

2009

## Revisions of the Thompson Memorandum and Avoiding the Stein Problems: A Review of the Federal Policy on the Prosecution of Business Organizations Note

Brendan J. Keefe

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### Recommended Citation

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# CONNECTICUT LAW REVIEW

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VOLUME 42

NOVEMBER 2009

NUMBER 1

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## Note

### REVISIONS OF THE THOMPSON MEMORANDUM AND AVOIDING THE STEIN PROBLEMS: A REVIEW OF THE FEDERAL POLICY ON THE PROSECUTION OF BUSINESS ORGANIZATIONS

BRENDAN J. KEEFE

*Since 1999, the Department of Justice has periodically issued memoranda instructing United States Attorneys on how to indict business organizations. These memoranda became constitutionally questionable after the Enron, WorldCom, and Adelphia scandals. Finally, a federal district court declared part of one memorandum—known as the Thompson Memorandum—in conjunction with the way the assistant U.S. attorney presented the case against certain high-ranking employees of a business organization, KPMG, LLP, to be in violation of the Fifth and Sixth Amendments. This case is United States v. Stein.*

*This Note examines the district court case, the Second Circuit case that affirmed the district court's decision, and the subsequent memoranda produced by the Department of Justice. This Note examines the subsequent memoranda to determine whether the constitutional deficiencies were remedied. This Note concludes that although the Stein problems were resolved in the later memoranda, other potentially constitutional problems exist. These problems are identified and discussed.*

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REVISIONS OF THE THOMPSON MEMORANDUM AND AVOIDING THE  
*STEIN* PROBLEMS: A REVIEW OF THE FEDERAL POLICY ON THE  
PROSECUTION OF BUSINESS ORGANIZATIONS

BRENDAN J. KEEFE\*

I. INTRODUCTION

The Department of Justice (“DOJ”) has attempted to finalize its policy on charging corporations criminally since 1999. In that year, then-Deputy Attorney General Eric Holder<sup>1</sup> released the first policy in a memorandum entitled “Bringing Criminal Charges Against Corporations” (“Holder Memorandum”).<sup>2</sup> Over the years there have been many catalysts forcing change to the policy. After the Enron and WorldCom scandals, the DOJ made the policy more stern. This new policy was formulated by then-Deputy Attorney General Larry D. Thompson in 2003. It was entitled “Principles of Federal Prosecution of Business Organizations” (“Thompson Memorandum”).<sup>3</sup> For various reasons discussed in detail below, the district court held in *United States v. Stein* that some aspects of this new policy were unconstitutional.<sup>4</sup> While appealing this decision, the Government changed the policy to make it conform better to the court’s holding.<sup>5</sup> The third attempt is known as the “McNulty Memorandum.”<sup>6</sup>

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\* Trinity College, B.A. 2007; University of Connecticut School of Law, J.D. Candidate 2010. I would like to thank Professor Leonard Orland for his invaluable comments and guidance, without which this Note would not have been possible. I would also like to thank the tireless staff of the *Connecticut Law Review* for their hard work. This Note is dedicated to my parents, Hugh and Dorothy Keefe, for their constant love and support. Any errors contained herein are mine and mine alone.

<sup>1</sup> Eric Holder is now serving as President Obama’s Attorney General. See Neil A. Lewis, *Holder Is Confirmed as Attorney General*, N.Y. TIMES, Feb. 2, 2009, <http://www.nytimes.com/2009/02/03/us/politics/03holder.html?hp> (“The Senate voted overwhelmingly Monday evening to confirm Eric H. Holder, Jr. to be the new attorney general of the United States.”).

<sup>2</sup> Memorandum from Eric Holder, Jr., Deputy Att’y Gen., to All Component Heads and United States Attorneys, on *Bringing Criminal Charges Against Corporations* (June 16, 1999), available at <http://www.usdoj.gov/criminal/fraud/docs/reports/1999/chargingcorps.html> [hereinafter Holder Memorandum].

<sup>3</sup> Memorandum from Larry D. Thompson, Deputy Att’y Gen., to Heads of Department Components, United States Attorneys, on *Principles of Federal Prosecution of Business Organizations* (Jan. 20, 2003), available at [http://www.usdoj.gov/dag/cftf/corporate\\_guidelines.htm](http://www.usdoj.gov/dag/cftf/corporate_guidelines.htm) [hereinafter Thompson Memorandum].

<sup>4</sup> *United States v. Stein (Stein I)*, 435 F. Supp. 2d 330 (S.D.N.Y. 2006).

<sup>5</sup> See James M. Keneally & Conor S. Harris, *Revisions to the DOJ’s Guidelines on Corporate Prosecutions*, 23 ANDREWS LITIG. REP. 3, 4 (2008) (“Soon after *Stein I* was issued, the Thompson Memorandum was replaced by the McNulty Memorandum, which was issued by then-Deputy Attorney General Paul McNulty Dec. 12, 2006.”).

<sup>6</sup> Memorandum from Paul J. McNulty, Deputy Att’y Gen., to Heads of Department Components, United States Attorneys, on *Principles of Federal Prosecution of Business Organizations* (Dec. 12,

On the same day that the *Stein* decision was affirmed by the Second Circuit Court of Appeals, the DOJ announced the latest revisions to its policy on prosecuting business organizations.<sup>7</sup> On August 28, 2008, then-Deputy Attorney General Mark R. Filip announced these revisions which were not in the form of a memorandum, but rather were made directly to the United States Attorney's Manual.<sup>8</sup> This Note examines whether the DOJ has cured the "*Stein* problems" with the Filip revisions.

In *Stein*, the Government attempted to prosecute sixteen employees<sup>9</sup> of the accounting firm KPMG, LLP ("KPMG") for allegedly creating and marketing fraudulent tax shelters.<sup>10</sup> This has been called the "largest tax fraud case in United States history."<sup>11</sup> *Time Magazine* summarized the case in the following way: "[T]he accountants have taken a prosecutorial beating. A Senate subcommittee publicly grilled them. The Justice Department suggested they blab without their lawyers present. KPMG, bending to government pressure, stopped covering its employees' crushing legal bills. And all this happened before any court ruled the tax shelters improper."<sup>12</sup> In preparing for the trial of these defendants, the district court held that the prosecution violated the defendants' Fifth and Sixth

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2006), available at [http://www.usdoj.gov/dag/speeches/2006/mcnulty\\_memo.pdf](http://www.usdoj.gov/dag/speeches/2006/mcnulty_memo.pdf) [hereinafter McNulty Memorandum].

<sup>7</sup> See *United States v. Stein (Stein I)*, 541 F.3d 130 (2d Cir. 2008); see also Keneally & Harris, *supra* note 5, at 4–5; Mark R. Filip, Deputy Att'y Gen., Remarks Prepared for Delivery by Deputy Att'y Gen. Mark R. Filip at Press Conference Announcing Revisions to Corporate Changing Guidelines (Aug. 28, 2008) [hereinafter Filip's August 28 Press Conference].

<sup>8</sup> U.S. Dep't of Justice, U.S. Attorneys' Manual, ch. 9-28.00 (2008) [hereinafter U.S. Attorneys' Manual], available at [http://www.usdoj.gov/usao/eousa/foia\\_reading\\_room/usam/title9/28mcrm.htm](http://www.usdoj.gov/usao/eousa/foia_reading_room/usam/title9/28mcrm.htm); Filip's August 28 Press Conference, *supra* note 7; see also Keneally & Harris, *supra* note 5, at 3.

<sup>9</sup> I will do as the court did and include KPMG partners in the term "employees" for ease of expression. *Stein I*, 435 F. Supp. 2d at 341 n.36.

<sup>10</sup> *Id.* at 330.

<sup>11</sup> See *id.* at 362 ("This is by no means a garden-variety criminal case. It has been described as the largest tax fraud case in United States history."); see also Reuters, *Defendants in KPMG Fraud Case Get a Break*, N.Y. TIMES, Apr. 8, 2008, at C9.

<sup>12</sup> Reynolds Holding, *Accounting for Crime*, TIME, Mar. 8, 2007, available at <http://www.time.com/time/magazine/article/0,9171,1597468,00.html>. With respect to the Senate subcommittee, the *Stein I* court described a particularly heated moment at the hearing:

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." This led to public hearings in November 2003 at which several senior KPMG partners or former partners—three of them now defendants here—testified.

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." At another point, Senator Levin, the ranking minority member, in obvious exasperation at a KPMG witness, suggested that the witness "try an honest answer."

*Stein I*, 435 F. Supp. 2d at 338–39.

Amendment rights.<sup>13</sup> This eventually led U.S. District Judge Lewis A. Kaplan of the Southern District of New York to dismiss thirteen of the indictments.<sup>14</sup> This decision was affirmed by the Second Circuit Court of Appeals, but only on the Sixth Amendment grounds.<sup>15</sup>

The Government made two decisions with respect to whom to hold accountable for the alleged fraud in this case. First, the Government decided to enter into a Deferred Prosecution Agreement (“DPA”) with the corporation, KPMG.<sup>16</sup> Second, the Government decided to indict and prosecute the individual employees *it* suspected of the criminal wrongdoing.<sup>17</sup> As mentioned above, the prosecutors depended on the Thompson Memorandum in deciding whether to indict corporations when making these decisions.<sup>18</sup> The Thompson Memorandum lists factors that must be considered by the United States Attorney’s Office (“USAO”) in determining whether to indict the corporation.<sup>19</sup> Unlike the Holder Memorandum, the Thompson Memorandum’s factors are mandatory.<sup>20</sup> At least one critic has said that the Thompson Memorandum has become “shorthand for prosecutorial abuse.”<sup>21</sup>

The way a corporation can stave off indictment is by fully cooperating with the Government.<sup>22</sup> Indeed, the Thompson Memorandum states that

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<sup>13</sup> See *Stein I*, 435 F. Supp. 2d at 330.

<sup>14</sup> See *United States v. Stein (Stein IV)*, 495 F. Supp. 2d 390, 394 (S.D.N.Y. 2007) (“The indictment therefore will be dismissed as to thirteen of the sixteen KPMG Defendants.”).

<sup>15</sup> *United States v. Stein (Stein V)*, 541 F.3d 130, 136 (2d Cir. 2008) (“In light of this disposition, we do not reach the district court’s Fifth Amendment ruling.”).

<sup>16</sup> See *Stein I*, 435 F. Supp. 2d at 349 (“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. In a nutshell, KPMG stands to avoid a criminal conviction if it lives up to its part of the bargain.”).

<sup>17</sup> See *id.* at 350 (“At about the same time [as the DPA was made], the government filed the initial indictment in this case.”).

<sup>18</sup> The Thompson Memorandum—unlike the Holder Memorandum—is mandatory. See, e.g., *id.* at 338 (“Unlike its predecessor, however, the Thompson Memorandum is binding on all federal prosecutors.”).

<sup>19</sup> Thompson Memorandum, *supra* note 3 §§ II–VIII.

<sup>20</sup> See *Stein I*, 435 F. Supp. 2d at 338 (“Unlike its predecessor, however, the Thompson Memorandum is binding on all federal prosecutors.”); see also *id.* at n.12 (“The Thompson Memorandum sets forth nine factors that federal prosecutors must consider in determining whether to charge a corporation or other business organization.” (quoting U.S. Dep’t of Justice, Criminal Resource Manual § 163 (2005))).

<sup>21</sup> Peter Lattman, *The Holder Memo and Its Progeny*, WALL ST. J., Dec. 13, 2006, <http://blogs.wsj.com/law/2006/12/13/the-holder-memo>.

