UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

August Term, 2006

(Argued: November 21, 2006 Decided: May 23, 2007)

Docket No. 06-4358-cv

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JEFFREY STEIN, MARK WATSON, PHILIP WIESNER, RANDALL BICKHAM, LARRY DELAP, JEFFREY EISCHEID, DAVID GREENBERG, STEVEN GREMMINGER, CARL HASTING, JOHN LANNING, JOHN LARSON, ROBERT PFAFF, GREGG RITCHIE, RICHARD ROSENTHAL, RICHARD SMITH, and CAROL G. WARLEY,

Plaintiffs-Appellees,

- v. -

KPMG, LLP,

Defendant-Appellant.

- -

B e f o r e: WINTER, HALL, Circuit Judges, and GLEESON,* District Judge.

Appeal from the exercise of ancillary jurisdiction in a criminal tax fraud prosecution by the United States District Court for the Southern District of New York (Lewis A. Kaplan, Judge) over a state law contractual claim for attorneys' fees, and from denial of a motion to compel arbitration under the

*The Honorable John Gleeson, of the United States District Court for the Eastern District of New York, sitting by designation.

Federal Arbitration Act. This assertion of jurisdiction was intended to provide a remedy for Fifth and Sixth Amendment violations found by the court. We treat the appeal as a petition for a writ of mandamus and grant the petition. We vacate the order asserting ancillary jurisdiction as beyond the district court's power.

SHEILA L. BIRNBAUM, Skadden, Arps, Meagher & Flom LLP, New York, New York (Barbara Wrubel, J. Russell Jackson, Preeta D. Bansal, Haydan A. Coleman, Skadden, Arps, Meagher & Flom LLP, New York, New York, Amy Sabrin, Skadden, Arps, Meagher & Flom LLP, Washington D.C., Charles A. Stillman, Stillman, Friedman & Shechtman, P.C., New York, New York, on the brief), for Defendant Appellant.

DAVID SPEARS, Spears & Imes LLP, New York, New York, for Plaintiffs-Appellees Jeffrey Stein and John Lanning.

RONALD E. DEPETRIS, DePetris & Bachrach, LLP, New York, New York (Marion Bachrach, on the brief), for Plaintiff-Appellee Richard Smith.

John A. Townsend, Townsend & Jones, LLP, Houston, Texas, on the brief, for Plaintiff-Appellee Carol G. Warley.

David C. Scheper, Overland Borenstein Scheper & Kim LLP, Los Angeles, California, on the brief, for Plaintiff-Appellee Robert Pfaff.

John F. Kaley, Doar Rieck Kaley & Mack, New York, New York, on the brief, for Plaintiff-Appellee Steven Gremminger.

David C. Smith, McNamara Spira & Smith, Los Angeles, California, on the brief, for Plaintiff-Appellee Gregg Ritchie.

Leonard F. Lesser, Simon Lesser P.C., New York, New York, on the brief, for Plaintiff-

Appellee David Greenberg.

Diana D. Parker, Law Offices of Diana D. Parker, New York, New York, on the brief, for Plaintiff-Appellee Larry DeLap.

Michael S. Kim, Kobre & Kim LLP, New York, New York, on the brief, for Plaintiff-Appellee Mark Watson.

Marc A. Fenster, Russ, August & Kabat, Los Angeles, California, on the brief, for Plaintiff-Appellee Randall Bickham.

Stanley S. Arkin, Arkin Kaplan Rice LLP, New York, New York, on the brief, for Plaintiff-Appellee Jeffrey Eischeid.

Robert S. Fink, Kostelanetz & Fink, LLP, New York, New York, on the brief, for Plaintiff-Appellee Richard Smith.

Stephen Willey, Savitt & Bruce LLP, Seattle, Washington, on the brief, for Plaintiff-Appellee John Larson.

Susan R. Necheles, Hafetz & Necheles, New York, New York, on the brief, for Plaintiff-Appellee Richard Rosenthal.

Russell M. Gioiella, Litman, Asche & Gioiella, New York, New York, on the brief, for Plaintiff-Appellee Carl Hasting.

WINTER, Circuit Judge:

This appeal is an offspring of a criminal tax fraud prosecution. In the course of the criminal prosecution, Judge Kaplan asserted ancillary jurisdiction over a state law contract claim brought against KPMG, LLP, by sixteen of the defendants in the criminal case, all former partners and employees of KPMG, seeking to force it to pay their legal expenses. KPMG appeals

from the decision allowing the ancillary proceeding and from the denial of its motion to compel arbitration of the contract claim. Construing KPMG's appeal as a petition for writ of mandamus, we grant the petition. We vacate the order of the district court asserting ancillary jurisdiction over the contract claim as beyond the district court's power. The issues regarding KPMG's motion to compel arbitration are therefore moot.

BACKGROUND

The full history of the proceedings underlying this appeal is reported in United States v. Stein, 435 F. Supp. 2d 330 (S.D.N.Y. 2006) (Stein I); United States v. Stein (Stein v. KPMG LLP), 452 F. Supp. 2d 230 (S.D.N.Y. 2006) (Stein II). Familiarity with these opinions is assumed, and we recount here only those facts pertinent to the disposition of the present appeal.

The underlying criminal prosecution is said to be the largest criminal tax case in American history. Stein II, 452 F. Supp. 2d at 237. Nineteen defendants are charged with conspiracy and tax evasion, including the appellees, who are former partners or employees of the accounting firm KPMG. Id. The defendants are alleged to have, inter alia, devised, marketed, and implemented fraudulent tax shelters that caused a tax loss to the United States Treasury of more than $2 billion. In connection with the alleged tax shelters, KPMG entered into a deferred

prosecution agreement with the government, agreeing to cooperate fully with the government and to pay $456 million in fines and penalties. Stein I, 435 F. Supp. 2d at 349-50. If KPMG performs its obligations under the agreement, it will escape prosecution. Id.

The particular dispute giving rise to this appeal concerns policies adopted by the Department of Justice in response to highly visible public concerns over the compliance by business firms with federal and state law. See Leonard Orland, The Transformation of Corporate Criminal Law, 1 Brook. J. Corp. Fin. & Com. L. 45 (2006). The policies were established in the so-called "Thompson Memorandum," which set out standards to be followed by federal prosecutors in determining whether to bring criminal prosecutions against firms as well as their agents.[1] See Mem. from Larry D. Thompson, Deputy Attorney General, U.S. Dep't. Of Justice, to Heads of Department Components, United States Attorneys, re: Principles of Federal Prosecution of Business Organizations (Jan. 20, 2003) ("Thompson Mem."), http://www.usdoj.gov/dag/cftf/business_ organizations.pdf. One such standard deemed a firm's voluntary payment of wrongdoing agents' legal expenses a factor favoring prosecution of the firm. Id. at 7-8.

During the course of the investigation, and prior to the indictments in this matter, KPMG negotiated with and paid the

legal fees of some, but not all, of the appellees. Upon indictment, however, KPMG stopped these payments. Stein I, 435 F. Supp. 2d at 350. In Stein I, the district court found that the government had used the threat of prosecution to pressure KPMG into cutting off payment of the appellees' legal fees and thereby violated appellees' Fifth and Sixth Amendment rights to a fair trial and the effective assistance of counsel. Id. at 382. The merits of that ruling are not before us on this appeal.

The district court suggested that the constitutional violation could be rendered harmless if the appellees could successfully force KPMG to re-commence -- or, for some of the appellees, commence -- paying their legal expenses. Id. at 373, 376-78. The court sua sponte instructed the clerk of the district court to open a civil docket number for an expected contract claim by the appellees against KPMG for advancement of their defense costs. Id. at 382. The district court stated that it would "entertain the claims pursuant to its ancillary jurisdiction over this case." Id.

The district court acknowledged a more obvious remedy for the constitutional violations it had found -- dismissal of the indictment -- and explicitly left that possibility open as an incentive for the government to strongarm KPMG to advance appellees' defense costs. Id. at 380. In short, having found that the government violated appellees' constitutional rights by

threatening to bring one indictment, the district court sought to remedy the violation by threatening to dismiss another.

Following this invitation, the appellees filed the anticipated complaints against KPMG. In the complaints, fifteen of the sixteen appellees relied primarily on an "implied-in-fact" contract with KPMG based on KPMG's alleged history of paying its employees' legal expenses. The sixteenth appellee, Jeffrey Stein, relied on an express breach of his written separation agreement with KPMG. In response, KPMG moved to dismiss for lack of subject matter jurisdiction and on the merits. It also argued that the case should be referred to arbitration under arbitration agreements between KPMG and the various appellees. The district court denied KPMG's motions in Stein II, 452 F. Supp. 2d 230.

The Stein II opinion contained three principal holdings: (i) a reaffirmation of the court's earlier holding that ancillary jurisdiction existed over the contractual fee dispute between appellees and KPMG; (ii) a rejection of KPMG's argument that the "implied-in-fact" contract claims of all of the appellees, save Stein, were foreclosed by written agreements containing merger clauses; and (iii) a finding that enforcement of any applicable arbitration clause would be against public policy. The court concluded that arbitration might interfere with the district court's ability to ensure a speedy trial, could lead to a dismissal of possibly meritorious criminal charges, would

endanger the appellees' rights to a fair trial, and would risk imposing unnecessary costs on taxpayers if the appellees should become indigent. Id. at 238-39.

The opinion closed by setting the trial of appellees' advancement claim for six weeks later, October 17, 2006, following an abbreviated period of limited discovery. Id. at 275. The procedural rules governing the trial were left to the future, the district court noting that "[i]t is not now entirely clear exactly how this will play out." Id. at 274. Although the district court stated that KPMG would have "the protections inherent in the Federal Rules of Civil Procedure," id. at 275, the court elsewhere stated that the advancement claim, although civil in nature, "is a criminal case to which the Civil Rules do not apply," id. at 260. It further expressed its intention to apply the Civil Rules only "to the extent they are consistent with the Criminal Rules." Id. at 269.

On appeal, KPMG argues that the district court lacks subject matter jurisdiction over appellees' advancement claims and also that, if jurisdiction exists, the district court further erred by refusing to compel arbitration.

DISCUSSION

a) Appeal or Mandamus

Appellees argue that we have no appellate jurisdiction to review the district court's assertion of ancillary jurisdiction

because the denial of KPMG's motion to dismiss appellees' advancement complaint was an unappealable interlocutory order in a criminal case. KPMG responds that we have jurisdiction under the Federal Arbitration Act (the "FAA")to review the district court's refusal to compel arbitration, and that we may then exercise pendent jurisdiction over the question of ancillary jurisdiction.

These arguments in turn spawn a tangle of counter- and counter-counter-arguments. Section 16 of the FAA provides for interlocutory appeal from a refusal to stay an action under Section 3 of the FAA, or of a refusal to compel arbitration under Section 4. 9 U.S.C. § 16(a)(1). KPMG, however, did not ask for a stay under Section 3 anywhere in its notice of motion to dismiss, and Section 4 applies only to orders by "any United States district court which, save for [the arbitration] agreement, would have jurisdiction under Title 28 . . . ." 9 U.S.C. § 4. However, the district court does not have jurisdiction over the advancement claim under Title 28. Moreover, even if KPMG is deemed to have constructively petitioned for a stay under Section 3, an exercise of pendent jurisdiction would require us to find that the issue of ancillary jurisdiction is "'inextricably intertwined' with an issue over which the court properly has appellate jurisdiction," as where "the same specific question underl[ies] both the appealable order

and the non-appealable order, or where resolution of the non-appealable order [is] subsidiary to resolution of the appealable order." Stolt-Nielsen SA v. Celanese AG, 430 F.3d 567, 576 (2d Cir. 2005) (citations omitted).

To undertake pendent jurisdiction, therefore, we would have to find that the issue of ancillary jurisdiction is inextricably intertwined with the denial of the motion to compel arbitration, presumably on the grounds that the district court's reasons for asserting ancillary jurisdiction and for finding that arbitration would be against public policy were the same, i.e., the need to afford an adequate and timely remedy for the constitutional violations. See Stein I at 377 (ancillary proceeding needed "[i]n order to guarantee [appellees'] right to choose their own counsel . . ."); Stein II at 245 (having found the constitutional violations, "the overreaching issue is what to do about it"), and 254 (need to promptly vindicate appellees' Fifth and Sixth Amendment rights are factors rendering arbitration clauses contrary to public policy).

We decline to resolve the question of appellate jurisdiction. We suggested at oral argument that it might be more appropriate to exercise our mandamus power. The parties were invited to file supplemental briefs on the issue, and Judge Kaplan himself filed a submission on the issue.

We have in the past treated an appeal as a petition for

leave to file a writ of mandamus. In re Repetitive Stress Injury Litigation, 11 F.3d 368, 373 (2d Cir. 1993); In re Hooker Investments, Inc., 937 F.2d 833, 837 (2d Cir. 1991). However, we have generally done so only after finding a lack of appellate jurisdiction. Repetitive Stress Injury Litigation, 11 F.3d at 373; Hooker Investments, 937 F.2d at 837. There has been criticism of the practice of resorting to mandamus without first resolving the issue of appellate jurisdiction, ACF Indus., Inc. v. EEOC, 439 U.S. 1081, 1085 (1979) (Powell, J., dissenting from denial of certiorari), but there is nevertheless precedent for doing so, see, e.g., In re Globe Newspaper Co., 920 F.2d 88 (1st Cir. 1990); Guam v. United States Dist. Court, 641 F.2d 816 (9th Cir. 1981); Wilk v. Am. Medical Assn., 635 F.2d 1295, 1298 (7th Cir. 1980); see also Wright, Miller & Cooper, 16 Fed. Prac. & Proc. Juris.2d § 3932.1. While the practice of resorting to mandamus only in the absence of jurisdiction may be of value in alerting courts to the danger of allowing mandamus to become a substitute for an appeal and thus to swallow the rule against interlocutory appeals, ACF Indus., 439 U.S. at 1085, the circumstances here fully justify the exercise of mandamus power without deciding whether we have appellate jurisdiction.

In turning to mandamus, we simply recognize that "[t]he traditional use of the writ in the aid of appellate jurisdiction both [at] common law and in the federal courts has been to

confine an inferior court to a lawful exercise of its prescribed jurisdiction . . . ." Roche v. Evaporated Milk Ass'n, 319 U.S. 21, 26 (1943). Because the actions of the district court were well outside its subject matter jurisdiction, our resort to mandamus does not in any way expand the potential use of that writ and avoids our unnecessarily addressing complex jurisdictional issues.

The jurisdictional issues are complex, but largely because, as we explain below, the proceeding challenged on this appeal -- a state law contract action against a non-party within a federal criminal proceeding -- is well outside the subject matter jurisdiction conferred by Congress on the federal courts. It is hardly surprising, therefore, that there is no statute or body of caselaw that clearly affords or clearly precludes appellate review of the commencement of such a proceeding. For example, the failure of Congress to mention Title 18 as well as Title 28 in Section 4 of the FAA is not evidence of an intent to preclude interlocutory appeals from orders refusing to compel arbitration in criminal cases. Rather, it is evidence that Congress did not expect such issues ever to arise in criminal cases. Indeed, the complexities surrounding our appellate jurisdiction underline the paucity of grounds supporting the district court's assertion of ancillary jurisdiction.

Were we to opine on the various arguments over appellate

jurisdiction, we would have to address issues involving the FAA and pendent jurisdiction that arise only because of the happenstances of this unique case. There is no need for a precedent regarding appellate jurisdiction in this context because our issuance of the writ disposes of this matter and renders the existence of future such cases unlikely. However, opining on the jurisdictional issues does risk the making of statements that might be misleading in future cases in a different context. We therefore turn to the mandamus remedy without deciding the jurisdictional issues.

b) The Merits

As discussed above, mandamus is available to confine courts to their designated jurisdiction. Other "touchstones" of mandamus review are "usurpation of power, clear abuse of discretion and the presence of an issue of first impression." Steele v. L.F. Rothschild & Co., Inc., 864 F.2d 1, 4 (2d Cir. 1988) (internal quotation marks omitted). Three conditions must be satisfied before the writ may issue: first, the party seeking relief must have "no other adequate means to attain the relief he desires," second, the petitioner must show that his right to the writ is "clear and indisputable," and third, the issuing court must be satisfied that the writ is appropriate under the circumstances. Cheney v. United States Dist. Court, 542 U.S. 367, 380-81 (2004) (internal quotation marks and citations

omitted). The writ is, of course, to be used sparingly. In addition to avoiding its use as a substitute for an appeal, discussed above, "the principal reasons for our reluctance to condone use of the writ [are] the undesirability of making a district court judge a litigant and the inefficiency of piecemeal appellate litigation." Mallard v. United States Dist. Court, 490 U.S. 296, 309 (1989). In the present matter, all of the standard requirements for granting mandamus relief are met, while the reasons underlying the traditional reluctance to resort to the writ are either not present or favor granting the writ.

Appellees argue that KPMG's right to relief is not "clear and indisputable" because the proper scope of ancillary jurisdiction is not well-settled by our caselaw. To be sure, "[t]he boundaries of ancillary jurisdiction are not easily defined and the cases addressing it are hardly a model of clarity." Garcia v. Teitler, 443 F.3d 202, 208 (2d Cir. 2006). However, because ancillary jurisdiction cannot be limitless and still be ancillary, boundaries there must be, and the exercise of ancillary jurisdiction here is clearly outside those boundaries.

As Garcia stated, "ancillary jurisdiction is aimed at enabling a court to administer justice within the scope of its jurisdiction." Id. (internal quotation marks omitted). Ancillary jurisdiction is intended "to permit disposition of claims that are, in varying respects and degrees, factually

interdependent by a single court, and . . . to enable a court to function successfully, that is, to manage its proceedings, vindicate its authority, and effectuate its decrees." Id. (quoting Kokkonen v. Guardian Life Ins. Co. of Am., 511 U.S. 375, 379-80 (1994)).

The most common exercise of ancillary jurisdiction is, probably, to resolve fee disputes between a party and its attorney arising in litigation in which the attorney represented the party. See, e.g., Cluett, Peabody & Co., Inc. v. CPC Acquisition Co., Inc., 863 F.2d 251 (2d Cir. 1988); Novinger v. E.I. DuPont de Nemours & Co., Inc., 809 F.2d 212 (3d Cir. 1987). In Garcia, for example, we upheld the exercise of ancillary jurisdiction to compel an attorney to return a retainer obtained to represent a party in the underlying litigation after the district court had ordered the attorney to withdraw as counsel because of misconduct. Garcia, 443 F.3d at 208, 211-12. Exercise of ancillary jurisdiction over a fee dispute between a party and an attorney functioning as an officer of the court in litigation over which a court has jurisdiction is, however, a world away from the exercise of ancillary jurisdiction in a criminal proceeding to adjudicate a contract dispute between the defendants and a non-party former employer.

When a court undertakes to resolve claims arising from a relationship between a party to an action and the party's

attorney in that action and involving the attorney's conduct of that litigation, the parties to the ancillary proceeding are already before the court as a litigant and officer of the court; the relevant facts are generally more accessible to that court than to another; and the ability of the court to conduct and dispose of the underlying litigation may turn on, or at least be greatly facilitated by, resolution of the issues raised in the ancillary proceeding. However, when a non-party to the primary proceeding is sought to be joined as a defendant in the ancillary proceeding, the need for the ancillary proceeding and the efficiencies provided by it must be both sufficiently great to outweigh the prejudice to the non-party and to be consistent with the limited jurisdiction of federal courts.

An ancillary proceeding may subject the non-party to what may be a different forum and different procedural or even substantive rules than would normally be involved in disposing of the claim at issue. In addition, the assertion of ancillary jurisdiction over matters that are otherwise outside the jurisdiction conferred by the Constitution and the Congress can be justified only by compelling needs arising in the exercise of the jurisdiction that is conferred. While we do not exclude the possibility of a legitimate ancillary proceeding involving a non-party to the primary litigation, we believe that the requisite compelling circumstances will be rare, as the need for such a

proceeding generally will be far less pressing than in cases involving parties already before the court.[2]

In the present matter, the prejudice to KPMG is clear, and the need for the ancillary proceeding is entirely speculative. The claims to be resolved in the ancillary proceeding sound in contract, i.e. appellees claim that KPMG impliedly -- in one case expressly -- promised to pay their expenses in defending the present criminal charges. The prejudice to KPMG in having these claims resolved in a proceeding ancillary to a criminal prosecution in the Southern District of New York is clear. At stake are garden variety state law claims, albeit for large sums. KPMG believed that contractual disputes between it and the appellees would be resolved by arbitration. Instead, KPMG is faced with a federal trial of more than a dozen individuals' multi-million dollar "implied-in-fact" contract claims. Moreover, because such a proceeding is governed by no express statutory authority, the district court has indicated its intention to apply to this expedited undertaking an ad hoc mix of the criminal and civil rules of procedure determined on the fly, as it were. See Stein II, 452 F. Supp. 2d at 274-75. The resolution of the contract claims against KPMG is thus to occur in an entirely sui generis proceeding even though it may require the scrutinizing of decades of KPMG's conduct, determining the states of mind of dozens of individuals, applying the findings

from those inquiries to the particular circumstances of each appellee, and resolving multiple questions of the law of several states. Waiting to appeal from a final judgment in this sort of proceeding can hardly be described as an "adequate means" of relief eliminating the need for mandamus. See Cheney, 542 U.S. at 380 (internal quotation marks omitted). This is especially the case where, as here, KPMG may have a contractual right to resolve these questions through arbitration and avoid such a proceeding altogether, as the FAA's provision for interlocutory appeals from refusals to stay an action or compel arbitration was intended precisely to avoid such outcomes.

The need for the particular ancillary proceeding is also far less pressing than contemplated by the district court. First, the interrelationship of the factual issues underlying the finding of constitutional violations and the asserted contract claims is marginal. The Fifth and Sixth Amendment violations were found to be the government's implementation of the policy stated in the Thompson Memorandum with regard to decisions to indict or not indict firms. Stein I, 435 F. Supp. 2d at 367. One aspect of that policy was to take into account whether the firm was voluntarily paying the legal expenses of members or employees who had been indicted, see Thompson Mem. at 7-8, a factor deemed to favor indictment under the Thompson Memorandum. Id. That document gave no such weight to payments required by

contract. As a result, the constitutional issues before the district court went solely to what pressure the government put on KPMG not to pay fees voluntarily and to what KPMG's response was. See Stein I, 435 F. Supp. 2d at 366, 343-49. A trial of claims to expenses based on contract -- especially implied contract -- will go over very different factual ground.

Second, while the ancillary proceeding is a major undertaking, its contribution to the efficient conclusion of the criminal proceeding is entirely speculative. Even if the holding that the government violated the Fifth and Sixth Amendments is correct -- an issue on which we express no opinion -- the ancillary proceeding will provide a "remedy" only if KPMG loses, hardly a foregone conclusion on the present record.[3] But even if there are constitutional violations and even if KPMG was contractually obligated to pay appellees' expenses, the ancillary proceeding is not an indispensable remedy and may not even constitute a full remedy. Dismissal of an indictment for Fifth and Sixth Amendment violations is always an available remedy. Moreover, if it violates the Fifth and Sixth Amendments for the government to coerce an employer to decline to pay expenses on a voluntary basis, it may well be a similar violation to coerce the employer to breach a contract to pay such expenses, thereby compelling the employees to pay the substantial costs of enforcing the contract in a civil action. Either way, the

government has used coercion to raise the costs of the defendants to obtain counsel of their own choosing. The ancillary proceeding may not, therefore, render any constitutional violation harmless.

Third, even if there were constitutional violations and even if KMPG is contractually obligated to advance appellees' attorneys' fees and costs, creating an ancillary proceeding to enforce that obligation was not the proper remedy. If the government's coercion of KMPG to withhold the advancement of fees to its employees' counsel constitutes a substantive due process violation, or has deprived appellees of their qualified right to counsel of choice, more direct (and far less cumbersome) remedies are available. Assuming the cognizability of a substantive due process claim and its merit here, dismissal of the indictment is the proper remedy. As for the Sixth Amendment deprivation, if it turns out that the government's conduct separates appellees from their counsel of choice (an event that has not yet occurred), appellees may seek relief on appeal if they are convicted. We do not mean to exclude the possibility of other forms of relief. If, for example, a Sixth Amendment violation is the result of ongoing government conduct, the district court of course may order the cessation of such conduct. Having said that, we hold, however, that the remedies available to the district court in the circumstances presented here did not include its novel exercise

of ancillary jurisdiction. The "summary advancement proceeding," id. at 381, it created may have been intended only as a vehicle for the government and KPMG to act on their "incentives" to somehow get appellees' counsel funded and thereby "avoid any risk of dismissal of [the indictment of the appellees] or other unpalatable relief." Stein I at 380. Or, as Stein II suggests, it might also have been envisioned as an uncharted hybrid legal proceeding for the expeditious resolution of numerous high-dollar and potentially complex contract claims. Either way, it was not an available remedy for either constitutional violation.

Finally, on the present record, a proceeding ancillary to a criminal prosecution was not necessary either to avoid perceived deficiencies in ordinary civil contract actions to enforce the alleged advancement contracts or to remove some barrier to the appellees' bringing of such actions. The fee issue has been known since the criminal investigation began and, unlike the situation in Weissman, see Note 2 supra, did not suddenly arise at an awkward period in the case. Many of the appellees were in negotiation with KPMG during the investigation period. Some sixteen months before the indictment, most of the appellees signed a letter that clearly indicated their knowledge of KPMG's intent not to pay post-indictment fees and could -- arguably must -- be read as a waiver of any right to such fees. Stein II, 452 F. Supp. 2d at 240-41. Nevertheless, appellees took none of the

available steps to enforce their alleged contracts with KPMG until well after the indictment when the district court raised the possibility of an ancillary proceeding and indicated its willingness to exercise jurisdiction over it.

The traditional factors weighing against mandamus -- the undesirability of casting a judge as a litigant and the desirability of avoiding piecemeal appeals -- also weigh in favor of mandamus in this case. The district judge is not a party, and, by granting the writ, we avoid an unnecessary, potentially costly, and time-consuming procedure that would certainly be vacated on appeal. The district court has acknowledged that the proceedings before him "would be facilitated by prompt review of the merits of the challenged order." The same considerations -- the magnitude and importance of the ongoing criminal proceedings -- also argue for swift review to avoid further delay of the underlying criminal proceedings. For all of the foregoing reasons, the three requirements of Cheney v. United States Dist. Court, 542 U.S. 367, 380-81 (2004), are met here.

