing the indemnification of corporate directors, officers, employees, and other agents.[105] Many have adopted also statutes providing for indemnification of members and employees of partnerships as well as of members, officers, and agents of newer forms of business organization such as limited partnerships and limited liability

101 *Figge v. Bergenthal,* 130 Wis. 594, 109 N.W. 581 (1907).

102 *New York Dock Co. v. McCollum,* 173 Misc. 106, 16 N.Y.S.2d 844 (Sup. Ct. Onondaga Co. 1939); *Griesse v. Lang,* 37 Ohio App. 553, 175 N.E. 222 (1931).

103 Bishop, 69 HARV. L. REV. at 1068-69; *accord,* 2 AMERICAN LAW INSTITUTE, PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 7.20, Reporter's Note 1, at 278 (1994) (hereinafter "ALI"); *see also Baker v. Health Mgmt. Sys., Inc.,* 98 N.Y.2d 80, 85, 745 N.Y.S.2d 741, 744 (2002) (New York corporate indemnification statute enacted to overrule *New York Dock*).

104 *Homestore, Inc.,* 888 A.2d at 211.

105 3A WILLIAM MEADE FLETCHER, FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 1344.10 (2002 rev. vol.) (hereinafter "FLETCHER").

companies.[106] Still others also protect employees with statutes relating specifically to the employment relationship.[107]

These statutes take different forms. Some require indemnification. Some permit indemnification where the corporation or other business entity elects to provide it.[108] A few provide the exclusive vehicle for indemnification while most permit indemnification as a matter of contract or otherwise as well as pursuant to statute.[109] Many provide for indemnification, at least in some circumstances, for the cost of defending employment-related criminal charges.[110] All or virtually all, however, share an additional characteristic. As the Delaware Supreme Court recently put it, "the right to indemnification cannot be established . . . until after the defense to legal proceedings has been 'successful on the merits or otherwise.'"[111]

This has been viewed as a problem. Persons who are sued can be subjected to "the personal out-of-pocket financial burden of paying the significant ongoing expenses inevitably involved with investigations and legal proceedings."[112] In consequence, many states authorize business entities to advance defense costs to their personnel, subject to the recipients' obligation to repay the money in the event it ultimately is determined that they are not entitled to indemnity.[113] This has been described as "an especially important corollary to indemnification as an inducement for attracting capable individuals into corporate service."[114] Advancement "fills the gap . . . so the [entity] may shoulder . . . interim costs," and its value "is that it is granted or denied while the underlying action is pending."[115] As Judge Haight has written, it protects the "ability [of the employee] to mount . . . a defense . . . by safeguarding his ability to meet his expenses at the time they arise, and to secure counsel on the basis of such an assurance."[116]

Against this background, we turn to KPMG's relationship with the KPMG Defendants.

B. KPMG

The statute that governs KPMG gives it the authority "to indemnify and hold harmless any partner or other person from and against any and all claims and demands

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106 There has been a parallel development with respect to indemnification of public officials and employees. As *New York Dock* pointed out, liability for suits and legal expenses incurred in their defense original was a risk of assuming public office. 173 Misc. at 111, 16 N.Y.S.2d at 849. New York and doubtless other states have enacted statutes addressing the subject of indemnification for public officers and employees. *E.g.*, N.Y. PUB. OFFICERS L. §§ 17-18 (McKinney 2001); *see* N.Y. LEGISLATIVE ANNUAL 158-59 (1981).

107 *See, e.g.*, CALIF. LABOR C. § 2802.

108 *See* 3A FLETCHER § 1344.10, at 556-57.

109 ALI § 7.20, Reporter's Note 3, at 279.

110 *See, e.g.*, 8 WEST'S DEL. CODE ANN. § 145(a); ALI § 7.20(a); *see generally* Pamela H. Bucy, *Indemnification of Corporation Executives Who Have Been Convicted of Crimes: An Assessment and Proposal*, 24 IND. L. REV. 279, 288-89 (1991).

111 *Homestore, Inc.*, 888 A.2d at 211 (quoting 8 WEST'S DEL. C. ANN. § 145(c)).

112 *Id.*

113 *See, e.g., id.*; *Kaung v. Cole Nat'l Corp.*, 884 A.2d 500, 509-10 (Del. Sup. 2005); 8 WEST'S DEL. C. ANN. § 145(e); *see generally* 3A FLETCHER § 1344.10, at 560-61.

114 *Homestore, Inc.*, 888 A.2d at 211.

115 *Kaung*, 884 A.2d at 509.

116 *United States v. Weissman*, No. S2 94 Crim. 760 (CSH), 1997 WL 334966, at *16 (S.D.N.Y. June 16, 1997).

whatsoever."[117] This includes the authority to advance defense costs prior to final judgment.[118] KPMG had an unbroken track record of paying the legal expenses of its partners and employees incurred as a result of their jobs, without regard to cost. All of the KPMG Defendants therefore had, at a minimum, every reason to expect that KPMG would pay their legal expenses in connection with the government's investigation and, if they were indicted, defending against any charges that arose out of their employment by KPMG. Indeed, it appears quite possible that all had contractual and other legal rights to indemnification and advancement of defense costs,[119] although the Court declines to decide that in this ruling.

[117] KPMG is a limited liability partnership. Its partnership agreement is governed by the law of Delaware. 6 WEST'S DEL. C. ANN. § 15-106 (2006); K248, ¶ 19.2. The Delaware Revised Uniform Partnership Act provides that "a partnership may, and shall have the power to, indemnify and hold harmless any partner or other person from and against any and all claims and demands whatsoever" subject to such standards and restrictions as are set forth in its partnership agreement. 6 WEST'S DEL. C. ANN. § 15-110 (2006). As the KPMG partnership agreement contains no such standards and restrictions, it is entirely free to indemnify its personnel.

[118] *See, e.g., Senior Tour Players 207 Mgmt. Co. LLC v. Golftown 207 Holding Co. LLC,* 853 A.2d 124, 126 (Del. Ch. 2004); *Delphi Easter Partners L.P. v. Spectacular Partners, Inc.,* Civ. A. No. 12409, 1993 WL 32807, at *4-*5 (Del. Ch. Aug. 6, 1993).

[119] All of the defendants save Stein, who has an express contract with KPMG, arguably are protected by a contract, implied in fact from KPMG's uniform past practice and the circumstances of the business, pursuant to which they are entitled to have their defense costs paid by KPMG. *See, e.g., Beth Israel Med. Ctr. v. Horizon Blue Cross and Blue Shield of New Jersey, 448 F.3d 573, 582* (2d Cir. 2006) (New York law); *Manchester Equip Co., Inc. v. Am. Way Moving & Storage Co., Inc.,* 176 F. Supp.2d 239, 245 (D. Del. 2001) (Delaware law); *Cal. Emergency Physicians Med. Group v. Pacificare of Cal.,* 111 Cal.App.4th 1127, 1134, 4 Cal.Rptr.3d 583, 592 (4th Dist. 2003) (California law). Stein's contract requires that KPMG retain on his behalf, and with his consent, "appropriate and qualified counsel" at the firm's expense if he is sued and joint representation is inappropriate, both of which are the case here. Ex. 6, ¶ 13. While KPMG argues that this obligation is limited by another provision of the contract, its position is questionable.

Quite apart from any question of contract, most of the KPMG California defendants appear to be entitled under California statutes to advancement of their defense costs.

Defendants Bickham and Larson were California employees, not partners. To the extent the investigation and indictment arose in consequence of that employment, California statutes require KPMG to advance their defense costs and, unless their actions were both unlawful and "believed by them to be unlawful"at the time, to indemnify them. CALIF. LABOR C. § 2802(a) (requirement of indemnification); CALIF. CIV. C. § 2778 (indemnity includes defense costs); *Jacobus v. Krambo Corp.,* 78 Cal. App.4th 1096, 93 Cal. Rptr.2d 425 (1st Dist. 2000) (LABOR C. § 2802 requires employer to defend or pay defense costs); *Alberts v. Amer. Cas. Co.,* 88 Cal.App.2d 891, 899, 200 P.2d 37, 42-43 (2d Dist. 1948) (indemnitee entitled to recover as soon as it becomes liable).

Defendant Hasting, who also was based in California, was a KPMG partner. Nevertheless, he arguably is covered by the same statutes. Hasting was a Class A partner of KPMG from July 1998 through October 2001. Under KPMG's by-laws, Class A partners were not entitled to share in the profit or required to bear a share of any losses of the firm and were ineligible to serve on the board of directors. (K0200, K0207) Thus, the fact that he bore the title "partner" may not be dispositive. *See, e.g., Clackamas Gastroenterology Assocs. v. Wells,* 538 U.S. 440, 446 (2003); *Hishon v. King & Spalding,* 467 U.S. 69, 80 n.2 (1984) (Powell, J., concurring).

II. *The Government Violated the Fifth and Sixth Amendments by Causing KPMG to Cut Off Payment of Legal Fees and Other Defense Costs Upon Indictment*

A. *The Right to Fairness in the Criminal Process*

1. *Nature of the Right*

> "'No general respect for, nor adherence to, the law as a whole can well be expected without judicial recognition of the paramount need for prompt, *eminently fair* and sober criminal law procedures. The methods we employ in the enforcement of our criminal law have aptly been called the measures by which the quality of our civilization may be judged.'"[120]

The Supreme Court long has protected a defendant's right to fairness in the criminal process. It has grounded this protection primarily in the Due Process Clause[121] as well as more specific provisions of the Bill of Rights, including the Confrontation and Assistance of Counsel

[120] *Douglas v. California,* 372 U.S. 353, 358 n.2 (1963) (quoting *Coppedge v. United States,* 369 U.S. 438, 449 (1962)) (emphasis added).

[121] U.S. CONST. amend. V, XIV.

Clauses of the Sixth Amendment.[122] Whatever the textual source, however, the Court consistently has held that criminal defendants are entitled to be treated fairly throughout the process. In everyday language, they are entitled to a fair shake.

This concern for the fairness of criminal proceedings runs throughout many of the Court's decisions regarding fair trials and access to the courts. For example, in *Powell v. Alabama*,[123] in which the Court first held that a defendant in a capital case has the right to the aid of counsel, it reasoned that if a tribunal were "arbitrarily to refuse to hear a party by counsel[,] it reasonably may not be doubted that such a refusal would be a denial of a hearing, and, therefore, of due process in the constitutional sense."[124] In other words, without counsel for the defense, a capital prosecution is presumptively unfair and therefore violates due process. The implied converse is that due process requires fair proceedings.

One aspect of the required fairness protects the autonomy of the criminal defendant. It rests on the common-sense truth that, at the end of the day, it is the defendant "who suffers the consequences if the defense fails."[125] So proper respect for the individual prevents the government from interfering with the manner in which the individual wishes to present a defense."[126] The underlying theme is that the government may not both prosecute a defendant and then seek to influence the manner in which he or she defends the case.

A defendant's right to control the manner and substance of the defense has several aspects. The defendant has the right to represent him- or herself,[127] even if such a decision objectively may appear to be unwise.[128] A defendant is guaranteed also "the right to be represented by an otherwise qualified attorney whom that defendant can afford to hire"[129] – in other words, to use his or her own assets to defend the case, free of government regulation. Nor may the government interfere at will with a defendant's choice of counsel, as the Constitution "protect[s] . . . the defendant's free choice independent of concern for the objective fairness of the proceedings."[130] Similarly, a defendant is generally free, within the procedural constraints that govern trials generally, to adduce evidence without unjustified restrictions[131] and may choose which witnesses to present

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122 *Id.* amend. VI.