<sup>22</sup> See *Stein I*, 435 F. Supp. 2d at 364, (“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.’”); see also Thompson Memorandum, *supra* note 3 (“The main focus of the revisions is increased emphasis on and scrutiny of the authenticity of a corporation’s cooperation.”).

the main reason for revising the Holder Memorandum was to put an “increased emphasis on and scrutiny of the authenticity of a corporation’s cooperation.”<sup>23</sup> The reason that the Thompson Memorandum is controversial is because it forces prosecutors to look negatively on a corporation if it pays for its employees’ legal fees, unless the corporation is legally bound to pay them—either by state statute or contractual agreement.<sup>24</sup> In other words, if a corporation pays the legal fees of their employees, the corporation is less likely to be deemed to have cooperated with the Government. This means that a corporation that pays for their employees’ legal fees is more likely to be indicted. This policy, the district court noted, seems to be at odds with the constitutional rights of the defendants—specifically, the Fifth Amendment right to Due Process and the Sixth Amendment right to counsel.<sup>25</sup>

Since the well-publicized indictment and subsequent collapse of Arthur Andersen, the attorney for KPMG, Robert S. Bennett, of Skadden Arps, Slate, Meagher & Flom LLP (“Skadden”) knew that an indictment could effectively kill KPMG. After Arthur Andersen, it became clear that a corporation could collapse from an indictment alone, without a conviction or even a trial.<sup>26</sup> Skadden was hired to “save” the corporation, not to “protect the individuals.”<sup>27</sup> Mr. Bennett made this explicitly clear at the first meeting between Skadden and the USAO.<sup>28</sup> Mr. Bennett also

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<sup>23</sup> Thompson Memorandum, *supra* note 3.

<sup>24</sup> See *Stein I*, 435 F. Supp. 2d at 338 (“Unlike its predecessor, however, the Thompson Memorandum is binding on all federal prosecutors.”); see also *id.* at 344 (“[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.”); Thompson Memorandum, *supra* note 3, at § VI.

<sup>25</sup> See *Stein I*, 435 F. Supp. 2d at 356 (“The Government Violated the Fifth and Sixth Amendments by Causing KPMG to Cut Off Payment of Legal Fees and Other Defense Costs Upon Indictment.”).

<sup>26</sup> See *id.* at 382 n.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.” (emphasis added)); see also *id.* at 337 n.11 (“[N]o major financial services firm has ever survived a criminal indictment.”); *United States v. Stein (Stein IV)*, 495 F. Supp. 2d 390, 414 (S.D.N.Y. 2007) (referring to prosecutors’ indictment power as their “life or death” power); Peter Spivack & Sujit Raman, *Regulating the ‘New Regulators’: Current Trends in Deferred Prosecution Agreements*, 45 AM. CRIM. L. REV. 159, 165–66 (2008) (“The company’s indictment ‘effectively put the eighty-nine-year-old firm out of business and forced tens of thousands of people to find new jobs. It also had a dramatic effect on the accounting industry, by turning the ‘big 5’ into the ‘big 4.’”).

<sup>27</sup> See *Stein I*, 435 F. Supp. 2d at 341 (“[In a meeting with prosecutors] 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 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.”).

<sup>28</sup> *Id.* at 340.

referenced Arthur Andersen at this first meeting; the court summarizes his remarks as follows: “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.”<sup>29</sup> With the demise of Arthur Andersen looming overhead, it was clear to Skadden that anything short of full cooperation with the Government would risk indictment.<sup>30</sup>

Because a simple indictment could be fatal to a corporation, the Government has the upper hand from the very beginning of the criminal justice process. This makes it very easy for the USAO to enforce the Thompson Memorandum and its cooperation policy. It also puts the Government in a paternalistic position. A corporation facing indictment will offer to do a lot of things it ordinarily would not do.<sup>31</sup> The Government has the responsibility to control the zealotry of the all-too-willing-to-please corporation to ensure that no one’s constitutional rights are being violated.<sup>32</sup> The district court here held that instead of looking out for the defendants’ constitutional rights, the Government encouraged KPMG to limit their defense whenever possible, thus violating the Fifth and Sixth Amendments.<sup>33</sup>

The history of the KPMG case can be somewhat confusing. Before the Government appealed the case to the Second Circuit, there were four separate rulings. For the convenience of the reader, the succinct summary of those rulings which was laid out by the Second Circuit is reproduced here:

The United States appeals from an order of the United States District Court for the Southern District of New York (Kaplan, J.), dismissing an indictment against thirteen former partners and employees of the accounting firm KPMG, LLP . . . (“*Stein P*”). . . .

In later decisions, Judge Kaplan ruled that defendants Richard Smith and Mark Watson’s proffer session statements

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<sup>29</sup> *Id.* at 341.

<sup>30</sup> *See id.* (“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.” (emphasis added)).

<sup>31</sup> *Id.* at 352.

<sup>32</sup> *See, e.g., id.* at 353 (“KPMG was extremely anxious to curry favor with the USAO by demonstrating how cooperative it could be, and . . . 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.”); *see also id.* at 381 (“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.’” (quoting *Berger v. United States*, 295 U.S. 78, 88 (1935))).

<sup>33</sup> *See id.* at 353 (“[T]he government conducted itself in a manner that evidenced a desire to minimize the involvement of defense attorneys.”).

were obtained in violation of their Fifth Amendment privilege against self-incrimination, and that their statements would be suppressed . . . (“*Stein II*”); that the court had ancillary jurisdiction over Defendants-Appellees’ civil suit against KPMG for advancement of fees[] . . . (“*Stein III*”), vacated, *Stein v. KPMG, LLP*, 486 F.3d 753 (2d Cir. 2007); and that dismissal of the indictment is the appropriate remedy for those constitutional violations . . . (“*Stein IV*”).<sup>34</sup>

In examining the courts’ opinions and the various policies of the DOJ on prosecuting corporations, it is important to keep in mind two, sometimes conflicting, principles of American jurisprudence. The first principle is that the United States distinguishes itself from other countries by not allowing corporations to get away with criminal wrongdoing. This principle is better stated by the journalist Thomas Friedman:

What makes capital provision work so well in America is the security and regulation of our capital markets, where minority shareholders are protected. Lord knows, there are scams, excesses, and corruption in our capital markets. That always happens when a lot of money is at stake. What distinguishes our capital markets is not that Enrons don’t happen in America—they sure do. It is that when they happen, they usually get exposed, either by the Securities and Exchange Commission or by the business press, and get corrected. What makes America unique is not Enron but Eliot Spitzer, the attorney general of New York State, who has doggedly sought to clean up the securities industry and corporate boardrooms.<sup>35</sup>

The second principle is that a criminal prosecutor’s interest is not in a conviction, but rather in the administration of justice. As Justice Sutherland wrote for a unanimous Supreme Court in *Berger v. United States*:

The United States Attorney is the representative not of an ordinary party to a controversy, but of a sovereignty whose obligation to govern impartially is as compelling as its obligation to govern at all; and whose interest, therefore, in a criminal prosecution is not that it shall win a case, but that justice shall be done. As such, he is in a peculiar and very definite sense the servant of the law, the twofold aim of which is that guilt shall not escape or innocence suffer. He

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<sup>34</sup> *United States v. Stein (Stein I)*, 541 F.3d 130, 135 & n.1 (2d Cir. 2008).

<sup>35</sup> THOMAS L. FRIEDMAN, *THE WORLD IS FLAT* 332 (2007).

may prosecute with earnestness and vigor—indeed, he should do so. But, while he may strike hard blows, he is not at liberty to strike foul ones. It is as much his duty to refrain from improper methods calculated to produce a wrongful conviction as it is to use every legitimate means to bring about a just one.<sup>36</sup>

Judge Kaplan concluded his opinion by saying that justice was not done in *Stein*:

Justice is not done when the government uses 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—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.<sup>37</sup>

Part II of this Note examines the pertinent facts of *Stein I*. Part III discusses the district court's reasoning behind ultimately finding that the KPMG defendants' Fifth and Sixth Amendment rights were violated. Part IV examines the reasoning behind the Second Circuit's holding that affirmed the district court's dismissal of the indictments, and identifies the relatively small piece of the district court's ruling that was actually affirmed. Part V examines the changes to the Thompson Memorandum and the DOJ policy on criminally charging corporations after the *Stein I* decision. It also discusses the ways federal prosecutors can avoid a *Stein* decision in the future.

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<sup>36</sup> *Berger v. United States*, 295 U.S. 78, 88 (1935). Judge Kaplan cited to Justice Sutherland's description in *Stein I*. *Stein I*, 435 F. Supp. 2d at 381. See also *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.'"). But see Kevin C. McMunigal, *Are Prosecutorial Ethics Standards Different?*, 68 FORDHAM L. REV. 1453, 1453–55 (2000) ("*Berger* neither defines nor applies an extraordinary prosecutorial duty. Rather, it enforces an obligation that is quite ordinary in the sense that it applies equally to prosecutors, criminal defense lawyers, and civil advocates—the obligation of lawyers in a trial not to assert their personal knowledge of facts in issue.").

<sup>37</sup> *Stein I*, 435 F. Supp. 2d at 381–82.

## II. FACTS OF *STEIN I*

What follows is a brief overview of the facts. Where there were any ambiguities or questions of fact, the court acted as the fact finder and made the ultimate conclusion.<sup>38</sup>

### A. *KPMG's Policy on Paying Legal Fees*

The defendants in *Stein I* were partners or employees of the accounting firm KPMG, one of the largest accounting firms in the world.<sup>39</sup> KPMG had a longstanding policy of paying for its employees' attorneys' fees, regardless of cost or whether the employees were charged with crimes.<sup>40</sup> The court noted that KPMG has gone to "remarkable" lengths in paying the legal fees of its employees.<sup>41</sup> The court stated that KPMG paid over \$20 million "to defend four partners in a criminal investigation and related civil litigation brought by the Securities and Exchange Commission."<sup>42</sup> The parties stipulated that KPMG's longstanding policy was to advance the legal fees without a preset cap or condition of cooperation with the Government.<sup>43</sup> Furthermore, another stipulation stated:

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.<sup>44</sup>

In other words, this was the first case in which KPMG did not pay its employees' legal costs without regard to cost and without being conditioned on cooperation with the Government.

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<sup>38</sup> *Id.* at 352.

<sup>39</sup> *Id.* at 336.

<sup>40</sup> *See id.* ("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.")

<sup>41</sup> *See id.* at 340 ("Moreover, the extent to which KPMG has gone is quite remarkable.")

<sup>42</sup> *Id.*

<sup>43</sup> *See id.* ("[I]t 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.")

<sup>44</sup> *Id.*

### B. DOJ Policy on Criminally Charging Corporations

As mentioned above, the first DOJ policy on the subject of indicting corporations was the Holder Memorandum in 1999.<sup>45</sup> This was written just before the corporate fraud scandals that occurred in the early 2000s. Shortly thereafter, Congress passed the Sarbanes-Oxley Act<sup>46</sup> and President Bush established the Corporate Fraud Task Force in 2002.<sup>47</sup> In the post-Enron, post-WorldCom era, and after the indictment and subsequent collapse of Arthur Andersen,<sup>48</sup> the DOJ put forth new and tougher guidelines called “Principles of Federal Prosecution of Business Organizations” (“Thompson Memorandum”) by then-Deputy Attorney General Larry D. Thompson in 2003.<sup>49</sup> It is this edition of the DOJ’s policy on prosecuting corporations that has upset many legal groups<sup>50</sup> and commentators<sup>51</sup> and inspired subsequent legislation.<sup>52</sup>

The Thompson Memorandum is similar to its predecessor the Holder Memorandum. It is identical to it in the area concerning cooperation and advancing legal fees by business entities.<sup>53</sup> Both the Holder and

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<sup>45</sup> Spivack & Raman, *supra* note 26, at 164. Each revision to the memoranda takes the name of the Deputy Attorney General who authored it. See Holder Memorandum, *supra* note 2.

<sup>46</sup> Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002).

<sup>47</sup> Spivack & Raman, *supra* note 26, at 164–65.

<sup>48</sup> See *id.* at 165–66 (“The company’s indictment ‘effectively put the eighty-nine-year-old firm out of business and forced tens of thousands of people to find new jobs. It also had a dramatic effect on the accounting industry, by turning the ‘Big 5’ into the ‘Big 4.’”).

<sup>49</sup> Thompson Memorandum, *supra* note 3.