CONCLUSION

We treat the appeal as a petition for writ of mandamus. We grant the petition, vacate the orders below to the extent that they find jurisdiction over the complaint against KPMG and dismiss appellees' complaint against KPMG.

FOOTNOTES

1. The Thompson Memorandum has been superseded by the "McNulty Memorandum." See Mem. From Paul J. McNulty, Deputy Attorney General, U.S. Dep't of Justice, to Heads of Department Components, United States Attorneys, re: Principles of Federal Prosecution of Business Organizations, http://www.usdoj.gov/dag/speech/2006/mcnulty_memo.pdf.

2. In United States v. Weissman, 1997 WL 334966 (S.D.N.Y. June 16, 1997), a district court asserted ancillary jurisdiction over a dispute concerning the advancement of legal fees by a former employer to a criminal defendant. In Weissman, a former Empire Blue Cross/Blue Shield executive had his defense costs advanced pursuant to a corporate by-law stipulating that the company would cover all legal costs unless "a judgment or other final adjudication" established that the officer had acted in bad faith or used deliberate dishonesty. Id. at *1. After the jury convicted the former executive, but prior to sentencing, the company stopped paying legal expenses. Id. at *2. The executive, however, argued that he was entitled to coverage of expenses through post-conviction motions and sentencing. Id. at *11. The question addressed in the ancillary proceeding was the legal question of "whether a jury's guilty verdict constitutes a

'final adjudication.'" Id. The court acknowledged that it could find no other example of a court in a criminal case exercising ancillary jurisdiction over an employer in an advancement case. Id. at *5. The Weissman court further noted that the "argument that complex questions of state law are implicated" in the dispute was the "most powerful challenge" to the court's ancillary jurisdiction. Id. at *8. We need intimate no view on the merits of Weissman because it is somewhat different from the present matter. On the one hand, in Weissman, the issue of the employer refusing to advance expenses arose at a time when no disposition of the issue could be reasonably obtained in another forum. On the other hand, there was no perceived Sixth Amendment violation by the government in need of a remedy.

3. That KPMG should lose on the merits is far from certain. KPMG's alleged "uniform practice," Stein I, 435 F. Supp. 2d at 356, of paying the legal fees for indicted employees and partners -- seemingly an indispensable element of an "implied-in-fact" contract -- appears to consist of a single instance in which KPMG paid the legal fees of two partners indicted and convicted in a 1974 criminal case, id. at 340. In addition, as a condition of having their pre-indictment legal fees paid by KPMG, most of the appellees signed fee letters acknowledging that KPMG would not pay post-indictment fees and -- on the most straight-forward

reading -- waiving any right to such fees. Stein II, 452 F. Supp. 2d at 240-41. What is more, when the appellees moved to dismiss the indictment on Sixth Amendment grounds, they took the position that the payment of legal fees was a matter of KPMG's freedom of choice, stipulating with the government that "it had been the longstanding voluntary practice of KPMG to advance and pay legal fees . . . ." Stein I, 435 F. Supp. 2d at 340 (emphasis added). Arguably, the appellees would be estopped from now arguing that KPMG had a contractual obligation -- implied or otherwise -- to pay post-indictment legal fees. Finally, we note that some of the district court's "public policy" reasons for refusing to compel arbitration -- i.e., that arbitration would interfere with the appellees' rights to counsel of their choice and risk the need for the government to provide counsel to indigent defendants -- seem to assume that KPMG would win any arbitration proceeding.

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

August Term, 2007

(Argued: March 25, 2008 Decided: August 28, 2008)

Docket No. 07-3042-cr

- -x

UNITED STATES OF AMERICA,

Appellant,

- v.-

JEFFREY STEIN, JOHN LANNING, RICHARD SMITH, JEFFREY EISCHEID, PHILIP WIESNER, MARK WATSON, LARRY DELAP, STEVEN GREMMINGER, GREGG RITCHIE, RANDY BICKHAM, CAROL G. WARLEY, CARL HASTING, and RICHARD ROSENTHAL,

Defendants-Appellees.

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Before: JACOBS, Chief Judge, FEINBERG and HALL, Circuit Judges.

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 Defendants-Appellees, thirteen former partners and employees of

accounting firm KPMG, LLP. We affirm the district court's ruling that the government deprived Defendants-Appellees of their right to counsel under the Sixth Amendment by causing KPMG to place conditions on the advancement of legal fees to Defendants-Appellees, and to cap the fees and ultimately end them. Because the government failed to cure the Sixth Amendment violation, and because no other remedy will return Defendants-Appellees to the status quo ante, we affirm the dismissal of the indictment. In a separate summary order filed today, we dismiss as moot the government's appeal from the order of the district court suppressing proffer statements made by Defendants-Appellees Richard Smith and Mark Watson.

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DENNIS JACOBS, Chief Judge:

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. Judge Kaplan found that, absent pressure from the government, KPMG would have paid defendants' legal fees and expenses without regard to cost. Based on this and other findings of fact, Judge Kaplan ruled that the government deprived defendants of their right to counsel under the Sixth Amendment by causing KPMG to impose conditions on the advancement of legal fees to defendants, to cap the fees, and ultimately to end payment. See United States v. Stein, 435 F. Supp. 2d 330, 367-73 (S.D.N.Y. 2006) ("Stein I"). Judge Kaplan also ruled that the government deprived defendants of their right to substantive due process under the Fifth Amendment.[1] Id. at 360-65.

[1]In later decisions, Judge Kaplan ruled that defendants Richard Smith and Mark Watson's proffer session statements were obtained in violation of their Fifth Amendment privilege against self-incrimination, and that their statements would be suppressed, see United States v. Stein, 440 F. Supp. 2d 315 (S.D.N.Y. 2006) ("Stein II"); that the court had ancillary jurisdiction over Defendants-Appellees' civil suit against KPMG for advancement of fees, see United States v. Stein, 452 F. Supp. 2d 230 (S.D.N.Y. 2006) ("Stein

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. 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.[2] In light of this disposition, we do not reach the district court's Fifth Amendment ruling.

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, see United States v. Stein, 495 F. Supp. 2d 390 (S.D.N.Y. 2007) ("Stein IV").

[2] In a separate summary order filed today, we dismiss as moot the government's appeal from the order of the district court suppressing proffer statements made by Defendants-Appellees Smith and Watson.

BACKGROUND

The Thompson Memorandum

In January 2003, then-United States Deputy Attorney General Larry D. Thompson promulgated a policy statement, Principles of Federal Prosecution of Business Organizations (the "Thompson Memorandum"), which articulated "principles" to govern the Department's discretion in bringing prosecutions against business organizations. The Thompson Memorandum was closely based on a predecessor document issued in 1999 by then-U.S. Deputy Attorney General Eric Holder, Federal Prosecution of Corporations. See Stein I, 435 F. Supp. 2d at 336-37. Along with the familiar factors governing charging decisions, the Thompson Memorandum identifies nine additional considerations, including the company's "timely and voluntary disclosure of wrongdoing and its willingness to cooperate in the investigation of its agents." Mem. from Larry D. Thompson, Deputy Att'y Gen., U.S. Dep't of Justice, Principles of Federal Prosecution of Business Organizations (Jan. 20, 2003), at II. The Memorandum explains that prosecutors should inquire

> whether the corporation appears to be protecting its culpable employees and agents [and that] a corporation's promise of support to culpable employees and agents, either through the advancing of attorneys

> fees, through retaining the employees without sanction for their misconduct, or through providing information to the employees about the government's investigation pursuant to a joint defense agreement, may be considered by the prosecutor in weighing the extent and value of a corporation's cooperation.

Id. at VI (emphasis added and footnote omitted). A footnote appended to the highlighted phrase explains that because certain states require companies to advance legal fees for their officers, "a corporation's compliance with governing law should not be considered a failure to cooperate." Id. at VI n.4. In December 2006--after the events in this prosecution had transpired--the Department of Justice replaced the Thompson Memorandum with the McNulty Memorandum, under which prosecutors may consider a company's fee advancement policy only where the circumstances indicate that it is "intended to impede a criminal investigation," and even then only with the approval of the Deputy Attorney General. Mem. from Paul J. McNulty, Deputy Att'y Gen., U.S. Dep't of Justice, Principles of Federal Prosecution of Business Organizations (Dec. 12, 2006), at VII n.3.

Commencement of the Federal Investigation

After Senate subcommittee hearings in 2002 concerning KPMG's possible involvement in creating and marketing fraudulent tax shelters, KPMG retained Robert S. Bennett of

the law firm Skadden, Arps, Slate, Meagher & Flom LLP ("Skadden") to formulate a "cooperative approach" for KPMG to use in dealing with federal authorities. Stein I, 435 F. Supp. 2d at 339. Bennett's strategy included "a decision to 'clean house'--a determination to ask Jeffrey Stein, Richard Smith, and Jeffrey Eischeid, all senior KPMG partners who had testified before the Senate and all now [Defendants-Appellees] 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." Id. Smith was transferred and Eischeid was put on administrative leave. Id. at 339 n.22. Stein resigned with arrangements for a three-year $100,000-per-month consultancy, and an agreement that KPMG would pay for Stein's representation in any actions brought against Stein arising from his activities at the firm. Id. at 339. KPMG negotiated a contract with Smith that included a similar clause; but that agreement was never executed. Stein IV, 495 F. Supp. 2d at 408.

In February 2004, KPMG officials learned that the firm and 20 to 30 of its top partners and employees were subjects of a grand jury investigation of fraudulent tax shelters.

Stein I, 435 F. Supp. 2d at 341. On February 18, 2004, KPMG's CEO announced to all partners that the firm was aware of the United States Attorney's Office's ("USAO") investigation and that "[a]ny present or former members of the firm asked to appear will be represented by competent coun[sel] at the firm's expense." Stein IV, 495 F. Supp. 2d at 407 (first alteration in original and internal quotation marks omitted).

The February 25, 2004 Meeting

In preparation for a meeting with Skadden on February 25, 2004, the prosecutors--including Assistant United States Attorneys ("AUSAs") Shirah Neiman and Justin Weddle--decided to ask whether KPMG would advance legal fees to employees under investigation. Stein I, 435 F. Supp. 2d at 341. Bennett started the meeting by announcing that KPMG had resolved to "clean house," that KPMG "would cooperate fully with the government's investigation," and that its goal was not to protect individual employees but rather to save the firm from being indicted. Id. AUSA Weddle inquired about the firm's plans for advancing fees and about any legal obligation to do so. Id. Later on, AUSA Neiman added that the government would "take into account" the firm's legal

obligations to advance fees, but that "the Thompson Memorandum [w]as a point that had to be considered." Id. Bennett then advised that although KPMG was still investigating its legal obligations to advance fees, its "common practice" was to do so. Id. at 342. However, Bennett explained, KPMG would not pay legal fees for any partner who refused to cooperate or "took the Fifth," so long as KPMG had the legal authority to do so. Id.

Later in the meeting, AUSA Weddle asked Bennett to ascertain KPMG's legal obligations to advance attorneys' fees. AUSA Neiman added that "misconduct" should not or cannot "be rewarded" under "federal guidelines." Id. One Skadden attorney's notes attributed to AUSA Weddle the prediction that, if KPMG had discretion regarding fees, the government would "look at that under a microscope." Id. at 344 (emphasis omitted).

Skadden then reported back to KPMG. In notes of the meeting, a KPMG executive wrote the words "[p]aying legal fees" and "[s]everance" next to "not a sign of cooperation." Stein IV, 495 F. Supp. 2d at 408.

Communications Between the Prosecutors and KPMG

On March 2, 2004, Bennett told AUSA Weddle that

although KPMG believed it had no legal obligation to advance fees, "it would be a big problem" for the firm not to do so given its partnership structure. Stein I, 435 F. Supp. 2d at 345 (internal quotation marks omitted). But Bennett disclosed KPMG's tentative decision to limit the amount of fees and condition them on employees' cooperation with prosecutors. Id.

Two days later, a Skadden lawyer advised counsel for Defendant-Appellee Carol G. Warley (a former KPMG tax partner) that KPMG would advance legal fees if Warley cooperated with the government and declined to invoke her Fifth Amendment privilege against self-incrimination. Id.

On a March 11 conference call with Skadden, AUSA Weddle recommended that KPMG tell employees that they should be "totally open" with the USAO, "even if that [meant admitting] criminal wrongdoing," explaining that this would give him good material for cross-examination. Id. (alteration in original and internal quotation marks omitted). That same day, Skadden wrote to counsel for the KPMG employees who had been identified as subjects of the investigation. Id. The letter set forth KPMG's new fees policy ("Fees Policy"), pursuant to which advancement of

fees and expenses would be

> [i] capped at $400,000 per employee;
>
> [ii] conditioned on the employee's cooperation with the government; and
>
> [iii] terminated when an employee was indicted.

Id. at 345-46. The government was copied on this correspondence. Id. at 345.

On March 12, KPMG sent a memorandum to certain other employees who had not been identified as subjects, urging them to cooperate with the government, advising them that it might be advantageous for them to exercise their right to counsel, and advising that KPMG would cover employees' "reasonable fees." Id. at 346 n.62.

The prosecutors expressed by letter their "disappoint[ment] with [the] tone" of this memorandum and its "one-sided presentation of potential issues," and "demanded that KPMG send out a supplemental memorandum in a form they proposed." Id. at 346. The government's alternative language, premised on the "assum[ption] that KPMG truly is committed to fully cooperating with the Government's investigation," Letter of David N. Kelley, United States Attorney, Southern District of New York, March 17, 2004, advised employees that they could "meet with

investigators without the assistance of counsel," Stein I, 435 F. Supp. 2d at 346 (emphasis omitted). KPMG complied, and circulated a memo advising that employees "may deal directly with government representatives without counsel." Id. (emphasis omitted).

At a meeting in late March, Skadden asked the prosecutors to notify Skadden in the event any KPMG employee refused to cooperate. Id. at 347. Over the following year, the prosecutors regularly informed Skadden whenever a KPMG employee refused to cooperate fully, such as by refusing to proffer or by proffering incompletely (in the government's view). Id. Skadden, in turn, informed the employees' lawyers that fee advancement would cease unless the employees cooperated. Id. The employees either knuckled under and submitted to interviews, or they were fired and KPMG ceased advancing their fees. For example, Watson and Smith attended proffer sessions after receiving KPMG's March 11 letter announcing the Fees Policy, and after Skadden reiterated to them that fees would be terminated absent cooperation. They did so because (they said, and the district court found) they feared that KPMG would stop advancing attorneys fees--although Watson concedes he

attended a first session voluntarily.[3] See United States v. Stein, 440 F. Supp. 2d 315, 330-33 (S.D.N.Y. 2006) ("Stein II"). As Bennett later assured AUSA Weddle: "Whenever your Office has notified us that individuals have not . . . cooperat[ed], KPMG has promptly and without question encouraged them to cooperate and threatened to cease payment of their attorney fees and . . . to take personnel action, including termination." Letter of Robert Bennett to United States Attorney's Office, November 2, 2004; see, e.g., Stein II, 440 F. Supp. 2d at 323 (describing KPMG's termination of Defendant-Appellant Warley after she invoked her Fifth Amendment privilege against self-incrimination).

KPMG Avoids Indictment

In an early-March 2005 meeting, then-U.S. Attorney David Kelley told Skadden and top KPMG executives that a non-prosecution agreement was unlikely and that he had reservations about KPMG's level of cooperation: "I've seen a lot better from big companies." Bennett reminded Kelley

[3]As discussed above, in a decision that is the subject of the summary order filed today, the district court held that Defendants-Appellees Smith and Watson's proffer statements were obtained in violation of their Fifth Amendment privilege against self-incrimination and that their statements would be suppressed. Id. at 337-38.

how KPMG had capped and conditioned its advancement of legal fees. Kelley remained unconvinced.

KPMG moved up the Justice Department's chain of command. At a June 13, 2005 meeting with U.S. Deputy Attorney General James Comey, Bennett stressed KPMG's pressure on employees to cooperate by conditioning legal fees on cooperation; it was, he said, "precedent[]setting." Stein I, 435 F. Supp. 2d at 349 (internal quotation marks omitted). KPMG's entreaties were ultimately successful: on August 29, 2005, the firm entered into a deferred prosecution agreement (the "DPA") under which KPMG admitted extensive wrongdoing, paid a $456 million fine, and committed itself to cooperation in any future government investigation or prosecution. Id. at 349-50.

Indictment of Individual Employees

On August 29, 2005--the same day KPMG executed the DPA--the government indicted six of the Defendants-Appellees (along with three other KPMG employees): Jeffrey Stein; Richard Smith; Jeffrey Eischeid; John Lanning, Vice Chairman of Tax Services; Philip Wiesner, a former tax partner; and Mark Watson, a tax partner. A superseding indictment filed on October 17, 2005 named ten additional employees,

including seven of the Defendants-Appellees: Larry DeLap, a former tax partner in charge of professional practice; Steven Gremminger, a former partner and associate general counsel; former tax partners Gregg Ritchie, Randy Bickham and Carl Hasting; Carol G. Warley; and Richard Rosenthal, a former tax partner and Chief Financial Officer of KPMG.[4] Pursuant to the Fees Policy, KPMG promptly stopped advancing legal fees to the indicted employees who were still receiving them. Id. at 350.

Procedural History

On January 12, 2006, the thirteen defendants (among others) moved to dismiss the indictment based on the government's interference with KPMG's advancement of fees.[5] In a submission to the district court, KPMG represented that

> the Thompson memorandum in conjunction with the government's statements relating to payment of legal fees affected KPMG's determination(s) with respect to the advancement of legal fees and other defense costs to present or former partners and employees . . . . In

[4]The superseding indictment filed on October 17, 2005 charged 19 defendants in 46 counts for conspiring to defraud the United States and the IRS, tax evasion and obstruction of the internal revenue laws (although not every individual was charged with every offense).

[5]According to the district court, "[a]ll defendants previously employed by KPMG joined in the motion." Id. at 336 n.5.

> fact, KPMG is prepared to state that the Thompson memorandum substantially influenced KPMG's decisions with respect to legal fees . . . .

Stein IV, 495 F. Supp. 2d at 405 (internal quotation marks and emphasis omitted).

At a hearing on March 30, 2006, Judge Kaplan asked the government whether it was "prepared at this point to commit that [it] has no objection whatsoever to KPMG exercising its free and independent business judgment as to whether to advance defense costs to these defendants and that if it were to elect to do so the government would not in any way consider that in determining whether it had complied with the DPA?" The AUSA responded: "That's always been the case, your Honor. That's fine. We have no objection to that . . . . They can always exercise their business judgment. As you described it, your Honor, that's always been the case. It's the case today, your Honor."

Judge Kaplan ordered discovery and held a three-day evidentiary hearing in May 2006 to ascertain whether the government had contributed to KPMG's adoption of the Fees Policy. The court heard testimony from two prosecutors, one IRS agent, three Skadden attorneys, and one lawyer from KPMG's Office of General Counsel, among others. Numerous

documents produced in discovery by both sides were admitted into evidence.

Stein I

Judge Kaplan's opinion and order of June 26, 2006 noted, as the parties had stipulated, that KPMG's past practice was to advance legal fees for employees facing regulatory, civil and criminal investigations without condition or cap. See Stein I, 435 F. Supp. 2d at 340. Starting from that baseline, Judge Kaplan made the following findings of fact. At the February 25, 2004 meeting, Bennett began by "test[ing] the waters to see whether KPMG could adhere to its practice of paying its employees' legal expenses when litigation loomed [by asking] for [the] government's view on the subject." Id. at 341 (footnote omitted). It is not clear what AUSA Neiman intended to convey when she said that "misconduct" should not or cannot "be rewarded" under "federal guidelines"; but her statement "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." Id. at 344 (internal quotation marks omitted).

"[W]hile 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." Id.

Based on those findings, Judge Kaplan arrived at the following ultimate findings of fact, all of which the government contests on appeal:

> [1] "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" and induced KPMG to seek "an indication from the USAO that payment of fees in accordance with its settled practice would not be held against it";
>
> [2] the government made repeated references to the Thompson Memo in an effort to "reinforce[] the threat inherent in the Thompson Memorandum";
>
> [3] "the government conducted itself in a manner that evidenced a desire to minimize the involvement of defense attorneys"; and
>
> [4] but for the Thompson Memorandum and the prosecutors' conduct, KPMG would have paid defendants' legal fees and expenses without consideration of cost.

Id. at 352-53.

Against that background, Judge Kaplan ruled that a defendant has a fundamental right under the Fifth Amendment to fairness in the criminal process, including the ability to get and deploy in defense all "resources lawfully available to him or her, free of knowing or reckless

government interference," id. at 361, and that the government's reasons for infringing that right in this case could not withstand strict scrutiny, id. at 362-65. Judge Kaplan also ruled that the same conduct deprived each defendant of the Sixth Amendment right "to choose the lawyer or lawyers he or she desires and to use one's own funds to mount the defense that one wishes to present." Id. at 366 (footnote omitted). He reasoned that "the government's law enforcement interests in taking the specific actions in question [do not] sufficiently outweigh the interests of the KPMG Defendants in having the resources needed to defend as they think proper against these charges." Id. at 368. "[T]he fact that advancement of legal fees occasionally might be part of an obstruction scheme or indicate a lack of full cooperation by a prospective defendant is insufficient to justify the government's interference with the right of individual criminal defendants to obtain resources lawfully available to them in order to defend themselves . . . ." Id. at 369.

Judge Kaplan rejected the government's position that defendants have no right to spend "other people's money" on high-priced defense counsel: "[T]he 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," 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." Id. at 367. He further determined that defendants need not show how their defense was impaired: the government's interference with their Sixth Amendment "right to be represented as they choose," "like a deprivation of the right to counsel of their choice, is complete irrespective of the quality of the representation they receive." Id. at 369.

As to remedy, Judge Kaplan conceded that dismissal of the indictment would be inappropriate unless other avenues for obtaining fees from KPMG were first exhausted. Id. at 373-80. To that end, Judge Kaplan invited defendants to file a civil suit against KPMG under the district court's ancillary jurisdiction. Id. at 377-80, 382. The suit was commenced, and Judge Kaplan denied KPMG's motion to dismiss. United States v. Stein, 452 F. Supp. 2d 230 (S.D.N.Y. 2006) ("Stein III"). However, this Court ruled that the district court lacked ancillary jurisdiction over the action. Stein

v. KPMG, LLP, 486 F.3d 753 (2d Cir. 2007).

Stein IV

Judge Kaplan dismissed the indictment against the thirteen defendants on July 16, 2007. Stein IV, 495 F. Supp. 2d at 427. He reinforced the ruling in Stein I that the government violated defendants' right to substantive due process by holding that the prosecutors' conduct also "independently shock[s] the conscience." Id. at 412-15. Judge Kaplan concluded that no remedy other than dismissal of the indictment would put defendants in the position they would have occupied absent the government's misconduct. Id. at 419-28.

The government appeals the dismissal of the indictment.

DISCUSSION

We review first **[I]** the government's challenges to the district court's factual findings, including its finding that but for the Thompson Memorandum and the prosecutors' conduct KPMG would have paid employees' legal fees--pre-indictment and post-indictment--without regard to cost. Next, because we are hesitant to resolve constitutional questions unnecessarily, **[II]** we inquire whether the

government cured the purported Sixth Amendment violation by the AUSA's in-court statement on March 30, 2006 that KPMG was free to decide whether to advance fees. Since we conclude that this statement did not return defendants to the status quo ante, **[III]** we decide whether the promulgation and enforcement of KPMG's Fees Policy amounted to state action under the Constitution and **[IV]** whether the government deprived defendants of their Sixth Amendment right to counsel.

I

The government challenges certain factual findings of the district court. We review those findings for clear error, viewing the evidence in the light most favorable to defendants and asking whether we are left "with the definite and firm conviction that a mistake has been committed." Anderson v. City of Bessemer City, 470 U.S. 564, 573 (1985) (internal quotation marks omitted).

The government points out that the Thompson Memorandum lists "fees advancement" as just one of many considerations in a complex charging decision, and thus argues that Judge Kaplan overread the Thompson Memorandum as a threat that

KPMG would be indicted unless it ceased advancing legal fees to its employees.

Judge Kaplan's finding withstands scrutiny. KPMG was faced with the fatal prospect of indictment; it could be expected to do all it could, assisted by sophisticated counsel, to placate and appease the government. As Judge Kaplan noted, KPMG's chief legal officer, Sven Erik Holmes, testified that he considered it crucial "to be able to say at the right time with the right audience, we're in full compliance with the Thompson Memorandum." Stein I, 435 F. Supp. 2d at 364 (emphasis added and internal quotation marks omitted). 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.

The government reads the Thompson Memorandum to say that fees advancement is to be considered as a negative factor only when it is part of a campaign to "circle the wagons," i.e., to protect culpable employees and obstruct investigators. And it is true that the Thompson Memorandum instructs a prosecutor to ask "whether the corporation appears to be protecting its culpable employees and agents."

But even if the government's reading is plausible, the wording nevertheless empowers prosecutors to determine which employees will be deprived of company-sponsored counsel: prosecutors may reasonably foresee that employees they identify as "culpable" will be cut off from fees.

The government also takes issue with Judge Kaplan's finding that the prosecutors (acting under DOJ policy) deliberately reinforced the threat inherent in the Thompson Memorandum. Id. at 352-53. It protests that KPMG considered conditioning legal fees on cooperation even before the February 25, 2004 meeting and that KPMG adopted its Fees Policy free from government influence. However, Judge Kaplan's interpretation of the meeting is supported by the following record evidence. Because withholding of fees would be problematic for a partnership like KPMG, Bennett began by attempting to "sound out" the government's position on the issue. Stein IV, 495 F. Supp. 2d at 402. The prosecutors declined to sign off on KPMG's prior arrangement. Instead they asked KPMG to ascertain whether it had a legal obligation to advance fees. KPMG responded with its fallback position: conditioning fees on cooperation. Id. In Judge Kaplan's view, this was not an

official policy announcement, but rather a proposal: Skadden lawyers repeatedly emphasized to the prosecutors that no final decision had been made. One available inference from all this is that the prosecutors' inquiry about KPMG's legal obligations was a routine check for conflicts of interest; but on this record, Judge Kaplan was entitled to see things differently.[6]

Nor can we disturb Judge Kaplan's finding that "the government conducted itself in a manner that evidenced a desire to minimize the involvement of defense attorneys." Stein I, 435 F. Supp. 2d at 353. During the March 11 phone call between the prosecutors and Skadden, AUSA Weddle demanded that KPMG tell its employees to be "totally open" with the USAO, "even if that [meant admitting] criminal wrongdoing," so that he could gather material for cross-examination. Id. at 345 (alterations in original and internal quotation marks omitted). On March 12, the prosecutors prevailed upon KPMG to supplement its

[6]It is unnecessary for us to determine the import of AUSA Neiman's statement that misconduct should not or cannot be rewarded or to decide whether AUSA Weddle actually said that the government would look at discretionary fee advancement "under a microscope." Stein I, 435 F. Supp. 2d at 344.

first advisory letter with another, which clarified that employees could meet with the government without counsel. In addition, prosecutors repeatedly used Skadden to threaten to withhold legal fees from employees who refused to proffer--even if defense counsel had recommended that an employee invoke the Fifth Amendment privilege. Judge Kaplan could reasonably reject the government's version of these events.