123 287 U.S. 45 (1932).

124 *Id.* at 64.

125 *Faretta v. California*, 422 U.S. 806, 820 (1975).

126 This general rule against government interference with the defense is based on a presumption that the criminal defendant, "after being fully informed, knows his own best interests and does not need them dictated by the State." *Martinez v. Court of Appeal of Cal.*, 528 U.S. 152, 165 (Scalia, J., concurring).

127 *See, e.g., Faretta,* 422 U.S. at 820-21.

128 *See Martinez,* 528 U.S. at 165 (Scalia, J., concurring).

129 *Caplin & Drysdale, Chartered v. United States,* 491 U.S. 617, 624 (1989).

130 *United States v. Panzardi Alvarez*, 816 F.2d 813, 818 (1st Cir. 1987) (internal citation and quotation omitted); *see also Wilson v. Mintzes*, 761 F.2d 275, 279 (6th Cir. 1985) ("[R]ecognition of the right [to counsel of choice] also reflects constitutional protection of the accused's free choice").

See also United States v. Laura, 607 F.2d 52, 56 (3d Cir. 1979) (Higginbotham, J.) (" We would reject reality if we were to suggest that lawyers are a homogeneous group. Attorneys are not fungible, as are eggs, apples and oranges. Attorneys may differ as to their trial strategy, their oratory style, or the importance they give to particular legal issues. The differences, all within the range of effective and competent advocacy, may be important in the development of the defense. Given this reality, a defendant's decision to select a particular attorney becomes critical to the type of defense he will make and thus falls within the ambit of the sixth amendment.").

131 *See, e.g., Crane v. Kentucky*, 476 U.S. 683, 690-91 (1986) (error to foreclose defendant's efforts to adduce evidence about the circumstances of his confession; "In the absence of any valid state justification, exclusion of this kind of exculpatory evidence deprives a defendant

or cross-examine.[132] In short, fairness in criminal proceedings requires that the defendant be firmly in the driver's seat, and that the prosecution not be a backseat driver.[133]

The constitutional requirement of fairness in criminal proceedings not only prevents the prosecution from interfering actively with the defense, but also from passively hampering the defendant's efforts. As the Court put it in *California v. Trombetta*,[134]

> "Under the Due Process Clause . . . , criminal prosecutions must comport with prevailing notions of fundamental fairness. We have long interpreted this standard of fairness to require that criminal defendants be afforded a meaningful opportunity to present a complete defense. To safeguard that right, the Court has developed what might loosely be called the area of constitutionally guaranteed access to evidence. Taken together, this group of constitutional privileges delivers exculpatory evidence into the hands of the accused, thereby protecting the innocent from erroneous conviction and ensuring the integrity of our criminal justice system."[135]

Hence, the prosecution may not conceal exculpatory evidence or plea agreements with key government witnesses.[136] In some instances, it may be required to disclose the identity of its undercover informants in possession of evidence critical to the defense.[137]

Prosecutors are required also by the Due Process Clause to conduct themselves fairly. They may not delay intentionally indictments to prejudice defendants.[138] They may not obstruct defendants' access to a potential witness unless that is necessary to protect the witness's safety.[139] Nor may they knowingly offer perjured or false evidence.[140] Entrapment by prosecutors and law enforcement officers is proscribed by the Due Process Clause.[141] While prosecutors appropriately

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of the basic right to have the prosecutor's case encounter and survive the crucible of meaningful adversarial testing.") (internal citation and quotation omitted).

132 *See, e.g., Chambers v. Mississippi*, 410 U.S. 284, 295 (1973).

This is not to say, of course, that defendants are free of appropriate regulation of such matters as the order of proof, the offering of cumulative evidence, and the length of presentations. *See United States v. Gonzalez-Lopez,* No. 05-352, 2006 U.S. LEXIS 5165, at *21-22 (June 26, 2006).

133 *See also, e.g., Mayer v. City of Chicago*, 404 U.S. 189, 195-96 (1971) (denial of free transcripts to indigent misdemeanor appellants violated due process); *Bounds v. Smith*, 430 U.S. 817 (1977) (due process required that prisoners have an adequate opportunity to present their claims fairly); *cf. Davis v. Alaska*, 415 U.S. 308, 319-20 (1974) (Confrontation Clause required that defendant be permitted to cross-examine witness as to his juvenile criminal record; unfair to "require the petitioner to bear the full burden of vindicating the State's interest in the secrecy of juvenile criminal records").

134 467 U.S. 479 (1984).

135 *Id.* at 485 (internal citations omitted).

136 *See Giglio v. United States,* 405 U.S. 150 (1972); *Brady v. Maryland*, 373 U.S. 83, 87 (1963); *see also United States v. Agurs*, 427 U.S. 97, 112 (1976) (prosecution has a constitutional duty to provide defendant with exculpatory evidence that would raise a reasonable doubt as to guilt).

137 *See Roviaro v. United States*, 353 U.S. 53 (1957).

138 *See, e.g., United States v. Lovasco,* 431 U.S. 783, 795 n.17 (1977); *United States v. Marion,* 404 U.S. 307, 324 (1971).

139 See *United States v. Gonzales,* 164 F.3d 1285, 1292 (10th 1999) (defendants have "a right to be free from prosecution interference with a witness' freedom of choice about whether to talk to the defense"); *Int'l Bus. Mach. Corp. v. Edelstein,* 526 F.2d 37, 44 (2d Cir. 1975) (supporting "wholeheartedly" the conclusion that "constitutional notions of fair play and due process dictate that defense counsel be free from obstruction, whether it come from the prosecutor in the case or from a state official or another state acting under color of law") (*quoting Coppolino v. Helpern,* 266 F. Supp. 930 (S.D.N.Y.1967)); *Gregory v. United States,* 369 F.2d 185, 188 (D.C. Cir. 1966) (defendant denied a fair trial where prosecutor advised witnesses to the alleged crime not to speak to defense counsel outside the prosecutor's presence); *see also United States v. Muirs,* 145 Fed. Appx. 208, 209 (9th Cir. 2005) ("[G]overnment interference with defense access to witnesses implicates due process."); .

140 *See, e.g., Briscoe v. LaHue,* 460 U.S. 325, 327 n.1 (1983); *Agurs,* 427 U.S. at 103 & nn. 8-9; *Napue v. Illinois,* 360 U.S. 264, 269 (1959); *Pyler v. Kansas,* 317 U.S. 213, 216 (1942); *Mooney v. Holohan,* 294 U.S. 103, 112 (1935).

141 *See, e.g., Cox v. Louisiana,* 379 U.S. 559, 571 (1965); *Raley v. Ohio,* 360 U.S. 423, 426 (1959).

are given great latitude in the arguments they make to juries, they cross into unconstitutional territory when they "infect[] the trial with unfairness."[142]

Finally, the requirement of fairness in criminal proceedings applies to the structure and conduct of the entire criminal justice system. For example, the Court held that Dr. Sam Sheppard's due process rights were violated when the trial court failed to protect him from the firestorm of prejudicial publicity surrounding his trial.[143] It has recognized also the right to trial before an unbiased tribunal. In *Ward v. Village of Monroeville,*[144] for example, it held that a defendant was denied due process when he was tried for traffic offenses before the village mayor, who was responsible for village finances and whose court provided a substantial portion of village funds through fines, forfeitures, costs, and fees. Similarly, in *Tumey v. Ohio,*[145] the Court reversed a conviction because the judge was paid from fines levied in his court and therefore received payment only upon conviction. The Court said that such a system "deprives a defendant . . . of due process of law to subject his liberty or property to the judgment of a court, the judge of which has a direct, personal, substantial pecuniary interest in reaching a conclusion against him in his case."[146]

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142 *Darden v. Wainwright,* 477 U.S. 168, 181 (1986) (quoting *Donnelly v. DeChristoforo,* 416 U.S. 637, 643 (1974)).

143 *See Sheppard v. Maxwell*, 384 U.S. 333, 362-63 (1966).

144 409 U.S. 57 (1972).

145 273 U.S. 510 (1927).

146 *Id.* at 524; *see also Bracy v. Gramley,* 520 U.S. 899, 904-05 (1997) ("The Due Process Clause clearly requires a "fair trial in a fair tribunal before a judge with no actual bias against the defendant or interest in the outcome of his particular case.") (internal citations and quotation marks omitted); *Johnson v. Mississippi,* 403 U.S. 212, 215-216 (1971) (due process violated where judge presided over a case in which one of the defendants was a previously successful litigant against him); *In re Murchison,* 349 U.S. 133, 137-139 (1955) (due process violated by a judge presiding over a criminal trial of a defendant who he had indicted under the state's one-man grand jury procedure).

The Court's jurisprudence thus makes clear that defendants have the right, under the Due Process Clause, to fundamental fairness throughout the criminal process.

2. *The Right to Fairness in the Criminal Process Is a Fundamental Liberty Interest Entitled to Substantive Due Process Protection Where, As Here, the Government Coerces a Third Party to Withhold Funds Lawfully Available to a Criminal Defendant*

The Due Process Clause has been interpreted to provide not only procedural protection for deprivations of life, liberty, and property, but also substantive protection for fundamental rights – those that are so essential to individual liberty that they cannot be infringed by the government unless the infringement is narrowly tailored to serve a compelling state interest.[147]

"Only fundamental rights and liberties which are deeply rooted in this Nation's history and tradition and implicit in the concept of ordered liberty qualify for such protection."[148] The right to fairness in criminal proceedings has not been explicitly so characterized by the Court.[149] The question here, then, is whether and to what extent it properly is regarded as fundamental for purposes of requiring strict scrutiny of alleged impingements. A number of guides point the way.

To begin with, many of the Supreme Court's criminal due process decisions described above can be understood in modern terms most readily in the substantive due process and

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147 *See, e.g., Washington v. Glucksberg*, 521 U.S. 702, 721 (1997).

148 *Chavez v. Martinez*, 538 U.S. 760, 775 (2003) (internal citations omitted).