<sup>50</sup> These groups include, among others, the Association of Corporate Counsels, the National Association of Criminal Defense Lawyers, the United States Chamber of Commerce, the Business Roundtable, the National Association of Manufacturers, the American Civil Liberties Union and the American Bar Association. See, e.g., ASSOCIATION OF CORPORATE COUNSEL, REPORT OF THE ASSOCIATION OF CORPORATE COUNSEL ATTORNEY-CLIENT PRIVILEGE: EROSION AND YET, PROGRESS (2007), available at <http://www.acc.com/public/reference/acpriv/adcom2006privilegeassessmt.pdf> (summarizing the work that the ACC accomplished in confronting the federal policy from Oct. 2005 to Jan. 2007); see also Letter from Michael S. Greco, American Bar Association, to Alberto Gonzales, Attorney General, Department of Justice (May 2, 2006), available at [http://www.abanet.org/poladv/letters/attyclient/060502letter\\_acprivgonz.pdf](http://www.abanet.org/poladv/letters/attyclient/060502letter_acprivgonz.pdf) (suggesting revisions to the DOJ policy on waiving the attorney-client privilege); Lynnley Browning, *U.S. Tactic on KPMG Questioned*, N.Y. TIMES, June 28, 2006, at C1; *Corporate Lawyers Launch Attack on “Culture of Waiver,”* CORP. CRIME REP., Mar. 6, 2006, available at <http://www.nacdl.org/public.nsf/whitecollar/WCnews025>.

<sup>51</sup> See, e.g., Lattman, *supra* note 21; Holding, *supra* note 12.

<sup>52</sup> See Keneally & Harris, *supra* note 5, at 5 (“Despite its attempt to alleviate some of the Thompson Memorandum’s perceived wrongs, the McNulty Memorandum failed to end criticism of the Department of Justice’s policy. Congress is considering passage of legislation. . . . The House of Representatives already passed H.R. 3013, the Attorney-Client Privilege Protection Act of 2007, and the Senate Judiciary Committee is currently considering its counterpart, S. 3217, the Attorney-Client Protection Act of 2008.”).

<sup>53</sup> See *Stein I*, 435 F. Supp. 2d 330, 338 (S.D.N.Y. 2006) (“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

Thompson Memoranda read, in pertinent part, as follows:

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.

...

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,*<sup>54</sup> 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.<sup>55</sup>

Clearly, both policies put a great emphasis on cooperation with the Government. The Thompson Memorandum, however, went further in this respect than did the Holder Memorandum. The Thompson Memorandum added the following paragraph, emphasizing what it would consider "impeding" behavior:

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Memorandum. Indeed, the language concerning cooperation and advancing of legal fees by business entities was carried forward without change.").

<sup>54</sup> See Thompson Memorandum, *supra* note 3, at n.4; see also Holder Memorandum, *supra* note 2, at n.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.").

<sup>55</sup> Holder Memorandum, *supra* note 2, § VI; Thompson Memorandum, *supra* note 3, § VI (emphasis added).

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.<sup>56</sup>

Still, the most important difference between the two memoranda is that the Thompson Memorandum is binding on all federal prosecutors.<sup>57</sup> The *Stein I* court noted, “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 of an attempt to protect culpable employees and as a factor weighing in favor of indictment of the entity.”<sup>58</sup>

### C. *Communication Between KPMG and USAO Determined to be Coercive*

Before examining these facts, it should be noted here that the actions of the federal prosecutors together with the underlying threat to uncooperative corporations inherent in the Thompson Memorandum were deemed to be “coercive” and thus violative of the defendants’ constitutional rights.<sup>59</sup> After becoming aware that KPMG could possibly be indicted—and believing that indictment could very well mean the end of the firm—the chairman of KPMG hired Skadden attorney Robert S. Bennett to save the company.<sup>60</sup> It was determined that the way to save KPMG was for the company to “cooperate” as best as it could with the

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<sup>56</sup> Thompson Memorandum, *supra* note 3, § VI; *see also* Keneally & Harris, *supra* note 5, at 4.

<sup>57</sup> *See Stein I*, 435 F. Supp. 2d at 338 (“Unlike its predecessor, however, the Thompson Memorandum is binding on all federal prosecutors.”).

<sup>58</sup> *Id.*

<sup>59</sup> *See id.* at 352 (“As a direct result of the threat to the firm inherent in the Thompson Memorandum . . . .”); *see also id.* at 373 (“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.”); *id.* at 360 (“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.”).

<sup>60</sup> *Id.* at 339.

Government.<sup>61</sup> KPMG's "cooperative approach" involved many aspects. The first aspect was to dissociate and sever ties with those who the Government may deem "culpable."<sup>62</sup> KPMG decided 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 chair-tax services, and a partner in personal financial planning, respectively."<sup>63</sup> It seemed "cleaning house" was not enough, as the IRS made a criminal referral to the DOJ, which forwarded the referral to the USAO for the Southern District of New York.<sup>64</sup> The USAO notified KPMG of the criminal referral, and they scheduled the first meeting.<sup>65</sup>

At this first meeting, Skadden told the USAO that it planned to "cooperate fully" with the Government's investigation.<sup>66</sup> Skadden went even further, saying "the object was to save KPMG, not to protect any individuals."<sup>67</sup> Then the USAO turned to the subject of legal fees and inquired whether KPMG was obligated to "pay the fees and what their plans were."<sup>68</sup> Skadden asked for the Government's view on the payment of legal fees.<sup>69</sup> The USAO answered by pointing to the Thompson Memorandum.<sup>70</sup> Skadden replied by saying that its common practice was to pay the legal fees, but the partnership agreements were vague and Delaware law gave the company the right to do whatever it wished.<sup>71</sup>

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<sup>61</sup> *See id.* ("[The chairman] retained . . . Robert S. Bennett[] 'to come up with a new cooperative approach.'").

<sup>62</sup> *See id.* ("One aspect of that new approach was a decision to 'clean house' . . .").

<sup>63</sup> *See id.* ("Given Mr. Stein's senior position and his relationship with Mr. O'Kelly, 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. 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 Mr. Stein.").

<sup>64</sup> *See id.* ("In the early part of 2004, the IRS made a criminal referral to the Department of Justice . . . which in turn passed it on to the United States Attorney's Office for this district.").

<sup>65</sup> *See id.* at 340–41 ("The USAO notified Skadden of the referral, and a meeting was scheduled for February 25, 2004.").

<sup>66</sup> *See id.* at 341 ("He reported that the firm had taken high-level personnel action already, that it would cooperate fully with the government's investigation . . .").

<sup>67</sup> *Id.*

<sup>68</sup> *Id.*

<sup>69</sup> *Id.*

<sup>70</sup> *See id.* ("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.").

<sup>71</sup> *See id.* at 342 ("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.").

Skadden then said that as long as it had the discretion to do so, it would not pay the legal fees for employees who declined to cooperate with the Government or who took the Fifth Amendment.<sup>72</sup> On the subject of KPMG's discretion to pay the legal fees, the USAO said that misconduct should not or could not be rewarded and referred to the federal guidelines.<sup>73</sup> This comment was understood by both KPMG and the Government as a reminder of what is laid out in the Thompson Memorandum—if KPMG paid the legal fees, beyond what it was legally obligated to pay, it could be held against the accounting firm in the Government's decision of whether to indict.<sup>74</sup> The statement made immediately after, also by the USAO, supported this finding: “[I]f u [sic] have discretion re fees—we'll look at that under a microscope.”<sup>75</sup> The Court concluded that, although “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.”<sup>76</sup>

Mr. Bennett told the Government that it would present a “big problem” if KPMG did not advance any legal fees because the firm was a partnership.<sup>77</sup> To solve this problem, Mr. Bennett said KPMG would put a limit on the fees (\$400,000) and condition the payment of the fees on the individual employee “cooperating fully with the company and the Government.”<sup>78</sup> KPMG would deem an employee “uncooperative” and thus stop payment on the legal fees if they invoked their Fifth Amendment privilege against self-incrimination.<sup>79</sup> On a conference call between Skadden and the USAO, Skadden lawyers made it clear that they would be “as cooperative as possible” in order to keep the Government from

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<sup>72</sup> *Id.*

<sup>73</sup> *Id.* There is some dispute over what the USAO meant by “federal guidelines”; however, the court found that the intent of the comment was immaterial because it was how the comment was understood that really mattered. *See id.* at 342–43 (“But the Court finds it unnecessary to decide [an AUSA's] subjective purpose in making the remark because what is more important is how her comment was understood.”).

<sup>74</sup> *See id.* at 344 (“In sum, [an AUSA'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.”).

<sup>75</sup> *Id.* (citing the handwritten notes of Mr. Pilchen, an attorney for KPMG).

<sup>76</sup> *Id.*

<sup>77</sup> *See id.* at 344–45 (“[Mr. Bennett] reported that KPMG did not think it had any binding legal obligation to pay legal fees, but that ‘it would be a big problem’ not to do so because the firm was a partnership.”)

<sup>78</sup> *Id.* at 345.

<sup>79</sup> *See id.* (“KPMG would pay his fees so long as Ms. Warley [an employee] 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.”).

indicting the firm.<sup>80</sup> In response, the USAO urged KPMG to tell its employees to be “totally open” with the USAO, “even if that meant admitting criminal wrongdoing.”<sup>81</sup> Skadden sent a form letter to all employees who “appeared to be under suspicion” by the Government.<sup>82</sup> This letter told them that their legal fees would be capped at \$400,000; conditioned on their cooperation with the Government and being “prompt, complete, and truthful,” and that the payment of legal fees would cease immediately if the employee is charged by the Government with criminal wrongdoing.<sup>83</sup> This was not enough for the USAO, however, and the Government demanded that KPMG send out a supplemental letter.<sup>84</sup> The Government wanted KPMG to emphasize to their employees that they could meet with an investigator without the assistance of counsel.<sup>85</sup> The court found that the purpose of demanding this 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.”<sup>86</sup>

When the Government began investigating and interviewing individual employees, Skadden asked to be notified whenever an employee failed to cooperate.<sup>87</sup> The Government notified Skadden many times about employees’ failure to cooperate.<sup>88</sup> Skadden would remind the employee that their legal fees would be terminated if they refused to cooperate.<sup>89</sup> In some cases, this would be enough for the employee to decide to cooperate. In others, they would continue to refuse whereupon they were fired and their legal fees were no longer paid.<sup>90</sup>

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<sup>80</sup> See *id.* (“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.”).

<sup>81</sup> See *id.* (“[The USAO] urged that KPMG tell its people that they should be ‘totally open’ with the USAO, ‘even if that [meant admitting] criminal wrongdoing.’”).

<sup>82</sup> See *id.* (“[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.”).

<sup>83</sup> *Id.* at 345–46.

<sup>84</sup> *Id.* at 346.

<sup>85</sup> See *id.* at 347 (“No one suggests that either the original KPMG advice or the government’s subsequent proposal misstated the law. The difference was one of *emphasis*.” (emphasis added)). The USAO proposed the following language (Government’s proposed language is italicized): “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.” *Id.* at 346.

<sup>86</sup> *Id.* at 347.

<sup>87</sup> *Id.*

<sup>88</sup> *Id.*

<sup>89</sup> *Id.*

<sup>90</sup> *Id.*

#### D. *The Deferred Prosecution Agreement*

Federal prosecutors—perhaps recognizing that indicting major corporations is not in the best interest of the public<sup>91</sup>—have increased the use of DPAs.<sup>92</sup> DPAs are a form of pretrial diversion where the Government agrees to suspend charges against a corporation if the corporation agrees to cooperate by making certain changes.<sup>93</sup> The corporation can avoid the severe collateral consequences of indictment by entering a probationary period during which it will agree to do two things: (1) the corporation will enact substantial internal reforms and (2) cooperate with the Government, effectively helping prosecutors build a case against individual employees.<sup>94</sup> These obligations are generally set forth in a detailed “contract.”<sup>95</sup> This contract usually states that the Government will agree not to pursue the criminal charges—that are typically filed simultaneously with the DPA<sup>96</sup>—and to dismiss them after a period of time—generally between one and two years—if the corporation agrees to honor all the terms of the agreement.<sup>97</sup> These agreements are recognized as a compromise between the only two other options: a declination of prosecution and a guilty plea.<sup>98</sup>

KPMG and the USAO entered into a DPA.<sup>99</sup> KPMG agreed, among other things, to waive indictment, be charged in a one-count information, admit extensive wrongdoing, pay a \$456 million fine, and accept

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<sup>91</sup> See Tom Bawden, *KPMG Warned of ‘Death Spiral’ in Tax Shelter Fraud Case*, TIMES, June 20, 2007, available at [http://business.timesonline.co.uk/tol/business/industry\\_sectors/banking\\_and\\_finance/article1957547.ece](http://business.timesonline.co.uk/tol/business/industry_sectors/banking_and_finance/article1957547.ece) (“KPMG . . . told the US Justice Department that it would unleash a ‘nuclear bomb’ that would leave more than 1,000 companies without an auditor, if it indicted the firm. . . . KPMG employed 20,000 people ‘whose lives will be destroyed,’ he said. . . . ‘We’re asking you to use a smart bomb, not a nuclear bomb.’ [The USAO] referred to Mr. Bennett’s argument as ‘ridiculous,’ according to the documents, although it seemed to work. Two senior US Justice Department officials intervened and KPMG avoided an indictment.”).