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. The government itself stipulated in Stein I that KPMG had a "longstanding voluntary practice" of advancing and paying employees' legal fees "without regard to economic costs or considerations" and "without a preset cap or condition of cooperation with the government . . . in any civil, criminal or regulatory proceeding" arising from activities within the scope of employment. Id. at 340 (internal quotation marks omitted). Although it "is far from certain" that KPMG is legally obligated to advance defendants' legal fees, Stein v. KPMG, LLP, 486 F.3d 753,

762 n.3 (2d Cir. 2007), a firm may have potent incentives to advance fees, such as the ability to recruit and retain skilled professionals in a profession fraught with legal risk. Also, there is evidence that, before the prosecutors' intervention, KPMG executed an agreement under which it would advance Stein's legal fees without cap or condition (and negotiated toward an identical agreement with Smith). And while the government maintains that the civil, criminal and regulatory investigations confronting KPMG constituted an unprecedented state of affairs that might have caused KPMG to adopt new and different policies, Judge Kaplan was not required to agree. Indeed, KPMG itself represented to the court that the Thompson Memorandum and the prosecutors' conduct "substantially influenced [its] determination(s) with respect to the advancement of legal fees."

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.

II

We now consider the government's claim of cure. If the government is correct, the "taint" of the purported Sixth Amendment violation would be "neutralize[d]," dismissal of the indictment would be inappropriate, and we could avoid deciding the constitutional question. United States v. Morrison, 449 U.S. 361, 365 (1981); see, e.g., id. at 366-67 (referring to "[t]he Sixth Amendment violation, if any" and concluding that "the violation, which we assume has occurred, has had no adverse impact upon the criminal proceedings" (emphases added)).

"Cases involving Sixth Amendment deprivations are subject to the general rule that remedies should be tailored to the injury suffered from the constitutional violation and should not unnecessarily infringe on competing interests." Id. at 364. Therefore, we must "identify and then neutralize the taint by tailoring relief appropriate in the circumstances to assure the defendant the effective assistance of counsel and a fair trial." Id. at 365. Dismissal of an indictment is a remedy of last resort, id., and is appropriate only where necessary to "restore[] the defendant to the circumstances that would have existed had

there been no constitutional error," United States v. Carmichael, 216 F.3d 224, 227 (2d Cir. 2000).

In Stein IV, Judge Kaplan concluded that dismissal of the indictment as to the thirteen defendants was warranted because no other remedy would restore them to the position they would have enjoyed but for the government's unconstitutional conduct. Stein IV, 495 F. Supp. 2d at 419-28. Specifically, Judge Kaplan found that the government deprived four defendants--Gremminger, Hasting, Ritchie and Watson--of counsel of their choice. Id. at 421 ("[T]hey simply lack the resources to engage the lawyers of their choice, lawyers who had represented them as long as KPMG was paying the bills." (footnote omitted)). Judge Kaplan also found that all thirteen defendants--even those who were still represented by their counsel of choice--were forced by KPMG's withholding of post-indictment legal fees "to limit their defenses . . . for economic reasons and that they would not have been so constrained if KPMG paid their expenses." Id. at 419. After reviewing defendants' finances and determining the estimated cost of legal representation, Judge Kaplan concluded: "[N]one of the thirteen KPMG Defendants . . . has the resources to defend

this case as he or she would have defended it had KPMG been paying the cost, even if he or she liquidated all property owned by the defendant." Id. at 425.

The government argues that it cured any Sixth Amendment violation on March 30, 2006, when it told the district court that KPMG was free to "exercise [its] business judgment." Therefore, the government contends, the appropriate remedy for any constitutional violation would be to allow defendants to retain their counsel of choice using whatever funds KPMG is willing to provide now. At most, the government claims, all that would be warranted is an adjournment of trial to afford defendants additional time to review documents and consult with counsel and expert witnesses; and since 16 months passed between the government's March 30, 2006 in-court statement and the July 16, 2007 dismissal of the indictment, defendants have already enjoyed this remedy.

Judge Kaplan was unpersuaded. In his view, KPMG is unlikely to pay defendants' legal fees as if the government had never exerted any pressure: KPMG might prefer not to be seen as reversing course and implicitly "admitting that it caved in to government pressure"; the defendants have been

"indicted on charges the full scope of which may not previously have been foreseeable to KPMG"--so that defense costs may be larger than expected; and KPMG has since paid a $456 million fine under the DPA, reducing the firm's available resources. Stein I, 435 F. Supp. 2d at 374.

We agree with the district court. The prosecutor's isolated and ambiguous statement in a proceeding to which KPMG was not a party (and the nearly 16-month period of legal limbo that ensued) did not restore defendants to the status quo ante.

Judge Kaplan asked whether the government would represent that [i] it has no objection to "KPMG exercising its free and independent business judgment as to whether to advance defense costs" and [ii] "if it were to elect to do so the government would not in any way consider that in determining whether it had complied with the DPA." The AUSA affirmed only the first proposition. See supra p. **[18]**. And as to that, the AUSA stated that the government's position had not changed: so the import of that statement depends on what position one thinks the government had previously adopted.

Furthermore, it was unrealistic to expect KPMG to

exercise uncoerced judgment in March 2006 as if it had never experienced the government's pressure in the first place. The government's intervention, coupled with the menace inherent in the Thompson Memorandum, altered the decisional dynamic in a way that the district court could find irreparable. Having assumed a supine position in the DPA--under which KPMG must continue to cooperate fully with the government[7]--it is not all that likely that the firm would feel free to reverse course.

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.) So, the government argues, even absent government pressure KPMG would not have advanced legal fees indefinitely and without condition.

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[7] "The cooperation provisions of the DPA . . . require KPMG to comply with demands by the USAO . . . [or else face] the risk that the government will declare that KPMG breached the DPA and prosecute the criminal information to verdict." Stein I, 435 F. Supp. 2d at 350.

This is certainly plausible; but it directly contradicts the 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." Id. at 353. Because we cannot disturb this finding, we cannot accept the government's claim of cure on this score.

* * *

The appropriate remedy for a constitutional violation is "one that as much as possible restores the defendant to the circumstances that would have existed had there been no constitutional error." Carmichael, 216 F.3d at 227. Since it has been found that, absent governmental interference, KPMG would have advanced unlimited legal fees unconditionally, only the unconditional, unlimited advancement of legal fees would restore defendants to the status quo ante. The government's in-court statement and the ensuing 16-month delay were not enough. If there was a Sixth Amendment violation, dismissal of the indictment is required.

III

Judge Kaplan found 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." Stein I, 435 F. Supp. 2d at 353 (emphasis added); see also Stein II, 440 F. Supp. 2d at 334 (relying on this finding to conclude that KPMG's conduct was fairly attributable to the State for Fifth Amendment purposes). The government protests that KPMG's adoption and enforcement of its Fees Policy was private action, outside the ambit of the Sixth Amendment.

When "[t]he district court's dismissal of [an] indictment raises questions of constitutional interpretation, . . . we review the district court's decision de novo." United States v. King, 276 F.3d 109, 111 (2d Cir. 2002).

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." Jackson v. Metro. Edison Co., 419 U.S. 345, 351 (1974). The "close nexus" test is not satisfied when the state "[m]ere[ly] approv[es] of or acquiesce[s] in the initiatives" of the private entity, S.F. Arts & Athletics, Inc. v. U.S. Olympic Comm., 483 U.S. 522, 547 (1987) (internal quotation marks omitted and first alteration in original), or when an entity is merely subject to governmental regulation, see Jackson, 419 U.S. at 350 & n.7. "The purpose of the [close-nexus requirement] is to assure that constitutional standards are invoked only when it can be said that the State is responsible for the specific conduct of which the plaintiff complains." Blum v. Yaretsky, 457 U.S. 991, 1004 (1982). 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." Id.

Although Supreme Court cases on this issue "have not been a model of consistency," Edmonson v. Leesville Concrete Co., 500 U.S. 614, 632 (1991) (O'Connor, J., dissenting), some principles emerge. "A nexus of state action exists

between a private entity and the state when the state exercises coercive power, is entwined in the management or control of the private actor, or provides the private actor with significant encouragement, either overt or covert, or when the private actor operates as a willful participant in joint activity with the State or its agents, is controlled by an agency of the State, has been delegated a public function by the state, or is entwined with governmental policies." Flagg v. Yonkers Sav. & Loan Ass'n, 396 F.3d 178, 187 (2d Cir. 2005) (emphasis added and internal quotation marks omitted); see also Skinner v. Ry. Labor Executives' Ass'n, 489 U.S. 602, 615 (1989) (finding state action where "the Government did more than adopt a passive position toward the underlying private conduct" and where it "made plain not only its strong preference for [the private conduct], but also its desire to share the fruits of such intrusions"). But see Maher v. Roe, 432 U.S. 464, 476 (1977) ("Constitutional concerns are greatest when the State attempts to impose its will by force of law; the State's power to encourage actions deemed to be in the public interest is necessarily far broader." (emphasis added)).

The government argues: KPMG simply took actions in the

shadow of an internal DOJ advisory document (the Thompson Memorandum) containing multiple factors and caveats; the government's approval of KPMG's Fees Policy did not render the government responsible for KPMG's actions enforcing it; even if the government had specifically required KPMG to adopt a policy that penalized non-cooperation, state action would still have been lacking because KPMG would have retained the power to apply the policy; and although the prosecutors repeatedly informed KPMG when employees were not cooperating, they did so at KPMG's behest, without knowing how KPMG would react. We disagree.

KPMG's adoption and enforcement of the Fees Policy amounted to "state action" because KPMG "operate[d] as a willful participant in joint activity" with the government, and because the USAO "significant[ly] encourage[d]" KPMG to withhold legal fees from defendants upon indictment.[8] Flagg, 396 F.3d at 187. The government brought home to KPMG that its survival depended on its role in a joint project with the government to advance government prosecutions. The

[8]As explained in section IV.A, infra, the government's pre-indictment conduct was designed to have an effect once defendants were indicted, and it is therefore proper to consider such conduct for purposes of evaluating state action.

government is therefore legally "responsible for the specific conduct of which the [criminal defendants] complain[]." Blum, 457 U.S. at 1004 (emphasis omitted).

The government argues that "KPMG's decision to condition legal fee payments on cooperation, while undoubtedly influenced by the Thompson Memorandum, was not coerced or directed by the Government." But that argument runs up against the district court's factual finding (which we do not disturb) that the fees decision "was the direct consequence" of the Memorandum and the prosecutors' conduct. Stein I, 435 F. Supp. 2d at 353. Nevertheless, it remains a question of law whether the facts as found by the district court establish state action. See Blum, 457 U.S. at 1004 (asking whether the private conduct "must in law be deemed to be that of the State" (emphasis added)).

State action is established here as a matter of law because the government forced KPMG to adopt its constricted Fees Policy. The Thompson Memorandum itself--which prosecutors stated would be considered in deciding whether to indict KPMG--emphasizes that cooperation will be assessed in part based upon whether, in advancing counsel fees, "the corporation appears to be protecting its culpable employees

and agents." 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.

The prosecutors reinforced this message by inquiring into KPMG's fees obligations, referring to the Thompson Memorandum as "a point that had to be considered," and warning that "misconduct" should not or cannot "be rewarded" under "federal guidelines." Stein I, 435 F. Supp. 2d at 341-42. The government had KPMG's full attention. It is hardly surprising, then, that KPMG decided to condition payment of fees on employees' cooperation with the government and to terminate fees upon indictment: only that policy would allow KPMG to continue advancing fees while minimizing the risk that prosecutors would view such advancement as obstructive.

To ensure that KPMG's new Fees Policy was enforced, prosecutors became "entwined in the . . . control" of KPMG. Flagg, 396 F.3d at 187. They intervened in KPMG's decisionmaking, expressing their "disappoint[ment] with

[the] tone" of KPMG's first advisory memorandum, Stein I, 435 F. Supp. 2d at 346, and declaring that "[t]hese problems must be remedied" by a proposed supplemental memorandum specifying that employees could meet with the government without being burdened by counsel. Prosecutors also "made plain" their "strong preference" as to what the firm should do, and their "desire to share the fruits of such intrusions." Skinner, 489 U.S. at 615. 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 pressure them to talk to prosecutors." Stein II, 440 F. Supp. 2d at 337. (The government's argument that it could not have known how KPMG would react when informed that certain employees were not cooperating is at best plausible only vis-à-vis the first few employees.) 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.[9]

[9]Because the Sixth Amendment attaches only upon indictment, the KPMG conduct attributable to the government is relevant only insofar as it contributed to KPMG's

The authorities cited by the government are not to the contrary. The government relies on Blum v. Yaretsky, 457 U.S. 991 (1982), and Albert v. Carovano, 851 F.2d 561 (2d Cir. 1988) (en banc), two cases in which state action was held to be lacking. In Blum, a class of Medicaid patients unsuccessfully challenged the transfer and discharge decisions of private nursing homes. The patients claimed that the private conduct was attributable to New York State because state regulations required that the nursing homes transfer patients to a facility providing the level of care "'indicated by the patient's medical condition or needs.'" Blum, 457 U.S. at 1007-08 (quoting N.Y. Comp. Codes R. & Regs. tit. 10, §§ 416.9(d)(1), 421.13(d)(1) (1980)). Even though the regulations "encouraged for efficiency reasons" the "downward" transfer of patients to "lower levels of care," id. at 1008 n.19 (emphasis added), and even though "federal law require[d] . . . state officials [to] review" nursing home assessments and "[a]djust[] . . . benefit

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decision to withhold legal fees upon defendants' indictment. See Part IV, infra. Many of KPMG's actions occurred prior to the August and October 2005 indictments. Nevertheless, when the defendants were indicted, KPMG had been so schooled by the government in the necessity of enforcing a particular fee advancement policy that KPMG understood what was expected of it once the indictments came down.

levels in response to a decision to discharge or transfer a patient," id. at 1010, the Supreme Court ruled that state action was lacking. As the Court explained, the "regulations do not require the nursing homes to rely on the [patient care assessment forms designed by New York] in making discharge or transfer decisions," and "do not dictate the decision to discharge or transfer in a particular case." Id. at 1008, 1010 (emphasis added). Instead, those decisions "ultimately turn[ed] on medical judgments made by private parties according to professional standards that are not established by the State." Id. at 1008.

Likewise, Albert declined to deem the disciplinary decisions of a private college to be state action, despite a New York law requiring colleges to adopt disciplinary rules and file them with the state. Albert, 851 F.2d at 568-69. We rejected plaintiffs' claim that the college was compelled by New York State to promulgate a disciplinary policy that it would not have adopted otherwise. The policy was not "a rule of conduct imposed by the state," we explained, because "[c]olleges are free to define breaches of public order however they wish, and they need not resort to a particular penalty in any particular case." Id. at 564, 568.

Moreover, even if the state had mandated a particular rule, "the ultimate power to select a particular sanction in individual cases would, as in [Blum], rest with the private party." Id. at 571. That is, there was "nothing in either the legislation or those rules" that "required that these appellants be suspended." Id. at 568 (emphasis added).

In Blum and Albert, it was decisive that [1] actions of the private entity were based on independent criteria (the medical standards; the college rules of conduct), and that [2] the government was not dictating the outcomes of particular cases.

Here, however, [1] KPMG was never "free to define" cooperation independently: AUSA Weddle 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. In addition, [2] the prosecution designated particular employees for deprivation of fees (and, in some cases, termination of employment) by demanding that KPMG threaten and penalize those employees

for non-cooperation. As Bennett later reported to the Deputy Attorney General, "[w]henever your Office has notified us that individuals have not . . . cooperat[ed], KPMG has promptly and without question encouraged them to cooperate and threatened to cease payment of their attorneys fees and . . . to take personnel action, including termination." Furthermore, by indicting the thirteen defendants after inspiring and shaping KPMG's Fees Policy and after exacting KPMG's compliance with it, prosecutors effectively selected which employees would be deprived of attorneys' fees. Having forced the constriction of KPMG's longstanding policy of advancing fees, the government then compelled KPMG to apply the Fees Policy to particular employees both pre- and post-indictment. This conduct finds no protection in Blum and Albert.

The government also directs us to another line of state action cases: D.L. Cromwell Investments, Inc. v. NASD Regulation, Inc., 279 F.3d 155 (2d Cir. 2002), and United States v. Solomon, 509 F.2d 863 (2d Cir. 1975). These cases involved parallel, cooperative investigations by private regulatory entities and government investigators. In D.L. Cromwell, the USAO and the National Association of

Securities Dealers ("NASD") simultaneously investigated plaintiff stockbrokers. The plaintiffs sought to enjoin NASD from compelling on-the-record interviews (on pain of expulsion from their profession), arguing under the Fifth Amendment that the NASD inquiry was a tool of the prosecutors. D.L. Cromwell, 279 F.3d at 156-57. Plaintiffs pointed to the informal and formal sharing of documents and information between the government and the NASD, id. at 157-58, 162, and the fact that the NASD interview demands followed shortly after plaintiffs contested grand jury subpoenas, id. at 162. Similarly, in Solomon, the New York Stock Exchange ("NYSE") had taken testimony from a trader under threat of suspension or expulsion, and then forwarded his deposition to the SEC pursuant to an SEC subpoena. 509 F.2d at 864-65.

In both cases, we held that there was no state action because the private actors had independent regulatory interests and motives for making their inquiries and for cooperating with parallel investigations being conducted by the government. In D.L. Cromwell, the NASD had a preexisting "regulatory duty to investigate questionable securities transactions," 279 F.3d at 163--that is, it would

have requested interviews regardless of governmental pressure. And in Solomon, the NYSE's efforts were "in pursuance of its own interests and obligations, not as an agent of the [government]," 509 F.2d at 869--absent SEC involvement, the NYSE would have investigated anyway. Because the NASD and the NYSE had preexisting and independent investigatory missions, their cooperation with the government was not state action. See Lisa Kern Griffin, Compelled Cooperation and the New Corporate Criminal Procedure, 82 N.Y.U. L. Rev. 311, 369 (2007) (observing that D.L. Cromwell and Solomon "turned in large part on the fact that requests for interviews" were not "generated by governmental persuasion or collusion"). By contrast (as the district court found), absent the prosecutors' involvement and the Thompson Memorandum, KPMG would not have changed its longstanding fee advancement policy or withheld legal fees from defendants upon indictment. See Stein I, 435 F. Supp. 2d at 353.

The government responds: Solomon declined to find state action even though it involved a private entity compelling interviews with one of its members, backed by the explicit threat of expulsion, in the context of continuous

coordination between the NYSE and the SEC on the same side. So how can KPMG, an adversary of the government, also be its partner? See Brentwood Acad. v. Tenn. Secondary Sch. Athletic Ass'n, 531 U.S. 288, 304 (2001) ("The state-action doctrine does not convert opponents into virtual agents.").

An adversarial relationship does not normally bespeak partnership. But KPMG faced ruin by indictment and reasonably believed it must do everything in its power to avoid it. The government's threat of indictment was easily sufficient to convert its adversary into its agent. KPMG was not in a position to consider coolly the risk of indictment, weigh the potential significance of the other enumerated factors in the Thompson Memorandum, and decide for itself how to proceed. See Griffin, 82 N.Y.U. L. Rev. at 367 ("The threat of [ruinous indictment] brings significant pressure to bear on corporations, and that threat 'provides a sufficient nexus' between a private entity's employment decision at the government's behest and the government itself.").

We therefore conclude that KPMG's adoption and enforcement of the Fees Policy (both before and upon defendants' indictment) amounted to state action. The

government may properly be held "responsible for the specific conduct of which the [criminal defendants] complain[]," Blum, 457 U.S. at 1004 (emphasis omitted), i.e., the deprivation of their Sixth Amendment right to counsel, if the violation is established.

IV

The district court's ruling on the Sixth Amendment was based on the following analysis (set out here in précis). The Sixth Amendment protects "an individual's right to choose the lawyer or lawyers he or she desires," Stein I, 435 F. Supp. 2d at 366 (citing Wheat v. United States, 486 U.S. 153, 164 (1988)), and "to use one's own funds to mount the defense that one wishes to present," id. (citing Caplin & Drysdale, Chartered v. United States, 491 U.S. 617, 624 (1989)). The goal is to secure "a defendant's right to spend his own money on a defense." Id. at 367. Because defendants reasonably expected to receive legal fees from KPMG, the fees "were, in every material sense, their property." Id. The government's interest in retaining discretion to treat as obstruction a company's advancement of legal fees "is insufficient to justify the government's

interference with the right of individual criminal defendants to obtain resources lawfully available to them in order to defend themselves." Id. at 369. Defendants need not make a "particularized showing" of how their defense was impaired, id. at 372, because "[v]irtually everything the defendants do in this case may be influenced by the extent of the resources available to them," such as selection of counsel and "what the KPMG Defendants can pay their lawyers to do," id. at 371-72. Therefore, the Sixth Amendment violation "is complete irrespective of the quality of the representation they receive." Id. at 369.[10]

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[10]In Stein IV, Judge Kaplan nevertheless expanded his findings as to Sixth Amendment harms suffered by particular defendants: defendants Gremminger, Hasting and Watson were deprived of their chosen counsel, "lawyers who had represented them as long as KPMG was paying the bills"; and defendant Ritchie was deprived of the services of Cadwalader Wickersham & Taft, "which was to have played an integral role in his defense." 495 F. Supp. 2d at 421. In addition:

> 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

A

Most of the state action relevant here--the promulgation of the Thompson Memorandum, the prosecutors' communications with KPMG regarding the advancement of fees, KPMG's adoption of a Fees Policy with caps and conditions, and KPMG's repeated threats to employees identified by prosecutors as being uncooperative--pre-dated the indictments of August and October 2005.[11] (Of course, after the indictments were filed KPMG ceased advancing fees to all thirteen of the present defendants who were still receiving fees up to that point. As explained in Part III, this was also state action.) So we must determine how this pre-

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

Id. at 418-19 (footnote omitted). Judge Kaplan explained that even though many defendants had net assets ranging from $1 million to $5 million, their resources were inadequate "to defend this case as they would have defended it absent the government's actions." Id. at 423.

[11]Again, "state action" includes both conduct by the government and conduct by KPMG that is fairly attributable to the government. See Part III, supra.

indictment conduct may bear on defendants' Sixth Amendment claim.

"The Sixth Amendment right of the 'accused' to assistance of counsel in 'all criminal prosecutions' is limited by its terms: it does not attach until a prosecution is commenced." Rothgery v. Gillespie County, 554 U.S. ---, 128 S. Ct. 2578, 2583 (2008) (quoting U.S. Const. amend. VI) (some internal quotation marks and footnote omitted). "Attachment" refers to "when the [Sixth Amendment] right may be asserted"; it does not concern the separate question of "what the right guarantees," i.e., what the "substantive guarantee of the Sixth Amendment" is at that stage of the prosecution. Id. at 2592, 2594 (Alito, J., concurring). The Supreme Court has "pegged commencement [of a prosecution] to 'the initiation of adversary judicial criminal proceedings—whether by way of formal charge, preliminary hearing, indictment, information, or arraignment.'" Id. at 2583 (majority opinion) (quoting United States v. Gouveia, 467 U.S. 180, 188 (1984)). "The rule is not 'mere formalism,' but a recognition of the point at which 'the government has committed itself to prosecute,' 'the adverse positions of government and defendant have

solidified,' and the accused 'finds himself faced with the prosecutorial forces of organized society, and immersed in the intricacies of substantive and procedural criminal law.'" Id. (quoting Kirby v. Illinois, 406 U.S. 682, 689 (1972) (plurality opinion)).

Judge Kaplan focused on KPMG's decision to withhold fees upon indictment: "[T]he constitutional violation pertinent to possible dismissal of the indictment was the government's role in KPMG's action in cutting off payment of legal fees for those who were indicted as distinct from the limitations on payment of legal fees during the investigative stage." Stein IV, 495 F. Supp. 2d at 404 n.54 (emphasis added) (citing Stein I, 435 F. Supp. 2d at 373). Therefore, Judge Kaplan explained, "[a]ctions by the government that affected only the payment of legal fees and defense costs for services rendered prior to the indictment . . . do not implicate the Sixth Amendment." Stein I, 435 F. Supp. 2d at 373 (emphasis added).

By the same token, state action that also (or only) affected the advancement of legal fees for services rendered post-indictment does implicate defendants' Sixth Amendment rights, regardless of when the conduct took place:

> It is true, of course, that the Sixth Amendment right to counsel typically attaches at the initiation of adversarial proceedings--at an arraignment, indictment, preliminary hearing, and so on. But the analysis can not end there. The Thompson Memorandum on its face and the USAO's actions were parts of an effort to limit defendants' access to funds for their defense. Even if this was not among the conscious motives, the Memorandum was adopted and the USAO acted in circumstances in which that result was known to be exceptionally likely. The fact that events were set in motion prior to indictment with the object of having, or with knowledge that they were likely to have, an unconstitutional effect upon indictment cannot save the government. This conduct, unless justified, violated the Sixth Amendment.

Id. at 366 (emphasis added). 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.

We endorse this analysis. Although defendants' Sixth Amendment rights attached only upon indictment, the district court properly considered pre-indictment state action that affected defendants post-indictment. When 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.[12] As Judge Ellis explained in

[12]As Judge Kaplan recognized, the pre-indictment conduct is separately constrained by the Fifth Amendment.

United States v. Rosen, 487 F. Supp. 2d 721 (E.D. Va. 2007), "it is entirely plausible that pernicious effects of the pre-indictment interference continued into the post-indictment period, effectively hobbling defendants' Sixth Amendment rights to retain counsel of choice with funds to which they had a right. . . . [I]f, as alleged, the government coerced [the employer] into halting fee advances on defendants' behalf and the government did so for the purpose of undermining defendants' relationship with counsel once the indictment issued, the government violated defendants' right to expend their own resources towards counsel once the right attached." Id. at 734.