149 The rights thus far explicitly characterized by the Supreme Court as fundamental in this specialized sense fall into five rough categories: the rights to freedom of association, to vote and participate in the electoral process, to travel interstate, to fairness in procedures concerning individual claims against governmental deprivation of life, liberty, or property, and to privacy relating to freedom of choice in matters relating to an individual's personal life. *See* 2 RONALD D. ROTUNDA & JOHN E. NOWAK, TREATISE ON CONSTITUTIONAL LAW: SUBSTANCE AND PROCEDURE § 15.7 (1999) ("ROTUNDA & NOWAK").

strict scrutiny framework. The requirement of an unbiased tribunal, for example, is not found in the explicit language of the Constitution. It rests instead on the proposition that a fair tribunal is "implicit in the concept of ordered liberty."[150] The state's legitimate interest in, for example, saving money by having the same person both run a town's finances and levy traffic fines is insufficient to justify infringing upon the right to a fair trial. Thus, the Supreme Court's repeated recognition of the constitutional mandate of fairness in criminal proceedings strongly suggests that this right is "fundamental" for substantive due process purposes, at least in some circumstances. Indeed, it would be difficult to conclude otherwise. Our concern with protection of the individual against the unfair use of the great power of the government is "deeply rooted in this Nation's history and tradition."[151] "[N]either liberty nor justice would exist" if fairness to criminal defendants were sacrificed.[152] Indeed, as one court put it, "What can be more basic to the scheme of constitutional rights precious to us all than the right to fairness throughout the proceedings in a criminal case?"[153]

These considerations have led the Second Circuit[154] and several other courts (often in *dicta*),[155] as well as respected commentators,[156] to conclude that the right to fairness in criminal proceedings is a fundamental liberty interest subject to substantive due process protection. But it is not necessary or, in this Court's view, appropriate, to go that far in order to decide this case. It is a venerable maxim of constitutional construction that courts should decide no more than is necessary.[157] And the only question now before the Court is whether a criminal defendant has a right to obtain and use in order to prepare a defense resources lawfully available to him or her, free of knowing or reckless government interference.[158] Given all that has been said above, this Court concludes that such a right is basic to our concepts of justice and fair play. It is fundamental.[159]

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150 *Glucksberg,* 521 U.S. at 721 (internal citations and quotations omitted).

151 *Moore v. City of East Cleveland*, 431 U.S. 494, 503 (1977) (plurality opinion).

152 *Glucksberg,* 521 U.S. at 721 (internal citations and quotations omitted).

153 *United States v. Curran*, 724 F. Supp. 1239, 1241 (C.D. Ill. 1989), *rev'd on other grounds*, *United States v. Spears*, 965 F.2d 262 (7th Cir. 1992), *cert. denied*, 506 U.S. 989 (1992).

154 *See Quill v. Vacco*, 80 F.3d 716, 724 (2d Cir. 1996) (recognizing the right to fairness in a criminal proceeding as a fundamental liberty interest subject to substantive due process analysis), *rev'd on other grounds*, 521 U.S. 793 (1997).

155 *See, e.g., Doe v. Taylor Independent Sch. Dist.*, 15 F.3d 443, 479 n.6 (5th Cir. 1994) (dissenting opinion) ("right to fair criminal process"); *Ryder v. Freeman*, 918 F. Supp. 157, 161 (W.D.N.C. 1996) ("fundamental fairness in the criminal process"); *Boyd v. Bulala*, 647 F. Supp. 781, 787 (W.D. Va. 1986) ("right to fairness in the criminal process"), *rev'd in part on other grounds*, 877 F.2d 1191 (4th Cir. 1989); *Grant v. City of Chicago*, 594 F. Supp. 1441, 1450 (D.C. Ill. 1984) ("[a]ccess to the complete criminal process"); *cf. Provident Mut. Life Ins. Co. of Philadelphia v. City of Atlanta*, 864 F. Supp. 1274, 1291 (N.D. Ga. 1994) (noting in equal protection analysis "the right to fairness in the criminal process").

156 *See* 2 ROTUNDA & NOWAK § 15.7 (right to fairness in criminal process implicitly recognized by the Court as fundamental); *see also, e.g.*, Gregory F. Intoccia, *Constitutionality of the Death Penalty Under the Uniform Code of Military Justice*, 32 A.F. L. REV. 395, 399 (1990) ("The Court views the right to fairness in the criminal process as fundamental and deserving of significant judicial protection."). *Cf.* Brad Snyder, *Disparate Impact on Death Row: M.L.B. and the Indigent's Right to Counsel at Capital State Postconviction Proceedings*, 107 YALE L.J. 2211, 2215 ("The two most frequently recognized fundamental equal protection rights are the right to vote and participate in elections and the right of access to the criminal process.").

157 *See, e.g., Ashwander v. Tenn. Valley Auth.*, 297 U.S. 288, 341 (1936) (Brandeis, J., concurring).

158 Indigent criminal defendants are entitled to competent defense representation. Serious questions have been raised about whether the means available for providing quality defenses for indigents are sufficient to accomplish that goal. *See, e.g., New York County Lawyers' Ass'n v. New York*, 196 Misc.2d 761, 763, 763 N.Y.S.2d 397, 399 (Sup. Ct. N.Y. Co. 2003) (granting declaratory relief increasing the hourly compensation for counsel assigned to represent indigents in New York State criminal cases after finding that the state had "ignore[d] its constitutional obligation to the poor by failing to increase the assigned counsel rates, [resulting] in many cases, in the denial of counsel, delay in the appointment of counsel, and less than meaningful and effective legal representation"). If these criticisms are well-founded, remedial measures are not only desirable, but constitutionally may be required. But that is a question for another day.

159 It is crucial to note that the Court deals here with extrajudicial action by the government that deliberately or recklessly tilts the playing field against a criminal defendant. Such actions

3. The Government's Actions Violated the Substantive Due Process Right to Fairness in the Criminal Process

a. The Effect on the KPMG Defendants

The Thompson Memorandum and the USAO pressure on KPMG to deny or cut off defendants' attorneys' fees necessarily impinge upon the KPMG Defendants' ability to defend themselves.

This is by no means a garden-variety criminal case. It has been described as the largest tax fraud case in United States history. The government thus far has produced in discovery, in electronic or paper form, at least 5 million to 6 million pages of documents *plus* transcripts of 335 depositions and 195 income tax returns.[160] The briefs on pretrial motions passed the 1,000-page mark some time ago.[161] The government expects its case in chief to last three months, while defendants expect theirs to be lengthy as well.[162] To prepare for and try a case of such length requires substantial resources.[163] Yet the government has interfered with the ability of the KPMG Defendants to obtain resources they otherwise would have had. Unless remedied, this interference almost certainly will affect what these defendants can afford to permit their counsel to do. This would impact the defendants' ability to present the defense they wish to present by limiting the means lawfully available to them. The Thompson Memorandum and the USAO's actions therefore are subject to strict scrutiny.

b. The Thompson Memorandum and the USAO's Actions Fail the Strict Scrutiny Test

To survive strict scrutiny, government action must be narrowly tailored to achieve a compelling government interest.[164]

The portion of the Thompson Memorandum at issue here – the language that states that payment of legal fees for employees and former employees may be viewed as protection of culpable employees and thus cut in favor of indicting the entity – purportedly serves three goals. First, it is intended to facilitate just charging decisions concerning business entities by focusing on a consideration pertinent to gauging their degrees of cooperation. Second, it seeks to strengthen the government's ability to investigate and prosecute corporate crime by encouraging companies to pressure their employees to aid the government – recall Mr. Weddle's urging KPMG to tell its people to be "totally open" with the USAO, "even if that [meant admitting] criminal wrongdoing." Finally, it seeks to punish those whom prosecutors deem culpable – it attempts to justify depriving employees of corporate aid by characterizing it as "protecting . . . culpable employees and agents."

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have nothing in common with fair and neutral regulation of, for example, the conduct of a criminal trial, which naturally are not subjected to strict scrutiny.

160 Anderson Decl. [docket item 561] ¶¶ 24, 27, 38-39, 41.

161 Tr., Mar. 30, 2006, at 9:10-14.

162 *See, e.g., United States v. Stein*, S1 05 Crim. 0888 (LAK), 2006 WL 1126807 (S.D.N.Y. Apr. 4, 2006).

163 If one were to assume a six-month trial of 117 days and that a defendant were represented by a single lawyer, who devoted eight hours for each trial day, the cost at $400 per hour simply to attend the trial would be almost $375,000, without taking into account such other expenses as transcripts, copying, travel expenses, and the like. That figure, moreover, would be misleadingly low, as it is difficult to imagine that this case could be defended competently without spending as much time reviewing at least some of the 5 to 6 million pages of documents produced by the government and otherwise preparing as in attending the trial. It therefore is quite reasonable to assume that even a minimal defense of this case could well cost $500,000 to $1 million, if not significantly more.

164 *See, e.g., Glucksberg*, 521 U.S. at 721 (internal citations and quotations omitted).

The final justification may be disposed of quickly. The job of prosecutors is to make the government's best case to a jury and to let the jury decide guilt or innocence. Punishment is imposed by judges subject to statute. The imposition of economic punishment by prosecutors, before anyone has been found guilty of anything, is not a legitimate governmental interest – it is an abuse of power. The government's other points, however, are far more substantial.

Any government's interest in investigating and fairly prosecuting crime is compelling. The consequences for civilization of another government's failure to accomplish that basic end are on view on the evening news every day.

In order properly to accomplish that task, the government must have the ability to make just charging decisions and to prevent obstruction of its investigations. Hence, no one disputes the proposition that a willingness to cooperate with the government is an appropriate consideration in deciding whether to charge an entity. Nor does anyone suggest that an entity's obstruction of a government investigation – what the government has called "circling the wagons"[165] – should be ignored in a charging decision. Many remember the Watergate case, in which the legal fees of individuals who broke into the offices of the Democratic National Committee were paid, along with other "hush money," to buy the silence of the burglars and to protect higher-ups.[166] Corporate equivalents no doubt occur. But the devil, as always, is in the details.

The first difficulty is that the Thompson Memorandum does not say that payment of legal fees may cut in favor of indictment *only if* it is used as a means to obstruct an investigation. Indeed, the text strongly suggests that advancement of defenses costs weighs against an organization independent of whether there is any "circling of the wagons."[167]

The USAO, possibly concerned with the breadth of the Thompson Memorandum, seeks to deal with this by asserting that, in practice, it considers the payment of legal fees as a negative factor only when payments are used to impede.[168] Perhaps so. But whatever the government may do in the privacy of U.S. Attorneys' offices and in the DOJ's Criminal Division is not what defense lawyers see. They see the Thompson Memorandum. Few if any competent defense lawyers would advise a corporate client at risk of indictment that it should feel free to advance legal fees to individuals in the face of the language of the Thompson Memorandum itself. It would be irresponsible to take the chance that prosecutors might view it as "protecting . . . culpable employees and agents." As KPMG's new chief legal officer, former U.S. District Judge Sven Erik Holmes, testified, he thought it indispensable (as would any defense lawyer) "to be able to say at the right time with the right audience, we're in full compliance with the Thompson Memorandum."[169]

The bottom line is plain enough. If the government means to take the payment of legal fees into account in making charging decisions only where the payments are part of an

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165 Tr. (Neiman) 292:21-293:22; *see also* Tr. 409:20-25.

166 *See United States v. Haldeman*, 559 F.2d 31, 55-57 (D.C. Cir. 1976), *cert. denied*, 431 U.S. 916, 933 (1977). *See also, e.g., United States v. Locascio*, 6 F.3d 924, 931-34 (2d Cir. 1993) (organized crime figure's payment of legal fees for crime family members appropriate proof of criminal enterprise).

167 The Thompson Memorandum's assessment of whether a company is cooperating includes an examination of whether "the corporation, while purporting to cooperate, has engaged in conduct that impedes the investigation." Thompson Memo at VI(A). The payment of legal fees is treated in a separate paragraph that focuses entirely on "whether the corporation appears to be protecting its culpable employees and agents." *Id.* at VI(B).

168 Tr. 409:20-25.

169 Docket item 544, Ex. B, at 74-75.

obstruction scheme – and thereby narrowly tailor its means to its ends – it would be easy enough to say so. But that is not what the Thompson Memorandum says.