<sup>92</sup> See Lisa Kern Griffin, *Compelled Cooperation and the New Corporate Criminal Procedure*, 82 N.Y.U. L. REV. 311, 321 (2007) (“Their popularity with prosecutors has increased since the public opprobrium that followed the Arthur Andersen case . . . .”); see also Spivack & Raman, *supra* note 26, at 159 (“In the four years between 2002 and 2005, prosecutors and major corporations entered into twice as many of these agreements . . . as in the previous ten years combined.”). But see Marcia Coyle, *Deferred, Nonprosecution Deals Fall By 60%*, NAT’L L.J., Feb. 9, 2009, available at <http://www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=1202428013402> (“The number of deferred and nonprosecution agreements between the U.S. Department of Justice and corporations declined by 60% in 2008—from a historic high of 40 in 2007 to 16 last year, according to a forthcoming study.”).

<sup>93</sup> Griffin, *supra* note 92, at 321.

<sup>94</sup> Spivack & Raman, *supra* note 26, at 160.

<sup>95</sup> Griffin, *supra* note 92, at 321.

<sup>96</sup> See *id.* at 322 (“Entry into a DPA ordinarily will coincide with the filing of formal criminal charges against a company, the suspension of Speedy Trial Act considerations, and the tolling of the statute of limitations.”).

<sup>97</sup> *Id.* at 322.

<sup>98</sup> *Id.* at 321.

<sup>99</sup> *Stein I*, 435 F. Supp. 2d 330, 349 (S.D.N.Y. 2006).

restrictions on its practice.<sup>100</sup> The Government agreed that it would seek dismissal of the information if KPMG complies with its obligations.<sup>101</sup> KPMG could avoid a criminal conviction if it lived up to its part of the bargain. The DPA also obliged KPMG to continue to cooperate extensively with the Government, both in general and in the Government's prosecution of this indictment. It provides in pertinent 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 [government].

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 [government], including but not limited to all information about activities of KPMG, present and former partners, employees, and agents of KPMG;

...

(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 . . .

...

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.<sup>102</sup>

In short, anything the Government regards as a failure to cooperate could result in the prosecution of the information.<sup>103</sup> If the Government decides

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<sup>100</sup> *Id.*

<sup>101</sup> *Id.*

<sup>102</sup> *Id.* at 349–50.

<sup>103</sup> *Id.* at 350.

to prosecute, they will almost certainly get a conviction because of the “extensive admissions of wrongdoing” KPMG made as part of the DPA.

#### E. *The Court Makes Four Factual Conclusions*

The court held an evidentiary hearing to determine “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.”<sup>104</sup> This hearing led the court to make four factual conclusions. The first factual conclusion was that the Thompson Memorandum alone caused KPMG to decide not to pay the legal fees of its employees.<sup>105</sup> Second, the actions of the USAO reinforced the threat inherent in the Thompson Memorandum, specifically that the paying of the legal fees could be held against the firm.<sup>106</sup> Third, the Government acted in a manner that suggested that it wanted to minimize the involvement of defense attorneys and wherever possible, to interview KPMG employees without a lawyer present.<sup>107</sup> 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.”<sup>108</sup>

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<sup>104</sup> *Id.* at 352.

<sup>105</sup> *See id.* (“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.”).

<sup>106</sup> *See id.* at 352–53 (“Second, . . . [the USAO] 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. [The USAO] 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.”).

<sup>107</sup> *See id.* at 353 (“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. . . . 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.”).

<sup>108</sup> *See id.* (“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.”).

### III. DISTRICT COURT HELD THAT THE DEFENDANTS' FIFTH AMENDMENT RIGHTS WERE VIOLATED

#### A. *Summary of the District Court's Due Process Analysis*

The district court's ruling can be summarized by a syllogism. First, a criminal defendant has a fundamental right to obtain and use resources lawfully available to him or her in order to prepare a defense, free of knowing or reckless government interference.<sup>109</sup> This fundamental right is rooted in the Due Process Clauses of the Fifth and Fourteenth Amendments.<sup>110</sup> Second, the defendants in this case had such resources available to them.<sup>111</sup> Third, but for the knowing or reckless government interference, the resources would not have been capped at \$400,000 and conditioned upon full cooperation with the Government.<sup>112</sup> Therefore, because the resources to prepare a defense were capped and conditioned, the defendants' rights were violated.<sup>113</sup> This section looks at each premise and the conclusion in turn.

#### B. *First Premise: The Fundamental Right to Use Resources Without Government Infringement*

The *Stein I* court concluded that a criminal defendant has a fundamental right to obtain and use resources lawfully available to him or

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<sup>109</sup> See *id.* at 361–62 (“[T]his Court concludes that such a right is basic to our concepts of justice and fair play. It is fundamental.”).

<sup>110</sup> See *id.* at 357, nn.121–22 and accompanying text (“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 as well as more specific provisions of the Bill of Rights, including the Confrontation and Assistance of Counsel Clauses of the Sixth Amendment. 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.” (internal citations omitted)).

<sup>111</sup> See *id.* at 336 (“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.”).

<sup>112</sup> See *id.* at 353 (“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.”); see also *id.* at 345–46 (“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. 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.’ 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.’”).

<sup>113</sup> See *id.* at 362 (“The Government’s Actions Violated the Substantive Due Process Right to Fairness in the Criminal Process.”).

her in order to prepare a defense, free of knowing or reckless government interference.<sup>114</sup> This statement can be broken down into three separate elements. First, the Government cannot knowingly or recklessly interfere with this right. Second, a defendant has the right to obtain and use resources lawfully available to him or her to prepare a defense. Third, that right is fundamental.

The Government is prevented from interfering with the manner in which a defendant wishes to present a defense.<sup>115</sup> The court noted that this “general rule” 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.’”<sup>116</sup> The court then went further, stating that the “underlying theme” of all the case law it has reviewed on the subject 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.”<sup>117</sup> The court noted that there are several aspects to a defendant’s right to control the manner and substance of the defense.<sup>118</sup> Two aspects of this right are particularly noteworthy.

First, the court explained, “[a] defendant is guaranteed . . . ‘the right to be represented by an otherwise qualified attorney whom that defendant can afford to hire’—in other words, to use his or her *own assets* to defend the case, free of government regulation.”<sup>119</sup> Second, the court said, “[n]or 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.’”<sup>120</sup> There is a subtle difference between these two separate aspects of the same right. The first principle says simply that a criminal defendant is entitled to hire whomever he determines to be the best attorney he can afford. The second principle says that the Government cannot interfere with a defendant’s choice of counsel.

Finally, having concluded that there is a right, the court considered whether the right is fundamental. The court began the analysis by noting that the “right to fairness in criminal proceedings has not been explicitly []

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<sup>114</sup> *Id.* at 361–62.

<sup>115</sup> *See id.* at 357 (“So proper respect for the individual prevents the government from interfering with the manner in ‘which the individual wishes to present a defense.’”).

<sup>116</sup> *Id.* at 357 n.126 (citing *Martinez v. Court of Appeal of Cal.*, 528 U.S. 152 (2000) (Scalia, J., concurring)).

<sup>117</sup> *Id.* at 357.

<sup>118</sup> *Id.*

<sup>119</sup> *Id.* (quoting *Caplin & Drysdale, Chartered v. United States*, 491 U.S. 617, 624 (1989) (emphasis added)).

<sup>120</sup> *Id.* at 357 n.130 (quoting *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.”).

characterized [as fundamental] by the [United States Supreme] Court.”<sup>121</sup> This problem is overcome by the necessity of fairness in the criminal justice process. The court held that this right was fundamental because “such a right is basic to our concepts of justice and fair play.”<sup>122</sup> The court cited many cases to support this conclusion. For example, the court quoted from *Glucksberg*: “[N]either liberty nor justice would exist if fairness to criminal defendants were sacrificed.”<sup>123</sup> The court also noted that:

[T]he 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.”<sup>124</sup>

C. *Second Premise: The Defendants in this Case Had Such Resources Available to Them, and They Were Entitled to Those Resources*

The district court found—as one of its four “Ultimate Factual Conclusions”—that KPMG had a long-standing policy of paying the legal fees and expenses of its personnel in all cases and investigations.<sup>125</sup> This was only part of the matter. It was more important that the defendants show that they were entitled to have their legal fees paid for them by their employer-company, KPMG. The district court began this opinion by referencing “three principles of American Law,” the third of which is as follows:<sup>126</sup>

The third principle is . . . simply this: an employer often

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<sup>121</sup> *Stein I*, 435 F. Supp. 2d at 360.

<sup>122</sup> *Id.* at 362.

<sup>123</sup> *Id.* at 361.

<sup>124</sup> *Id.*

<sup>125</sup> *See id.* at 352 (“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.”).

<sup>126</sup> *Id.* at 355. The other two principles are as follows:

The first principle is that everyone accused of a crime is entitled to a fundamentally fair trial. 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. 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. This is at the heart of the Sixth Amendment.

*Id.*

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 . . . 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 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.<sup>127</sup>

The defendants in this case claimed that KPMG was obligated to advance to them their legal fees since they were being charged with a crime that arose out of their duty to do their jobs.<sup>128</sup> To paraphrase and combine the two aspects mentioned above,<sup>129</sup> the court reasoned that a defendant has the right to use his or her *own assets* to defend the case, free of government regulation. As mentioned above, the defendants in *Stein I* were not prevented from using *their own money* to defend their case; indeed, the crux of the case was that their employer, KPMG, would not pay for their legal fees, or at least not unconditionally. This seeming disconnect is no small matter and the court did not overlook it. The court considered this argument under its Sixth Amendment analysis, but it is equally applicable here. The court wrote, “the government . . . 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.”<sup>130</sup> The court then turned to tort laws to show that the defendants’ did indeed have a property interest in the legal fees:<sup>131</sup>

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<sup>127</sup> *Id.*

<sup>128</sup> *See id.* at 336 (“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.”).

<sup>129</sup> *See supra* text accompanying notes 119–24.

<sup>130</sup> *Stein I*, 435 F. Supp. 2d at 367.

<sup>131</sup> *See id.* at 367 n.180 (“The torts of interference with prospective economic advantage and inducement of breach of contract are well known. Interference with prospective economic advantage

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. 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.<sup>132</sup>

*D. Third Premise: If the Government Did Not Interfere, Then KPMG Would Have Paid for the Defendants’ Legal Fees Unconditionally and Without Regard to Cost*

*1. The District Court’s Findings*

The defendants went further than just claiming that they were entitled to have their legal fees paid for by KPMG.<sup>133</sup> They claimed that the only reason that their fees were cut off was because of improper government pressure.<sup>134</sup> In other words, if the Government had not improperly pressured KPMG then KPMG would not have, among other things, capped the fees at \$400,000 and conditioned the payment of these fees on cooperation with the Government.<sup>135</sup> Eventually, the court agreed with the defendants, holding as one of its four “Ultimate Factual Conclusions” that:

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

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covers interference with the ability to pursue legal remedies against another party.” (internal citations omitted)).

<sup>132</sup> *Id.*

<sup>133</sup> Indeed the *Stein I* court recognized this, “If that were all there were to the dispute, it would be a private matter between KPMG and its former personnel.” *Id.* at 336.

<sup>134</sup> *See id.* at 336 (“These 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.”).

<sup>135</sup> *See id.* at 345–46 (“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. 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.’ 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.’”).