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 scrutiny under the Sixth Amendment.[13]

[13]We need not decide whether KPMG's pre-indictment conditioning and capping of fees--conduct we have determined was state action--establishes a Sixth Amendment violation by

B

We now consider "what the [Sixth Amendment] right guarantees." Rothgery, 128 S. Ct. at 2592 (Alito, J., concurring).

The Sixth Amendment ensures that "[i]n all criminal prosecutions, the accused shall enjoy the right . . . to have the Assistance of Counsel for his defence." U.S. Const. amend. VI. Thus "the Sixth Amendment guarantees the defendant the right to be represented by an otherwise qualified attorney whom that defendant can afford to hire, or who is willing to represent the defendant even though he is without funds." Caplin & Drysdale, Chartered v. United States, 491 U.S. 617, 624-25 (1989). "[A]n element of this right is the right of a defendant who does not require appointed counsel to choose who will represent him." United States v. Gonzalez-Lopez, 548 U.S. 140, 144 (2006).[14]

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itself. As discussed below, KPMG's termination of fees upon indictment deprived defendants of their Sixth Amendment right to counsel.

[14]Although the Sixth Amendment right to counsel of choice "has been regarded as the root meaning of the constitutional guarantee," id. at 147-48, the right is qualified: the attorney must be admitted to the bar, willing to represent the defendant, free from certain conflicts of interest, compliant with the rules of the court, and so on, see Wheat v. United States, 486 U.S. 153, 159-60 (1988).

The government must "honor" a defendant's Sixth Amendment right to counsel:

> This means more than simply that the State cannot prevent the accused from obtaining the assistance of counsel. The Sixth Amendment also imposes on the State an affirmative obligation to respect and preserve the accused's choice to seek this assistance. . . . [A]t the very least, the prosecutor and police have an affirmative obligation not to act in a manner that circumvents and thereby dilutes the protection afforded by the right to counsel.

Maine v. Moulton, 474 U.S. 159, 170-71 (1985). This is intuitive: 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.

Consistent with this principle of non-interference, courts have identified violations of the Sixth Amendment right to counsel where the government obtains incriminating statements from a defendant outside the presence of counsel and then introduces those statements at trial. See, e.g., id. at 176; Massiah v. United States, 377 U.S. 201, 206 (1964). Likewise, the government violates the Sixth Amendment when it intrudes on the attorney-client relationship, preventing defense counsel from "participat[ing] fully and fairly in the adversary factfinding process." Herring v. New York, 422 U.S. 853,

858 (1975); see, e.g., id. at 858-59 (holding that a New York statute allowing judges in a criminal bench trial to deny counsel the opportunity to make a closing argument deprived defendant of his Sixth Amendment right to the assistance of counsel); Geders v. United States, 425 U.S. 80, 91 (1976) (holding that a trial court's order that defendant not consult with his attorney during an overnight recess during trial violated the Sixth Amendment).

Defendants-Appellees do not say that they were deprived of constitutionally effective counsel. See Strickland v. Washington, 466 U.S. 668, 686 (1984). Their claim is that the government unjustifiably interfered with their relationship with counsel and their ability to mount the best defense they could muster.

The government, relying on Caplin & Drysdale, Chartered v. United States, 491 U.S. 617 (1989), contends that a defendant has no Sixth Amendment right to a defense funded by someone else's money. In that case, the Supreme Court ruled that a defendant's Sixth Amendment right to retain counsel of choice was not violated when the funds he earmarked for defense were seized under a federal forfeiture statute, because title to the forfeitable assets had vested

in the United States. Id. at 628; see also United States v. Monsanto, 491 U.S. 600, 616 (1989) (holding that pretrial restraining order based on showing of probable cause that property is forfeitable "does not 'arbitrarily' interfere with a defendant's 'fair opportunity' to retain counsel").

The government focuses on the following passage from Caplin & Drysdale:

> Whatever the full extent of the Sixth Amendment's protection of one's right to retain counsel of his choosing, that protection does not go beyond 'the individual's right to spend his own money to obtain the advice and assistance of . . . counsel.' Walters v. National Assn. of Radiation Survivors, 473 U.S. 305, 370 (1985) (Stevens, J., dissenting). A defendant has no Sixth Amendment right to spend another person's money for services rendered by an attorney, even if those funds are the only way that that defendant will be able to retain the attorney of his choice. A robbery suspect, for example, has no Sixth Amendment right to use funds he has stolen from a bank to retain an attorney to defend him if he is apprehended. The money, though in his possession, is not rightfully his . . . .

Caplin & Drysdale, 491 U.S. at 626 (emphasis added and first omission in original). The holding of Caplin & Drysdale is narrow: the Sixth Amendment does not prevent the government from reclaiming its property from a defendant even though the defendant had planned to fund his legal defense with it. It is easy to distinguish the case of an employee who reasonably expects to receive attorneys' fees as a benefit

or perquisite of employment, whether or not the expectation arises from a legal entitlement. As has been found here as a matter of fact, these defendants would have received fees from KPMG but for the government's interference. Although "there is no Sixth Amendment right for a defendant to obtain counsel using tainted funds, [a defendant] still possesses a qualified Sixth Amendment right to use wholly legitimate funds to hire the attorney of his choice." United States v. Farmer, 274 F.3d 800, 804 (4th Cir. 2001) (emphasis added).

It is axiomatic that if defendants had already received fee advances from KPMG, the government could not (absent justification) deliberately interfere with the use of that money to fuel their defenses. And the government concedes that it could not prevent a lawyer from furnishing a defense gratis. See Caplin & Drysdale, 491 U.S. at 624-25 ("[T]he Sixth Amendment guarantees a defendant the right to be represented by an otherwise qualified attorney . . . who is willing to represent the defendant even though he is without funds."). Presumably, such a lawyer could pay another lawyer to represent the defendant (subject, of course, to ethical rules governing third-party payments to counsel, see United States v. Locascio, 6 F.3d 924, 932-33 (2d Cir.

1993)). And if the Sixth Amendment prohibits the government from interfering with such arrangements, then surely it also prohibits the government from interfering with financial donations by others, such as family members and neighbors--and employers. See United States v. Inman, 483 F.2d 738, 739-40 (4th Cir. 1973) (per curiam) ("The Sixth Amendment right to counsel includes not only an indigent's right to have the government appoint an attorney to represent him, but also the right of any accused, if he can provide counsel for himself by his own resources or through the aid of his family or friends, to be represented by an attorney of his own choosing." (emphasis added)). In 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.

The government points out that KPMG's past fee practice was voluntary and subject to change, and that defendants therefore could have had no reasonable expectation of the ongoing advancement of fees. But this argument simply quarrels with Judge Kaplan's finding that absent any state action, KPMG would have paid defendants' legal fees and expenses without regard to cost. See Stein I, 435 F. Supp.

2d at 353. Defendants were not necessarily entitled to fee advancement as a matter of law, see Stein v. KPMG, LLP, 486 F.3d 753, 762 n.3 (2d Cir. 2007) (commenting that defendants' likelihood of success in obtaining a judgment against KPMG for legal fees is "far from certain"); but the Sixth Amendment prohibits the government from impeding the supply of defense resources (even if voluntary or gratis), absent justification. Therefore, unless the government's interference was justified, it violated the Sixth Amendment.

The government is sometimes allowed to interfere with defendants' choice or relationship with counsel, such as to prevent certain conflicts of interest. See, e.g., United States v. Curcio, 680 F.2d 881 (2d Cir. 1982). However, the government has failed to establish a legitimate justification for interfering with KPMG's advancement of legal fees.

The government argues that it may inquire into third-party payment of legal fees in certain circumstances. For example, in United States v. Locascio, we affirmed the disqualification of defendant's counsel based in part on defendant's "benefactor payments" to the attorney to serve as "house counsel" to members of the Gambino organized crime

family. Locascio, 6 F.3d at 932. We explained that "the acceptance of such 'benefactor payments' . . . raises an ethical question as to whether the attorney's loyalties are with the client or the payor," id. (some internal quotation marks omitted), and that "proof of house counsel can be used by the government to help establish the existence of the criminal enterprise under RICO, by showing the connections among the participants," id. at 932-33.

The government's reliance on Locascio is misplaced. There, the attorney's status as "house counsel" "was potentially part of the proof of the Gambino criminal enterprise," id. at 933, i.e., it was evidence going to an element of the crime itself, and it was relevant to ascertaining and preventing potential conflicts of interest, id. at 932. But here, the government claims no such compelling justifications.

It is also urged that a company may pretend cooperation while "circling the wagons," that payment of legal fees can advance such a strategy, and that the government has a legitimate interest in being able to assess cooperation using the payment of fees as one factor. Even if that can be a legitimate justification, it would not be in play here:

prosecutors testified before the district court that they were never concerned that KPMG was "circling the wagons." Moreover, it is unclear how the circling of wagons is much different from the legitimate melding of a joint defense.

The government conceded at oral argument that it is in the government's interest that every defendant receive the best possible representation he or she can obtain. A company that advances legal fees to employees may stymie prosecutors by affording culpable employees with high-quality representation. But if it is in the government's interest that every defendant receive the best possible representation, it cannot also be in the government's interest to leave defendants naked to their enemies.

Judge Kaplan found that defendants Gremminger, Hasting, Ritchie and Watson were unable to retain the counsel of their choosing as a result of the termination of fee advancements upon indictment. Stein IV, 495 F. Supp. 2d at 421-22. The government does not contest this factual finding, and we will not disturb it. A defendant who is deprived of counsel of choice (without justification) need not show how his or her defense was impacted; such errors are structural and are not subject to harmless-error review.

See Gonzalez-Lopez, 548 U.S. at 144, 148-52. "[T]he right at stake here is the right to counsel of choice, . . . and that right was violated because the deprivation of counsel was erroneous. No additional showing of prejudice is required to make the violation 'complete.'" Id. at 146. Of course, a completed constitutional violation may still be remediable. However, as explained in Part II, the government has failed to cure this Sixth Amendment violation. Therefore, the government deprived defendants Gremminger, Hasting, Ritchie and Watson of their Sixth Amendment right to counsel of choice.

The remaining defendants--Bickham, DeLap, Eischeid, Lanning, Rosenthal, Smith, Stein, Warley, and Wiesner--do not claim they were deprived of their chosen counsel. Rather, they assert that the government unjustifiably interfered with their relationship with counsel and their ability to defend themselves. In the district court, the government conceded that these defendants are also entitled to dismissal of the indictment, assuming the correctness of Stein I. See Stein IV, 495 F. Supp. 2d at 393. We agree: these defendants can easily demonstrate interference in their relationships with counsel and impairment of their

ability to mount a defense based on Judge Kaplan's non-erroneous findings that the post-indictment termination of fees "caused them to restrict the activities of their counsel," and thus to limit the scope of their pre-trial investigation and preparation. Id. at 418. Defendants were indicted based on a fairly novel theory of criminal liability; they faced substantial penalties; the relevant facts are scattered throughout over 22 million documents regarding the doings of scores of people, id. at 417; the subject matter is "extremely complex," id. at 418; technical expertise is needed to figure out and explain what happened; and trial was expected to last between six and eight months, id. As Judge Kaplan found, these defendants "have been forced to limit their defenses . . . for economic reasons and . . . they would not have been so constrained if KPMG paid their expenses." Id. at 419. We therefore hold that these defendants were also deprived of their right to counsel under the Sixth Amendment.[15]

[15]This case does not raise, and therefore we have no occasion to consider, the application of our holding to the following scenario: A defendant moves unsuccessfully in the district court to dismiss the indictment on the same Sixth Amendment theory. The defendant proceeds to trial with his or her chosen attorney, and the attorney is forced to limit the scope of his or her efforts due to the defendant's

CONCLUSION

For the foregoing reasons, we AFFIRM the judgment of the district court dismissing defendants' indictment.

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financial constraints. The defendant is convicted based on overwhelming evidence of his or her guilt.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

- x

UNITED STATES OF AMERICA,

-against- S1 05 Crim. 0888 (LAK)

JEFFREY STEIN, et al.,

Defendants.

- x

OPINION

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LEWIS A. KAPLAN, *District Judge.*

The issue now before the Court arises at an intersection of three principles of American law.

The first principle is that everyone accused of a crime is entitled to a fundamentally fair trial.[1] This is a central meaning of the Due Process Clause of the Constitution

The second principle, a corollary of the first, is that everyone charged with a crime is entitled to the assistance of a lawyer.[2] A defendant with the financial means has the right to hire the best lawyers money can buy. A poor defendant is guaranteed competent counsel at government expense.[3] This is at the heart of the Sixth Amendment.

The third principle is not so easily stated, not of constitutional dimension, and not so universal. But it too plays an important role in this case. It is simply this: an employer often must reimburse an employee for legal expenses when the employee is sued, or even charged with a crime, as a result of doing his or her job. Indeed, the employer often must advance legal expenses to an employee up front, although the employee sometimes must pay the employer back if the employee has been guilty of wrongdoing.

This third principle is not the stuff of television and movie drama. It does not remotely approach *Miranda* warnings in popular culture. But it is very much a part of American life. Persons in jobs big and small, private and public, rely on it every day. Bus drivers sued for accidents, cops sued for allegedly wrongful arrests, nurses named in malpractice cases, news reporters sued in libel cases, and corporate chieftains embroiled in securities litigation generally

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[1] U.S. CONST. amend. V (Due Process Clause).

[2] U.S. CONST. amend. VI.

[3] *Gideon v. Wainwright,* 372 U.S. 335 (1963).

have similar rights to have their employers pay their legal expenses if they are sued as a result of their doing their jobs. This right is as much a part of the bargain between employer and employee as salary or wages.[4]

Most of the defendants in this case worked for KPMG, one of the world's largest accounting firms. KPMG long has paid for the legal defense of its personnel, regardless of the cost and regardless of whether its personnel were charged with crimes. The defendants who formerly worked for KPMG say that it is obligated to do so here. KPMG, however, has refused.

If that were all there were to the dispute, it would be a private matter between KPMG and its former personnel. But it is not all there is. These defendants[5] (the "KPMG Defendants") claim that KPMG has refused to advance defense costs to which the defendants are entitled because the government pressured KPMG to cut them off. The government, they say, thus violated their rights and threatens their right to a fair trial.

Having heard testimony from KPMG's general counsel, some of its outside lawyers, and government prosecutors, the Court concludes that the KPMG Defendants are right. KPMG refused to pay because the government held the proverbial gun to its head. Had that pressure not been brought to bear, KPMG would have paid these defendants' legal expenses.

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[4] The existence of this right is not a product of charitable instincts. The law long has recognized that litigation can be expensive and that it could prove difficult to obtain the services of competent employees unless they are protected against the cost of lawsuits that arise out of the employers' business. *E.g., Homestore, Inc. v. Tafeen,* 888 A.2d 204, 218 (Del. 2005) (advancement of legal expenses "is actually a desirable underwriting of risk by the corporation in anticipation of greater corporate-wide rewards for its shareholders. The broader salient benefits that the public policy . . . seeks to accomplish . . . will only be achieved if the promissory terms of advancement contracts are enforced by courts even when corporate officials . . . are accused of serious misconduct") (internal quotation marks and footnote omitted).

[5] All defendants previously employed by KPMG joined in the motion.

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

Facts

The Thompson Memorandum

In June 1999, then-U.S. Deputy Attorney General Eric Holder issued a document entitled *Federal Prosecution of Corporations* (the "Holder Memorandum") to provide "guidance as to what factors should generally inform a prosecutor in making the decision whether to charge a corporation in a given case."[6] He took pains to make clear that the factors articulated in the memorandum were not "outcome-determinative" and that "[f]ederal prosecutors [we]re not required to reference these factors in a particular case, nor [we]re they required to document the weight they accorded specific factors in reaching their decision." Nevertheless, the language that plays a central role in the present controversy first was found in the Holder Memorandum.

The Holder Memorandum set forth some common sense considerations. Prosecutors, in deciding whether to indict a company, should pay attention to things like the nature and seriousness of the offense, the pervasiveness of wrongdoing within the entity, the company's efforts to remedy past misconduct, the adequacy of other remedies, and the like. It mentioned also:

> "the corporation's timely and voluntary disclosure of wrongdoing *and its willingness to cooperate in the investigation of its agents*, including, if necessary, the waiver of the corporate attorney-client and work product protection . . ."[7]

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[6] http://www.usdoj.gov/criminal/fraud/policy/Chargingcorps.html (last visited June 23, 2006).

[7] Holder Memorandum § II, ¶ 4 (emphasis added).

Section VI elaborated on what was meant by cooperation. The general principle was that "[i]n gauging the extent of the corporation's cooperation, the prosecutor may consider the corporation's willingness to identify the culprits within the corporation, including senior executives, to make witnesses available, to disclose the complete results of its internal investigation, and to waive attorney-client and work-product privileges."[8] The memorandum then set out several paragraphs of commentary, the most relevant for present purposes being this:

> "Another factor to be weighed by the prosecutor is whether the corporation appears to be protecting its culpable employees and agents. Thus, while cases will differ depending upon the circumstances, a corporation's promise of support to culpable employees and agents, either *through the advancing of attorneys fees,* through retaining the employees without sanction for their misconduct, or through providing information to the employees about the government's investigation pursuant to a joint defense agreement, may be considered by the prosecutor in weighing the extent and value of a corporation's cooperation."[9]

A footnote to the comment concerning the advancing of attorneys' fees read:

> "Some states require corporations to pay the legal fees of officers under investigation prior to a formal determination of their guilt. Obviously, a corporation's compliance with governing law should not be considered a failure to cooperate."[10]

Thus, the Holder Memorandum made clear that advancing of attorneys' fees to personnel of a business entity under investigation, except where such advances were required by law, might be viewed by the government as protection of culpable individuals and might contribute to a government decision to indict the entity.

The Court, with the consent of the parties, takes judicial notice of the Holder Memorandum.

[8] *Id.* § VI, ¶ A.

[9] *Id.* ¶ B (emphasis added).

[10] *Id.* ¶ B, n.3.

As noted, the Holder Memorandum was not binding. Federal prosecutors were free to take it into account, or not, as they saw fit. But the corporate scandals of the earlier part of this decade changed that.

In late 2001, Enron, Global Crossing, Tyco International, Adelphia Communications and ImClone, among other companies, found themselves in worlds of trouble, much of it apparently of their own making. Bankruptcies and criminal prosecutions followed including, notably, the indictment of Enron's auditors, Arthur Andersen LLP – an indictment that resulted in the collapse of the firm, well before the case was tried.[11] And on July 9, 2002, the President issued Executive Order 13271, which established a Corporate Fraud Task Force (the "Task Force") headed by United States Deputy Attorney General Larry D. Thompson.

On January 20, 2003, Mr. Thompson issued a document entitled *Principles of Federal Prosecution of Business Organizations* (the "Thompson Memorandum") which, in many respects, was a modest revision of the Holder Memorandum. Indeed, the language concerning cooperation and advancing of legal fees by business entities was carried forward without change. Unlike its predecessor, however, the Thompson Memorandum is binding on all federal prosecutors.[12] Thus, all United States Attorneys now are obliged to consider the advancing of legal fees by business entities, except such advances as are required by law, as at least possibly indicative

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[11] *Amici* point out that no major financial services firm has ever survived a criminal indictment. Brief for The Securities Industry Ass'n *et al.* at 6 [docket item 470] (quoting Ken Brown, *et al.*, *Called to Account: Indictment of Andersen in Shredding Case Puts Its Future in Question,* WALL. ST. J., Mar. 15, 2002, at A1).

[12] U.S. DEP'T OF JUSTICE, CRIMINAL RESOURCE MANUAL § 163 (2005) ("The Thompson Memorandum sets forth nine factors that federal prosecutors must consider in determining whether to charge a corporation or other business organization.") (available online http://www.usdoj.gov/usao/eousa/foia_reading_room/usam/title9/crm00163.htm) (last visited June 23, 2006).

of an attempt to protect culpable employees and as a factor weighing in favor of indictment of the entity.[13]

KPMG Gets Into Trouble and "Cleans House"

While all of this was going on, the Internal Revenue Service ("IRS") began investigating tax shelters, including a number that are subjects of the indictment in this case. In early 2002, it issued nine summonses to KPMG, which was less than fully compliant. Accordingly, on July 9, 2002, the government filed a petition in the United States District Court for the District of Columbia to enforce them.[14]

A few months later, the Permanent Subcommittee on Investigations of the Senate Committee on Governmental Affairs "began an investigation into the development, marketing and

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[13] Mr. Thompson was quoted in the press as having defended pressuring companies to cut off payment of defense costs for their employees on the ground that "they [the employees] don't need fancy legal representation" if they do not believe that they acted with criminal intent. Laurie P. Cohen, *In the Crossfire: Prosecutors' Tough New Tactics Turn Firms Against Employees,* WALL. ST. J., June 4, 2004, A1. Naturally, the Court does not consider it in deciding this matter, as it is not in evidence. It notes, however, that such a view, whether held by Mr. Thompson or anyone else, would be misguided, to say the least.

The innocent need able legal representation in criminal matters perhaps even more than the guilty. In addition, defense costs in investigations and prosecutions arising out of complex business environments often are far greater than in less complex criminal matters. Counsel with the skills, business sophistication, and resources that are important to able representation in such matters often are more expensive than those in less complex criminal matters. Moreover, the need to review and analyze frequently voluminous documentary evidence increases the amount of attorney time required for, and thus the cost of, a competent defense. Thus, even the innocent need substantial resources to minimize the chance of an unjust indictment and conviction.

[14] *United States v. KPMG LLP,* 316 F. Supp.2d 30, 31-32 (D. D.C. 2004).

It appears that the IRS was conducting also a penalty promoter audit of KPMG. Tr. (Neiman) 270:8-11.

implementation of abusive tax shelters by accountants, lawyers, financial advisors, and bankers."[15] This led to public hearings in November 2003 at which several senior KPMG partners or former partners – three of them now defendants here – testified.[16]

The firm's reception at the hearing was not favorable. Senator Coleman, the subcommittee chair, for example, opened the hearing by saying that "the ethical standards of the legal and accounting profession have been pushed, prodded, bent and, in some cases, broken, for enormous monetary gain."[17] At another point, Senator Levin, the ranking minority member, in obvious exasperation at a KPMG witness, suggested that the witness "try an honest answer."[18]

Eugene O'Kelly, then KPMG chair,[19] was concerned about the Senate hearing and the IRS proceedings.[20] He retained Skadden Arps Slate Meagher & Flom ("Skadden"), and particularly Robert S. Bennett, "to come up with a new cooperative approach."[21] One aspect of that new approach was a decision to "clean house" – a determination to ask Jeffrey Stein, Richard Smith, and Jeffrey Eischeid, all senior KPMG partners who had testified before the Senate and all now defendants here – to leave their positions as deputy chair and chief operating officer of the firm, vice

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15 STAFF OF THE PERMANENT SUBCOMM. ON INVESTIGATIONS OF THE S. COMM. ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS, THE ROLE OF PROF. FIRMS IN THE U.S. TAX SHELTER INDUS. 1 (Comm. Print 2005) ("SENATE REPORT").

16 *Id.* at 1-2.

17 *U.S. Tax Shelter Industry: The Role of Accountants, Lawyers, and Financial Professionals, Hearings Before the Permanent Subcomm. on Investigation of the S. Comm. on Governmental Affairs,* 108th Cong. 2 (2003).

18 *Id.* at 43.

19 Mr. O'Kelly is deceased.

20 Tr. (Neiman) 270:8-16.

21 *Id.*

chair – tax services, and a partner in personal financial planning, respectively.[22]

Given Mr. Stein's senior position and his relationship with Mr. O'Kelly,[23] his departure was cushioned substantially, although many of the facts have come to light only recently. He "retired" from the firm with a $100,000 per month, three-year consulting agreement. He agreed to release the firm and all of its partners, principals, and employees from all claims.[24] He and KPMG agreed also that Mr. Stein would be represented, at KPMG's expense, in any suits brought against KPMG or its personnel and himself, by counsel acceptable to both him and the firm or, if joint representation were inappropriate or if Mr. Stein were the only party to a proceeding, by counsel reasonably acceptable to Stein.[25]

Despite KPMG's effort to stave off trouble by "cleaning house," much damage already had been done. In the early part of 2004, the IRS made a criminal referral to the Department

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[22] U113, ¶¶ 8, 28-29; *see* SENATE REPORT 2.

Mr. Eischeid was placed on administrative leave and Mr. Smith transferred. Tr. (Neiman) 274:16-20.

[23] Mr. O'Kelly had selected Mr. Stein as deputy chair of KPMG. *See* Tr. (Loonan) 169:17-21. Although he felt compelled to ask Mr. Stein to retire, he personally negotiated the very generous terms of the severance. *Id.* 167:16-21; 169:23-170:7. Mr. Loonan, who worked out the terms of the written agreement with Mr. Stein's counsel (whose fee for doing the agreement ultimately was borne by KPMG), described the negotiation as "very friendly." *Id.* 168:23-169:16.

[24] DX 6A, ¶¶ 7, 9(a).

There were limited exceptions that are not relevant here.

[25] DX 6, ¶ 13.

The agreement provided also that, "[n]otwithstanding any other provision of [the] Agreement," if Mr. Stein were named as a defendant in any action based on his activities with the firm, KPMG would indemnify him "(through its Professional Indemnity Insurance Program)," except as to "wilful or intentional unlawful acts," to the same extent it would have done had he remained with KPMG. DX 6B, ¶ 22.

of Justice ("DOJ"), which in turn passed it on to the United States Attorney's Office for this district ("USAO").[26]

KPMG's Policy on Payment of Legal Fees

KPMG's policy prior to this matter concerning the payment of legal fees of its partners and employees is clear. While KPMG's partnership agreement and by-laws are silent on the subject, the parties have stipulated as follows:

> "1. Prior to February 2004, . . . it had been the longstanding voluntary practice of KPMG to advance and pay legal fees, without a preset cap or condition of cooperation with the government, for counsel for partners, principals, and employees of the firm in those situations where separate counsel was appropriate to represent the individual in any civil, criminal or regulatory proceeding involving activities arising within the scope of the individual's duties and responsibilities as a KPMG partner, principal, or employee.