The concerns do not end here. The argument that payment of legal fees to employees and former employees is relevant to gauging the extent of a company's cooperation also is problematic. There is no necessary inconsistency between an entity cooperating with the government and, at the same time, paying defense costs of individual employees and former employees. An entity may pay out of a judgment that extending this benefit will aid it in keeping and hiring competent and honest employees. It may pay in recognition that an employee caught up in an investigation, or even charged with a crime, because the employee did his or her job for the company has at least some claim to assistance, even in the absence of a legal right. In either case, however, a company may pay at the same time that it does its best to bare its corporate soul, stands at the government's beck and call to provide information and witnesses, and does a myriad of other things to aid the government and clean the corporate house. So it simply cannot be said that payment of legal fees for the benefit of employees and former employees necessarily or even usually is indicative of an unwillingness to cooperate fully. This is especially unlikely after employees have been indicted and fired, as is the situation here.

For these reasons, this aspect of the Thompson Memorandum is not narrowly tailored to achieve a compelling objective. It discourages and, as a practical matter, often prevents companies from providing employees and former employees with the financial means to exercise their constitutional rights to defend themselves. It does so in the face of state indemnification statutes that expressly permit businesses entities to provide those means because the states have determined that legitimate public interests may be served. It does so even where companies obstruct nothing and, to the contrary, do everything within their power to make a clean breast of the facts to the government and to take responsibility for any offenses they may have committed. It therefore burdens excessively the constitutional rights of the individuals whose ability to defend themselves it impairs and, accordingly, fails strict scrutiny. The legal fee advancement provision violates the Due Process Clause.[170]

c. The Actions of the USAO

The actions of the USAO in this case compounded the problem that the Thompson Memorandum created.

The Thompson Memorandum says that the payment of legal fees (beyond any legal obligation) may be held against a business entity if the government views the payments as protection of "culpable employees" or as evidence of a lack of full and complete cooperation. The USAO took advantage of that uncertainty by emphasizing the threat.

Within days of receiving the criminal referral on February 5, 2004, the USAO put the payment of employee legal fees near the top of the government's agenda for the very first meeting with KPMG's lawyers. On February 25, 2004, Mr. Bennett reported that KPMG had

[170] It makes no difference that the Thompson Memorandum is a policy of the DOJ and implemented by the USAO rather than legislation enacted by Congress. Due process requires that government action "through any of its agencies must be consistent with the fundamental principles of liberty and justice which lie at the base of our civil and political institutions, which not infrequently are designated as 'the law of the land.'" *DuBose v. Kelly*, 187 F.3d 999, 1004 (8th Cir. 1999) (quoting *Buchalter v. New York*, 319 U.S. 427, 429(1943)). The government cannot avoid strict scrutiny of actions that impinge upon the fundamental right of fairness in the criminal process simply by acting through DOJ policy rather than by statute or formal regulation. *See, e.g., Nicholson v. Williams*, 203 F. Supp.2d 153, 243 (E.D.N.Y. 2002) ("In considering the constitutionality of the policy or practice of a state agency rather than the specific acts of individual officers, it is appropriate to apply the higher standard and stricter analysis that is applied to legislation.").

cleaned house and pledged full cooperation with the government. But Mr. Weddle immediately raised the legal fee issue. When Mr. Bennett sought to elicit the USAO's view on that subject, the response was a reference to the Thompson Memorandum. This was followed later in the meeting by Ms. Neiman's statement, on the heels of a reference to payment of employee legal expenses, that misconduct should not be rewarded and Mr. Weddle's threat that the government would look at the payment of legal fees that KPMG was not legally obliged to pay "under a microscope." And it did all this despite the fact that it does not claim that KPMG obstructed its investigation, least of all by using the payment of legal fees to prevent employees or former employees from talking to the government or telling it the truth.

The individual prosecutors in the USAO acted pursuant to the established policy of the DOJ as expressed in the Thompson Memorandum. They understood, however, that the threat inherent in the Thompson Memorandum, coupled with their own reinforcement of that threat, was likely to produce exactly the result that occurred – KPMG's determination to cut off the payment of legal fees for any employees or former employees who were indicted and to limit and condition their payment during the investigative stage. Their actions cannot withstand strict scrutiny under the Due Process Clause because they too were not narrowly tailored to serving compelling governmental interests.

B. The Sixth Amendment Right to Counsel

1. The Nature and Scope of the Right to Counsel

Quite apart from the due process analysis, the KPMG Defendants argue that the Thompson Memorandum and its implementation by the government infringed their Sixth Amendment right to counsel. They are correct.

The Sixth Amendment provides that "[i]n all criminal prosecutions, the accused shall enjoy the right to . . . have the Assistance of Counsel for his defence."[171] As already has been demonstrated, however, this guarantees more than the mere presence of a lawyer at a criminal trial. It protects, among other things, an individual's right to choose the lawyer or lawyers he or she desires[172] and to use one's own funds to mount the defense that one wishes to present.[173] Moreover, a defendant's exercise of his Sixth Amendment right to counsel is not to be feared or avoided by the government:

> "No system worth preserving should have to fear that if an accused is permitted to consult with a lawyer, he will become aware of, and exercise those rights. If the exercise of constitutional rights will thwart the effectiveness of a system of law enforcement, there is something very wrong with that system."[174]

The government nevertheless argues that the KPMG Defendants have no Sixth Amendment rights at stake here for two principal reasons.

a. Attachment of Sixth Amendment Rights

The government first argues that the Sixth Amendment right to counsel attaches only upon the initiation of a criminal proceeding. As the Thompson Memorandum was adopted and the USAO did its handiwork before the KPMG Defendants were indicted, it contends, there was no Sixth Amendment violation.

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171 U.S. CONST. amend VI.

172 *See, e.g., Wheat,* 486 U.S. at 164.

173 *Caplin & Drysdale, Chartered,* 491 U.S. at 624.

174 *Escobedo v. Illinois,* 378 U.S. 478, 490 (1964).

It is true, of course, that the Sixth Amendment right to counsel typically attaches at the initiation of adversarial proceedings – at an arraignment, indictment, preliminary hearing, and so on.[175] But the analysis can not end there. The Thompson Memorandum on its face and the USAO's actions were parts of an effort to limit defendants' access to funds for their defense. Even if this was not among the conscious motives, the Memorandum was adopted and the USAO acted in circumstances in which that result was known to be exceptionally likely. The fact that events were set in motion prior to indictment with the object of having, or with knowledge that they were likely to have, an unconstitutional effect upon indictment cannot save the government. This conduct, unless justified, violated the Sixth Amendment.[176]

The government argues that this conclusion will open the door for future defendants to argue that all sorts of pre-indictment actions violate the Sixth Amendment and thus hamstring every investigation and prosecution. This is singularly unpersuasive. The government here acted with the purpose of minimizing these defendants' access to resources necessary to mount their defenses or, at least, in reckless disregard that this would be the likely result of its actions. In these circumstances, it is not unfair to hold it accountable.

b. "Other People's Money"

The government next argues that the KPMG Defendants have no right, under the Sixth Amendment or otherwise, to spend "other people's money" on expensive defense counsel. The rhetoric is appealing, but the characterization of the issue – and therefore the conclusion – are wrong.

The argument is based on *Caplin & Drysdale, Chartered v. United States*[177] and *United States v. Monsanto*,[178] which held that the Sixth Amendment does not creates a right for those in possession of property forfeitable to the United States to spend that money on their legal defense. That is hardly surprising – the money belongs to the government. But that is not the issue here.

Caplin & Drysdale recognized that the Sixth Amendment does protect a defendant's right to spend his own money on a defense.[179] Here, the KPMG Defendants had at least an expectation that their expenses in defending any claims or charges brought against them by reason of their employment by KPMG would be paid by the firm. The law protects such interests against unjustified and improper interference.[180] Thus, both the expectation and any benefits that would have flowed from that expectation – the legal fees at issue now – were, in every material sense, their property, not that of a third party. The government's contention that the defendants seek to spend "other people's money" is thus incorrect.

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175 *See Kirby v. Illinois*, 406 U.S. 682, 689-90 (1972); *see also, e.g., United States v. Ash*, 413 U.S. 300, 303 n.3 (1973).

176 *Cf. United States v. Harrison*, 213 F.3d 1206, 1207 (9th Cir. 2000) (holding that ongoing pre-indictment attorney-client relationship, of which the government was aware, invoked the Sixth Amendment as a matter of law upon indictment).

177 491 U.S. at 619.

178 491 U.S. 600, 602 (1989).

179 491 U.S. at 624.

180 The torts of interference with prospective economic advantage and inducement of breach of contract are well known. *See generally Kirch v. Liberty Media Corp.*, No. 04-5852-CV, 2006 WL 1523036, at *10 (2d Cir. June 5, 2006); *Israel v. Wood Dolson Co.*, 1 N.Y.2d 116, 151 N.Y.S.2d 1 (1956). Interference with prospective economic advantage covers interference with the ability to pursue legal remedies against another party. *See, e.g., Reilly v. Natwest Mkts. Group, Inc.*, 178 F. Supp.2d 420, 429 (S.D.N.Y. 2001); *Ripepe v. Crown Equip. Corp.*, 293 A.D.2d 462, 463, 741 N.Y.S.2d 64, 66 (2d Dept. 2002); *Curran v. Auto Lab Svc. Ctr., Inc.*, 280 A.D.2d 636, 637, 721 N.Y.S.2d 662, 663 (2d Dept. 2001).

2. The Thompson Memorandum and the Government's Implementation Violated the KPMG Defendants' Sixth Amendment Right to Counsel

The KPMG Defendants have established that the government's implementation of the Thompson Memorandum impinged on their Sixth Amendment rights to counsel and to present a complete defense. Interference with these rights is improper if the government's actions are "wrongfully motivated or without adequate justification."[181] The remaining question, then, is whether justification exists.

There is not much case law on the standard to be applied in making this determination. In comparable circumstances, federal courts often have looked to the common law of torts to "enrich the [federal] jurisprudence"[182] and to provide "an appropriate starting point,"[183] always keeping in mind that we do so to inform our construction of the Constitution, not to apply state tort law.[184]

The common law tort of interference with prospective economic advantage necessarily deals with the issue whether a private actor is justified in interfering in the economic relations of another. In assessing claims of justification in private settings, courts look to a series of factors including the relative importance of the interests served by the plaintiff and the defendant.[185] Making appropriate adjustments for the fact that this analysis involves the public sector, the dispositive question is whether the government's law enforcement interests in taking the specific actions in question sufficiently outweigh the interests of the KPMG Defendants in having the resources needed to defend as they think proper against these charges.

Our nation made a deliberate choice more than two centuries ago. We determined that a person charged with a crime has "the right in an adversary criminal trial to make a defense as we know it."[186] That choice rests on the premise that "partisan advocacy on both sides of a case will best promote the ultimate objective that the guilty be convicted and the innocent go free."[187]

The Thompson Memorandum discourages and, as a practical matter, often prevents companies from providing employees and former employees with the financial means to exercise their constitutional rights to defend themselves. This is so even where companies obstruct nothing and, to the contrary, do everything within their power to make a clean breast of the facts to the

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181 *Via v. Cliff*, 470 F.2d 271, 274-75 (3d Cir. 1972); *accord, United States v. Morrison*, 602 F.2d 529, 531 (3d Cir. 1979), *rev'd on other grounds*, 449 U.S. 361 (1981).