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.<sup>136</sup>

The court put it another way, earlier in the opinion, this time emphasizing that it really was not a *choice* made by KPMG, as in there was no other option available to KPMG: “KPMG refused to pay because the government held the proverbial gun to its head.”<sup>137</sup>

The Government argued that—the Thompson Memorandum and the actions of the USAO notwithstanding—the decision to cap and condition the advancement of attorneys’ fees was made completely by KPMG. The court noted that:

[T]he 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.’<sup>138</sup>

In short, the Government argued that KPMG came up with the idea to cap and condition the fees. The Government could have pointed to something KPMG attorney Robert S. Bennett, of Skadden, said about this: “In addition, it [KPMG] had done something ‘never heard of before’—conditioned the payment of attorney’s fees on full cooperation with the investigation. . . . He noted that what was really ‘precedent-setting’ about the case was the conditioning of payment of legal fees on cooperation.”<sup>139</sup> This strongly suggests that it was KPMG and not the Government that came up with the idea to condition the payment of the attorney’s fees on full cooperation with the Government. Indeed, it seems like KPMG was taking credit for coming up with this strategy and looking to benefit from doing so.

The court responded to this argument by saying that “the argument [is] 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.”<sup>140</sup> In other words, the Government’s argument fails to take into consideration the Thompson Memorandum and the actions of the USAO. It was the influence of the Thompson Memorandum and the actions of the USAO that pressured KPMG to decide to cap and condition the legal fees.

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<sup>136</sup> *Id.* at 353 (emphasis added).

<sup>137</sup> *Id.* at 336.

<sup>138</sup> *Id.* at 353 n.97.

<sup>139</sup> *Id.* at 349.

<sup>140</sup> *Id.* at 353 n.97.

## 2. Discussion on Causation

It is an interesting conclusion the court reaches when it finds that there is no inconsistency between KPMG making the decision *for its own reasons* and the decision having been a product of Government pressure. The court says that it is perfectly consistent because the Government pressure was the reason that KPMG made the decision. This is interesting because it means that at least for the duration of time it took to make this decision, the interests of KPMG and the Government were the same, and that the Government acted first. In other words, the court says that the Government *made* KPMG's interests match the Government's interests. In doing what was best for KPMG, Skadden was also doing what the Government wanted. Indeed, this was the purpose of the Thompson Memorandum and the USAO's actions—to get corporation like KPMG to cooperate. The only problem with this, of course, is that it is violative of the defendants' constitutional rights.<sup>141</sup>

Another argument the Government made was that although the Thompson Memorandum is strong in its language, in practice the Government only considers the payment of legal fees as a negative factor when those fees are used to impede.<sup>142</sup> This argument was ultimately unpersuasive. The problem was that the Government coerced KPMG to cap and condition legal fees. The only piece of information that a defense lawyer can act on to have an idea of how the Government is going to treat the corporation he or she represents is the Thompson Memorandum, which is binding on all prosecutors. Hence, what prosecutors do in practice is not important because it cannot be easily known to the defense attorneys:

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

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<sup>141</sup> See *id.* at 356 (“The Government Violated the Fifth and Sixth Amendments by Causing KPMG to Cut Off Payment of Legal Fees and Other Defense Costs Upon Indictment.”); see also *Stein V*, 541 F.3d 130, 136 (2d Cir. 2008) (“We further hold that the government thus unjustifiably interfered with defendants’ relationship with counsel and their ability to mount a defense, in violation of the Sixth Amendment, and that the government did not cure the violation. Because no other remedy will return defendants to the status quo ante, we affirm the dismissal of the indictment as to all thirteen defendants.”).

<sup>142</sup> See *Stein I*, 435 F. Supp. 2d at 364 (“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.”).

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.”<sup>143</sup>

E. *Conclusion: Because the Resources to Prepare a Defense Were Capped and Conditioned, the Defendants’ Rights Were Violated*<sup>144</sup>

The conclusion that the defendants’ constitutional rights were violated must follow if we accept the first three premises. The defendants were not permitted by the Government to present the defense they wished to present because the Government limited the funds that were lawfully available to the defendants.<sup>145</sup> Therefore, the Thompson Memorandum and the actions of the USAO are subject to strict scrutiny review. “The Fourteenth Amendment ‘forbids the government to infringe . . . ‘fundamental’ liberty interests at all, no matter what process is provided, unless the infringement is narrowly tailored to serve a compelling [government] interest.’”<sup>146</sup> In other words, there were two different requirements to survive strict scrutiny—the action must be narrowly tailored and the action must serve a compelling government interest.

The *Stein I* court listed three independent goals of the Thompson Memorandum. First, it is intended to be used as a guide for prosecutors who must decide whether to charge business entities.<sup>147</sup> Second, it encourages these business entities to pressure their employees to help and cooperate with the Government.<sup>148</sup> Third, it seeks to punish those whom the USAO deem culpable; indeed it attempts to frame the paying of legal fees as “protecting . . . culpable employees.”<sup>149</sup> The *Stein I* court held that the Thompson Memorandum and the actions of the USAO failed the strict scrutiny test because of the second and third “goals” listed above.

The court noticed that the Thompson Memorandum did 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,” and therefore was not narrowly tailored.<sup>150</sup> The Thompson Memorandum simply stated that “while cases

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<sup>143</sup> *Id.* at 364.

<sup>144</sup> *See id.* at 362 (“The Government’s Actions Violated the Substantive Due Process Right to Fairness in the Criminal Process.”).

<sup>145</sup> *Id.*

<sup>146</sup> *Washington v. Glucksberg*, 521 U.S. 702, 721 (1997) (emphasis omitted).

<sup>147</sup> *Stein I*, 435 F. Supp. 2d at 363.

<sup>148</sup> *Id.*

<sup>149</sup> *Id.*

<sup>150</sup> *See id.* (“Nor does anyone suggest that an entity’s obstruction of a government investigation—what the government has called ‘circling the wagons’ should be ignored in a charging decision.”).

will differ depending on the circumstances, a corporation's promise of support to culpable employees and agents, either through the advancing of attorneys fees . . . may be considered by the prosecutor in weighing the extent and value of a corporation's cooperation."<sup>151</sup> The *Stein I* court took issue with the fact that the Thompson Memorandum could deem certain employees "culpable" long before there is any hearing on the matter. The court wrote that "[t]he job of prosecutors is to make the Government's best case to a jury and to let the jury decide guilt or innocence."<sup>152</sup> The *Stein I* court went further, saying that the Thompson Memorandum requires the prosecutors to "abuse [their] power."<sup>153</sup> It is because of this that the Thompson Memorandum was not narrowly tailored to achieve a compelling government objective.<sup>154</sup>

The court took issue with the premise inherent in the Thompson Memorandum—that a company cannot at the same time cooperate fully with the Government and pay for the legal fees of its employees.<sup>155</sup> It is clear that the court did not like the presumption made in the Thompson Memorandum that irrespective of guilt, the payment of legal fees for their employees automatically implies non-cooperation. The court provided the following explanation:

[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.<sup>156</sup>

Although this did not come from the mind of Mr. Thompson—as this part was also in the Holder Memorandum—he did defend the policy. He was quoted as saying "that if employees really don't believe they acted with criminal intent, 'they don't need fancy legal representation' to defend themselves. There are lots of reasonably priced lawyers, he says."<sup>157</sup> The

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<sup>151</sup> See *supra* text accompanying notes 56–57.

<sup>152</sup> *Stein I*, 435 F. Supp. 2d at 363.

<sup>153</sup> See *id.* ("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.").

<sup>154</sup> *Id.* at 364.

<sup>155</sup> See *id.* ("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.").

<sup>156</sup> *Id.*

<sup>157</sup> See Laurie P. Cohen, *Prosecutors' Tough New Tactics Turn Firms Against Employees—As Sentencing Rules Stiffen, KPMG Axes Tax Partners, Won't Pay Their Legal Costs—What*

court was aware of this quote,<sup>158</sup> and refuted it. The court wrote that:

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.<sup>159</sup>

For all the reasons mentioned here and above, the court held that the legal fee advancement provision violated the Due Process Clause because it was not narrowly tailored to achieve a compelling objective.<sup>160</sup>

#### F. *Remedy*

An indictment is only dismissed if there is no other remedy available. Indeed, it “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.”<sup>161</sup> Remedies for constitutional violations are narrowly tailored to the injury suffered.<sup>162</sup> The *Stein I* court reviewed many possible remedies; it dismissed some<sup>163</sup> and left the possibility to finding a remedy open and to be considered in the future. It left the possibility of finding a monetary remedy open, stating the following:

Thus, there are at least two possibilities for resolving the issue of advancement of defense costs. . . . Should that come

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*‘Cooperation’ Entails*, WALL ST. J., June 4, 2004, at A1 (“But given that legal costs can run hundreds of thousands of dollars, isn’t the government being unfair to company employees if it pressures their employers not to pick up the tab? Mr. Thompson’s response is that if employees really don’t believe they acted with criminal intent, ‘they don’t need fancy legal representation’ to defend themselves. There are lots of reasonably priced lawyers, he says.”).

<sup>158</sup> Although it did not take it into account in its decision because it was not entered into evidence. See *Stein I*, 435 F. Supp. 2d at 338, n.13 (“Naturally, the Court does not consider it in deciding this matter, as it is not in evidence.”).

<sup>159</sup> *Id.*

<sup>160</sup> *Id.* at 364–65.

<sup>161</sup> *Id.* at 374 (quoting *United States v. Artuso*, 618 F.2d 192, 196–97 (2d Cir. 1980)).

<sup>162</sup> *Id.*

<sup>163</sup> See *id.* at 376 (“This Court agrees. Accordingly, monetary sanctions do not overcome sovereign immunity.”).

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.<sup>164</sup>

In *Stein II*, the court ruled it “had ancillary jurisdiction over Defendants[] civil suit against KPMG for advancement of fees.”<sup>165</sup> In *Stein III*, the Second Circuit vacated the *Stein II* ruling, thus ridding the district court of a possible remedy.<sup>166</sup> In *Stein IV*, the court held that there is no other remedy available and it dismissed the indictments.<sup>167</sup> The *Stein IV* court noted its reluctance to dismiss the indictments:

The Court has reached this conclusion only after pursuing every alternative short of dismissal and only with the greatest reluctance. This indictment charges serious crimes. They should have been decided on the merits as to every defendant. The Court well understands, moreover, that prosecutors can and should be aggressive in the pursuit of the public interest. It respects the distinguished record of the United States Attorney’s Office for the Southern District of New York, which long has been, and continues to be, a model for the nation. But there are limits on the permissible actions of even the best prosecutors.<sup>168</sup>

The Second Circuit’s review of this case is discussed in great detail below.

#### IV. THE SECOND CIRCUIT AND THE VIOLATION OF THE SIXTH AMENDMENT RIGHT TO COUNSEL

The Second Circuit affirmed the district court’s dismissal of thirteen defendants’ indictments on Sixth Amendment grounds.<sup>169</sup> It should be noted that the circuit court reached this holding by affirming only a relatively small piece of the district court’s decision. As mentioned above, the district court found numerous Fifth and Sixth Amendment violations by the Government. The circuit court only found it necessary to affirm one, and it did not reach the district court’s other rulings. The specific action that the circuit court affirms as violative of the defendants’ Sixth Amendment right to counsel is “KPMG’s termination of fees upon

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<sup>164</sup> *Id.* at 380.

<sup>165</sup> *Stein V*, 541 F.3d 130, 135–36 (2d Cir. 2008).

<sup>166</sup> *Id.*

<sup>167</sup> *Stein IV*, 495 F. Supp. 2d 390, 423, 427 (S.D.N.Y. 2007).

<sup>168</sup> *Id.* at 427.