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[26] The United States Attorneys' Manual explains the process as follows:

> "The IRS' Criminal Investigation Division (CID) is responsible for investigating violations of the criminal provisions of the internal revenue laws, including cases falling within the General Enforcement Plea Program . . . and related violations of the criminal provisions of 18 U.S.C. CID special agents are responsible for conducting administrative investigations . . . of alleged criminal violations arising under the internal revenue laws.
>
> "Upon concluding an administrative investigation, a special agent recommending prosecution must prepare a special agent's report (SAR) that details the investigation and the agent's recommendations. After review within CID, the SAR, together with the exhibits, is reviewed by District Counsel. . . When prosecution is deemed warranted, District Counsel prepares a criminal reference letter (CRL) and refers the matter . . . either to the Tax Division or, in those circumstances when direct referral of certain classes of cases is authorized, to the United States Attorney. . . The CRL discusses the nature of the crime(s) for which prosecution is recommended, the evidence relied upon to prove it, technical aspects and anticipated difficulties of prosecution, and the prosecution recommendations themselves." U.S. DEP'T OF JUSTICE, UNITED STATES ATTORNEYS' MANUAL § 6-4.110 (1997) (hereinafter "UNITED STATES ATTORNEYS' MANUAL"). *See also id.* § 6-4.122. It appears that the decision whether to prosecute complex tax matters referred by the IRS is made by the Tax Division of the DOJ. *Id.* 6-4.212, subd. 1.

> "2. This practice was followed without regard to economic costs or considerations with respect to individuals or the firm.
>
> "3. With the exception of the instant matter, KPMG is not aware of any current or former partner, principal or employee who has been indicted for conduct arising within the scope of the individual's duties and responsibilities as a KPMG partner, principal, or employee since [two partners] were indicted and convicted of violation of federal criminal law in 1974. Although KPMG has located no documents regarding payment of legal fees in that case, KPMG believes that it did pay pre- and post-indictment legal fees for the individuals in that case."

The Court infers and finds that KPMG in fact paid the pre- and post-indictment legal fees for the individuals in the 1974 criminal case. Moreover, the extent to which KPMG has gone is quite remarkable. In one recent situation involving KPMG's relationship with Xerox Corporation, it paid over $20 million to defend four partners in a criminal investigation and related civil litigation brought by the Securities and Exchange Commission.[27]

The Initial Discussion between the USAO and Skadden

When the referral reached the USAO on February 5, 2004, it came under the supervision of Shirah Neiman, who was chief counsel to the United States Attorney, the USAO's liaison to the IRS, a participant in the drafting of the Holder Memorandum, and a very experienced prosecutor.[28] The USAO notified Skadden of the referral, and a meeting was scheduled for February 25, 2004.

In the meantime, on February 9, 2004, the USAO prepared "subject" letters – letters advising the recipient that he or she "is a person whose conduct is within the scope of [a] grand

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[27] Tr. (Loonan) 129:23-130:18.

[28] Tr. (Neiman) 264:9-266:6, 268:3-9.

jury's investigation"[29] – to between 20 and 30 KPMG partners and employees, including all but five of the defendants in this case.[30]

In preparation for the meeting, Ms. Neiman, Assistant United States Attorneys ("AUSA") Weddle and Okula, and other members of the prosecution team conferred. They decided to ask Skadden whether KPMG was paying the legal fees of individuals under investigation.[31] Accordingly, the government prepared a document headed "Skadden Meeting Points" setting forth matters that the government intended to discuss at the meeting.[32] The first page of the three-page list contained an item that read:

> "● Is KPMG paying/going to pay the legal fees of employees? Current or former?
> What about taxpayers?
>
> Who?
>
> ♦ Any agreements or other obligations to do so? What are they?"[33]

The meeting was attended by Mr. Bennett, Ms. Neiman, and many others on both sides. Mr. Weddle began by telling Skadden that the government was there to hear what Skadden had to say and that it had a few questions. Mr. Bennett explained that Skadden had been hired in view of Mr. O'Kelly's concern about the controversy with the IRS and the Senate hearings and that

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[29] UNITED STATES ATTORNEYS' MANUAL § 9-11.151.

[30] Tr. (Okula) 85:22-25, 92:25-93:12; K159-84; Docket item 524 (letter, Stanley J. Okula, May 22, 2006). It appears that the letters were hand-delivered between February 18 and 26, 2004, with most delivered by February 20, 2004. *Id.*

[31] Tr. (Okula) 66:15-19.

[32] *Id.* 63:23-64:21; *see id.* (Neiman) 282:17-283:16.

[33] U6; U98.

KPMG had decided to clean house and change the atmosphere at the firm. He reported that the firm had taken high-level personnel action already, that it would cooperate fully with the government's investigation, and that the object was to save KPMG, not to protect any individuals. In an obvious reference to the fate of Arthur Andersen, he said that an indictment of KPMG would result in the firm going out of business.[34]

After a discussion of the structure of KPMG and of potential conflicts of interest, Mr. Weddle "got to the subject of legal fees and asked whether KPMG was obligated to pay fees and what their plans were."[35] Mr. Bennett tested the waters to see whether KPMG could adhere to its practice of paying its employees'[36] legal expenses when litigation loomed. He asked for government's view on the subject.[37] Ms. Neiman said that the government would take into account KPMG's legal obligations, if any, to advance legal expenses, but referred specifically to the Thompson Memorandum as a point that had to be considered.[38]

At or about that point, Messrs. Bennett and Bialkin told the USAO that KPMG's "common practice" had been to pay legal fees. They added that the partnership agreement was vague and that Delaware law gave the company the right to do whatever it wished, but said that KPMG still was checking on its legal obligations. It would not, however, pay legal fees for

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[34] *Id.* (Neiman) 269:19-271:12.

[35] *Id.* 271:13-272:10.; *id.* (Pilchen) 23:4-7, 32:25-33:2; U113 ¶ 23.

Mr. Weddle asked also for copies of KPMG's partnership agreement and by-laws. K313; U105.

[36] The Court includes KPMG partners in the term "employees" for ease of expression.

[37] *Id.;* Tr. (Pilchen) 23:8-12; K313.

[38] *Id.* 23:12-15; *id.* (Okula) 75:20-76:1.

employees who declined to cooperate with the government, or who took the Fifth Amendment, as long as it had discretion to take that position.[39]

The conversation then shifted briefly to a discussion of the personnel changes that KPMG had made.[40] Mr. Bennett reported that Messrs. Stein, Eischeid, and Smith had been asked to leave, but explained that neither KPMG nor Skadden had done an internal investigation to determine who were "bad guys" or whether any crime had been committed.[41] Almost immediately, Mr. Weddle reverted to the subject of attorneys' fees, asking Mr. Bennett to determine KPMG's obligations in that regard.[42] Ms. Neiman then said that "misconduct" should not or cannot "be rewarded" and referred to federal guidelines.[43]

There is no dispute, and the Court finds, that this comment came immediately on the heels of a statement by Mr. Bennett relating to lawyers for KPMG partners.[44] There are disputes, however, about precisely what Ms. Neiman said about "guidelines" and what she meant by it.[45] The

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[39] K313; U105; U116 ¶¶ 24-25; Tr. (Neiman) 273:13-17; *id.* (Pilchen) 24:6-19.

[40] U116, ¶¶ 27-30; Tr. (Neiman) 274:4-25.

[41] Tr. (Neiman) 274:3-8; *id.* (Okula) 110:3-5; U106, ¶ 26; U116, ¶ 28.

[42] U117, ¶ 31; K313.

[43] U117, ¶ 31; U106, ¶ 27; K313

[44] *E.g.,* Tr. (Neiman) 275:3-10; *id.* (Pilchen) 21:12-23:16: *id.* (Okula) 114:13-115:2.

[45] According to Ms. Neiman, she said "that the federal sentencing guidelines specifically address in its corporate compliance section the issue of providing discipline for people who engage in misconduct, and [that KPMG] can't reward misconduct and you have to be mindful of that." (Tr. (Neiman) 275:3-10) The Court assumes that this was what went through her mind and does not question the sincerity of the testimony. The contemporaneous notes and subsequent memorandum of the government's designated note taker and the contemporaneous notes of a Skadden partner, however, do not refer to corporate compliance and contain the word "guidelines" without specifying sentencing guidelines or the Thompson Memorandum. U106, ¶ 28; U117, ¶ 31; K313. The Court is not

parties have focused in particular on whether Ms. Neiman intended her remark to be directed to the legal fee issue – *i.e.,* to be a statement to the effect that payment by KPMG of employee legal fees could be viewed as rewarding misconduct – or to be directed instead at any severance arrangements between KPMG and Messrs. Stein, Eischeid, and Smith. Ms. Neiman testified that her intent was the latter.[46] But the Court finds it unnecessary to decide Ms. Neiman's subjective purpose in making the remark because what is more important is how her comment was understood.

As Ms. Neiman's remark came immediately after a statement concerning whether KPMG would be paying for lawyers for its personnel, it would have been quite natural to understand

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persuaded that Ms. Neiman, whatever she had in mind, referred to the sentencing guidelines or to corporate compliance. She said, without elaboration, that misconduct cannot or should not be rewarded under federal guidelines. It is no stretch to conclude that this remark was taken by those who heard it as a reference to the Thompson Memorandum. In fact, KPMG's present chief legal officer, former U.S. District Judge Sven Erik Holmes, referred in a different context to the Thomson Memorandum as the "Thompson Guidelines" in a civil deposition. Docket item 544, Ex. B, at 74-75.

[46] The government's post-hearing brief attempts to support Ms. Neiman's claim that she referred to the federal sentencing guidelines, not to the Thompson Memorandum, and that she was speaking at the time of corporate compliance programs. It maintains that "Ms. Neiman consistently refers to the Sentencing Guidelines when lecturing on the issues of corporate compliance programs and cooperation" and appends a copy of a lecture she gave on the subject that referred to the sentencing guidelines. Docket item 510 at 20; *id.* Ex. A. It attaches also a copy of an interview with former Deputy Attorney General Comey regarding waiver of privileges by corporate entities under the Thompson Memorandum. In light of these materials, it maintains, the Court should find that Ms. Nieman referred to the sentencing guidelines and that her warning against rewarding misconduct was intended to encourage KPMG to take appropriate personnel actions against culpable employees and not as a reference to payment of legal fees. *Id.* at 21-23; *id.* Ex. B.

The Court declines to consider the appended material. The government could have sought to examine Ms. Neiman about her lecture at the hearing and could have called Mr. Comey as a witness. It did neither. To consider these materials, first submitted after the conclusion of the hearing, would deprive the KPMG Defendants of the right to cross-examine. Even more important, the documents are not probative, and at least no strongly so, of what Ms. Neiman said to KPMG in the February 25, 2004 meeting and what KPMG understood from her comment. Accordingly, they would not alter the result even if the Court considered them.

the comment as having been directed at payment of legal fees. And that is exactly what happened:

- The IRS agent's handwritten notes, taken at the meeting, state:

  "BB - [illegible] Skadden may recommend lawyers for this. Wants lawyers who understand cooperation is the best way to go in this type of case.

  He feels it is in the best interests of KPMG for its people to get attorneys that will cooperate with Go[vt]. Want to save the firm.

  "Per SN

  Fees – under Federal Guideline
  – Misconduct C/N Be rewarded.

  JW - figure out firms obligations ~~and~~ [illegible]"[47]

- The IRS agent's typewritten memorandum, prepared from her notes, state:

  "31. AUSA Weddle finally asked Mr. Bennett to find out what KPMG's obligations would be. Shirah Neiman further advised them that under the federal guidelines misconduct can not be rewarded."[48]

- Skadden's Mr. Pilchen recorded:

  "SP - No decisions made. No counsel have been recommended – we have had discussions @ what the firm does in typical situations - but no final decisions made.

  "SN - misconduct shdn't be rewarded."[49]

- Not long afterward, Mr. Pilchen told a lawyer for a KPMG employee that the government had implied that it preferred that KPMG not pay employee legal

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[47] U106.

[48] U117.

[49] K313.

fees.[50]

- AUSA Okula testified:

"Q In response to the topic of cooperation, isn't it a fact that Shirah Neiman goes back to the fees and says, well, remember, we're looking at that under federal guidelines. Yes or no?

"A Yes.

"Q And that was about fees, wasn't it?

"A Fees, yes, that's what it says.

"Q It wasn't about terminating Eischeid or Stein or anybody else. It was about paying fees and cooperation. Correct?

"A Correct."[51]

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[50] K316-17; *cf.* Tr. (Michael) 44:9-45:17.

[51] Tr. (Okula) 124:24-125:13.

This testimony was given with respect to the IRS agent's note of Ms. Neiman's remark to the effect that misconduct should not be rewarded. U106. That note came immediately after a note of a statement by Mr. Bennett that he felt it was "in the best interests of KPMG for it's [*sic*] people to get attorneys that will cooperate with Go[vt]" and that he wanted to "save the firm." *Id.*

Elsewhere in his testimony, Mr. Okula implied that he believed that Ms. Neiman's remark was a comment on the fact that Mr. Stein had been "let go with a severance package that exceeded $8 million or $10 million," which Mr. Okula thought inconsistent with an attempt by Skadden to claim credit for taking aggressive personnel action. Tr. (Okula) 115:3-13. This testimony, the Court finds, was mistaken.

The parties have stipulated that KPMG did not produce Mr. Stein's severance agreement to the government until recently. Tr. 181:18-24; *see also* Weddle Decl. [docket item 435] ¶ 7. Moreover, at an August 4, 2004 meeting, Karen Seymour, chief of the criminal division of the USAO, told Skadden that "KPMG's employment actions to grant rich severance packages without making statements to the public, or privately to its employees, of the wrongdoing that went on" was a "troubling issue under the 'Thompson Memo.'" U72; *see* Tr. (Loonan) 154:22-155:20. Notes of the meeting produced by the government indicate that Mr. Weddle was "very upset about this." U51.

It is difficult to see why the size of Mr. Stein's severance package would have provoked such

In sum, Ms. Neiman's comment that "misconduct" cannot or should not "be rewarded" under "federal guidelines," whatever went through her mind when she said it, was understood by both KPMG and government representatives as a reminder that payment of legal fees by KPMG, beyond any that it might legally be obligated to pay, could well count against KPMG in the government's decision whether to indict the firm. And if there were any doubt that this was the message conveyed, the doubt quickly was dispelled by Mr. Weddle. As Mr. Pilchen's notes recorded, he followed up Ms. Neiman's comment by saying:

"JW – if u have discretion re fees – we'll look at that under a microscope."[52]

Thus, while the USAO did not say in so many words that it did not want KPMG to pay legal fees, no one at the meeting could have failed to draw that conclusion.[53]

KPMG Gets the Message

Shortly after the February 25, 2004 meeting, Mr. Bennett got back to Mr. Weddle on the legal fee issue. He reported that KPMG did not think it had any binding legal obligation to pay

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a response in August 2004 if, as Mr. Okula suggested, its terms had been disclosed in February. In all the circumstances, the Court finds that the government was unaware at the time of the February 25, 2004 meeting of the financial arrangements between Mr. Stein and KPMG.

[52] K314 (emphasis in original).

This comment appears only in Mr. Pilchen's notes, and no witness at the hearing had any present recollection of it. Nevertheless, Mr. Pilchen testified that his notes were an effort "to record [his] impressions and recollections of what was being said." Tr. 19:16-17. The notes specifically attribute the remark to Mr. Weddle, which is not consistent with their being a recordation of a subjective thought by Mr. Pilchen. Mr. Pilchen underlined them. In light of the memorable language and these additional circumstances, the Court finds that Mr. Weddle made the comment.

[53] Mr. Okula frankly admitted that it was his personal view that KPMG should not pay the fees. Tr. (Okula) 69:1-4.

legal fees,[54] but that "it would be a big problem" not to do so because the firm was a partnership. He said that KPMG was planning on putting a cap, or limit, on fees and conditioning their payment for any given partner or employee on that individual "cooperating fully with the company and the government."[55] Apparently satisfied with the government's response, KPMG began to implement the policy.

On March 4, 2004, Mr. Pilchen of Skadden spoke to Mr. Townsend, an attorney for defendant Carolyn Warley. He told Townsend that KPMG would pay his fees so long as Ms. Warley cooperated with the government. For example, he said, no fees would be paid if Ms. Warley invoked her privilege against self-incrimination under the Fifth Amendment.[56]

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[54] KPMG was blatantly self-interested on this point. While the Thompson Memorandum countenances compliance with legal obligations to advance fees, KPMG had an interest in avoiding advancement of fees if its legal obligation to do so might be questioned, as the government might view advancement of fees as protecting culpable personnel. Those of its partners and employees who were or might become subjects of the investigation, on the other hand, had an interest in taking the broadest possible view of KPMG's legal obligations.

In these circumstances, it is of more than passing interest that the government, which knew or at least was chargeable with knowledge of this obvious fact, appears to have made no effort to verify KPMG's claim beyond asking for and presumably reading the partnership and by-laws. There is no evidence, for example, that it ever inquired into exactly what KPMG's practices had been in this regard.

Nor did the government question the obvious conflict of interest manifest in Skadden's offer to recommend as counsel to targeted KPMG employees "law firms that were familiar with these types of proceedings and who understood that cooperation with the government was the best way to proceed." U119, ¶ 56; U106. Cooperation may have been the best way for KPMG to proceed, but it was not necessarily best for its employees. Skadden's effort to curry favor with the government by offering to seek to compromise the interests of KPMG's employees by inducing them to retain counsel who would serve KPMG's interest in cooperating and the government's apparent failure to take issue with it both are quite disturbing.

[55] U30.

[56] U316-17; Tr. (Michael) 41:16-44:8.

On March 11, 2004, the Skadden team had a conference call with the USAO. Mr. Bennett assured the USAO that KPMG would be "as cooperative as possible" so that the office would not exercise its discretion to indict the firm. Mr. Weddle urged that KPMG tell its people that they should be "totally open" with the USAO, "even if that [meant admitting] criminal wrongdoing." He commented that this would give him good material for cross-examination,[57] a statement that strongly indicates that at least the lead line AUSA on the case expected, even at this stage, to prosecute individuals.

The actions of the USAO, coupled with the Thompson Memorandum, had the desired effect. On the same date, Skadden's Mr. Rauh wrote to the USAO, enclosing among other things a form letter that Skadden was sending to counsel for the KPMG Defendants then employed by KPMG who had received subject letters from the government or otherwise appeared to be under suspicion.[58] The form letter stated that KPMG would pay an individual's legal fees and expenses, up to a maximum of $400,000, on the condition that the individual "cooperate with the government and . . . be prompt, complete, and truthful."[59] Importantly, however, it went even further. It made clear that *"payment of . . . legal fees and expenses will cease immediately if . . . [the recipient] is charged by the government with criminal wrongdoing."*[60] In addition, on March 12, 2004, Joseph Loonan, then KPMG's deputy general counsel, sent an advisory memorandum to a broader audience

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[57] U318-19; Tr. (Michael) 45:22-50:12.

[58] K5-16.

[59] *Id.* at15-16.

[60] *Id.* at 16 (emphasis added).

of KPMG personnel regarding potential contacts by the government.[61] The memorandum urged full cooperation with the investigation. But it advised also that recipients had a right to be represented by counsel if they were contacted by the government, mentioned some advantages of consultation with counsel, and stated that KPMG had arranged for independent counsel for those who wished to consult them.[62]

The USAO took no issue with KPMG's announcement that it would cut off payment of legal fees for anyone who was indicted and that it would condition the limited preindictment payments on cooperation with the government. The advisory memorandum, on the other hand, upset Mr. Weddle and Kevin Downing, another member of the prosecution team.[63] They immediately advised Skadden that it was "disappointed with [its] tone" and allegedly "one-sided presentation of potential issues" and demanded that KPMG send out a supplemental memorandum in a form they proposed.[64] The only significant point of difference between the memorandum that the government demanded and Mr. Loonan's original memorandum was the language in the government's proposal italicized below:

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[61] Skadden sent a copy to the government on the same day. K270.

[62] K271-73; Tr. (Loonan) 145:2-149:22.

The memorandum indicated also that KPMG would "be responsible for the payment of reasonable fees and related expenses in connection with . . . representation regarding this investigation." K271-73, at 272. The failure to indicate that payment of legal fees would cease if the recipient were charged or to refer to the $400,000 cap apparently is attributable to the fact that those limitations were contained in letters sent to counsel for persons who already had received subject letters from the government while the advisory memorandum went to a broader group.

[63] Tr. (Loonan) 149:23-150:1.

[64] K275-77.

> "Employees are not required to use this counsel, or any counsel at all. Rather, employees are free to obtain their own counsel, *or to meet with investigators without the assistance of counsel.* It is entirely your choice."[65]

In due course, KPMG capitulated to the USAO demand. It put out in "Q & A" format a document containing the following language:

> *"Do I have to be assisted by a lawyer?*
>
> "**Answer:** No. Although we believe that it is probably in your best interests to consult with a lawyer before speaking to government representatives, whether you do so is entirely your choice. *As we said in the March 12 OGC [Office of General Counsel] memorandum, you may deal directly with government representatives without counsel.* In any event, the Firm expects you to cooperate fully with the government representatives and provide complete and truthful information to them."[66]

This exchange is revealing. No one suggests that either the original KPMG advice or the government's subsequent proposal misstated the law. The difference was one of emphasis. But it is entirely plain that the government's purpose in demanding the supplement was to increase the chances that KPMG employees would agree to interviews without consulting or being represented by counsel, whether provided by KPMG or otherwise.

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[65] U276 (emphasis added).

[66] U294-308, at U299 (emphasis added).

The USAO's demand was a focus of a meeting or telephone call with Skadden on March 29, 2004. Mr. Bennett protested that it had sent out memoranda such as those that had been sent on behalf of KPMG in other matters without objection. He emphasized that KPMG would not even pay attorneys' fees unless its personnel agreed to cooperate and that it would cut off payments to KPMG personnel who invoked the Fifth Amendment. Nevertheless, he ultimately acquiesced in the government's demands, stating that KPMG was in the process of sending out in "Q & A format" a "more balanced approach." K321.

The Government Presses Its Advantage

The KPMG lawyers met again with the USAO on March 29, 2004. In an effort to demonstrate that KPMG was cooperating, Skadden asked the government to notify it if any current or former KPMG employee refused to meet with prosecutors or otherwise failed to cooperate.[67]

From that point forward, the government took full advantage. It repeatedly notified Skadden when KPMG personnel failed to comply with government demands.[68] In each case, Skadden promptly advised the attorney for the individual in question that the payment of legal fees would be terminated "[a]bsent an indication from the government within the next ten business days that your client no longer refuses to participate in an interview with the government."[69] In some cases, the individuals in question relented under pressure of the threats from KPMG and submitted to interviews with the government. In others, they did not, whereupon KPMG terminated their employment and cut off the payment of legal fees.[70]

The Conclusion of the Investigation, KPMG's Stein Problem and the Deferred Prosecution Agreement

As the matter unfolded, meetings between KPMG and its counsel and the USAO continued, with KPMG seeking a resolution short of an indictment of the firm and the government

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[67] U32; *see also, e.g.,* K30; K43.

[68] *See, e.g.,* K30; K43; K44.1; K47; K49; K55; K56; K60; K66; K81; K127; K268; *see also* K68.

[69] *See, e.g.,* K42-43; K44-44.1; K45; K51; K57-58; K61-62; K68; K76-77; *see also* K129 (suspending payment of legal fees and warning that payment would be discontinued entirely absent indication of cooperation from the government); K134 (same).

[70] *See, e.g.,* K54; K68; K93; K126; K132-33; K186-90.

pressing for admissions of extensive wrongdoing, a great deal of money, and changes in KPMG's business.

On August 4, 2004, the KPMG executives and lawyers met with Karen Seymour, then chief of the criminal division of the USAO, and other prosecutors. In the course of the meeting, Ms. Seymour said that the government had learned that KPMG had granted rich severance packages to certain executives and that this raised a "troubling issue under the 'Thompson Memo.'"[71] Mr. Bennett deflected the issue, agreeing that severance packages were "high in one or two cases" but reiterating that KPMG's "expectation" was that legal fees of individuals would be paid only up to $400,000 and only on condition that recipients cooperated with the government.[72] But the Stein severance agreement was not produced.

As time went by, KPMG came to view the Stein severance agreement as something of a ticking bomb. For one thing, KPMG had not adhered in Mr. Stein's case to the $400,000 pre-indictment legal fee cap that it had adopted in response to government pressure. It passed that figure by late October 2004,[73] and so was at odds with its representation to the government.[74] For another,

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71 U69-77, at U72.

72 *Id.*

73 Docket item 512, Att. A, ¶ 6.

74 KPMG sought to explain this by suggesting that it had paid $646,000 in fees for both the criminal investigation and for civil litigation and that its representations to the government therefore may not have been inaccurate. Tr. (Loonan) 182:19-185:13. In fact, however, the parties later stipulated that KPMG paid $646,757.80 in Mr. Stein's legal fees for the criminal investigation alone. Docket item 512, Att. A, ¶ 5.

it had known since August 2004 that the USAO was unhappy that rich severance packages had been given to senior executives.[75]

Notwithstanding this problem, KPMG repeatedly tried to convince the USAO not to indict the firm, touting its cooperation with the investigation and its limitation of attorneys' fees for individuals. In meetings in March 2005 with David N. Kelley, then United States Attorney, however, this approach did not yield the desired result. Indeed, On March 2, 2005, Mr. Kelley interrupted Mr. Bennett's claim that the firm had cooperated by saying, "Let me put it this way. I've seen a lot better from big companies."[76] That meeting, in the words of KPMG's Mr. Loonan, was "not particularly encouraging,"[77] and a subsequent meeting in New York went no better.

With the scene about to shift to Washington and a last ditch effort to prevent an indictment by an appeal at the highest levels of the Justice Department, KPMG's objective was "to be able to say at the right time with the right audience, we're in full compliance with the Thompson Guidelines."[78] It concluded that the Stein situation involved too great a risk. So on May 5, 2005, eight days before KPMG was to meet with U.S. Deputy Attorney General James Comey to plead its case, KPMG unilaterally terminated the consulting services portion of the severance agreement

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[75] The record is unclear as to exactly when the government learned the economic terms of the severance packages with Messrs. Stein and others, although it certainly was aware by August 2004 of the fact that they were sizeable. KPMG's Mr. Loonan testified that the government at some point was told the size of Mr. Stein's package, but he did not say when. In any case, his testimony leaves considerable doubt as to whether he had personal knowledge of the facts. Tr. (Loonan) 180:17-25.

[76] U334-36, at 336.

[77] Tr. (Loonan) 187:15-17.

[78] Docket item 544, Ex. B, at 74-75.