182 *Adickes v. S. H. Kress & Co.*, 398 U.S. 144, 231-32 (1970) (Brennan, J., concurring and dissenting) ([W]here the wrong under [Section] 1983 is closely analogous to a wrong recognized in the law of torts, it is appropriate for the federal court to apply the relevant tort doctrines . . .").

183 *Carey v. Piphus*, 435 U.S. 247, 257-58 (1978); *see also, e.g., Wilson v. Garcia*, 471 U.S. 261, 277 (1985) ("[W]e have found tort analogies compelling in establishing the elements of a cause of action under § 1983 . . . and in identifying the immunities available to defendants.") *superceded by statute on other grounds as recognized in Jones v. R.R. Donnelley & Sons Co.*, 541 U.S. 369 (2004); *Smith v. Wade*, 461 U.S. 30, 34 (U.S. 1983) ("In the absence of more specific guidance, we looked first to the common law of torts (both modern and as of 1871), with such modification or adaptation as might be necessary to carry out the purpose and policy of [Section 1983]."); *Imbler v. Pachtman*, 424 U.S. 409, 418 (1976) ("[Section] 1983 is to be read in harmony with general principles of tort immunities and defenses, rather than in derogation of them."); *Pierson v. Ray*, 386 U.S. 547, 556 (1967) ("[Section] 1983 should be read against the background of tort liability that makes a man responsible for the natural consequences of his actions.") (internal quotation marks omitted); *Singer v. Fulton County Sheriff*, 63 F.3d 110, 118 (2d Cir. 1995), *cert. denied*, 517 U.S. 1189 (1996); *Cook v. Sheldon*, 41 F.3d 73, 79 (2d Cir. 1994) (borrowing the elements for a claim of malicious prosecution under Section 1983 from state tort law); *Raysor v. Port Authority of New York and New Jersey*, 768 F.2d 34, 39-40 (2d Cir. 1985), *cert. denied*, 475 U.S. 1027 (1986); *All Aire Conditioning v. City of New York*, 979 F. Supp. 1010, 1020 n. 47 (S.D.N.Y. 1997), *aff'd*, 166 F.3d 1199 (1998); *C.A.U.T.I.O.N., Ltd. v. City of New York*, 898 F. Supp. 1065, 1072 (S.D.N.Y. 1995).

184 *Monroe v. Pape*, 365 U.S. 167, 187 (1961).

185 *See, e.g.*, RESTATEMENT (SECOND) OF TORTS § 767 (1979).

186 *Faretta*, 422 U.S. at 818.

187 *Herring v. New York*, 422 U.S. 853, 862 (1975).

government and to take responsibility for any offenses they may have committed. It undermines the proper functioning of the adversary process that the Constitution adopted as the mode of determining guilt or innocence in criminal cases. The actions of prosecutors who implement it can make matters even worse, as occurred here.

The Court holds that the fact that advancement of legal fees occasionally might be part of an obstruction scheme or indicate a lack of full cooperation by a prospective defendant is insufficient to justify the government's interference with the right of individual criminal defendants to obtain resources lawfully available to them in order to defend themselves, regardless of the legal standard of scrutiny applied.

3. The KPMG Defendants Are Not Obliged to Establish Prejudice, Which in Any Case Would Be Presumed Here

The government argues the KPMG Defendants' motion nevertheless should be denied because they have not shown prejudice under *Strickland v. Washington,*[188] which requires a defendant seeking to overturn his or her conviction based on ineffective assistance of counsel to show "a reasonable probability that, but for counsel's unprofessional errors, the result of the proceeding would have been different."[189] But the government is mistaken.

This conclusion follows from *United States v. Gonzalez-Lopez,*[190] a case involving a deprivation of the defendant's right to counsel of his choice. The Court there held that *Strickland* did not require a showing of prejudice in such a case because:

> "Deprivation of the right [to counsel of choice] is 'complete' when the defendant is erroneously prevented from being represented by the lawyer he wants, regardless of the quality of the representation he received. To argue otherwise is to confuse the right to counsel of choice – which is the right to a particular lawyer regardless of comparative effectiveness – with the right to effective counsel – which imposes a baseline requirement of competence on whatever lawyer is chosen or appointed."[191]

Here, the violation is analogous to that at issue in *Gonzalez-Lopez.* The government has interfered with the KPMG Defendants' right to be represented as they choose, subject to the constraints imposed by the resources lawfully available to them. This violation, like a deprivation of the right to counsel of their choice, is complete irrespective of the quality of the representation they receive. Thus, *Strickland* has no bearing here.[192]

This result is consistent with common sense. Improper government conduct has created a significant risk that the KPMG Defendants' ability to present the defense they choose has been compromised. Corrective action now may well prevent that. There is, in consequence, a countervailing interest in *not* going blindly forward with a lengthy trial, which will consume vast judicial and party resources, without dealing with the issue. No one would set out to drive across a desert with half a tank of gas, knowing that one might run out before reaching the other side, without pausing first to fill up the tank. The prudent course is to avoid the problem at the outset – not to take a chance on being stranded and then having to try to figure out what to do about it.

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188 466 U.S. 668, 692 (1984).

189 *Id.* at 694.

190 2006 U.S. LEXIS 5165 at *4.

191 *Id.* at *15.

192 This would have been so even before *Gonzalez-Lopez. Strickland* by its terms applies to "[a] convicted defendant's claim that counsel's assistance was so defective as to require reversal of a conviction." *Strickland,* 466 U.S. at 687. Its requirement of a showing that the result of the trial that ended in conviction would have been different but for counsel's substandard performance would have no bearing here in any case, as no trial yet has occurred. Moreover, the requirement that a convicted defendant in an ineffective assistance case demonstrate prejudice stems at least in significant part from the Court's appropriate concern with preserving the finality of convictions and with society's need to "justify reliance on the outcome of the proceeding." *Id.* at 692. As there has been no trial yet, the interest in finality is not implicated.

The approach to cases involving criminal defense counsel burdened by conflicts of interest supports this conclusion. A district court that learns before trial of a possible conflict of interest between a defense attorney and a client is obliged to protect the defendant's Sixth Amendment right to unconflicted legal representation by immediately investigating the conflict and, if necessary, either obtaining a knowing or intelligent waiver from the defendant or disqualifying the conflicted attorney.[193] The rationale for doing so is simple. Prejudice is likely in conflict situations, and "such circumstances involve impairments of the Sixth Amendment right that are easy to identify and, for that reason and because the prosecution is directly responsible, easy for the government to prevent."[194] That rationale is fully applicable here.

Even if prejudice were relevant at this stage of the proceedings, however, the government's argument still would fail. Although *Strickland* generally requires convicted defendants to demonstrate that the result of the trial probably would have been different but for the ineffective assistance of counsel, this requirement does not apply where a violation resulted in a "structural defect[] in the constitution of the trial mechanism"[195] that "affected – and contaminated – the entire criminal proceeding."[196] In other words, there are two distinct types of constitutional errors: trial errors, which occur during the presentation of evidence at trial, and structural errors, which are overarching and permeate the entire proceeding.[197] As trial errors occur during the presentation of a case to the jury, they "may . . . be quantitatively assessed in the context of other evidence presented in order to determine whether" their commission "was harmless beyond a reasonable doubt."[198] Structural errors, on the other hand, "defy analysis by 'harmless-error' standards."[199] They affect "[t]he entire conduct of the trial from beginning to end."[200] Prejudice "is so likely that case-by-case inquiry into prejudice is not worth the cost."[201]

Structural defects exist – and prejudice must be presumed – where a defendant is actively or constructively denied counsel at a critical stage of the trial or where defense counsel is burdened by an actual conflict of interest.[202] Structural errors "may be present [also] on some occasions when, although counsel is available to assist the accused during trial, the likelihood that any lawyer, even a fully competent one, could provide effective assistance is so small that a presumption of prejudice is appropriate without inquiry into the actual conduct of the trial."[203] In *Powell v. Alabama,* for example, the trial court, on the day of the trial, appointed an attorney from a different state – who professed himself to be unfamiliar with the facts of the case and the local procedure – to represent defendants in a highly publicized capital case. The Supreme Court held

193 *See, e.g., Wheat,* 486 U.S. at 160; *United States v. Perez,* 325 F.3d 115, 125-26 (2d Cir. 2003); *United States v. Schwarz,* 283 F.3d 76, 95-96 (2d Cir. 2002); *United States v. Levy,* 25 F.3d 146, 153 (2d Cir. 1994); *United States v. Fulton,* 5 F.3d 605, 612-13 (2d Cir. 1993); *United States v. Curcio,* 680 F.2d 881, 888-90 (2d Cir. 1982); *United States v. Scala,* No. S1 04 Cr. 0070 (LAK), 2006 WL 1589772, at *2-4 (S.D.N.Y. June 12, 2006).

194 *Strickland,* 466 U.S. at 692.

195 *Arizona v. Fulminante,* 499 U.S. 279, 309 (1991).

196 *Satterwhite v. Texas,* 486 U.S. 249, 257 (1988); *see also Brecht v. Abrahamson,* 507 U.S. 619, 629-30 (1993); *United States v. Cronic,* 466 U.S.648, 658 (1984).

197 *Fulminante,* 499 U.S. at 307-10.

198 *Id.* at 307-08.

199 *Id.* at 309.

200 *Id.* at 310.

201 *Strickland,* 466 U.S. at 692 (citing *Cronic,* 466 U.S. at 658); *accord, Fulminante,* 499 U.S. at 309-10; *see also Lainfiesta v. Artuz,* 253 F.3d 151, 157 (2d Cir. 2001).

202 *See, e.g., Cronic,* 466 U.S. at 659 & n.25 & n.28; *Fulminante,* 499 U.S. at 309-10; *Strickland,* 466 at 692; *Cuyler* v. *Sullivan,* 446 U.S. 335, 349-50 (1980).

203 *Cronic,* 466 U.S. at 659-60.

that the likelihood that counsel could have performed as an effective advocate in those circumstances was so remote as to render the trial inherently unfair, obviating the requirement that the defendants affirmatively demonstrate prejudice.[204]

Although the circumstances here differ from those in *Powell,* the government's conduct threatens to contaminate this proceeding. Properly defending this case, in all its complexity, has required, and will continue to require, substantial financial resources. The government has spent years investigating the case, presumably reviewing millions of pages of documents[205] and interviewing scores of witnesses if not more. The KPMG Defendants, however, have limited resources. Although each defendant is represented by retained counsel, the government's interference almost inevitably has affected at least some lawyer selections and, equally important, limited what the KPMG Defendants can pay their lawyers to do. At least most of them likely will be unable to afford to pay their attorneys to review all or even most of the documents the government has produced or, perhaps, to interview even a fraction of the witnesses the government has interviewed. They may not be able to afford tax experts to advise trial counsel and, if need be, answer those whom the government may present at trial.

In these circumstances, demonstrating prejudice after the fact would be all but impossible. In order to show that the trial outcome would have been different had a convicted defendant been able to afford better preparation before trial, the defendant's counsel, after conviction, would have to do the work that the defendant could not afford to have done in the first place. If the defendant could not afford to have the work done in the first place, the defendant certainly could not afford to have it done after conviction. And relying upon the possibility of counsel appointed under the Criminal Justice Act to do so, should a convicted defendant have become indigent, simply would be unrealistic. In any case, assessing the impact of pretrial omissions and errors could require extensive evidentiary proceedings. In consequence, it is difficult to imagine circumstances in which an error more properly could be said to threaten to taint an entire proceeding.