<sup>169</sup> *Stein V*, 541 F.3d 130 at 136.

indictment.”<sup>170</sup> This means that the circuit court did not reach a decision on whether the “*pre*-indictment conditioning and capping of fees—conduct . . . determined [to be] state action—establishes a Sixth Amendment violation by itself.”<sup>171</sup> The circuit court did not consider the district court’s Fifth Amendment ruling either.<sup>172</sup>

The Second Circuit reviewed each of Judge Kaplan’s four ultimate factual conclusions, and could not find clear error.<sup>173</sup> Most importantly, the court determined that Judge Kaplan’s factual finding that absent the Thompson Memorandum and the prosecutors’ conduct, KPMG would have advanced fees without condition or cap survives scrutiny.<sup>174</sup> Since the court could not find clear error, it adopted these factual findings.<sup>175</sup> The circuit court held to this finding even though it deemed the Government’s argument “plausible.”<sup>176</sup> The Government argued that “even absent government pressure KPMG would not have advanced legal fees indefinitely and without condition.”<sup>177</sup> This was supported by the “undisputed” fact that KPMG’s longstanding fees policy was voluntary and subject to revision—in other words, it was not mandated by Delaware statute or in the employees work contracts.<sup>178</sup> The circuit court refused to accept this argument because it directly contradicts Judge Kaplan’s “central” finding that “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.”<sup>179</sup>

#### A. *Government Action*

The court found that the actions of KPMG were influenced by the Government in such a controlling manner as to constitute “state action”:

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<sup>170</sup> *Id.* at 153–54 n.13.

<sup>171</sup> *Id.*

<sup>172</sup> *See id.* at 136 (“In light of this disposition, we do not reach the district court’s Fifth Amendment ruling.”).

<sup>173</sup> *Id.* at 142–45.

<sup>174</sup> *See id.* at 143 (“Finally, we cannot say that the district court’s ultimate finding of fact—that absent the Thompson Memorandum and the prosecutors’ conduct KPMG would have advanced fees without condition or cap—was clearly erroneous.”).

<sup>175</sup> *See id.* at 144 (“For the foregoing reasons, we cannot disturb Judge Kaplan’s factual findings, including his finding that, but for the Thompson Memorandum and the prosecutors’ conduct, KPMG would have advanced legal fees without condition or cap.”).

<sup>176</sup> *Id.* at 146.

<sup>177</sup> *Id.*

<sup>178</sup> *See id.* (“True, even if KPMG had decided initially to advance legal fees, it might always have changed course later: it is undisputed that KPMG’s longstanding fees policy was voluntary and subject to revision. (In fact, in the civil suit KPMG represented that it would not have obligated itself to pay millions of dollars in fees on behalf of an unknown number of employees without regard to the charges ultimately lodged against them.)”).

<sup>179</sup> *Id.* (internal quotation marks omitted).

Actions of a private entity are attributable to the State if there is a sufficiently close nexus between the State and the challenged action of the . . . entity so that the action of the latter may be fairly treated as that of the State itself. . . . Such responsibility is normally found when the State has exercised coercive power or has provided such significant encouragement, either overt or covert, that the choice must in law be deemed to be that of the State.<sup>180</sup>

The court took into account the delicate nature of large corporations. It noted how lethal an indictment could be to a corporation—regardless of whether the corporation is ever convicted.<sup>181</sup> This showed that KPMG had good reason to believe that if it were indicted, it would collapse. In order to stave off indictment, KPMG would have to cooperate fully with the Government. Indeed, the reason KPMG retained Skadden was to formulate a “cooperative approach” when dealing with the USAO.<sup>182</sup>

Since the Government’s Thompson Memorandum deemed the paying of legal fees to count toward indictment, KPMG’s defense attorney had no choice but to give in to government pressure on the matter. As the court wrote, “Since defense counsel’s objective in a criminal investigation will virtually always be to protect the client, KPMG’s risk was that fees for defense counsel would be advanced to someone the Government considered culpable. So the only safe course was to allow the Government to become (in effect) paymaster.”<sup>183</sup> But the Government did not just control KPMG’s policy on advancing legal fees. The Government became “entwined in the control of [the company] KPMG.”<sup>184</sup> This was evidenced by the supplemental letter they demanded be sent to the employees stating that they do not *need* an attorney when interviewed by prosecutors.<sup>185</sup> Also, prosecutors regularly reported to KPMG the names of employees who it deemed uncooperative because “the USAO knew full well that KPMG would pressure them to talk to prosecutors.”<sup>186</sup> The court

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<sup>180</sup> *Id.* at 146–47 (quoting *Jackson v. Metro. Edison Co.*, 419 U.S. 345 (1974); *Blum v. Yaretsky*, 457 U.S. 991, 1004 (1982) (internal quotation marks omitted)).

<sup>181</sup> *See Stein V*, 541 F.3d 130 at 142 (noting that “KPMG was faced with the fatal prospect of indictment”); *see also id.* (“Moreover, KPMG’s management and counsel had reason to consider the impact of the firm’s indictment on the interests of the firm’s partners, employees, clients, creditors and retirees.”).

<sup>182</sup> *Id.* at 137.

<sup>183</sup> *Id.* at 148.

<sup>184</sup> *Id.* (quoting *Flagg v. Yonkers Sav. & Loan Ass’n*, 396 F.3d 178, 187 (2d Cir. 2005)).

<sup>185</sup> *See id.* at 143 (“On March 12, the prosecutors prevailed upon KPMG to supplement its first advisory letter with another, which clarified that employees could meet with the government without counsel.”).

<sup>186</sup> *See id.* at 148 (“They did so by regularly ‘reporting to KPMG the identities of employees who refused to make statements in circumstances in which the USAO knew full well that KPMG would

determined that this “overt encouragement” demonstrated sufficient control over KPMG’s decisions to support the conclusion that KPMG’s actions are properly attributed to the state.<sup>187</sup> The Government took advantage of its influence over the company and calibrated KPMG’s desires to match the Government’s desires; in other words the Government attempted to get KPMG to think like the Government. This was demonstrated by the following facts, as explained by the circuit court:

KPMG was never “free to define” cooperation independently: [the USAO] told Bennett that he 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 [the prosecutors] define it.” KPMG’s fees advancement decisions in individual cases thus depended largely on state-influenced standards.<sup>188</sup>

*B. The Sixth Amendment Attaches at the Initiation of Adversarial Proceedings*

What should happen when the Government action occurs before the initiation of adversarial proceedings—and thus before Sixth Amendment protection—but the effect continues throughout the whole process? Is the Sixth Amendment not implicated or is the Government unfairly gaming the system? The Thompson Memorandum and the actions of the USAO had the effect of limiting access to funds for the defense of the defendants long before the first indictment.<sup>189</sup> Even if this was not the intentional motive of the Government it certainly knew it was an “exceptionally” likely result.<sup>190</sup> The court reasoned that because the result will be “unconstitutional,” the fact that the actions took place before any defendants were indicted does not “save the government.”<sup>191</sup> As the court wrote: “In other words, the government’s pre-indictment conduct was of a kind that would have post-indictment effects of Sixth Amendment significance, and did.”<sup>192</sup>

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pressure them to talk to prosecutors.” (quoting *United States v. Stein (Stein II)*, 440 F. Supp. 2d 315, 337 (S.D.N.Y. 2006)).

<sup>187</sup> *See id.* (“The prosecutors thus steered KPMG toward their preferred fee advancement policy and then supervised its application in individual cases. Such ‘overt’ and ‘significant encouragement’ supports the conclusion that KPMG’s conduct is properly attributed to the State.”).

<sup>188</sup> *Id.* at 149.

<sup>189</sup> *Id.* at 153.

<sup>190</sup> *See id.* (“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.”).

<sup>191</sup> *See id.* (“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.”).

<sup>192</sup> *Id.*

If the Government is “saved” and the Sixth Amendment protections do not attach, the result would give federal prosecutors almost complete control over the corporations.<sup>193</sup> The Government would assume complete control over the corporations for the same reasons that KPMG’s actions were deemed to be state actions in this case: a corporate defense attorney will do all in his or her power to avoid indictment.<sup>194</sup> If the Government knows that corporations will be willing to fully cooperate with them, the prosecutors in effect also assume the roles of jury and sentencing-judge. This gives the Government tremendous bargaining power when the two parties attempt to reach a deferred prosecution agreement. It also would open the door for the Government to interfere with the employee-defendants’ defense without recourse. This would simply give the prosecution too much authority and too much power over the employees of corporations.

The alternative is to allow Sixth Amendment rights to attach for state action that occurs before the initiation of the adversarial process—before indictment—when that state action affects defendants after the adversarial process has begun.<sup>195</sup> The circuit court explained that “[w]hen the Government acts prior to indictment so as to impair the suspect’s relationship with counsel post-indictment, the pre-indictment actions ripen into cognizable Sixth Amendment deprivations upon indictment.”<sup>196</sup> Thus, the court did not change the rule that the Sixth Amendment “attaches only upon indictment.”<sup>197</sup> The court does, however, say that pre-indictment governmental interference with the accused’s relationship with counsel becomes “ripe” upon indictment. In other words, potentially coercive state action cannot go unexamined simply because it occurred before an indictment and especially because it helped to lead to that indictment.

For this case, the circuit court wrote the following:

Since the Government forced KPMG to adopt the constricted Fees Policy—including the provision for terminating fee advancement upon indictment—and then compelled KPMG to enforce it, it was virtually certain that KPMG would terminate defendants’ fees upon indictment. We therefore reject the Government’s argument that its actions (virtually all pre-indictment) are immune from

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<sup>193</sup> Absent intervening congressional legislation or changing of the DOJ policy, of course.

<sup>194</sup> See *supra* Part III.D.2.

<sup>195</sup> See *Stein V*, 541 F.3d 130, 153 (2d Cir. 2008) (“Although defendants’ Sixth Amendment rights attached only upon indictment, the district court properly considered pre-indictment state action that affected defendants post-indictment.”).

<sup>196</sup> *Id.* at 153.

<sup>197</sup> *Id.* at 148 n.9.

scrutiny under the Sixth Amendment.<sup>198</sup>

Thus, the court refused to let the Government control and manipulate KPMG's decisions without examining these actions under the Sixth Amendment. Again, as mentioned above, the court only reached a decision on KPMG's decision to terminate fees upon indictment—that this action is violative of the defendants' Sixth Amendment right to counsel.<sup>199</sup>

The circuit court reviewed the protection that is afforded an accused by the Sixth Amendment right to counsel. The court determined that the Government cannot prevent an accused from obtaining counsel and it imposes on the state the affirmative obligation to respect the decision of the accused.<sup>200</sup> The court also noted that “the right to counsel in an adversarial legal system would mean little if defense counsel could be controlled by the Government or vetoed without good reason.”<sup>201</sup> This led the court to ultimately conclude that “[i]n a nutshell, the Sixth Amendment protects against unjustified governmental interference with the right to defend oneself using whatever assets one has or might reasonably and lawfully obtain.”<sup>202</sup> In other words, it does not matter that the funds were “other people's money” as the Government argued.<sup>203</sup> Because the circuit court adopted the district court's finding—that, 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—that simply interfering with the subject-to-change legal fees policy of the corporation was enough for a Sixth Amendment violation.

In conclusion, the district court found that the defendants were forced to limit their defense—in the economic sense—and would not have had to do so had the Government not interfered in violation of their constitutional rights.<sup>204</sup> The circuit court found the same.<sup>205</sup> This interference “caused

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<sup>198</sup> *Id.* at 153.

<sup>199</sup> *Id.* at 153 n.13.

<sup>200</sup> *Id.* at 154 (citing *Maine v. Moulton*, 474 U.S. 159, 170–71 (1985)).

<sup>201</sup> *Id.*

<sup>202</sup> *Id.* at 156.

<sup>203</sup> *Id.* at 141.

<sup>204</sup> *Stein IV*, 495 F. Supp. 2d 390, 419 (S.D.N.Y. 2007).