This civil deposition was received in evidence in this matter. Docket item 558.

and cut off payment of Mr. Stein's attorneys' fees.[79] It did so, as Mr. Loonan candidly admitted, "because [KPMG] thought it would help [the firm] with the government."[80]

Having dealt, as best it could, with the Stein problem, KPMG turned to attempting to persuade Deputy Attorney General Comey not to indict the firm. The meeting took place on June 13, 2005. Once again, Mr. Bennett relied upon KPMG's cooperation with the government, in addition of course to other arguments. A Skadden memorandum of the meeting recounts some of his remarks as follows:

> "In addition, it [KPMG] had done something 'never heard of before' – conditioned the payment of attorney's fees on full cooperation with the investigation. 'We said we'd pressure – although we didn't use that word – our employees to cooperate. We told employees that attorney fees would not be paid unless they fully cooperated with the investigation.' He noted that whenever an individual indicated he or she would not cooperate, 'Justin [Weddle] or Stan [Okula] would tell us,' and KPMG took action. He went on to note that 'what played out' was that current or former personnel who otherwise would not have cooperated did cooperate, and those who did not had their fees cut off and, in two instances, were separated from the firm. This process exhibited 'a level of cooperation that is rarely done.'
>
> * * *
>
> "He noted that what was really 'precedent-setting' about the case was the conditioning of payment of legal fees on cooperation."[81]

This time, KPMG was more successful.

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[79] DX 7; Tr. (Loonan) 190:22-191:4.

[80] *Id.* 196:13-23.

KPMG unpersuasively sought to explain the payment of almost $650,000 in legal fees as an oversight and the termination of payments as consistent with the severance agreement. It has offered no justification for terminating the consulting payments. Nor does the Court credit its benign excuses for cutting off payment of the legal fees. It did so purely to create a response for use in the event the government were to discover that KPMG had exceeded the cap on legal costs that it had told the government it had imposed.

[81] U347-51, at 349-51.

The Deferred Prosecution Agreement and the Indictment in This Case

On August 29, 2005, KPMG and the government entered into a Deferred Prosecution Agreement ("DPA"). KPMG agreed, among other things, to waive indictment, to be charged in a one-count information, to admit extensive wrongdoing, to pay a $456 million fine, and to accept restrictions on its practice. The government agreed that it will seek dismissal of the information if KPMG complies with its obligations.[82] In a nutshell, KPMG stands to avoid a criminal conviction if it lives up to its part of the bargain.

One additional aspect of the DPA is noteworthy in the present context. The DPA obliges KPMG to cooperate extensively with the government, both in general and in the government's prosecution of this indictment. It provides in part:

> "7. KPMG acknowledges and understands that its cooperation with the criminal investigation by the Office [USAO] is an important and material factor underlying the Office's decision to enter into this Agreement, and, therefore, *KPMG agrees to cooperate fully and actively with the Office, the IRS, and with any other agency of the government designated by the Office ('Designated Agencies') regarding any matter relating to the Office's investigation about which KPMG has knowledge or information.*
>
> "8. KPMG agrees that its continuing cooperation with the Office's investigation shall include, *but not be limited to,* the following:
>
> "(a) Completely and truthfully disclosing all information in its possession to the Office and the IRS about which the Office and the IRS may inquire, including but not limited to all information about activities of KPMG, present and former partners, employees, and agents of KPMG;
>
> * * *
>
> "(d) Assembling, organizing, and providing, in responsive and prompt fashion, and, upon request, expedited fashion, all documents, records, information,

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[82] *United States v. KPMG LLP,* 05 Crim. 0903 (LAP), docket item 4 (filed Aug. 29, 2005).

> and other evidence in KPMG's possession, custody, or control as may be requested by the Office or the IRS;
>
> "(e) Not asserting, in relation to the Office, any claim of privilege (including but not limited to the attorney-client privilege and the work product protection) as to any documents, records, information, or testimony requested by the Office related to its investigation . . . [; and]
>
> "(f) Using its reasonable best efforts to make available its present and former partners and employees to provide information and/or testimony as requested by the Office and the IRS, including sworn testimony before a grand jury or in court proceedings, as well as interviews with law enforcement authorities . . .
>
> "9. KPMG agrees that its obligations to cooperate will continue even after the dismissal of the Information, and *KPMG will continue to fulfill the cooperation obligations set forth in this Agreement in connection with any investigation, criminal prosecution or civil proceeding brought by the Office* or by or against the IRS or the United States relating to or arising out of the conduct set forth in the Information and the Statement of Facts and relating in any way to the Office's investigation."[83]

The cooperation provisions of the DPA thus require KPMG to comply with demands by the USAO in connection with this prosecution, with little or no regard to cost. If it does not comply, it will be open to the risk that the government will declare that KPMG breached the DPA and prosecute the criminal information to verdict. Anything the government regards as a failure to cooperate, in other words, almost certainly will result in the criminal conviction that KPMG has labored so mightily to avoid, as the admissions that KPMG now has made would foreclose a successful defense.

At about the same time, the government filed the initial indictment in this case. True to its word, KPMG cut off payments to the defendants of legal fees and expenses.

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[83] *Id.* ¶¶ 7-9 (emphasis added).

The Present Motion

The Government's Initial Response

On January 19, 2006, the KPMG Defendants moved to dismiss the indictment or for other relief on the ground that the government had interfered improperly with the advancement of attorneys' fees by KPMG in violation of their constitutional and other rights.

The government filed its memorandum in opposition to this and other motions on March 3, 2006.[84] It represented:

> "With respect to the facts[,] KPMG, which determined that it had no obligation under either Delaware partnership law or contract to advance legal fees at all, *decided of its own volition* that it would in fact advance such fees, but subject them to certain limitations. That KPMG, an entity that by its own admission engaged in a breathtaking tax fraud conspiracy with and through the defendants and others, may have made that decision as a matter of good partnership governance and in order to better position itself with prosecutors, does not detract from the fact that *it was KPMG's decision alone.* Tellingly, the defendants have not – and indeed cannot – point to any evidence supporting their spurious claims that the United States 'coerc[ed]' or 'bull[ied]' KPMG into making its decision to limit the advancement of fees."[85]

The motion was heard on March 30, 2006. In the course of the argument, the government, for the first time, took the position that it had "no objection whatsoever to KPMG exercising its free and independent business judgment as to whether to advance defense costs . . . and that if it were to elect to do so the government would not in any way consider that in determining whether [KPMG] had complied with the DPA."[86] Nevertheless, the Court expressed

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[84] The memorandum bore the names of Messrs. Weddle and Okula and two other AUSAs, in that order.

[85] Docket item 346, at 164 (emphasis added).

[86] Tr., Mar. 30, 2006, at 37.

concern about the impact of the Thompson Memorandum on KPMG's decision with respect to the payment of legal fees and ultimately invited the defendants to make a written submission as to the precise factual issue(s) as to which they sought an evidentiary hearing.[87]

The government sought to avoid a hearing. It responded to the defendants' submission with a declaration by Mr. Weddle and a letter brief.

Mr. Weddle's declaration stated in relevant part:

> "2. On February 25, 2004, legal counsel for KPMG met with me and other representatives of the United States Attorney's Office for the first time in connection with this investigation. At this meeting, among other things:
>
> * * *
>
> "d. KPMG's lawyers stated that they were looking into the issue of their obligations to pay fees, and indicated that if it was within KPMG's discretion whether to pay fees, KPMG would not pay fees for individuals who do not cooperate.
>
> "e. *The Government did not instruct or request KPMG to implement that plan or to implement a contrary plan.*
>
> "3. * * * *Once again, in this call [March 2, 2004], the Government did not tell KPMG's counsel that KPMG's decision to pay legal fees was improper, nor did we instruct or request KPMG to change its decision about paying fees, capping the payment of fees, or conditioning of fees on an employee's or a partner's cooperation."*[88]

The letter brief[89] stated:

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[87] Tr., Mar. 30, 2006, at 128:19-129:7.

[88] Weddle Decl., docket item 435 (emphasis added).

[89] Docket item 432. The letter brief was signed by Mr. Weinstein. As he was not present at the February 25, 2004 meeting with Skadden and there is no evidence that he was involved in the later communications with Skadden described above, the Court assumes that his letter brief simply repeated the facts set out in Mr. Weddle's declaration and prior submissions.

> *"The Government did not instruct or request KPMG to implement that plan* [*i.e.*, KPMG's plan to advance fees subject to a cap and a requirement of cooperation with the government] *or to implement a contrary plan.*
>
> * * *
>
> "Once again, the Government did not tell KPMG that its decision to pay legal fees was improper. *Nor did the Government instruct or request KPMG to change its decision about paying fees, capping the payment of fees, or conditioning the payment of fees on an employee's or a partner's cooperation.*
>
> * * *
>
> "In sum, during the course of its dealings with KPMG, *the United States Attorney's Office did not instruct KPMG whether KPMG should pay legal fees, whether KPMG should cap the payment of legal fees, or whether KPMG should condition the payment of legal fees."*[90]

Prehearing Proceedings

On April 12, 2006, the Court ordered an evidentiary hearing and limited discovery on the motion and, particularly, on "whether the government, through the Thompson Memorandum or otherwise, affected KPMG's determination(s) with respect to the advancement of legal fees and other defense costs to present or former partners and employees with respect to the investigation and prosecution of this case and such subsidiary issues as relate thereto."[91] The order granted the KPMG Defendants leave to serve a Rule 17(c) subpoena on KPMG for documents.

Without getting into unnecessary detail, it is fair to say that KPMG's participation from that point on was more extensive than simply responding to the subpoena. It sought to block or, at least, delay issuance of the subpoena while it tried to broker stipulations between defendants and the government in an effort to limit the scope of discovery from KPMG and testimony by its

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[90] Docket item 432, at 2, 3 (emphasis added).

[91] Docket item 436, at 2.

personnel.[92] It sought and obtained, for its own convenience, a delay of the hearing.[93] And it obtained leave for its counsel appear not only for the purpose of responding to the subpoena "in this matter," but "for any purposes relating to this matter that the Court may so [*sic*] order."[94]

The Hearing

The Court conducted an evidentiary hearing on May 8-10, 2006. Counsel for KPMG were present throughout. At the conclusion of argument by other counsel, the Court addressed counsel for KPMG: "You certainly have notice that a remedy is being sought against your client, and I'm now making it clear in words of one syllable. You will have a chance to be heard if you want it."[95] It went on to emphasize that it would welcome any submission on behalf of KPMG and that KPMG could "make whatever reservation of rights [it wished] in submitting."[96]

KPMG ultimately submitted a memorandum of law. It did not seek to offer any evidence, to question any witnesses, or to make any offer of proof.

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92 Docket item 547.

93 Docket item 448.

94 Docket item 450, 455.

95 Tr., May 10, 2006, at 426:24-427:2.

96 *Id.* at 427:15-430:23.

Ultimate Factual Conclusions

Several broad conclusions follow from the foregoing.

First, the Thompson Memorandum caused KPMG to consider departing from its long-standing policy of paying legal fees and expenses of its personnel in all cases and investigations even before it first met with the USAO. As a direct result of the threat to the firm inherent in the Thompson Memorandum, it sought an indication from the USAO that payment of fees in accordance with its settled practice would not be held against it.

Second, the USAO did not give KPMG the comfort it sought. To the contrary, it deliberately, and consistent with DOJ policy, reinforced the threat inherent in the Thompson Memorandum. It placed the issue of payment of legal fees high on its agenda for its first meeting with KPMG counsel, which emphasized the prosecutors' concern with the issue. Mr. Weddle raised the issue and then repeatedly focused on KPMG's "obligations," thus clearly implying – consistent with the language of the Thompson Memorandum – that compliance with legal obligations would be countenanced, but that anything more than compliance with demonstrable legal obligations could be held against the firm. Ms. Neiman's statement, in response to a comment about payment of legal fees by KPMG, that misconduct should not be rewarded quite reasonably was understood in the same vein, whatever its intent. And Mr. Weddle's colorful warning that the USAO would look at any discretionary payment of fees by KPMG "under a microscope" drove the point home.

Third, the government conducted itself in a manner that evidenced a desire to minimize the involvement of defense attorneys. This objective arguably is inherent, to some degree, in the Thompson Memorandum itself. But there is considerably more proof, specific to this case, here. The *contretemps* with KPMG over its Advisory Memorandum demonstrated the

government's desire, wherever possible, to interview KPMG witnesses without their being represented by lawyers. The USAO's ready acceptance of KPMG's offer to cut off payment of legal fees for anyone who was indicted speaks for itself. It speaks even more eloquently when one considers that the USAO accepted KPMG's assurance that it had no legal obligation to pay legal fees, knowing that (1) KPMG's "common practice" had been to make such payments, (2) KPMG was extremely anxious to curry favor with the USAO by demonstrating how cooperative it could be, and (3) KPMG had an obvious conflict of interest with its present and former personnel on the question whether it had a legal obligation to pay fees. Had the government been less concerned with punishing those it deemed culpable right from the outset, it would not have accepted KPMG's word on this point.

Fourth, KPMG's decision to cut off all payments of legal fees and expenses to anyone who was indicted and to limit and to condition such payments prior to indictment upon cooperation with the government was the direct consequence of the pressure applied by the Thompson Memorandum and the USAO. Absent the Thompson Memorandum and the actions of the USAO, KPMG would have paid the legal fees and expenses of all of its partners and employees both prior to and after indictment, without regard to cost.[97]

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[97] In a brief on another motion, filed after this one was taken under submission, the government points to the Statement of Facts attached to the DPA as evidence that KPMG made the decision concerning legal fees "on its own initiative" and argues that "this decision [w]as one reached by the firm for its own reasons, not at the request or direction of the Government." Docket item 569, at 15 n.5. Even if one put aside the fact that the government failed to offer this in evidence or make this argument on the present motion, the argument would be without merit. There is no inconsistency between KPMG making the decision "for its own reasons" and the decision having been a product of government pressure. The government pressure in fact was the reason that KPMG made the decision.

Discussion

I. The Relationship Between KPMG and its Personnel With Respect to Advancement of Legal Fees and Defense Costs

A. Indemnification and Advancement Generally

The issue of employer payment of legal expenses incurred by their employees as a result of doing their jobs arises in a context that dates back many years.

In the nineteenth century, Justice Story stated what already was an established proposition: "if an agent has, without his own default, incurred losses or damages in the course of transacting the business of his agency, or in following the instructions of his principal, he will be entitled to full compensation therefor" from the employer.[98] The modern common law rule is the same. And it extends to payment of expenses incurred by an employee or other agent in defending a lawsuit on a claim with respect to which the employee is entitled to indemnity.[99]

The success of the corporation as a business form brought growing pains. Lawsuits against corporate directors became ever more common. By the early part of the last century, the situation had become what one commentator described as "open season on directors."[100] The question whether directors who successfully defended such suits were entitled to be reimbursed for the expenses of defending such suits despite the fact that they often were not employees began to arise.

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[98] JOSEPH STORY, STORY ON AGENCY § 339, at 413 (Charles P. Greenough ed. 1882).

[99] *E.g.,* RESTATEMENT (SECOND) OF AGENCY § 438(2) & cmt. e (1958).

[100] Joseph W. Bishop, Jr., *Current Status of Corporate Directors' Right to Indemnification,* 69 HARV. L. REV. 1057, 1058 (1956) (hereinafter "Bishop").

At least one early decision favored reimbursement, commonly called indemnification.[101] In the 1930s, however, courts in Ohio and New York came to the opposite conclusion.[102] These decisions gave rise to a "not unnatural cry for legislation."[103] Taking the view that "[i]ndemnification encourages corporate service by capable individuals by protecting their personal financial resources from depletion [as a result of] . . . litigation that results by reason of that service,"[104] legislatures all over the country responded.

Today, all states have statutes addressing the indemnification of corporate directors, officers, employees, and other agents.[105] Many have adopted also statutes providing for indemnification of members and employees of partnerships as well as of members, officers, and agents of newer forms of business organization such as limited partnerships and limited liability

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101 *Figge v. Bergenthal,* 130 Wis. 594, 109 N.W. 581 (1907).

102 *New York Dock Co. v. McCollum,* 173 Misc. 106, 16 N.Y.S.2d 844 (Sup. Ct. Onondaga Co. 1939); *Griesse v. Lang,* 37 Ohio App. 553, 175 N.E. 222 (1931).

103 Bishop, 69 HARV. L. REV. at 1068-69; *accord,* 2 AMERICAN LAW INSTITUTE, PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 7.20, Reporter's Note 1, at 278 (1994) (hereinafter "ALI"); *see also Baker v. Health Mgmt. Sys., Inc.,* 98 N.Y.2d 80, 85, 745 N.Y.S.2d 741, 744 (2002) (New York corporate indemnification statute enacted to overrule *New York Dock*).

104 *Homestore, Inc.,* 888 A.2d at 211.

105 3A WILLIAM MEADE FLETCHER, FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 1344.10 (2002 rev. vol.) (hereinafter "FLETCHER").

companies.[106] Still others also protect employees with statutes relating specifically to the employment relationship.[107]

These statutes take different forms. Some require indemnification. Some permit indemnification where the corporation or other business entity elects to provide it.[108] A few provide the exclusive vehicle for indemnification while most permit indemnification as a matter of contract or otherwise as well as pursuant to statute.[109] Many provide for indemnification, at least in some circumstances, for the cost of defending employment-related criminal charges.[110] All or virtually all, however, share an additional characteristic. As the Delaware Supreme Court recently put it, "the right to indemnification cannot be established . . . until after the defense to legal proceedings has been 'successful on the merits or otherwise.'"[111]

This has been viewed as a problem. Persons who are sued can be subjected to "the personal out-of-pocket financial burden of paying the significant ongoing expenses inevitably

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106 There has been a parallel development with respect to indemnification of public officials and employees. As *New York Dock* pointed out, liability for suits and legal expenses incurred in their defense original was a risk of assuming public office. 173 Misc. at 111, 16 N.Y.S.2d at 849. New York and doubtless other states have enacted statutes addressing the subject of indemnification for public officers and employees. *E.g.,* N.Y. PUB. OFFICERS L. §§ 17-18 (McKinney 2001); *see* N.Y. LEGISLATIVE ANNUAL 158-59 (1981).

107 *See, e.g.,* CALIF. LABOR C. § 2802.

108 *See* 3A FLETCHER § 1344.10, at 556-57.

109 ALI § 7.20, Reporter's Note 3, at 279.

110 *See, e.g.,* 8 WEST'S DEL. CODE ANN. § 145(a); ALI § 7.20(a); *see generally* Pamela H. Bucy, *Indemnification of Corporation Executives Who Have Been Convicted of Crimes: An Assessment and Proposal,* 24 IND. L. REV. 279, 288-89 (1991).

111 *Homestore, Inc.,* 888 A.2d at 211 (quoting 8 WEST'S DEL. C. ANN. § 145(c)).

involved with investigations and legal proceedings."[112] In consequence, many states authorize business entities to advance defense costs to their personnel, subject to the recipients' obligation to repay the money in the event it ultimately is determined that they are not entitled to indemnity.[113] This has been described as "an especially important corollary to indemnification as an inducement for attracting capable individuals into corporate service."[114] Advancement "fills the gap . . . so the [entity] may shoulder . . . interim costs," and its value "is that it is granted or denied while the underlying action is pending."[115] As Judge Haight has written, it protects the "ability [of the employee] to mount . . . a defense . . . by safeguarding his ability to meet his expenses at the time they arise, and to secure counsel on the basis of such an assurance."[116]

Against this background, we turn to KPMG's relationship with the KPMG Defendants.

B. KPMG

The statute that governs KPMG gives it the authority "to indemnify and hold harmless any partner or other person from and against any and all claims and demands

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112 *Id.*

113 *See, e.g., id.*; *Kaung v. Cole Nat'l Corp.,* 884 A.2d 500, 509-10 (Del. Sup. 2005); 8 WEST'S DEL. C. ANN. § 145(e); *see generally* 3A FLETCHER § 1344.10, at 560-61.

114 *Homestore, Inc.,* 888 A.2d at 211.

115 *Kaung,* 884 A.2d at 509.

116 *United States v. Weissman,* No. S2 94 Crim. 760 (CSH), 1997 WL 334966, at *16 (S.D.N.Y. June 16, 1997).

whatsoever."[117] This includes the authority to advance defense costs prior to final judgment.[118] KPMG had an unbroken track record of paying the legal expenses of its partners and employees incurred as a result of their jobs, without regard to cost. All of the KPMG Defendants therefore had, at a minimum, every reason to expect that KPMG would pay their legal expenses in connection with the government's investigation and, if they were indicted, defending against any charges that arose out of their employment by KPMG. Indeed, it appears quite possible that all had contractual and other legal rights to indemnification and advancement of defense costs,[119] although the Court

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[117] KPMG is a limited liability partnership. Its partnership agreement is governed by the law of Delaware. 6 WEST'S DEL. C. ANN. § 15-106 (2006); K248, ¶ 19.2. The Delaware Revised Uniform Partnership Act provides that "a partnership may, and shall have the power to, indemnify and hold harmless any partner or other person from and against any and all claims and demands whatsoever" subject to such standards and restrictions as are set forth in its partnership agreement. 6 WEST'S DEL. C. ANN. § 15-110 (2006). As the KPMG partnership agreement contains no such standards and restrictions, it is entirely free to indemnify its personnel.

[118] *See, e.g., Senior Tour Players 207 Mgmt. Co. LLC v. Golftown 207 Holding Co. LLC,* 853 A.2d 124, 126 (Del. Ch. 2004); *Delphi Easter Partners L.P. v. Spectacular Partners, Inc.,* Civ. A. No. 12409, 1993 WL 32807, at *4-*5 (Del. Ch. Aug. 6, 1993).

[119] All of the defendants save Stein, who has an express contract with KPMG, arguably are protected by a contract, implied in fact from KPMG's uniform past practice and the circumstances of the business, pursuant to which they are entitled to have their defense costs paid by KPMG. *See, e.g., Beth Israel Med. Ctr. v. Horizon Blue Cross and Blue Shield of New Jersey, 448 F.3d 573, 582* (2d Cir. 2006) (New York law); *Manchester Equip Co., Inc. v. Am. Way Moving & Storage Co., Inc.,* 176 F. Supp.2d 239, 245 (D. Del. 2001) (Delaware law); *Cal. Emergency Physicians Med. Group v. Pacificare of Cal.,* 111 Cal.App.4th 1127, 1134, 4 Cal.Rptr.3d 583, 592 (4th Dist. 2003) (California law). Stein's contract requires that KPMG retain on his behalf, and with his consent, "appropriate and qualified counsel" at the firm's expense if he is sued and joint representation is inappropriate, both of which are the case here. Ex. 6, ¶ 13. While KPMG argues that this obligation is limited by another provision of the contract, its position is questionable.

Quite apart from any question of contract, most of the KPMG California defendants appear to be entitled under California statutes to advancement of their defense costs.

Defendants Bickham and Larson were California employees, not partners. To the extent the investigation and indictment arose in consequence of that employment, California statutes require KPMG to advance their defense costs and, unless their actions were both

declines to decide that in this ruling.

II. The Government Violated the Fifth and Sixth Amendments by Causing KPMG to Cut Off Payment of Legal Fees and Other Defense Costs Upon Indictment

A. The Right to Fairness in the Criminal Process

1. Nature of the Right

> "'No general respect for, nor adherence to, the law as a whole can well be expected without judicial recognition of the paramount need for prompt, *eminently fair* and sober criminal law procedures. The methods we employ in the enforcement of our criminal law have aptly been called the measures by which the quality of our civilization may be judged.'"[120]

The Supreme Court long has protected a defendant's right to fairness in the criminal process. It has grounded this protection primarily in the Due Process Clause[121] as well as more specific provisions of the Bill of Rights, including the Confrontation and Assistance of Counsel

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unlawful and "believed by them to be unlawful"at the time, to indemnify them. CALIF. LABOR C. § 2802(a) (requirement of indemnification); CALIF. CIV. C. § 2778 (indemnity includes defense costs); *Jacobus v. Krambo Corp.,* 78 Cal. App.4th 1096, 93 Cal. Rptr.2d 425 (1st Dist. 2000) (LABOR C. § 2802 requires employer to defend or pay defense costs); *Alberts v. Amer. Cas. Co.,* 88 Cal.App.2d 891, 899, 200 P.2d 37, 42-43 (2d Dist. 1948) (indemnitee entitled to recover as soon as it becomes liable).

Defendant Hasting, who also was based in California, was a KPMG partner. Nevertheless, he arguably is covered by the same statutes. Hasting was a Class A partner of KPMG from July 1998 through October 2001. Under KPMG's by-laws, Class A partners were not entitled to share in the profit or required to bear a share of any losses of the firm and were ineligible to serve on the board of directors. (K0200, K0207) Thus, the fact that he bore the title "partner" may not be dispositive. *See, e.g., Clackamas Gastroenterology Assocs. v. Wells,* 538 U.S. 440, 446 (2003); *Hishon v. King & Spalding,* 467 U.S. 69, 80 n.2 (1984) (Powell, J., concurring).

[120] *Douglas v. California,* 372 U.S. 353, 358 n.2 (1963) (quoting *Coppedge v. United States*, 369 U.S. 438, 449 (1962)) (emphasis added).

[121] U.S. CONST. amend. V, XIV.

Clauses of the Sixth Amendment.[122] Whatever the textual source, however, the Court consistently has held that criminal defendants are entitled to be treated fairly throughout the process. In everyday language, they are entitled to a fair shake.

This concern for the fairness of criminal proceedings runs throughout many of the Court's decisions regarding fair trials and access to the courts. For example, in *Powell v. Alabama*,[123] in which the Court first held that a defendant in a capital case has the right to the aid of counsel, it reasoned that if a tribunal were "arbitrarily to refuse to hear a party by counsel[,] it reasonably may not be doubted that such a refusal would be a denial of a hearing, and, therefore, of due process in the constitutional sense."[124] In other words, without counsel for the defense, a capital prosecution is presumptively unfair and therefore violates due process. The implied converse is that due process requires fair proceedings.

One aspect of the required fairness protects the autonomy of the criminal defendant. It rests on the common-sense truth that, at the end of the day, it is the defendant "who suffers the consequences if the defense fails."[125] So proper respect for the individual prevents the government from interfering with the manner in which the individual wishes to present a defense."[126] The

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122 *Id.* amend. VI.

123 287 U.S. 45 (1932).

124 *Id.* at 64.

125. *Faretta v. California*, 422 U.S. 806, 820 (1975).

126 This general rule against government interference with the defense is based on a presumption that the criminal defendant, "after being fully informed, knows his own best interests and does not need them dictated by the State." *Martinez v. Court of Appeal of Cal.*, 528 U.S. 152, 165 (Scalia, J., concurring).

underlying theme is that the government may not both prosecute a defendant and then seek to influence the manner in which he or she defends the case.