This conclusion too is supported by *Gonzalez-Lopez.* Speaking of a deprivation of the right to counsel of choice, the Supreme Court wrote:

> "We have little trouble concluding that erroneous deprivation of the right to counsel of choice, 'with consequences that are necessarily unquantifiable and indeterminate, unquestionably qualifies as "structural error."' Different attorneys will pursue different strategies with regard to investigation and discovery, development of the theory of defense, selection of the jury, presentation of the witnesses, and style of witness examination and jury argument. And the choice of attorney will affect whether and on what terms the defendant cooperates with the prosecution, plea bargains, or decides instead to go to trial. In light of those myriad aspects of representation, the erroneous denial of counsel bears directly on the 'framework within which the trial proceeds,' – or indeed on whether it proceeds at all. It is impossible to know what different choices the rejected counsel would have made, and then to quantify the impact of those different choices on the outcome of the proceedings. Many counseled decisions, including those involving plea bargains and cooperation with the government, do not even concern the conduct of the trial at all. Harmless-error analysis in such a context would be a speculative inquiry into what might have occurred in an alternate universe."[206]

The same reasoning applies here. Virtually everything the defendants do in this case may be influenced by the extent of the resources available to them. There simply would be no way to know, after the fact, whether the outcome had been influenced by limitations improperly placed upon the availability of resources.

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[204] 287 U.S. at 53.

[205] The government thus far has produced, in electronic or paper form, at least 5 to 6 million pages of documents *plus* transcripts of 335 depositions and 195 income tax returns. Anderson Decl. [docket item 561] ¶¶ 24, 27, 38-39, 41.

[206] 2006 U.S. LEXIS 5165 at *18-19 (internal citations omitted).

Further, the government's interference in the KPMG Defendants' ability to mount a defense "creates an appearance of impropriety that diminishes faith in the fairness of the criminal justice system in general."[207] This injury to the criminal justice system is not dependent on whether or not the KPMG Defendants ultimately are convicted or – more to the point – whether they would have been convicted even if the government had not interfered with their constitutional right to counsel.

Accordingly, there is no need for a particularized showing of prejudice here. While a defendant does not have a constitutional right to the most expensive lawyer or to unlimited defense funds, government interference with those resources that a defendant does have or legally may obtain fundamentally alters the structure of the adversary process. As the late Judge Wyzanski explained, although "'a criminal trial is not a game in which the participants are expected to enter the ring with a near match in skills, neither is it a sacrifice of unarmed prisoners to gladiators.'"[208]

The considerations that support a presumption of prejudice – the government's responsibility for the problem and the ease with which the trial court can detect and remedy that problem prior to trial – both are present here. The government is responsible for the infringement of the KPMG Defendants' rights. The problem has been detected, and it probably is susceptible of cure before trial. Were the Court to refrain from seeking to remedy the problem now, it would abdicate its responsibility to safeguard defendants' constitutional rights.

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[207] *Young v. United States ex rel. Vuitton et Fils S.A.*, 481 U.S. 787, 811 (1987); *see also Offutt v. United States*, 348 U.S. 11, 14 (1954) ("[J]ustice must specify the appearance of justice.").

[208] *Cronic*, 466 U.S. at 657 (quoting *United States ex rel. Williams v. Twomey*, 510 F.2d 634, 640 (7th Cir. 1975).

III. It is Premature to Consider the Government's Actions With Respect to Payment of Legal Expenses Incurred Before Indictment

The KPMG Defendants argue also that the government's actions with respect to advancement of legal fees interfered with their rights prior to indictment. But the preindictment interference must be evaluated in a very different context.

To begin with, the legal analysis differs. The Sixth Amendment attaches only upon indictment. Actions by the government that affected only the payment of legal fees and defense costs for services rendered prior to the indictment therefore do not implicate the Sixth Amendment. Any relief must be grounded in the Due Process Clause alone.

Second, the impact of the government's actions was quite different. KPMG paid attorneys' fees prior to indictment for all of the KPMG Defendants on condition that the employees cooperate with the government. There is no suggestion that any defendant reached the $400,000 cap save Mr. Stein, and KPMG ignored the $400,000 ceiling in his case until very late in the day. In consequence, there is no reason to suppose that the ability of any of the KPMG Defendants to undertake activities designed to ward off an indictment was impaired by the government's actions save in one respect – at least some of the KPMG Defendants made proffers to the government that they conceivably would not have made had they not induced to do so by the threat of having payment of their legal fees cut off. These proffers are of significance only if they may be used at trial, either on the government's case in chief or, perhaps more importantly, to cross examine a defendant who testifies on the defense case. This has an important consequence.

The Supreme Court has made clear that remedies for constitutional violations "should be tailored to the injury suffered . . . and should not unnecessarily infringe on competing interests,"

including the interest in the administration of criminal justice.[209] Its "approach has thus been to identify and then neutralize the taint by tailoring relief appropriate in the circumstances to assure the defendant the effective assistance of counsel and a fair trial."[210] Hence, if the government's pressure on KPMG ultimately resulted in improperly coerced statements, the matter may be fully redressed by suppression of the statements.

The question whether the statements should be suppressed is before the Court on another motion by the KPMG Defendants that has not yet been fully briefed. Accordingly, it would be premature to address it here.

IV. The Remedy

The next question concerns the appropriate remedy for the violation of the KPMG Defendants' constitutional rights. Defendants ask the Court to dismiss the indictment or to order payment of their legal fees either by the government or by KPMG. The government argues that any relief should be limited to requiring KPMG to consider anew whether it wishes to advance expenses to the defendants, now free of the threat of government retaliation by virtue of the government's recent statement that it does not object to KPMG doing as it pleases.

The Court rejects the government's alternative. The government's belated statement that KPMG may do as it wishes without government retribution is not sufficient to put the KPMG Defendants in the position they would have enjoyed had the government not interfered with the advancement of defense costs in the first place. It ignores altogether the Court's finding that KPMG would have advanced defense costs absent the government's interference. It ignores KPMG's possible interest in not being seen to reverse course and thus as admitting that it caved in to government pressure in this respect at the expense of individual members and employees of the firm. It ignores also the fact that circumstances have changed dramatically since KPMG, under government pressure, decided in 2004 to cut off anyone who was indicted. KPMG has yielded to the government's demand that the firm pay a fine of $456 million. The individual defendants have been indicted on charges the full scope of which may not previously have been foreseeable to KPMG. Thus, the defense costs that KPMG is being asked to advance perhaps are larger than might earlier have been foreseeable. The resources available to pay them have been reduced. Accordingly, the Court is not persuaded that the damage the government has done can be remedied by now leaving KPMG to do as it pleases. So the Court moves on to the appropriate remedies for the government's actions.

As discussed above, remedies for constitutional violations should be tailored narrowly to the injury suffered.[211] Dismissal of an indictment on the grounds of prosecutorial misconduct is an "extreme and drastic sanction"[212] that should not even be considered unless it is otherwise "impossible to restore a criminal defendant to the position that he would have occupied" but for the misconduct.[213]

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209 *United States v. Morrison*, 449 U.S. at 365.

210 *Id.*

211 *Morrison*, 449 U.S. at 365.

212 *United States v. Rubio*, 709 F.2d 146, 152 (2d Cir. 1983) (internal citations omitted); *see also Morrison*, 449 U.S. at 366 n.3 (citing *United States v. Blue*, 384 U.S. 251, 255 (1966)); *United States v. Estrada*, 164 F.3d 619, 621 (2d Cir. 1998); *United States v. Fields*, 592 F.2d 638, 647-48 (2d Cir.1978), *cert. denied*,442 U.S. 917 (1979).

213 *United States v. Artuso*, 618 F.2d 192, 196-97 (2d Cir. 1980), *cert. denied*,449 U.S. 879 (1980); *see also Carmichael v. United States*, 216 F.3d 224, 227 (2d Cir. 2000).

The KPMG Defendants can be restored to the position they would have occupied but for the government's constitutional violation if defense costs already incurred and yet to be incurred are paid. Indeed, although the KPMG Defendants have not conceded that dismissal would be inappropriate as long as they are put in funds for their defense, they have devoted most of their attention to monetary relief. In consequence, consideration of dismissal of the indictment would be premature prior to exhaustion of all possible courses that could lead to that outcome.

A. Monetary Relief Against the Government Is Precluded by Sovereign Immunity

The first avenue suggested is an order directing the government to pay. But the KPMG Defendants immediately run into the doctrine of sovereign immunity.

"Absent an express waiver of sovereign immunity, money awards cannot be imposed against the United States."[214] Only Congress may waive sovereign immunity, and it may do so only through unequivocal statutory language.[215]

The KPMG Defendants first contend that monetary sanctions against the government pursuant to the Court's supervisory powers would not be money damages and therefore are not barred by sovereign immunity. But they point to no statute that specifically waives sovereign immunity from monetary sanctions imposed pursuant to supervisory power of the federal courts. They imply instead that supervisory powers automatically trump sovereign immunity, even absent a waiver.

A number of federal courts have addressed the interplay between sovereign immunity and the judiciary's power to impose monetary sanctions for litigation abuse.[216] Although the Second Circuit has not reached the precise question, the First Circuit's analysis in *United States v. Horn*[217] is instructive. There, the district court had used its supervisory powers to order the government to pay the defendants' legal fees and costs as punishment for prosecutorial misconduct. The First Circuit, however, reversed, explaining that "sovereign immunity ordinarily will trump supervisory power in a head-to-head confrontation" because

> "supervisory powers are discretionary and carefully circumscribed; [whereas] sovereign immunity is mandatory and absolute . . . In other words, unlike the doctrine of supervisory power, the doctrine of sovereign immunity proceeds by fiat: if Congress has not waived the sovereign's immunity in a given context, the courts

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214 *McBride v. Coleman*, 955 F.2d 571, 576 (8th Cir. 1992); *see also Ruckelshaus v. Sierra Club*, 463 U.S. 680, 685-686 (1983); *United States v. Bodcaw Co.*, 440 U.S. 202, 203 n.3 (1979); *United States v. Waksberg*, 112 F.3d 1225, 1227 (D.C. Cir. 1997); *Robinson v. Overseas Military Sales Corp.*, 21 F.3d 502, 510 (2d Cir. 1994).

215 *See, e.g., United States v. King*, 395 U.S. 1, 5 (1969); *Samuels, Kramer & Co. v. Comm'r of Internal Revenue*, 930 F.2d 975, 983 (2d Cir. 1991).