<sup>205</sup> *See Stein V*, 541 F.3d at 151–52 n.10. The court explained that, in *Stein IV*:

All of the [present] KPMG Defendants . . . say that KPMG's refusal to pay their post-indictment legal fees has caused them to restrict the activities of their counsel, limited or precluded their attorneys' review of the documents produced by the government in discovery, prevented them from interviewing witnesses, caused them to refrain from retaining expert witnesses, and/or left them without information technology assistance necessary for dealing with the mountains of electronic discovery. The government has not contested these assertions. The Court therefore has no reason to doubt, and hence finds, that all of them have been forced to limit their defenses in the respects claimed for economic reasons and that they would not have been so constrained if KPMG paid their expenses subject only to the usual sort

them to restrict the activities of their counsel, and thus to limit the scope of their pre-trial investigation and preparation.”<sup>206</sup> This is emphasized by the “extremely complex” nature of the case and the expectation that a trial was expected to last between six to eight months.<sup>207</sup> Therefore, the court concluded that the defendants’ rights were violated under the Sixth Amendment. Finding no other remedy available, the court affirmed the district court’s dismissal of the indictments.<sup>208</sup>

Although the court specifically said it did not reach the issue of whether the capping and conditioning of fees violates the defendants’ Sixth Amendment right to counsel, there was no reason to believe that the Court would not find that it did violate the Sixth Amendment.<sup>209</sup> First, the circuit court already deemed this action as “state action.”<sup>210</sup> Second, the court held that KPMG’s termination of fees upon indictment deprived defendants of their Sixth Amendment right to counsel because the defendants were forced to limit their defense—something they would not have had to do if the Government had not interfered.<sup>211</sup> The decision to put a cap on the legal fees and to condition the payment of the fees on cooperation had the same effect on their defense as did terminating the fees upon indictment. It was the same because they were deprived of funds that would have been advanced to them, had the Government not interfered.<sup>212</sup>

There is no reason to believe that terminating the payment of fees upon indictment is any more violative of the Sixth Amendment right to counsel than terminating the payment of fees upon not cooperating with the Government. Indeed, once the act of conditioning the payment of legal fees on cooperation with the state is deemed a state action—as it was

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of administrative requirements typically imposed by corporate law departments on outside counsel fees.

*Id.*

<sup>206</sup> *Id.* at 157.

<sup>207</sup> *Id.*

<sup>208</sup> *See id.* (“In the district court, the government conceded that these defendants are also entitled to dismissal of the indictment, assuming the correctness of *Stein I.* We agree.” (internal citations omitted)).

<sup>209</sup> *Id.* at 153 n.13.

<sup>210</sup> *See id.* at 136 (“We hold that KPMG’s adoption and enforcement of a policy under which it conditioned, capped and ultimately ceased advancing legal fees to defendants followed as a direct consequence of the government’s overwhelming influence, and that KPMG’s conduct therefore amounted to state action.”).

<sup>211</sup> *See id.* at 157 (“In the district court, the government conceded that these defendants are also entitled to dismissal of the indictment, assuming the correctness of *Stein I.* We agree.” (internal citations omitted)).

<sup>212</sup> *See id.* at 146 (“[T]he district court’s central finding—which is not clearly erroneous—that ‘[a]bsent 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.’ Because we cannot disturb this finding, we cannot accept the government’s claim of cure on this score.” (internal references omitted)).

deemed so here by the circuit court<sup>213</sup>—it is difficult to see how it could be any more violative of the Sixth Amendment. This would mean that the government is conditioning the payment of the defendants’ legal fees on the defendants’ cooperation with the government. This is even more shocking since it is the Government that defines “cooperation” by the factors listed in the Thompson Memorandum.<sup>214</sup>

## V. REVISIONS OF THE THOMPSON MEMORANDUM AND CURING THE *STEIN* PROBLEMS

Because the Holder Memorandum and the Thompson Memorandum are examined in detail in Part II of this Note, this discussion will only consider the revisions since the Thompson Memorandum: the McNulty Memorandum and the Filip revisions.

### A. *The McNulty Memorandum*

There were two main problems with the Thompson Memorandum. First, it encouraged prosecutors to seek waivers of the attorney-client and work product privileges.<sup>215</sup> Second, it held against the corporation the advancement of legal fees to its employees.<sup>216</sup> The McNulty Memorandum sought to fix some of these problems. The McNulty Memorandum is prefaced with a shorter memorandum explaining the revisions:

I have decided to adjust certain aspects of our policy in ways that will further promote public confidence in the Department, encourage corporate fraud prevention efforts, and clarify our goals without sacrificing our ability to prosecute these important cases effectively. The new language expands upon the Department's long-standing

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<sup>213</sup> See *supra* note 210.

<sup>214</sup> See Thompson Memorandum, *supra* note 3, § VI.A (“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.”).

<sup>215</sup> See Thompson Memorandum, *supra* note 3, § II.A.4 (“[T]he 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 also *id.* § VI.A (“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 waive attorney-client and work product protection.”).

<sup>216</sup> See *id.* § VI.B (“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 . . . may be considered by the prosecutor in weighing the extent and value of a corporation’s cooperation.”).

policies concerning how we evaluate the authenticity of a corporation's cooperation with a government investigation.<sup>217</sup>

Mr. McNulty also notes that he is aware of the criticisms of the Thompson Memorandum by groups within the corporate legal community.<sup>218</sup>

For waivers of the attorney-client and work product privileges, the McNulty Memorandum instructs prosecutors to seek a waiver only if a legitimate need for it exists, and then in the least intrusive manner.<sup>219</sup> The McNulty Memorandum distinguishes between "Category I" and "Category II" privileged information. Prosecutors are instructed to try to obtain purely factual information relating to the underlying misconduct first; this is Category I information. This information may or may not be privileged. "Only if the purely factual information provides an incomplete basis to conduct a thorough investigation should prosecutors then request that the corporation provide attorney-client communications or non-factual attorney work product."<sup>220</sup> This is Category II information. "This information includes legal advice given to the corporation before, during, and after the underlying misconduct occurred."<sup>221</sup> Under the McNulty Memorandum, prosecutors must obtain written authorization from the United States Attorney when seeking Category I information and they must obtain written authorization from the Deputy Attorney General before seeking waiver for Category II information.<sup>222</sup> If a corporation refuses to provide Category II information, prosecutors are not allowed to consider this as a negative factor; however, if they do provide the information, prosecutors are allowed to consider this as a positive factor.<sup>223</sup>

The McNulty Memorandum made a few changes to the policy on advancing legal fees. It states, "[p]rosecutors generally should not take into account whether a corporation is advancing attorneys' fees to employees or agents under investigation and indictment."<sup>224</sup> In a footnote, the memorandum makes an exception of this general principle for "extremely rare cases" when "the totality of the circumstances show that it

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<sup>217</sup> McNulty Memorandum, *supra* note 6.

<sup>218</sup> *See id.* ("Many of those associated with the corporate legal community have expressed concern that our practices may be discouraging full and candid communications between corporate employees and legal counsel. To the extent this is happening, it was never the intention of the Department for our corporate charging principles to cause such a result.")

<sup>219</sup> *Id.* § 7.B.2; *see also* Keneally & Harris, *supra* note 5, at 4.

<sup>220</sup> McNulty Memorandum, *supra* note 6, § 7.B.2.

<sup>221</sup> *Id.*

<sup>222</sup> *Id.*

<sup>223</sup> *See id.* ("If a corporation declines to provide a waiver for Category II information after a written request from the United States Attorney, prosecutors must not consider this declination against the corporation in making a charging decision. Prosecutors may always favorably consider a corporation's acquiescence to the government's waiver request in determining whether a corporation has cooperated in the government's investigation."); *see also* Keneally & Harris, *supra* note 5, at 4.

<sup>224</sup> McNulty Memorandum, *supra* note 6, § 7.B.3.

was intended to impede a criminal investigation.<sup>225</sup> The memorandum goes on to define what it considers impeding conduct. Such conduct includes the following:

[O]verly 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 . . . omissions; and failure to promptly disclose illegal conduct known to the corporation.<sup>226</sup>

The memorandum specifically notes that this “conduct intended to impede” does not need to reach the level of criminal obstruction.<sup>227</sup> Thus, while it appears to be fixing the Stein problem, it carves out a relatively large exception.

The McNulty Memorandum failed to redress some other problems of the Thompson Memorandum. This memorandum continued to allow prosecutors to independently deem specific employees culpable for criminal wrongdoing and then hold this against the corporation if prosecutors believe the corporation is protecting them.<sup>228</sup> The memorandum also allows prosecutors to consider negatively whether the corporation has entered into a joint-defense agreement.<sup>229</sup> Because the memorandum left some of these problems unaddressed, or because they were not cured as well as they could have been Congress decided to intervene. The House of Representatives has already passed H.R. 3013, the Attorney-Client Privilege Protection Act of 2007.<sup>230</sup> If passed in the Senate, prosecutors would be prevented from requesting waivers of the attorney-client and work-product privilege, and it would prevent prosecutors from considering the assertion of these privileges as well as the advancement of attorneys’ fees and the retention of employees by an organization.<sup>231</sup>

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<sup>225</sup> *Id.* § 7.B.3, n.3.

<sup>226</sup> *Id.* § 7.B.4.

<sup>227</sup> *See id.* § 7.B.4 (“Another factor to be weighed by the prosecutor is whether the corporation, while purporting to cooperate, has engaged in conduct intended to impede the investigation (whether or not rising to the level of criminal obstruction).”).

<sup>228</sup> *See id.* § 7.B.3 (“Another factor to be weighed by the prosecutor is whether the corporation appears to be protecting its culpable employees and agents.”).

<sup>229</sup> *Id.*

<sup>230</sup> Keneally & Harris, *supra* note 5, at 5.

<sup>231</sup> *See id.*

### B. *The Filip Revisions*

On August 28, 2008, the same day the Second Circuit affirmed the *Stein I* decision, Mark R. Filip announced the revisions to the DOJ's corporate charging guidelines.<sup>232</sup> Before announcing the specific revisions, Mr. Filip described the reasons he decided to revise the policy. In doing so, he highlighted the criticisms of past policies:

[M]any in the legal community have argued that prosecutors have unfairly demanded that corporations produce privileged materials or waive attorney-client or work-product protections as a precondition for receiving cooperation credit. Others have expressed concern that the Department could unfairly withhold such credit from a corporation that advanced attorneys' fees to its employees, or failed to sanction culpable employees, or entered into joint defense agreements.<sup>233</sup>

Mr. Filip demonstrated a desire to assuage concerns of prosecutorial abuse by engaging in "extended discussions" with a diverse array of groups.<sup>234</sup> These groups include "for example, the criminal defense bar, the civil liberties community, and the business community" as well as former DOJ officials.<sup>235</sup> Mr. Filip lists as critical mandates that guide the revisions three principles: to enforce the law aggressively, to respect the rights of criminal defendants and others involved in the criminal justice process, and to promote fair outcomes for the American people.<sup>236</sup> These revised principles were set forth for the first time not in the form of a memorandum, but in the United States Attorneys' Manual.<sup>237</sup> They were made binding on all federal prosecutors and made effective immediately.<sup>238</sup>

The Filip revisions made four broad changes to the past policies. First, the revisions shift the emphasis from waiving attorney-client and work-product privileges to simply disclosing relevant facts in a timely manner. Mr. Filip announced, "[c]orporations that timely disclose relevant facts may receive due credit for cooperation, regardless of whether they waive

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<sup>232</sup> Filip's August 28 Press Conference, *supra* note 7; *see also* Jonathan D. Glater & Michael M. Grynbaum, *U.S. Lifts a Policy in Corporate Crime Cases*, N.Y. TIMES, Aug. 29, 2008, at C6 ("Two branches of government in one day have announced their agreement that the government cannot pressure businesses and other entities to treat individuals in a way that it would be unconstitutional for the government to do directly," Stephanie Martz, director of the white-collar crime project for the National Association of Criminal Defense Lawyers, wrote in an e-mail message.").

<sup>233</sup> Filip's August 28 Press Conference, *supra* note 7.

<sup>234</sup> *Id.*

<sup>235</sup> *Id.*

<sup>236</sup> *Id.*

<sup>237</sup> *Id.*; *see also* U.S. Attorneys' Manual, *supra* note 8.