A defendant's right to control the manner and substance of the defense has several aspects. The defendant has the right to represent him- or herself,[127] even if such a decision objectively may appear to be unwise.[128] A defendant is guaranteed also "the right to be represented by an otherwise qualified attorney whom that defendant can afford to hire"[129] – in other words, to use his or her own assets to defend the case, free of government regulation. Nor may the government interfere at will with a defendant's choice of counsel, as the Constitution "protect[s] . . . the defendant's free choice independent of concern for the objective fairness of the proceedings."[130] Similarly, a defendant is generally free, within the procedural constraints that govern trials generally, to adduce evidence without unjustified restrictions[131] and may choose which witnesses to present

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127 *See, e.g., Faretta,* 422 U.S. at 820-21.

128 *See Martinez,* 528 U.S. at 165 (Scalia, J., concurring).

129 *Caplin & Drysdale, Chartered v. United States,* 491 U.S. 617, 624 (1989).

130 *United States v. Panzardi Alvarez*, 816 F.2d 813, 818 (1st Cir. 1987) (internal citation and quotation omitted); *see also Wilson v. Mintzes*, 761 F.2d 275, 279 (6th Cir. 1985) ("[R]ecognition of the right [to counsel of choice] also reflects constitutional protection of the accused's free choice").

See also United States v. Laura, 607 F.2d 52, 56 (3d Cir. 1979) (Higginbotham, J.) (" We would reject reality if we were to suggest that lawyers are a homogeneous group. Attorneys are not fungible, as are eggs, apples and oranges. Attorneys may differ as to their trial strategy, their oratory style, or the importance they give to particular legal issues. The differences, all within the range of effective and competent advocacy, may be important in the development of the defense. Given this reality, a defendant's decision to select a particular attorney becomes critical to the type of defense he will make and thus falls within the ambit of the sixth amendment.").

131 *See, e.g., Crane v. Kentucky*, 476 U.S. 683, 690-91 (1986) (error to foreclose defendant's efforts to adduce evidence about the circumstances of his confession; "In the absence of any valid state justification, exclusion of this kind of exculpatory evidence deprives a defendant

or cross-examine.[132] In short, fairness in criminal proceedings requires that the defendant be firmly in the driver's seat, and that the prosecution not be a backseat driver.[133]

The constitutional requirement of fairness in criminal proceedings not only prevents the prosecution from interfering actively with the defense, but also from passively hampering the defendant's efforts. As the Court put it in *California v. Trombetta*,[134]

> "Under the Due Process Clause . . . , criminal prosecutions must comport with prevailing notions of fundamental fairness. We have long interpreted this standard of fairness to require that criminal defendants be afforded a meaningful opportunity to present a complete defense. To safeguard that right, the Court has developed what might loosely be called the area of constitutionally guaranteed access to evidence. Taken together, this group of constitutional privileges delivers exculpatory evidence into the hands of the accused, thereby protecting the innocent from erroneous conviction and ensuring the integrity of our criminal justice system."[135]

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of the basic right to have the prosecutor's case encounter and survive the crucible of meaningful adversarial testing.") (internal citation and quotation omitted).

[132] *See, e.g., Chambers v. Mississippi*, 410 U.S. 284, 295 (1973).

This is not to say, of course, that defendants are free of appropriate regulation of such matters as the order of proof, the offering of cumulative evidence, and the length of presentations. *See United States v. Gonzalez-Lopez,* No. 05-352, 2006 U.S. LEXIS 5165, at *21-22 (June 26, 2006).

[133] *See also, e.g., Mayer v. City of Chicago*, 404 U.S. 189, 195-96 (1971) (denial of free transcripts to indigent misdemeanor appellants violated due process); *Bounds v. Smith*, 430 U.S. 817 (1977) (due process required that prisoners have an adequate opportunity to present their claims fairly); *cf. Davis v. Alaska*, 415 U.S. 308, 319-20 (1974) (Confrontation Clause required that defendant be permitted to cross-examine witness as to his juvenile criminal record; unfair to "require the petitioner to bear the full burden of vindicating the State's interest in the secrecy of juvenile criminal records").

[134] 467 U.S. 479 (1984).

[135] *Id.* at 485 (internal citations omitted).

Hence, the prosecution may not conceal exculpatory evidence or plea agreements with key government witnesses.[136] In some instances, it may be required to disclose the identity of its undercover informants in possession of evidence critical to the defense.[137]

Prosecutors are required also by the Due Process Clause to conduct themselves fairly. They may not delay intentionally indictments to prejudice defendants.[138] They may not obstruct defendants' access to a potential witness unless that is necessary to protect the witness's safety.[139] Nor may they knowingly offer perjured or false evidence.[140] Entrapment by prosecutors and law enforcement officers is proscribed by the Due Process Clause.[141] While prosecutors appropriately

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[136] *See Giglio v. United States,* 405 U.S. 150 (1972); *Brady v. Maryland*, 373 U.S. 83, 87 (1963); *see also United States v. Agurs*, 427 U.S. 97, 112 (1976) (prosecution has a constitutional duty to provide defendant with exculpatory evidence that would raise a reasonable doubt as to guilt).

[137] *See Roviaro v. United States*, 353 U.S. 53 (1957).

[138] *See, e.g., United States v. Lovasco,* 431 U.S. 783, 795 n.17 (1977); *United States v. Marion,* 404 U.S. 307, 324 (1971).

[139] See *United States v. Gonzales,* 164 F.3d 1285, 1292 (10th 1999) (defendants have "a right to be free from prosecution interference with a witness' freedom of choice about whether to talk to the defense")*; Int'l Bus. Mach. Corp. v. Edelstein,* 526 F.2d 37, 44 (2d Cir. 1975) (supporting "wholeheartedly" the conclusion that "constitutional notions of fair play and due process dictate that defense counsel be free from obstruction, whether it come from the prosecutor in the case or from a state official or another state acting under color of law") (*quoting Coppolino v. Helpern,* 266 F. Supp. 930 (S.D.N.Y.1967)); *Gregory v. United States,* 369 F.2d 185, 188 (D.C. Cir. 1966) (defendant denied a fair trial where prosecutor advised witnesses to the alleged crime not to speak to defense counsel outside the prosecutor's presence); *see also United States v. Muirs,* 145 Fed. Appx. 208, 209 (9th Cir. 2005) ("[G]overnment interference with defense access to witnesses implicates due process."); .

[140] *See, e.g., Briscoe v. LaHue,* 460 U.S. 325, 327 n.1 (1983); *Agurs,* 427 U.S. at 103 & nn. 8-9; *Napue v. Illinois,* 360 U.S. 264, 269 (1959); *Pyler v. Kansas,* 317 U.S. 213, 216 (1942); *Mooney v. Holohan,* 294 U.S. 103, 112 (1935).

[141] *See, e.g., Cox v. Louisiana,* 379 U.S. 559, 571 (1965); *Raley v. Ohio,* 360 U.S. 423, 426 (1959).

are given great latitude in the arguments they make to juries, they cross into unconstitutional territory when they "infect[] the trial with unfairness."[142]

Finally, the requirement of fairness in criminal proceedings applies to the structure and conduct of the entire criminal justice system. For example, the Court held that Dr. Sam Sheppard's due process rights were violated when the trial court failed to protect him from the firestorm of prejudicial publicity surrounding his trial.[143] It has recognized also the right to trial before an unbiased tribunal. In *Ward v. Village of Monroeville,*[144] for example, it held that a defendant was denied due process when he was tried for traffic offenses before the village mayor, who was responsible for village finances and whose court provided a substantial portion of village funds through fines, forfeitures, costs, and fees. Similarly, in *Tumey v. Ohio,*[145] the Court reversed a conviction because the judge was paid from fines levied in his court and therefore received payment only upon conviction. The Court said that such a system "deprives a defendant . . . of due process of law to subject his liberty or property to the judgment of a court, the judge of which has a direct, personal, substantial pecuniary interest in reaching a conclusion against him in his case."[146]

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142 *Darden v. Wainwright,* 477 U.S. 168, 181 (1986) (quoting *Donnelly v. DeChristoforo,* 416 U.S. 637, 643 (1974)).

143 *See Sheppard v. Maxwell*, 384 U.S. 333, 362-63 (1966).

144 409 U.S. 57 (1972).

145 273 U.S. 510 (1927).

146 *Id.* at 524; *see also Bracy v. Gramley,* 520 U.S. 899, 904-05 (1997) ("The Due Process Clause clearly requires a "fair trial in a fair tribunal before a judge with no actual bias against the defendant or interest in the outcome of his particular case.") (internal citations and quotation marks omitted); *Johnson v. Mississippi,* 403 U.S. 212, 215-216 (1971) (due process violated where judge presided over a case in which one of the defendants was a previously successful litigant against him); *In re Murchison,* 349 U.S. 133, 137-139 (1955) (due process violated by a judge presiding over a criminal trial of a defendant who he had indicted under the state's one-man grand jury procedure).

The Court's jurisprudence thus makes clear that defendants have the right, under the Due Process Clause, to fundamental fairness throughout the criminal process.

2. The Right to Fairness in the Criminal Process Is a Fundamental Liberty Interest Entitled to Substantive Due Process Protection Where, As Here, the Government Coerces a Third Party to Withhold Funds Lawfully Available to a Criminal Defendant

The Due Process Clause has been interpreted to provide not only procedural protection for deprivations of life, liberty, and property, but also substantive protection for fundamental rights – those that are so essential to individual liberty that they cannot be infringed by the government unless the infringement is narrowly tailored to serve a compelling state interest.[147]

"Only fundamental rights and liberties which are deeply rooted in this Nation's history and tradition and implicit in the concept of ordered liberty qualify for such protection."[148] The right to fairness in criminal proceedings has not been explicitly so characterized by the Court.[149] The question here, then, is whether and to what extent it properly is regarded as fundamental for purposes of requiring strict scrutiny of alleged impingements. A number of guides point the way.

To begin with, many of the Supreme Court's criminal due process decisions described above can be understood in modern terms most readily in the substantive due process and

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147 *See, e.g., Washington v. Glucksberg*, 521 U.S. 702, 721 (1997).

148 *Chavez v. Martinez*, 538 U.S. 760, 775 (2003) (internal citations omitted).

149 The rights thus far explicitly characterized by the Supreme Court as fundamental in this specialized sense fall into five rough categories: the rights to freedom of association, to vote and participate in the electoral process, to travel interstate, to fairness in procedures concerning individual claims against governmental deprivation of life, liberty, or property, and to privacy relating to freedom of choice in matters relating to an individual's personal life. *See* 2 RONALD D. ROTUNDA & JOHN E. NOWAK, TREATISE ON CONSTITUTIONAL LAW: SUBSTANCE AND PROCEDURE § 15.7 (1999) ("ROTUNDA & NOWAK").

strict scrutiny framework. The requirement of an unbiased tribunal, for example, is not found in the explicit language of the Constitution. It rests instead on the proposition that a fair tribunal is "implicit in the concept of ordered liberty."[150] The state's legitimate interest in, for example, saving money by having the same person both run a town's finances and levy traffic fines is insufficient to justify infringing upon the right to a fair trial. Thus, the Supreme Court's repeated recognition of the constitutional mandate of fairness in criminal proceedings strongly suggests that this right is "fundamental" for substantive due process purposes, at least in some circumstances. Indeed, it would be difficult to conclude otherwise. Our concern with protection of the individual against the unfair use of the great power of the government is "deeply rooted in this Nation's history and tradition."[151] "[N]either liberty nor justice would exist" if fairness to criminal defendants were sacrificed.[152] Indeed, as one court put it, "What can be more basic to the scheme of constitutional rights precious to us all than the right to fairness throughout the proceedings in a criminal case?"[153]

These considerations have led the Second Circuit[154] and several other courts (often in *dicta*),[155] as well as respected commentators,[156] to conclude that the right to fairness in criminal

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150 *Glucksberg,* 521 U.S. at 721 (internal citations and quotations omitted).

151 *Moore v. City of East Cleveland*, 431 U.S. 494, 503 (1977) (plurality opinion).

152 *Glucksberg,* 521 U.S. at 721 (internal citations and quotations omitted).

153 *United States v. Curran*, 724 F. Supp. 1239, 1241 (C.D. Ill. 1989), *rev'd on other grounds*, *United States v. Spears*, 965 F.2d 262 (7th Cir. 1992), *cert. denied*, 506 U.S. 989 (1992).

154 *See Quill v. Vacco*, 80 F.3d 716, 724 (2d Cir. 1996) (recognizing the right to fairness in a criminal proceeding as a fundamental liberty interest subject to substantive due process analysis), *rev'd on other grounds*, 521 U.S. 793 (1997).

155 *See, e.g., Doe v. Taylor Independent Sch. Dist.*, 15 F.3d 443, 479 n.6 (5th Cir. 1994) (dissenting opinion) ("right to fair criminal process"); *Ryder v. Freeman*, 918 F. Supp. 157, 161 (W.D.N.C. 1996) ("fundamental fairness in the criminal process"); *Boyd v. Bulala*, 647 F. Supp. 781, 787 (W.D. Va. 1986) ("right to fairness in the criminal process"), *rev'd in*

proceedings is a fundamental liberty interest subject to substantive due process protection. But it is not necessary or, in this Court's view, appropriate, to go that far in order to decide this case. It is a venerable maxim of constitutional construction that courts should decide no more than is necessary.[157] And the only question now before the Court is whether a criminal defendant has a right to obtain and use in order to prepare a defense resources lawfully available to him or her, free of knowing or reckless government interference.[158] Given all that has been said above, this Court concludes that such a right is basic to our concepts of justice and fair play. It is fundamental.[159]

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part on other grounds, 877 F.2d 1191 (4th Cir. 1989); *Grant v. City of Chicago*, 594 F. Supp. 1441, 1450 (D.C. Ill. 1984) ("[a]ccess to the complete criminal process"); *cf. Provident Mut. Life Ins. Co. of Philadelphia v. City of Atlanta*, 864 F. Supp. 1274, 1291 (N.D. Ga. 1994) (noting in equal protection analysis "the right to fairness in the criminal process").

156 *See* 2 ROTUNDA & NOWAK § 15.7 (right to fairness in criminal process implicitly recognized by the Court as fundamental); *see also, e.g.*, Gregory F. Intoccia, *Constitutionality of the Death Penalty Under the Uniform Code of Military Justice*, 32 A.F. L. REV. 395, 399 (1990) ("The Court views the right to fairness in the criminal process as fundamental and deserving of significant judicial protection."). *Cf.* Brad Snyder, *Disparate Impact on Death Row: M.L.B. and the Indigent's Right to Counsel at Capital State Postconviction Proceedings*, 107 YALE L. J. 2211, 2215 ("The two most frequently recognized fundamental equal protection rights are the right to vote and participate in elections and the right of access to the criminal process.").

157 *See, e.g., Ashwander v. Tenn. Valley Auth.,* 297 U.S. 288, 341 (1936) (Brandeis, J., concurring).

158 Indigent criminal defendants are entitled to competent defense representation. Serious questions have been raised about whether the means available for providing quality defenses for indigents are sufficient to accomplish that goal. *See, e.g., New York County Lawyers' Ass'n v. New York,*196 Misc.2d 761, 763, 763 N.Y.S.2d 397, 399 (Sup. Ct. N.Y. Co. 2003) (granting declaratory relief increasing the hourly compensation for counsel assigned to represent indigents in New York State criminal cases after finding that the state had "ignore[d] its constitutional obligation to the poor by failing to increase the assigned counsel rates, [resulting] in many cases, in the denial of counsel, delay in the appointment of counsel, and less than meaningful and effective legal representation"). If these criticisms are well-founded, remedial measures are not only desirable, but constitutionally may be required. But that is a question for another day.

159 It is crucial to note that the Court deals here with extrajudicial action by the government that deliberately or recklessly tilts the playing field against a criminal defendant. Such actions

3. The Government's Actions Violated the Substantive Due Process Right to Fairness in the Criminal Process

a. The Effect on the KPMG Defendants

The Thompson Memorandum and the USAO pressure on KPMG to deny or cut off defendants' attorneys' fees necessarily impinge upon the KPMG Defendants' ability to defend themselves.

This is by no means a garden-variety criminal case. It has been described as the largest tax fraud case in United States history. The government thus far has produced in discovery, in electronic or paper form, at least 5 million to 6 million pages of documents *plus* transcripts of 335 depositions and 195 income tax returns.[160] The briefs on pretrial motions passed the 1,000-page mark some time ago.[161] The government expects its case in chief to last three months, while defendants expect theirs to be lengthy as well.[162] To prepare for and try a case of such length requires substantial resources.[163] Yet the government has interfered with the ability of the KPMG

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have nothing in common with fair and neutral regulation of, for example, the conduct of a criminal trial, which naturally are not subjected to strict scrutiny.

160 Anderson Decl. [docket item 561] ¶¶ 24, 27, 38-39, 41.

161 Tr., Mar. 30, 2006, at 9:10-14.

162 *See, e.g., United States v. Stein*, S1 05 Crim. 0888 (LAK), 2006 WL 1126807 (S.D.N.Y. Apr. 4, 2006).

163 If one were to assume a six-month trial of 117 days and that a defendant were represented by a single lawyer, who devoted eight hours for each trial day, the cost at $400 per hour simply to attend the trial would be almost $375,000, without taking into account such other expenses as transcripts, copying, travel expenses, and the like. That figure, moreover, would be misleadingly low, as it is difficult to imagine that this case could be defended competently without spending as much time reviewing at least some of the 5 to 6 million pages of documents produced by the government and otherwise preparing as in attending the trial. It therefore is quite reasonable to assume that even a minimal defense of this case

Defendants to obtain resources they otherwise would have had. Unless remedied, this interference almost certainly will affect what these defendants can afford to permit their counsel to do. This would impact the defendants' ability to present the defense they wish to present by limiting the means lawfully available to them. The Thompson Memorandum and the USAO's actions therefore are subject to strict scrutiny.

b. The Thompson Memorandum and the USAO's Actions Fail the Strict Scrutiny Test

To survive strict scrutiny, government action must be narrowly tailored to achieve a compelling government interest.[164]

The portion of the Thompson Memorandum at issue here – the language that states that payment of legal fees for employees and former employees may be viewed as protection of culpable employees and thus cut in favor of indicting the entity – purportedly serves three goals. First, it is intended to facilitate just charging decisions concerning business entities by focusing on a consideration pertinent to gauging their degrees of cooperation. Second, it seeks to strengthen the government's ability to investigate and prosecute corporate crime by encouraging companies to pressure their employees to aid the government – recall Mr. Weddle's urging KPMG to tell its people to be "totally open" with the USAO, "even if that [meant admitting] criminal wrongdoing." Finally, it seeks to punish those whom prosecutors deem culpable – it attempts to justify depriving employees of corporate aid by characterizing it as "protecting . . . culpable employees and agents."

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could well cost $500,000 to $1 million, if not significantly more.

[164] *See, e.g., Glucksberg*, 521 U.S. at 721 (internal citations and quotations omitted).

The final justification may be disposed of quickly. The job of prosecutors is to make the government's best case to a jury and to let the jury decide guilt or innocence. Punishment is imposed by judges subject to statute. The imposition of economic punishment by prosecutors, before anyone has been found guilty of anything, is not a legitimate governmental interest – it is an abuse of power. The government's other points, however, are far more substantial.

Any government's interest in investigating and fairly prosecuting crime is compelling. The consequences for civilization of another government's failure to accomplish that basic end are on view on the evening news every day.

In order properly to accomplish that task, the government must have the ability to make just charging decisions and to prevent obstruction of its investigations. Hence, no one disputes the proposition that a willingness to cooperate with the government is an appropriate consideration in deciding whether to charge an entity. Nor does anyone suggest that an entity's obstruction of a government investigation – what the government has called "circling the wagons"[165] – should be ignored in a charging decision. Many remember the Watergate case, in which the legal fees of individuals who broke into the offices of the Democratic National Committee were paid, along with other "hush money," to buy the silence of the burglars and to protect higher-ups.[166] Corporate equivalents no doubt occur. But the devil, as always, is in the details.

The first difficulty is that the Thompson Memorandum does not say that payment of legal fees may cut in favor of indictment *only if* it is used as a means to obstruct an investigation.

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[165] Tr. (Neiman) 292:21-293:22; *see also* Tr. 409:20-25.

[166] *See United States v. Haldeman,* 559 F.2d 31, 55-57 (D.C. Cir. 1976), *cert. denied,* 431 U.S. 916, 933 (1977). *See also, e.g., United States v. Locascio,* 6 F.3d 924, 931-34 (2d Cir. 1993) (organized crime figure's payment of legal fees for crime family members appropriate proof of criminal enterprise).

Indeed, the text strongly suggests that advancement of defenses costs weighs against an organization independent of whether there is any "circling of the wagons."[167]

The USAO, possibly concerned with the breadth of the Thompson Memorandum, seeks to deal with this by asserting that, in practice, it considers the payment of legal fees as a negative factor only when payments are used to impede.[168] Perhaps so. But whatever the government may do in the privacy of U.S. Attorneys' offices and in the DOJ's Criminal Division is not what defense lawyers see. They see the Thompson Memorandum. Few if any competent defense lawyers would advise a corporate client at risk of indictment that it should feel free to advance legal fees to individuals in the face of the language of the Thompson Memorandum itself. It would be irresponsible to take the chance that prosecutors might view it as "protecting . . . culpable employees and agents." As KPMG's new chief legal officer, former U.S. District Judge Sven Erik Holmes, testified, he thought it indispensable (as would any defense lawyer) "to be able to say at the right time with the right audience, we're in full compliance with the Thompson Memorandum."[169]

The bottom line is plain enough. If the government means to take the payment of legal fees into account in making charging decisions only where the payments are part of an

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[167] The Thompson Memorandum's assessment of whether a company is cooperating includes an examination of whether "the corporation, while purporting to cooperate, has engaged in conduct that impedes the investigation." Thompson Memo at VI(A). The payment of legal fees is treated in a separate paragraph that focuses entirely on "whether the corporation appears to be protecting its culpable employees and agents." *Id.* at VI(B).

[168] Tr. 409:20-25.

[169] Docket item 544, Ex. B, at 74-75.

obstruction scheme – and thereby narrowly tailor its means to its ends – it would be easy enough to say so. But that is not what the Thompson Memorandum says.

The concerns do not end here. The argument that payment of legal fees to employees and former employees is relevant to gauging the extent of a company's cooperation also is problematic. There is no necessary inconsistency between an entity cooperating with the government and, at the same time, paying defense costs of individual employees and former employees. An entity may pay out of a judgment that extending this benefit will aid it in keeping and hiring competent and honest employees. It may pay in recognition that an employee caught up in an investigation, or even charged with a crime, because the employee did his or her job for the company has at least some claim to assistance, even in the absence of a legal right. In either case, however, a company may pay at the same time that it does its best to bare its corporate soul, stands at the government's beck and call to provide information and witnesses, and does a myriad of other things to aid the government and clean the corporate house. So it simply cannot be said that payment of legal fees for the benefit of employees and former employees necessarily or even usually is indicative of an unwillingness to cooperate fully. This is especially unlikely after employees have been indicted and fired, as is the situation here.

For these reasons, this aspect of the Thompson Memorandum is not narrowly tailored to achieve a compelling objective. It discourages and, as a practical matter, often prevents companies from providing employees and former employees with the financial means to exercise their constitutional rights to defend themselves. It does so in the face of state indemnification statutes that expressly permit businesses entities to provide those means because the states have determined that legitimate public interests may be served. It does so even where companies obstruct

nothing and, to the contrary, do everything within their power to make a clean breast of the facts to the government and to take responsibility for any offenses they may have committed. It therefore burdens excessively the constitutional rights of the individuals whose ability to defend themselves it impairs and, accordingly, fails strict scrutiny. The legal fee advancement provision violates the Due Process Clause.[170]

c. The Actions of the USAO

The actions of the USAO in this case compounded the problem that the Thompson Memorandum created.

The Thompson Memorandum says that the payment of legal fees (beyond any legal obligation) may be held against a business entity if the government views the payments as protection of "culpable employees" or as evidence of a lack of full and complete cooperation. The USAO took advantage of that uncertainty by emphasizing the threat.

Within days of receiving the criminal referral on February 5, 2004, the USAO put the payment of employee legal fees near the top of the government's agenda for the very first meeting with KPMG's lawyers. On February 25, 2004, Mr. Bennett reported that KPMG had

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[170] It makes no difference that the Thompson Memorandum is a policy of the DOJ and implemented by the USAO rather than legislation enacted by Congress. Due process requires that government action "through any of its agencies must be consistent with the fundamental principles of liberty and justice which lie at the base of our civil and political institutions, which not infrequently are designated as 'the law of the land.'" *DuBose v. Kelly,* 187 F.3d 999, 1004 (8th Cir. 1999) (quoting *Buchalter v. New York*, 319 U.S. 427, 429(1943)). The government cannot avoid strict scrutiny of actions that impinge upon the fundamental right of fairness in the criminal process simply by acting through DOJ policy rather than by statute or formal regulation. *See, e.g., Nicholson v. Williams*, 203 F. Supp.2d 153, 243 (E.D.N.Y. 2002) ("In considering the constitutionality of the policy or practice of a state agency rather than the specific acts of individual officers, it is appropriate to apply the higher standard and stricter analysis that is applied to legislation.").

cleaned house and pledged full cooperation with the government. But Mr. Weddle immediately raised the legal fee issue. When Mr. Bennett sought to elicit the USAO's view on that subject, the response was a reference to the Thompson Memorandum. This was followed later in the meeting by Ms. Neiman's statement, on the heels of a reference to payment of employee legal expenses, that misconduct should not be rewarded and Mr. Weddle's threat that the government would look at the payment of legal fees that KPMG was not legally obliged to pay "under a microscope." And it did all this despite the fact that it does not claim that KPMG obstructed its investigation, least of all by using the payment of legal fees to prevent employees or former employees from talking to the government or telling it the truth.

The individual prosecutors in the USAO acted pursuant to the established policy of the DOJ as expressed in the Thompson Memorandum. They understood, however, that the threat inherent in the Thompson Memorandum, coupled with their own reinforcement of that threat, was likely to produce exactly the result that occurred – KPMG's determination to cut off the payment of legal fees for any employees or former employees who were indicted and to limit and condition their payment during the investigative stage. Their actions cannot withstand strict scrutiny under the Due Process Clause because they too were not narrowly tailored to serving compelling governmental interests.