216 *See, e.g., United States v. Woodley*, 9 F.3d 774, 782 (9th Cir. 1993) (noting that courts may impose monetary sanctions on the government – notwithstanding sovereign immunity – in order to remedy the violation of a recognized right and ensure that "government attorneys maintain ethical standards," but holding that monetary sanctions were inappropriate in this case and noting that other remedies are more appropriate); *Coleman v. Espy*, 986 F.2d 1184, 1191-92 (8th Cir. 1993) (sovereign immunity bars compensatory contempt sanctions against the United States); *McBride*, 955 F.2d at 576-77 (noting that the district court's imposition of compensatory contempt sanctions against the government likely violated the doctrine of sovereign immunity, but reversing on other grounds); *Barry v. Bowen*, 884 F.2d 442, 443-44 (9th Cir. 1989) (noting that the district court's imposition of compensatory contempt sanctions against the government likely violated the doctrine of sovereign immunity, but reversing on other grounds); *Yancheng Baolong Biochemical Prods. Co., Ltd. v. United States*, 343 F. Supp. 2d 1226, 1241 (Ct. Int'l Trade 2004) (collecting cases and holding that award of attorneys' fees against the government was barred by sovereign immunity); *United States v. Prince*, No. CR 93-1073 (RR), 1994 WL 99231, *1-*2 (E.D.N.Y. Mar. 10, 1994) (withdrawing assessment of jury costs against U.S. Attorney's Office under court's supervisory power, in the face of a motion for reconsideration arguing constraints imposed by sovereign immunity); *see also Waksberg*, 112 F.3d at 1227-28 (invoking the doctrine of constitutional avoidance to defer review of the district court's finding that sovereign immunity barred the award of compensatory damages against the United States).

217 29 F.3d 754, 767 (1st Cir. 1994).

are obliged to honor that immunity."[218]

This Court agrees. Accordingly, monetary sanctions do not overcome sovereign immunity.

The KPMG Defendants next argue that the Federal Tort Claims Act[219] (the "FTCA") and the Administrative Procedure Act[220] (the "APA") waive sovereign immunity. Each, however, waives sovereign immunity only for certain civil actions against the government.[221] Neither deals with sanctions for prosecutorial misconduct. The KPMG Defendants point to no case law suggesting that the FTCA and APA waivers apply in this context, and the Court is aware of none. Given the Court's obligation to construe narrowly any statutory waiver of sovereign immunity,[222] it would be inappropriate to read the FTCA or the APA as waiving the government's immunity to monetary sanctions in this case.

Accordingly, sovereign immunity bars this Court from ordering the government to pay the KPMG Defendants' legal fees.[223] This is not the end of the analysis, however. As the First Circuit explained in *Horn,* "[t]he fact that sovereign immunity forecloses the imposition of monetary sanctions against the federal government in criminal cases does not leave federal courts at the mercy of cantankerous prosecutors. Courts have many other weapons in their armamentarium."[224] The Court therefore turns to other options, addressing first the possibility of monetary relief against KPMG.

B. Monetary Relief May Be Available Against KPMG

The KPMG Defendants urge the Court to order KPMG to advance their defense costs. KPMG, which is not formally a party here but which has been heard in any case, resists on several grounds.

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218 *Id.* at 764.

The *Horn* court noted also that courts have means apart from monetary sanctions by which to punish prosecutorial misconduct, including public reprimand and other equitable relief. *Id.* at 767.

219 28 U.S.C. § 1346.

220 5 U.S.C. § 702.

221 The FTCA waives sovereign immunity in "civil actions on claims against the United States, for money damages, accruing on and after January 1, 1945, for injury or loss of property, or personal injury or death caused by the negligent or wrongful act or omission of any employee of the Government while acting within the scope of his office or employment, under circumstances where the United States, if a private person, would be liable to the claimant in accordance with the law of the place where the act or omission occurred." 28 U.S.C. § 1346(b).

The APA waives immunity in "action[s] in a court of the United States seeking relief other than money damages and stating a claim that an agency or an officer or employee thereof acted or failed to act in an official capacity or under color of legal authority." 5 U.S.C. § 702.

222 "Waivers of immunity must be construed strictly in favor of the sovereign and not enlarge[d] . . . beyond what the language requires." *Ruckelshaus,* 463 U.S. at 686 (internal citations and quotation marks omitted); *Lehman v. Nakshian,* 453 U.S. 156, 161 (1981). Courts must strictly construe also any limitations or conditions imposed by Congress on a particular waiver of immunity. *Id.* at 160-61.

223 The KPMG Defendants attempt to avoid this conclusion by asking the Court to order the government to pay their defense costs out of the $256 million fine it already has received from KPMG or to order KPMG to pay the $200 million final installment of the fine into the registry of the Court, where so much as is required to pay the defense costs would be distributed to the KPMG Defendants and the balance to the government. They appear to argue that either remedy would be injunctive in nature and not a monetary sanction against the government. Sovereign immunity, however, "stands as an obstacle to virtually all direct assaults against the public fisc, save only those incursions from time to time authorized by Congress." *Horn,* 29 F.3d at 761. The relief the KPMG Defendants have requested here would be no less an assault on the public fisc simply because it would be addressed to a fine already received by the government or monies to which the government already is entitled. Put another way, requiring the government to pay the money from a particular account or to forego revenues to which it is entitled would not make such relief any less a monetary sanction.

224 29 F.3d at 766.

1. This Court Has Subject Matter Jurisdiction

Federal courts are courts of limited jurisdiction. They have only such judicial power as is conferred upon them by statute and, in the case of the Supreme Court, Article III of the Constitution.[225]

The Court's subject matter jurisdiction in this case rests on Section 3231 of the Criminal Code,[226] which gives "[t]he district courts of the United States . . . original jurisdiction, exclusive of the courts of the States, of all offenses against the laws of the United States." And it is well established that a district court having subject matter jurisdiction over a federal criminal case has ancillary jurisdiction over at least some related matters.[227]

Our Circuit recently addressed the scope of ancillary jurisdiction in criminal cases in *Garcia v. Teitler.*[228] The question there presented was whether a district court had jurisdiction to order an attorney who had appeared and then withdrawn as counsel for the defendants, and who was not a party to the action, to return a retainer the defendants had paid him so that the defendants could retain another attorney to defend the case. The Court held that it did, writing:

> "At its heart, ancillary jurisdiction is aimed at enabling a court to administer 'justice within the scope of its jurisdiction.' Without the power to deal with issues ancillary or incidental to the main action, courts would be unable to 'effectively dispose of the principal case nor do complete justice in the premises.' Along these lines, the Supreme Court has instructed that ancillary jurisdiction may be exercised 'for two separate, though sometimes related, purposes: (1) to permit disposition of claims that are, in varying respects and degrees, factually interdependent by a single court, and (2) to enable a court to function successfully, that is, to manage its proceedings, vindicate its authority, and effectuate its decrees."
>
> "Whatever the outer limits of ancillary jurisdiction may be, we hold that resolving a fee dispute after an attorney withdraws . . . is within a district court's ancillary powers, as it relates to the court's ability to 'function successfully.' * * *
>
> "Although [defendants] have been able to obtain new counsel, the record reflects that they are of limited means and that the funds paid to Teitler may be needed to pay their new counsel. In order to guarantee a defendant's right to choose his own counsel where, as here, his criminal case is ongoing, and to avoid the possibility of defendants becoming indigent and requiring the appointment of counsel, a district court must be able to exercise ancillary jurisdiction to resolve a fee dispute."[229]

So too here. While the KPMG Defendants all are represented by retained counsel, the cost of mounting their defenses in this complex case is potentially very large. In order to guarantee their right to choose their own counsel, to ensure that they can afford to pay those counsel to do what they think appropriate to defend the case, and to avoid the possibility of their becoming indigent and requiring the appointment of counsel, this Court has the power to exercise ancillary jurisdiction to resolve their right to the advancement of expenses by KPMG.[230] This is confirmed by *United States v. Weissman,*[231] cited with approval in *Garcia,* in which Judge Haight exercised ancillary jurisdiction to determine whether a company that formerly employed an individual who was facing criminal charges in this Court was obliged to continue to advance the defense costs.

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225 *See, e.g., Ins. Corp. of Ireland, Ltd. v. Compagnie des Bauxites de Guinee,* 456 U.S. 694, 701-02 (1982); *W.G. v. Senatore,* 18 F.3d 60, 64 (2d Cir. 1994).

226 18 U.S.C. § 3231.

227 *See Garcia v. Teitler,* 443 F.3d 202, 208 (2d Cir. 2006).

228 *Id.*

229 *Id.* at 208, 209 (internal citations omitted).

230 The Court need not here decide whether its ancillary jurisdiction includes the power to determine whether KPMG is obliged to indemnify the KPMG Defendants or, if not, whether the KPMG Defendants would be obliged to repay any funds advanced to them. The immediate concern is with the Court's power to ensure that the KPMG Defendants, if they are entitled to it, have the means to finance the defense before this Court.

231 1997 WL 334966 at *9.

Accordingly, the Court holds that it has ancillary jurisdiction to determine the claims of the KPMG Defendants for advancement. As Judge Gleeson did in *Garcia,* the Court will direct the Clerk, as a matter of administrative convenience, to open a civil docket number for the claims of the KPMG Defendants against KPMG.[232]

2. *Personal Jurisdiction, Even If It Does Not Already Exist, May Be Obtained Over KPMG*

The fact that the Court has subject matter jurisdiction is not alone sufficient to proceed with the claims. KPMG objects that it is not a party to this action and that the Court lacks jurisdiction over its person.

KPMG of course is not a defendant in this case.[233] Nevertheless, it long has been well aware of these proceedings. It attended the hearing and submitted papers. But it never has been served with a summons and complaint seeking advancement of legal fees.

There is reason to question whether the lack of a summons and complaint, which ordinarily would be fatal in a garden-variety civil case,[234] should have that consequence in the unique circumstances here.[235] But it is unnecessary to go down that path, which in any case would threaten to complicate and perhaps delay the important determination that may lie within this Court's province – whether KPMG must at least advance defense costs to the KPMG defendants.

The KPMG Defendants, if so advised, may file a complaint in the civil file opened pursuant to this decision, obtain the issuance of a summons, and serve KPMG provided they do so within 14 days of the date of this decision. The complaint may contain a prayer for declaratory relief and a request for a speedy hearing,[236] which would be appropriate in any case in view of the fact that the determination of rights to advancement is made in summary proceedings[237] in order to permit

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232 *Garcia v. Teitler,* No. 04 Civ. 0832 (JG), 2004 WL 1636982, *1 n.2 (E.D.N.Y. July 22,2004), *aff'd,* 443 F.3d 202 (2d Cir. 2006).

233 It is a defendant in a related action in this district, that commenced by the filing of the information pursuant to the DPA. *United States v. KPMG LLP,* 05 Crim. 0903 (LAP) (filed Aug. 29, 2005).

234 *See, e.g., OSRecovery, Inc. v. One Group Int'l, Inc.,* 234 F.R.D. 59, 60-61 (S.D.N.Y. 2005).