<sup>238</sup> Filip's August 28 Press Conference, *supra* note 7.

attorney-client privilege or work product protection in the process.<sup>239</sup> He attempted to restate this in other ways to be more clear, saying, “[t]he government will assess neither a credit nor a penalty based on whether the disclosed materials are protected by the attorney-client privilege or attorney work product.”<sup>240</sup> The revisions forbid prosecutors from seeking what the McNulty Memorandum called Category II information.<sup>241</sup> This prohibition has only two exceptions, but as Mr. Filip notes, both of which are well-recognized in existing law.<sup>242</sup>

Second, prosecutors are “not to consider whether a corporation has advanced attorneys’ fees to its employees, officers, or directors when evaluating cooperativeness.”<sup>243</sup> There is an exception to this, but unlike the McNulty Memorandum, it is only for conduct that rises to the level of criminal obstruction of justice.<sup>244</sup> Mr. Filip notes that this will generally not be the case.<sup>245</sup> Specifically, the new policy says the following on the subject:

In evaluating cooperation, however, prosecutors should not take into account whether a corporation is advancing or reimbursing attorneys’ fees or providing counsel to employees, officers, or directors under investigation or indictment. Likewise, prosecutors may not request that a corporation refrain from taking such action. This prohibition is not meant to prevent a prosecutor from asking questions about an attorney’s representation of a corporation or its employees, officers, or directors, where otherwise appropriate under the law. Neither is it intended to limit the otherwise applicable reach of criminal obstruction of justice statutes such as 18 U.S.C. § 1503. If the payment of attorney fees were used in a manner that would otherwise constitute criminal obstruction of justice—for example, if fees were advanced on the condition that an employee adhere to a version of the facts that the corporation and the employee knew to be false—these Principles would not (and could not) render inapplicable such criminal prohibitions.<sup>246</sup>

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<sup>239</sup> *Id.*

<sup>240</sup> *Id.*

<sup>241</sup> *Id.*

<sup>242</sup> *Id.*

<sup>243</sup> *Id.*

<sup>244</sup> *See id.* (“A corporation’s payment of or advancement of attorneys’ fees to its employees will be relevant only in the rare situation where it, combined with other circumstances, would rise to the level of criminal obstruction of justice.”).

<sup>245</sup> *Id.*

<sup>246</sup> U.S. Attorneys’ Manual, *supra* note 8, at ch. 9-28.730 (emphasis added).

Third, “federal prosecutors may not consider whether the corporation has entered into a joint defense agreement in evaluating whether to give the corporation credit for cooperating.”<sup>247</sup> Fourth, under the new revisions prosecutors are not allowed to consider whether a corporation disciplined or terminated employees for the purpose of evaluating cooperation.<sup>248</sup> However, prosecutors may consider whether a corporation has “disciplined employees that the *corporation* identifies as culpable, and only for the purpose of evaluating the corporation’s remedial measures or compliance program.”<sup>249</sup> Filip reminds corporations toward the end of his statements that a corporation’s refusal to cooperate is not evidence of guilt just as it would not be evidence of guilt for an individual.<sup>250</sup> Mr. Filip made it clear that all of the revisions, “indeed the policy as a whole, reflect [the DOJ’s] commitment to treating corporations that are under investigation no better and no worse than individuals who are under investigation.”<sup>251</sup>

### C. *Curing the “Stein Problems”*

It is important not to forget that *Stein I* had two problems. The Thompson Memorandum was only one. The second problem was how the Government dealt with the zealous corporation that was exceedingly willing to cooperate. The Thompson Memorandum alone was not the whole problem. Where the revisions to the DOJ policy have been made, they have only addressed part of the *Stein* problem. The underlying facts will still be the same in the future. A corporation will still believe that an indictment would bring ruin.<sup>252</sup> This means that a corporation under suspicion will still be extremely willing to cooperate with prosecutors. Therefore, the USAO will still be exposed to the risk of controlling the decisions of the corporation. Judge Kaplan suggested that prosecutors should shift their goal from only being concerned with punishing the individuals who it deemed culpable to making sure that the corporation does not cross the line when it is trying to cooperate. He wrote:

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

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<sup>247</sup> Filip’s August 28 Press Conference, *supra* note 7.

<sup>248</sup> *Id.*

<sup>249</sup> *Id.* (emphasis added).

<sup>250</sup> *Id.*

<sup>251</sup> Mark R. Filip, Deputy Attorney Gen., Remarks as Delivered by Deputy Attorney General Mark R. Filip at American Bar Association Securities Fraud Conference (Oct. 2, 2008).

<sup>252</sup> *See, e.g., supra* note 26 and accompanying text.

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.<sup>253</sup>

This suggests that the USAO has dual roles. It is supposed to prosecute the case but at the same time it is also supposed to play the role of a watchful guardian or paternal figure. Under the paternal role, the USAO should make sure the corporation is not undertaking policies that strip their employees of constitutional rights. Moreover, they should *discourage* corporations from activities that would make the criminal justice process unfair to their employees. This is a proactive responsibility. Judge Kaplan seems to suggest that simply being passive and compliant while the corporation makes decisions is not enough. The suggestion is that the Government must oversee the process while making sure that the corporation does not go too far.

Here, Judge Kaplan says that the Government would not have accepted KPMG's word that they had no duty to pay the employees' legal fees if it had not been so concerned with punishing those it deemed culpable. Judge Kaplan expected the Government to at least inquire more into KPMG's obligation (or lack thereof) to pay the legal fees. This act would seem to go against the prosecutor's obvious desire to get a conviction. However, as noted above, the duty of the prosecutor is not to get a conviction, but to help administer justice.<sup>254</sup> There may always be opportunity for the Government to abuse its position and power—that may be unavoidable. However, if all prosecutors enter these situations acknowledging their dual roles and the responsibilities that accompany them, the occurrence of abuse will decline.

## VI. CONCLUSION

On the issue of advancement of attorneys' fees, the Thompson Memorandum could have been relatively easily revised to comply with Judge Kaplan's *Stein I* holding. Judge Kaplan even offered a proposal. He wrote that:

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<sup>253</sup> *Stein I*, 435 F. Supp. 2d 330, 353 (S.D.N.Y. 2006).

<sup>254</sup> See *supra* text accompanying note 36.

[T]he 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.”<sup>255</sup>

Judge Kaplan suggested that this would be enough to make the Government interference narrowly tailored. He wrote that:

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 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.<sup>256</sup>

The DOJ attempted to comply with this suggestion, but it took advantage of Judge Kaplan’s seemingly ambiguous uses of the word “obstruction.” As mentioned above, the McNulty Memorandum instructed prosecutors not to factor into their decision whether corporations advance attorneys’ fees unless “the totality of the circumstances show that it was intended to *impede* a criminal investigation.”<sup>257</sup> The McNulty Memorandum uses the word “impede,”<sup>258</sup> and not the word “obstruct.”<sup>259</sup> The Memorandum specifically notes that this “conduct intended to impede” does not need to reach the level of criminal obstruction.<sup>260</sup> This leaves the potential for a court to find that the policy is not “narrowly tailored” enough to pass the strict scrutiny test.

Mr. Filip recognized this as a potential problem. The Filip revisions closed this gap by only allowing prosecutors to take into consideration the advancement of attorneys’ fees for conduct that rises to the level of criminal obstruction of justice.<sup>261</sup> The Filip revisions strip from the

<sup>255</sup> *Stein I*, 435 F. Supp. 2d at 363 (emphasis in original).

<sup>256</sup> *Id.* at 364.

<sup>257</sup> McNulty Memorandum, *supra* note 6 § 7.B.3 n.3 (emphasis added).

<sup>258</sup> *See id.* (“In extremely rare cases, the advancement of attorneys’ fees may be taken into account when the totality of the circumstances show that it was intended to impede a criminal investigation.”).

<sup>259</sup> In § 7.B.4 of the McNulty Memorandum, the word “obstructing” is used, but immediately distinguished from “criminal obstruction.” *Id.* §§ 7.B., 7.B.4.

<sup>260</sup> *See id.* (“Another factor to be weighed by the prosecutor is whether the corporation, while purporting to cooperate, has engaged in conduct intended to impede the investigation (whether or not rising to the level of criminal obstruction).”).

<sup>261</sup> *See* Filip’s August 28 Press Conference, *supra* note 7 (“A corporation’s payment of or advancement of attorneys’ fees to its employees will be relevant only in the rare situation where it, combined with other circumstances, would rise to the level of criminal obstruction of justice.”); *see also* U.S. Attorneys’ Manual, *supra* note 8, at ch. 9-28.730 (“This prohibition is not meant to prevent a prosecutor from asking questions about an attorney’s representation of a corporation or its employees,

assessment any individual discretion of a prosecutor to decide whether there exists impeding conduct. This means that Judge Kaplan would most likely approve of this new policy because it has “narrowly tailor[ed] its means to its ends.”<sup>262</sup> It now appears that the DOJ’s policy on the advancement of legal fees has been rectified.

However, the Filip revisions may not have resolved all of the problems in the Thompson Memorandum. Mr. Filip made many changes to the policy on seeking waiver of the attorney-client and work-product privileges. The attempt resulted in a compromise. The revisions keep the credit-for-cooperation system, but forbid prosecutors from seeking information formally called “Category II” information. Again, Category II information is attorney-client communications or any non-factual attorney work product.<sup>263</sup>

The Filip revisions may not have fixed the problem of waiver. As former Deputy Attorney General Paul McNulty pointed out:

While the primary, commendable aim of the revisions is to eliminate the perceived pressure to waive privilege in exchange for cooperation credit, the practical impact of these revisions remains to be seen. Because the extent to which a corporation discloses relevant facts remains the touchstone of the credit-for-cooperation analysis, there may be significant pressure, implicit or explicit, to continue to waive if such facts are protected by privilege.<sup>264</sup>

In other words, a corporation being investigated will still want to do everything within its power to avoid the indictment. This means that it will still seek to get as much credit as possible, thus, it will still want to hand over the “Category II” information. The only difference is that the prosecutor is not going to be the one initiating the transfer of this information. The idea being that courts will likely find it very difficult to establish “state action” when it appears that the corporation is volunteering this information. In reality, very little has changed. Mr. McNulty suggests that the “significant pressure” to waive still exists, and may always exist in a credit-for-cooperation system.

The problem is rooted in the fact that indictments are fatal to major corporations.<sup>265</sup> This means that from the beginning of the process, a corporation is *compelled* to follow the prosecution’s instructions on how to

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officers, or directors, where otherwise appropriate under the law. . . . Neither is it intended to limit the otherwise applicable reach of criminal obstruction of justice statutes such as 18 U.S.C. § 1503.”)

<sup>262</sup> *Stein I*, 435 F. Supp. 2d 330, 364 (S.D.N.Y. 2006).

<sup>263</sup> McNulty Memorandum, *supra* note 6, § 7.B.2.

<sup>264</sup> Paul J. McNulty, *Against Backdrop of Setback in KPMG Case, Feds Revise McNulty Memo*, 23 ANDREWS LITIG. REP. 8, 9 (2008).

<sup>265</sup> *See supra* note 26 and accompanying text.

avoid indictment. Under the Filip revisions, like it was under the Thompson Memorandum, the way to avoid indictment is by cooperating with the Government. Now, the Government will not view negatively a corporation's refusal to give privileged information. It will, however, still give credit for that privileged information. Thus, a corporation is still compelled under the Filip revisions to disclose attorney-client and work-product privileged information. Under the Filip revisions the compelling is done differently, almost passively—allowing the implied threat of indictment to do the work.

The DOJ has made significant changes to its policy on prosecuting business organizations. It now seems unlikely that a case like *Stein I* where the Government interferes with the advancement of attorneys' fees will occur under the Filip revisions. However, there are other problems within the policy that may not have been cured by the Filip revisions. One problem that remains is the potential for prosecutorial abuse. Judge Kaplan found the actions of the prosecution to have violated the Constitution.<sup>266</sup> This potential for abuse is inherent in the delicate nature of prosecuting corporations. A second problem is that the revisions may not have sufficiently resolved the waiver dispute. The future of the DOJ's policy remains to be seen. It is therefore appropriate to conclude with something a unanimous Supreme Court wrote long ago and that Judge Kaplan noted in *Stein I*: that the interest of the Government "in a criminal prosecution is not that it shall win a case, but that justice shall be done."<sup>267</sup>

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<sup>266</sup> See *Stein I*, 435 F. Supp. 2d at 336 ("The government, however, has let its zeal get in the way of its judgment. It has violated the Constitution it is sworn to defend.").

<sup>267</sup> *Id.* at 381 (quoting *Berger v. United States*, 295 U.S. 78, 88 (1935)).