235 Some states, at least in the past, held that a defendant who appeared in an action for any purpose consented to the exercise of personal jurisdiction, *See York v. Texas,* 137 U.S. 15 (1890). To amerliorate this rule, many adopted statutes or rules permitting a defendant who wished to challenge the exercise of personal jurisdiction to appear specially for that purpose alone without thereby appearing generally. *See id.* at 20; *see also, e.g., Orange Theatre Corp. v. Rayherstz Amusement Corp.,* 139 F.2d 871, 874 (3d Cir. 1944). Even in such states, any action before the court beyond challenging the exercise of jurisdiction constitutes a general appearance and waives the jurisdictional objection. *See, e.g., Regents of the Univ. of Calif. v. Golf Mktg., LLC,* 92 Conn. App. 378, 381-82, 885 A.2d 201, 203 (2005) (party who seeks relief on any basis other than a motion to quash for lack of personal jurisdiction deemed to have made general appearance and waived all objections to defects in service, process, or personal jurisdiction) (California law) (quotation marks omitted); *Davis v. Eighth Jud. Dist. of Nevada,* 97 Nev. 332, 334-36, 629 P.2d 1209, 1211-12 (1981) (opposition to motion for leave to amend waived special appearance and subjected party to personal jurisdiction), *arbrogated by statute as recognized in Hansen v. Eighth Jud. Dist. of Nevada,* 116 Nev. 650, 655-56, 6 P.3d 982, 985 (2000); *Woods v. Billy's Automotive,* 622 S.E.2d 193, 197 (N.C. App. 2005) ("[I]f a party invoked the judgment of the court for any other purpose [than contesting service of process] he made a general appearance and by so doing he submitted himself to the jurisdiction of the court whether he intended to do so or not.") (citation and internal quotation marks omitted); *Lyren v. Ohr,* 271 Va. 155, 158-59, 623 S.E.2d 883, 884-85 (2006) (appearance for any purpose other than objecting to the jurisidiction is general appearance even if denominated "special"); *Maryland Cas. Co. v. Clintwood Bank, Inc.,* 155 Va. 181, 186, 154 S.E. 492, 494 (1930) (any action by defendant, except an objection to jurisdiction, recognizing a case as in court is general appearance). The Federal Rules of Civil Procedure, and many modern state codes, go further, abolishing the distinction between general and special appearances and permitting a defendant to preserve a personal jurisdiction objection by answer or timely motion to dismiss. These rules, however, do not apply in a criminal case. It therefore is arguable that KPMG's actions before the Court constituted a general appearance and thus waived any objection to personal jurisdiction.

236 FED. R. CIV. P. 57.

237 *See* 6 WEST'S DEL. CODE ANN. § 145(k) (2006); N.Y. BUS. CORP. L. §§ 724(a), 1319(a)(4) (McKinney 2003). *See generally* Steven A. Radin, *"Sinners Who Find Religion": Advancement of Litigation Expenses to Corporate Officials Accused of Wrongdoing,* 25 REV. LITIG. 251, 263-68 (2006) (hereinafter "Radin") (summarizing Delaware cases on

the issue to be decided while the underlying case is pending.[238] Should that occur, the matter would proceed expeditiously.[239]

summary nature of advancement proceedings).

The scope of an advancement proceeding "is limited to determining 'the issue of entitlement according to the corporation's advancement provisions and not to issues regarding the movant's alleged conduct in the underlying litigation.'" *Kaung,* 884 A.2d at 509 (Del. 2005) (quoting *Homestore, Inc. v. Tafeen,* 886 A.2d 502, 503 (Del. 2005)). "Neither indemnification nor recoupment of sums previously advanced are appropriate for litigation in a summary proceeding" and necessarily would be reserved for subsequent proceedings, possibly in another forum. Radin, 25 REV. LITIG. at 265-66. In any case, although it is unnecessary to decide the issue now, it is questionable whether the Court's ancillary jurisdiction extends beyond determining the right to advancement.

There is no jurisdictional obstacle to a federal court determining advancement under state law. *See, e.g., Truck Components Inc. v. Beatrice Co.,* 143 F.3d 1057, 1061 (7th Cir. 1998).

238 The Federal Rules of Criminal Procedure state that they "are to be interpreted for the just determination of every criminal proceeding, to secure simplicity in procedure and fairness in administration, and to eliminate unjustifiable expense and delay." FED. R. CRIM. P. 2. Likewise, the Federal Rules of Civil Procedure, which govern "all suits of a civil nature," are to "be construed and administered to secure the just, speedy, and inexpensive determination of every action." FED. R. CIV. P. 1. Accordingly, the Court will treat the papers already filed by the KPMG Defendants as a motion for an order directing KPMG to advance the defense costs reasonably incurred and to be incurred by them from the date of the indictment forward. It will consider the papers already filed by KPMG as an opposition to that motion. KPMG may file such additional response as it wishes within 14 days after the date of service of any summons and complaint.

239 The Court is mindful of KPMG's contention that those of the KPMG Defendants who were partners in the firm are obliged by the partnership agreement to arbitrate the issue of advancement. Assuming that the KPMG Defendants pursue relief against KPMG and that KPMG remains insistent upon its alleged arbitration remedy, the questions whether the arbitration clause properly is so construed and, if so, whether it is void as against public policy to the extent that it would foreclose an advancement determination in a criminal case by the court in which the indictment is pending will be addressed in any advancement proceeding the KPMG Defendants may bring pursuant to this decision.

C. Possible Dismissal and Other Remedies

A summary advancement proceeding is not the only means by which the KPMG Defendants might be restored to the position they would have occupied had the government not interfered improperly with their prospects for advancement of defense costs.

The government has substantial influence and, almost certainly, power over KPMG by virtue of the cooperation clauses in the DPA. It may well be in its interest to use that influence or power to cause KPMG to advance the defense costs.[240]

Nor is KPMG lacking in incentives, if it needs them, to aid the government in solving the problem the government created for itself. The government now may seek to use its leverage against KPMG to cause KPMG to advance defenses costs in order to avoid any risk of dismissal of this indictment or other unpalatable relief. Moreover, KPMG may conclude that obstruction of the efforts of its former partners and employees to obtain advancement of defense costs, or even a prompt adjudication of their right to such advancement, would not further its interest in recruiting and retaining top flight personnel.

Thus, there are at least two possibilities for resolving the issue of advancement of defense costs. KPMG, either on its own or at the government's urging or insistence, may advance the defense costs. Alternatively, the KPMG Defendants may succeed in obtaining an advancement

240 Among other avenues open to the government if it were disposed to seek to remedy the problem it has created might be to persuade KPMG to eliminate obstacles to prompt resolution of the advancement issue. KPMG might, for example, waive any right that it may have to compel its former partners to arbitrate, or to claim a jury trial on, the question whether the KPMG Defendants are entitled to advancement of defense costs. Such a waiver need not affect any claims by the KPMG Defendants for indemnification (as distinguished from advancement) by KPMG or any claims that KPMG may have against the KPMG Defendants, neither of which would be a proper subject of a summary advancement proceeding in any event.

order in a summary proceeding before this Court. In either event, the effect of the government's unconstitutional interference would have been remedied or, at least, mitigated substantially. Should that come to pass, the possibilities of dismissal of the indictment and other remedies likely would appear in a different light. In consequence, the Court declines to consider additional relief at this time, although it may do so in the future if KPMG does not, for one reason or another, advance defense costs.

V. Some of the Actions of the USAO in Response to the Motion Were Not Appropriate

The foregoing discussion of remedies is addressed solely to the unconstitutional interference with the KPMG Defendants' prospects of obtaining advancement of defense costs from KPMG. One matter remains – the actions of the USAO in resisting this motion.

The Court begins from a widely held premise. We long have been well-served by the United States Attorney's office for this district and by the many lawyers who have served in it with great distinction. It is a model for the nation.[241] While the office's actions in this case with respect to the advancement of attorneys' fees contributed to an unconstitutional result, they were consistent with policies established in Washington. Moreover, they occurred at a time when the propriety of those policies had not previously been addressed by any court. The Court declines to chastise the office or its members further on the basis of those actions. There is, however, one matter that should be addressed.

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[241] *See generally* Lewis A. Kaplan, *Henry L. Stimson Award Ceremony: Remarks,* 54 RECORD OF THE ASS'N OF THE BAR OF THE CITY OF NEW YORK 420 (1999).

The government was economical with the truth in its early responses to this motion. It is difficult to defend even the literal truth of the position it took in its first memorandum of law. KPMG's decision on payment of attorneys' fees was influenced by its interaction with the USAO and thus cannot fairly be said to have been a decision "made by KPMG alone," as the government represented. The government's assertion that the legal fee decision was made without "coercion" or "bullying" by the government can be justified only by tortured definitions of those terms. And while it is literally true, as Mr. Weddle wrote in his later declaration, that the government did not "instruct" or "request" KPMG to do anything with respect to legal fees, that was far from the whole story. Those submissions did not even hint at Mr. Weddle's raising of the legal fee issue at the very first meeting, at Ms. Neiman's "rewarding misconduct" comment, at Mr. Weddle's statement that the USAO would look at the payment of legal fees "under a microscope," or at the government's use of KPMG's willingness to cut off payment of legal fees to pressure KPMG personnel to waive their Fifth Amendment rights and make proffers to the government. Those omissions rendered the declaration and the brief that accompanied it misleading.

Every court is entitled to complete candor from every attorney, and most of all from those who represent the United States. These actions by the USAO are disappointing. There should be no recurrence.

Conclusion

The Thompson Memorandum's treatment of advancement of defense costs no doubt serves the government's interest in obtaining criminal convictions in complex business cases. So

too the actions of the USAO in this case. But the government's proper concern is not with obtaining convictions.

As a unanimous Supreme Court wrote long ago, the interest of the government "in a criminal prosecution is not that it shall win a case, but that justice shall be done."[242] Justice is not done when the government use the threat of indictment – a matter of life and death to many companies and therefore a matter that threatens the jobs and security of blameless employees[243] – to coerce companies into depriving their present and even former employees of the means of defending themselves against criminal charges in a court of law. If those whom the government suspects are culpable in fact are guilty, they should pay the price. But the determination of guilt or innocence must be made fairly – not in a proceeding in which the government has obtained an unfair advantage long before the trial even has begun.

The motions of the KPMG Defendants to dismiss the indictment or for other relief are granted only to the extent that:

1. The Court declares that so much of the Thompson Memorandum and the activities of the USAO as threatened to take into account, in deciding whether to indict KPMG, whether KPMG would advance attorneys' fees to present or former employees in the event they were indicted for activities undertaken in the course of their employment interfered with the rights of such employees to a fair trial and to the effective assistance of counsel and therefore violated the Fifth and Sixth Amendments to the Constitution.

2. The government shall adhere to its representation that any payment by KPMG of the defense costs of the KPMG Defendants is acceptable to the government and will not be considered in determining whether KPMG has complied with the DPA or otherwise prejudice KPMG.

3. The Clerk shall open a civil docket number to accommodate the claims of the KPMG Defendants against KPMG for advancement of defense costs should they elect to pursue them. If they file a complaint within 14 days, the Clerk shall issue a summons to KPMG. The Court in that event will entertain the claims pursuant to its ancillary jurisdiction over this case.

The motions are denied insofar as they seek monetary sanctions against the government. The Court reserves decision as to whether to grant additional relief.

The foregoing constitute the Court's findings of fact and conclusions of law.

SO ORDERED.

Dated: June 26, 2006

Lewis A. Kaplan
United States District Judge

(The manuscript signature above is not an image of the signature on the original document in the Court file.)

[242] *Berger v. United States,* 295 U.S. 78, 88 (1935); *see also, e.g., Brady,* 373 U.S. at 87 ("Society wins not only when the guilty are convicted but when criminal trials are fair; our system of the administration of justice suffers when any accused is treated unfairly. An inscription on the walls of the Department of Justice states the proposition candidly under the federal domain: 'The United States wins a point whenever justice is done its citizens in the courts.'").

[243] The indictment of Arthur Andersen LLP resulted in the effective demise of that large accounting firm, and the loss of many thousands of jobs of innocent employees, long before the case ever went to trial.