B. The Sixth Amendment Right to Counsel

1. The Nature and Scope of the Right to Counsel

Quite apart from the due process analysis, the KPMG Defendants argue that the Thompson Memorandum and its implementation by the government infringed their Sixth

Amendment right to counsel. They are correct.

The Sixth Amendment provides that "[i]n all criminal prosecutions, the accused shall enjoy the right to . . . have the Assistance of Counsel for his defence."[171] As already has been demonstrated, however, this guarantees more than the mere presence of a lawyer at a criminal trial. It protects, among other things, an individual's right to choose the lawyer or lawyers he or she desires[172] and to use one's own funds to mount the defense that one wishes to present.[173] Moreover, a defendant's exercise of his Sixth Amendment right to counsel is not to be feared or avoided by the government:

> "No system worth preserving should have to fear that if an accused is permitted to consult with a lawyer, he will become aware of, and exercise those rights. If the exercise of constitutional rights will thwart the effectiveness of a system of law enforcement, there is something very wrong with that system."[174]

The government nevertheless argues that the KPMG Defendants have no Sixth Amendment rights at stake here for two principal reasons.

a. Attachment of Sixth Amendment Rights

The government first argues that the Sixth Amendment right to counsel attaches only upon the initiation of a criminal proceeding. As the Thompson Memorandum was adopted and the USAO did its handiwork before the KPMG Defendants were indicted, it contends, there was no Sixth Amendment violation.

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171 U.S. CONST. amend VI.

172 *See, e.g., Wheat,* 486 U.S. at 164.

173 *Caplin & Drysdale, Chartered,* 491 U.S. at 624.

174 *Escobedo v. Illinois,* 378 U.S. 478, 490 (1964).

It is true, of course, that the Sixth Amendment right to counsel typically attaches at the initiation of adversarial proceedings – at an arraignment, indictment, preliminary hearing, and so on.[175] But the analysis can not end there. The Thompson Memorandum on its face and the USAO's actions were parts of an effort to limit defendants' access to funds for their defense. Even if this was not among the conscious motives, the Memorandum was adopted and the USAO acted in circumstances in which that result was known to be exceptionally likely. The fact that events were set in motion prior to indictment with the object of having, or with knowledge that they were likely to have, an unconstitutional effect upon indictment cannot save the government. This conduct, unless justified, violated the Sixth Amendment.[176]

The government argues that this conclusion will open the door for future defendants to argue that all sorts of pre-indictment actions violate the Sixth Amendment and thus hamstring every investigation and prosecution. This is singularly unpersuasive. The government here acted with the purpose of minimizing these defendants' access to resources necessary to mount their defenses or, at least, in reckless disregard that this would be the likely result of its actions. In these circumstances, it is not unfair to hold it accountable.

b. "Other People's Money"

The government next argues that the KPMG Defendants have no right, under the Sixth Amendment or otherwise, to spend "other people's money" on expensive defense counsel. The

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[175] *See Kirby v. Illinois*, 406 U.S. 682, 689-90 (1972); *see also, e.g., United States v. Ash*, 413 U.S. 300, 303 n.3 (1973).

[176] *Cf. United States v. Harrison*, 213 F.3d 1206, 1207 (9th Cir. 2000) (holding that ongoing pre-indictment attorney-client relationship, of which the government was aware, invoked the Sixth Amendment as a matter of law upon indictment).

rhetoric is appealing, but the characterization of the issue – and therefore the conclusion – are wrong.

The argument is based on *Caplin & Drysdale, Chartered v. United States*[177] and *United States v. Monsanto*,[178] which held that the Sixth Amendment does not creates a right for those in possession of property forfeitable to the United States to spend that money on their legal defense. That is hardly surprising – the money belongs to the government. But that is not the issue here.

Caplin & Drysdale recognized that the Sixth Amendment does protect a defendant's right to spend his own money on a defense.[179] Here, the KPMG Defendants had at least an expectation that their expenses in defending any claims or charges brought against them by reason of their employment by KPMG would be paid by the firm. The law protects such interests against unjustified and improper interference.[180] Thus, both the expectation and any benefits that would have flowed from that expectation – the legal fees at issue now – were, in every material sense, their property, not that of a third party. The government's contention that the defendants seek to spend "other people's money" is thus incorrect.

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177 491 U.S. at 619.

178 491 U.S. 600, 602 (1989).

179 491 U.S. at 624.

180 The torts of interference with prospective economic advantage and inducement of breach of contract are well known. *See generally Kirch v. Liberty Media Corp.,* No. 04-5852-CV, 2006 WL 1523036, at *10 (2d Cir. June 5, 2006); *Israel v. Wood Dolson Co.,* 1 N.Y.2d 116, 151 N.Y.S.2d 1 (1956). Interference with prospective economic advantage covers interference with the ability to pursue legal remedies against another party. *See, e.g., Reilly v. Natwest Mkts. Group, Inc.,* 178 F. Supp.2d 420, 429 (S.D.N.Y. 2001); *Ripepe v. Crown Equip. Corp.,* 293 A.D.2d 462, 463, 741 N.Y.S.2d 64, 66 (2d Dept. 2002); *Curran v. Auto Lab Svc. Ctr., Inc.,* 280 A.D.2d 636, 637, 721 N.Y.S.2d 662, 663 (2d Dept. 2001).

2. The Thompson Memorandum and the Government's Implementation Violated the KPMG Defendants' Sixth Amendment Right to Counsel

The KPMG Defendants have established that the government's implementation of the Thompson Memorandum impinged on their Sixth Amendment rights to counsel and to present a complete defense. Interference with these rights is improper if the government's actions are "wrongfully motivated or without adequate justification."[181] The remaining question, then, is whether justification exists.

There is not much case law on the standard to be applied in making this determination. In comparable circumstances, federal courts often have looked to the common law of torts to "enrich the [federal] jurisprudence"[182] and to provide "an appropriate starting point,"[183]

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[181] *Via v. Cliff*, 470 F.2d 271, 274-75 (3d Cir. 1972); *accord, United States v. Morrison*, 602 F.2d 529, 531 (3d Cir. 1979), *rev'd on other grounds*, 449 U.S. 361 (1981).

[182] *Adickes v. S. H. Kress & Co.,* 398 U.S. 144, 231-32 (1970) (Brennan, J., concurring and dissenting) ([W]here the wrong under [Section] 1983 is closely analogous to a wrong recognized in the law of torts, it is appropriate for the federal court to apply the relevant tort doctrines . . .").

[183] *Carey v. Piphus,* 435 U.S. 247, 257-58 (1978); *see also, e.g., Wilson v. Garcia,* 471 U.S. 261, 277 (1985) ("[W]e have found tort analogies compelling in establishing the elements of a cause of action under § 1983 . . . and in identifying the immunities available to defendants.") *superceded by statute on other grounds as recognized in Jones v. R.R. Donnelley & Sons Co.,* 541 U.S. 369 (2004); *Smith v. Wade,* 461 U.S. 30, 34 (U.S. 1983) ("In the absence of more specific guidance, we looked first to the common law of torts (both modern and as of 1871), with such modification or adaptation as might be necessary to carry out the purpose and policy of [Section 1983]."); *Imbler v. Pachtman*, 424 U.S. 409, 418 (1976) ("[Section] 1983 is to be read in harmony with general principles of tort immunities and defenses, rather than in derogation of them."); *Pierson v. Ray,* 386 U.S. 547, 556 (1967) ("[Section] 1983 should be read against the background of tort liability that makes a man responsible for the natural consequences of his actions.") (internal quotation marks omitted); *Singer v. Fulton County Sheriff,* 63 F.3d 110, 118 (2d Cir. 1995), *cert. denied,* 517 U.S. 1189 (1996); *Cook v. Sheldon,* 41 F.3d 73, 79 (2d Cir. 1994) (borrowing the elements for a claim of malicious prosecution under Section 1983 from state tort law); *Raysor v. Port Authority of New York and New Jersey,* 768 F.2d 34, 39-40 (2d Cir. 1985), *cert. denied,* 475 U.S. 1027 (1986); *All Aire Conditioning v. City of New York,* 979 F. Supp. 1010, 1020 n. 47 (S.D.N.Y. 1997), *aff'd,* 166 F.3d 1199 (1998); *C.A.U.T.I.O.N., Ltd. v. City of New York,* 898 F. Supp. 1065, 1072 (S.D.N.Y. 1995).

always keeping in mind that we do so to inform our construction of the Constitution, not to apply state tort law.[184]

The common law tort of interference with prospective economic advantage necessarily deals with the issue whether a private actor is justified in interfering in the economic relations of another. In assessing claims of justification in private settings, courts look to a series of factors including the relative importance of the interests served by the plaintiff and the defendant.[185] Making appropriate adjustments for the fact that this analysis involves the public sector, the dispositive question is whether the government's law enforcement interests in taking the specific actions in question sufficiently outweigh the interests of the KPMG Defendants in having the resources needed to defend as they think proper against these charges.

Our nation made a deliberate choice more than two centuries ago. We determined that a person charged with a crime has "the right in an adversary criminal trial to make a defense as we know it."[186] That choice rests on the premise that "partisan advocacy on both sides of a case will best promote the ultimate objective that the guilty be convicted and the innocent go free."[187]

The Thompson Memorandum discourages and, as a practical matter, often prevents companies from providing employees and former employees with the financial means to exercise their constitutional rights to defend themselves. This is so even where companies obstruct nothing and, to the contrary, do everything within their power to make a clean breast of the facts to the

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184 *Monroe v. Pape,* 365 U.S. 167, 187 (1961).

185 *See, e.g.,* RESTATEMENT (SECOND) OF TORTS § 767 (1979).

186 *Faretta,* 422 U.S. at 818.

187 *Herring v. New York,* 422 U.S. 853, 862 (1975).

government and to take responsibility for any offenses they may have committed. It undermines the proper functioning of the adversary process that the Constitution adopted as the mode of determining guilt or innocence in criminal cases. The actions of prosecutors who implement it can make matters even worse, as occurred here.

The Court holds that the fact that advancement of legal fees occasionally might be part of an obstruction scheme or indicate a lack of full cooperation by a prospective defendant is insufficient to justify the government's interference with the right of individual criminal defendants to obtain resources lawfully available to them in order to defend themselves, regardless of the legal standard of scrutiny applied.

3. *The KPMG Defendants Are Not Obliged to Establish Prejudice, Which in Any Case Would Be Presumed Here*

The government argues the KPMG Defendants' motion nevertheless should be denied because they have not shown prejudice under *Strickland v. Washington,*[188] which requires a defendant seeking to overturn his or her conviction based on ineffective assistance of counsel to show "a reasonable probability that, but for counsel's unprofessional errors, the result of the proceeding would have been different.'"[189] But the government is mistaken.

This conclusion follows from *United States v. Gonzalez-Lopez,*[190] a case involving a deprivation of the defendant's right to counsel of his choice. The Court there held that *Strickland* did not require a showing of prejudice in such a case because:

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[188] 466 U.S. 668, 692 (1984).

[189] *Id.* at 694.

[190] 2006 U.S. LEXIS 5165 at *4.

> "Deprivation of the right [to counsel of choice] is 'complete' when the defendant is erroneously prevented from being represented by the lawyer he wants, regardless of the quality of the representation he received. To argue otherwise is to confuse the right to counsel of choice – which is the right to a particular lawyer regardless of comparative effectiveness – with the right to effective counsel – which imposes a baseline requirement of competence on whatever lawyer is chosen or appointed."[191]

Here, the violation is analogous to that at issue in *Gonzalez-Lopez.* The government has interfered with the KPMG Defendants' right to be represented as they choose, subject to the constraints imposed by the resources lawfully available to them. This violation, like a deprivation of the right to counsel of their choice, is complete irrespective of the quality of the representation they receive. Thus, *Strickland* has no bearing here.[192]

This result is consistent with common sense. Improper government conduct has created a significant risk that the KPMG Defendants' ability to present the defense they choose has been compromised. Corrective action now may well prevent that. There is, in consequence, a countervailing interest in *not* going blindly forward with a lengthy trial, which will consume vast judicial and party resources, without dealing with the issue. No one would set out to drive across a desert with half a tank of gas, knowing that one might run out before reaching the other side, without pausing first to fill up the tank. The prudent course is to avoid the problem at the outset – not to take a chance on being stranded and then having to try to figure out what to do about it.

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[191] *Id.* at *15.

[192] This would have been so even before *Gonzalez-Lopez. Strickland* by its terms applies to "[a] convicted defendant's claim that counsel's assistance was so defective as to require reversal of a conviction." *Strickland,* 466 U.S. at 687. Its requirement of a showing that the result of the trial that ended in conviction would have been different but for counsel's substandard performance would have no bearing here in any case, as no trial yet has occurred. Moreover, the requirement that a convicted defendant in an ineffective assistance case demonstrate prejudice stems at least in significant part from the Court's appropriate concern with preserving the finality of convictions and with society's need to "justify reliance on the outcome of the proceeding." *Id.* at 692. As there has been no trial yet, the interest in finality is not implicated.

The approach to cases involving criminal defense counsel burdened by conflicts of interest supports this conclusion. A district court that learns before trial of a possible conflict of interest between a defense attorney and a client is obliged to protect the defendant's Sixth Amendment right to unconflicted legal representation by immediately investigating the conflict and, if necessary, either obtaining a knowing or intelligent waiver from the defendant or disqualifying the conflicted attorney.[193] The rationale for doing so is simple. Prejudice is likely in conflict situations, and "such circumstances involve impairments of the Sixth Amendment right that are easy to identify and, for that reason and because the prosecution is directly responsible, easy for the government to prevent."[194] That rationale is fully applicable here.

Even if prejudice were relevant at this stage of the proceedings, however, the government's argument still would fail. Although *Strickland* generally requires convicted defendants to demonstrate that the result of the trial probably would have been different but for the ineffective assistance of counsel, this requirement does not apply where a violation resulted in a "structural defect[] in the constitution of the trial mechanism"[195] that "affected – and contaminated – the entire criminal proceeding."[196] In other words, there are two distinct types of constitutional errors: trial errors, which occur during the presentation of evidence at trial, and structural errors,

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193 *See, e.g., Wheat,* 486 U.S. at 160; *United States v. Perez,* 325 F.3d 115, 125-26 (2d Cir. 2003); *United States v. Schwarz,* 283 F.3d 76, 95-96 (2d Cir. 2002); *United States v. Levy,* 25 F.3d 146, 153 (2d Cir. 1994); *United States v. Fulton,* 5 F.3d 605, 612-13 (2d Cir. 1993); *United States v. Curcio,* 680 F.2d 881, 888-90 (2d Cir. 1982); *United States v. Scala,* No. S1 04 Cr. 0070 (LAK), 2006 WL 1589772, at *2-4 (S.D.N.Y. June 12, 2006).

194 *Strickland*, 466 U.S. at 692.

195 *Arizona v. Fulminante,* 499 U.S. 279, 309 (1991).

196 *Satterwhite v. Texas,* 486 U.S. 249, 257 (1988); *see also Brecht v. Abrahamson,* 507 U.S. 619, 629-30 (1993); *United States v. Cronic,* 466 U.S.648, 658 (1984).

which are overarching and permeate the entire proceeding.[197] As trial errors occur during the presentation of a case to the jury, they "may . . . be quantitatively assessed in the context of other evidence presented in order to determine whether" their commission "was harmless beyond a reasonable doubt."[198] Structural errors, on the other hand, "defy analysis by 'harmless-error' standards."[199] They affect "[t]he entire conduct of the trial from beginning to end."[200] Prejudice "is so likely that case-by-case inquiry into prejudice is not worth the cost."[201]

Structural defects exist – and prejudice must be presumed – where a defendant is actively or constructively denied counsel at a critical stage of the trial or where defense counsel is burdened by an actual conflict of interest.[202] Structural errors "may be present [also] on some occasions when, although counsel is available to assist the accused during trial, the likelihood that any lawyer, even a fully competent one, could provide effective assistance is so small that a presumption of prejudice is appropriate without inquiry into the actual conduct of the trial."[203] In *Powell v. Alabama,* for example, the trial court, on the day of the trial, appointed an attorney from a different state – who professed himself to be unfamiliar with the facts of the case and the local procedure – to represent defendants in a highly publicized capital case. The Supreme Court held

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197 *Fulminante,* 499 U.S. at 307-10.

198 *Id.* at 307-08.

199 *Id.* at 309.

200 *Id.* at 310.

201 *Strickland,* 466 U.S. at 692 (citing *Cronic,* 466 U.S. at 658); *accord, Fulminante,* 499 U.S. at 309-10; *see also Lainfiesta v. Artuz,* 253 F.3d 151, 157 (2d Cir. 2001).

202 *See, e.g., Cronic,* 466 U.S. at 659 & n.25 & n.28; *Fulminante,* 499 U.S. at 309-10; *Strickland,* 466 at 692; *Cuyler* v. *Sullivan,* 446 U.S. 335, 349-50 (1980).

203 *Cronic,* 466 U.S. at 659-60.

that the likelihood that counsel could have performed as an effective advocate in those circumstances was so remote as to render the trial inherently unfair, obviating the requirement that the defendants affirmatively demonstrate prejudice.[204]

Although the circumstances here differ from those in *Powell,* the government's conduct threatens to contaminate this proceeding. Properly defending this case, in all its complexity, has required, and will continue to require, substantial financial resources. The government has spent years investigating the case, presumably reviewing millions of pages of documents[205] and interviewing scores of witnesses if not more. The KPMG Defendants, however, have limited resources. Although each defendant is represented by retained counsel, the government's interference almost inevitably has affected at least some lawyer selections and, equally important, limited what the KPMG Defendants can pay their lawyers to do. At least most of them likely will be unable to afford to pay their attorneys to review all or even most of the documents the government has produced or, perhaps, to interview even a fraction of the witnesses the government has interviewed. They may not be able to afford tax experts to advise trial counsel and, if need be, answer those whom the government may present at trial.

In these circumstances, demonstrating prejudice after the fact would be all but impossible. In order to show that the trial outcome would have been different had a convicted defendant been able to afford better preparation before trial, the defendant's counsel, after conviction, would have to do the work that the defendant could not afford to have done in the first

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[204] 287 U.S. at 53.

[205] The government thus far has produced, in electronic or paper form, at least 5 to 6 million pages of documents *plus* transcripts of 335 depositions and 195 income tax returns. Anderson Decl. [docket item 561] ¶¶ 24, 27, 38-39, 41.

place. If the defendant could not afford to have the work done in the first place, the defendant certainly could not afford to have it done after conviction. And relying upon the possibility of counsel appointed under the Criminal Justice Act to do so, should a convicted defendant have become indigent, simply would be unrealistic. In any case, assessing the impact of pretrial omissions and errors could require extensive evidentiary proceedings. In consequence, it is difficult to imagine circumstances in which an error more properly could be said to threaten to taint an entire proceeding.

This conclusion too is supported by *Gonzalez-Lopez*. Speaking of a deprivation of the right to counsel of choice, the Supreme Court wrote:

> "We have little trouble concluding that erroneous deprivation of the right to counsel of choice, 'with consequences that are necessarily unquantifiable and indeterminate, unquestionably qualifies as "structural error."' Different attorneys will pursue different strategies with regard to investigation and discovery, development of the theory of defense, selection of the jury, presentation of the witnesses, and style of witness examination and jury argument. And the choice of attorney will affect whether and on what terms the defendant cooperates with the prosecution, plea bargains, or decides instead to go to trial. In light of those myriad aspects of representation, the erroneous denial of counsel bears directly on the 'framework within which the trial proceeds,' – or indeed on whether it proceeds at all. It is impossible to know what different choices the rejected counsel would have made, and then to quantify the impact of those different choices on the outcome of the proceedings. Many counseled decisions, including those involving plea bargains and cooperation with the government, do not even concern the conduct of the trial at all. Harmless-error analysis in such a context would be a speculative inquiry into what might have occurred in an alternate universe."[206]

The same reasoning applies here. Virtually everything the defendants do in this case may be influenced by the extent of the resources available to them. There simply would be no way to know, after the fact, whether the outcome had been influenced by limitations improperly placed upon the availability of resources.

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[206] 2006 U.S. LEXIS 5165 at *18-19 (internal citations omitted).

Further, the government's interference in the KPMG Defendants' ability to mount a defense "creates an appearance of impropriety that diminishes faith in the fairness of the criminal justice system in general."[207] This injury to the criminal justice system is not dependent on whether or not the KPMG Defendants ultimately are convicted or – more to the point – whether they would have been convicted even if the government had not interfered with their constitutional right to counsel.

Accordingly, there is no need for a particularized showing of prejudice here. While a defendant does not have a constitutional right to the most expensive lawyer or to unlimited defense funds, government interference with those resources that a defendant does have or legally may obtain fundamentally alters the structure of the adversary process. As the late Judge Wyzanski explained, although "'a criminal trial is not a game in which the participants are expected to enter the ring with a near match in skills, neither is it a sacrifice of unarmed prisoners to gladiators.'"[208]

The considerations that support a presumption of prejudice – the government's responsibility for the problem and the ease with which the trial court can detect and remedy that problem prior to trial – both are present here. The government is responsible for the infringement of the KPMG Defendants' rights. The problem has been detected, and it probably is susceptible of cure before trial. Were the Court to refrain from seeking to remedy the problem now, it would abdicate its responsibility to safeguard defendants' constitutional rights.

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[207] *Young v. United States ex rel. Vuitton et Fils S.A.,* 481 U.S. 787, 811 (1987); *see also Offutt v. United States,* 348 U.S. 11, 14 (1954) ("[J]ustice must specify the appearance of justice.").

[208] *Cronic,* 466 U.S. at 657 (quoting *United States ex rel. Williams v. Twomey,* 510 F.2d 634, 640 (7th Cir. 1975).

III. It is Premature to Consider the Government's Actions With Respect to Payment of Legal Expenses Incurred Before Indictment

The KPMG Defendants argue also that the government's actions with respect to advancement of legal fees interfered with their rights prior to indictment. But the preindictment interference must be evaluated in a very different context.

To begin with, the legal analysis differs. The Sixth Amendment attaches only upon indictment. Actions by the government that affected only the payment of legal fees and defense costs for services rendered prior to the indictment therefore do not implicate the Sixth Amendment. Any relief must be grounded in the Due Process Clause alone.

Second, the impact of the government's actions was quite different. KPMG paid attorneys' fees prior to indictment for all of the KPMG Defendants on condition that the employees cooperate with the government. There is no suggestion that any defendant reached the $400,000 cap save Mr. Stein, and KPMG ignored the $400,000 ceiling in his case until very late in the day. In consequence, there is no reason to suppose that the ability of any of the KPMG Defendants to undertake activities designed to ward off an indictment was impaired by the government's actions save in one respect – at least some of the KPMG Defendants made proffers to the government that they conceivably would not have made had they not induced to do so by the threat of having payment of their legal fees cut off. These proffers are of significance only if they may be used at trial, either on the government's case in chief or, perhaps more importantly, to cross examine a defendant who testifies on the defense case. This has an important consequence.

The Supreme Court has made clear that remedies for constitutional violations "should be tailored to the injury suffered . . . and should not unnecessarily infringe on competing interests,"

including the interest in the administration of criminal justice.[209] Its "approach has thus been to identify and then neutralize the taint by tailoring relief appropriate in the circumstances to assure the defendant the effective assistance of counsel and a fair trial."[210] Hence, if the government's pressure on KPMG ultimately resulted in improperly coerced statements, the matter may be fully redressed by suppression of the statements.

The question whether the statements should be suppressed is before the Court on another motion by the KPMG Defendants that has not yet been fully briefed. Accordingly, it would be premature to address it here.

IV. The Remedy

The next question concerns the appropriate remedy for the violation of the KPMG Defendants' constitutional rights. Defendants ask the Court to dismiss the indictment or to order payment of their legal fees either by the government or by KPMG. The government argues that any relief should be limited to requiring KPMG to consider anew whether it wishes to advance expenses to the defendants, now free of the threat of government retaliation by virtue of the government's recent statement that it does not object to KPMG doing as it pleases.

The Court rejects the government's alternative. The government's belated statement that KPMG may do as it wishes without government retribution is not sufficient to put the KPMG Defendants in the position they would have enjoyed had the government not interfered with the advancement of defense costs in the first place. It ignores altogether the Court's finding that KPMG

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209 *United States v. Morrison,* 449 U.S. at 365.

210 *Id.*

would have advanced defense costs absent the government's interference. It ignores KPMG's possible interest in not being seen to reverse course and thus as admitting that it caved in to government pressure in this respect at the expense of individual members and employees of the firm. It ignores also the fact that circumstances have changed dramatically since KPMG, under government pressure, decided in 2004 to cut off anyone who was indicted. KPMG has yielded to the government's demand that the firm pay a fine of $456 million. The individual defendants have been indicted on charges the full scope of which may not previously have been foreseeable to KPMG. Thus, the defense costs that KPMG is being asked to advance perhaps are larger than might earlier have been foreseeable. The resources available to pay them have been reduced. Accordingly, the Court is not persuaded that the damage the government has done can be remedied by now leaving KPMG to do as it pleases. So the Court moves on to the appropriate remedies for the government's actions.

As discussed above, remedies for constitutional violations should be tailored narrowly to the injury suffered.[211] Dismissal of an indictment on the grounds of prosecutorial misconduct is an "extreme and drastic sanction"[212] that should not even be considered unless it is otherwise "impossible to restore a criminal defendant to the position that he would have occupied" but for the misconduct.[213]

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[211] *Morrison,* 449 U.S. at 365.

[212] *United States v. Rubio,* 709 F.2d 146, 152 (2d Cir. 1983) (internal citations omitted); *see also Morrison,* 449 U.S. at 366 n.3 (citing *United States v. Blue,* 384 U.S. 251, 255 (1966)); *United States v. Estrada,* 164 F.3d 619, 621 (2d Cir. 1998); *United States v. Fields,* 592 F.2d 638, 647-48 (2d Cir.1978), *cert. denied,*442 U.S. 917 (1979).

[213] *United States v. Artuso,* 618 F.2d 192, 196-97 (2d Cir. 1980), *cert. denied,*449 U.S. 879 (1980); *see also Carmichael v. United States,* 216 F.3d 224, 227 (2d Cir. 2000).

The KPMG Defendants can be restored to the position they would have occupied but for the government's constitutional violation if defense costs already incurred and yet to be incurred are paid. Indeed, although the KPMG Defendants have not conceded that dismissal would be inappropriate as long as they are put in funds for their defense, they have devoted most of their attention to monetary relief. In consequence, consideration of dismissal of the indictment would be premature prior to exhaustion of all possible courses that could lead to that outcome.

A. Monetary Relief Against the Government Is Precluded by Sovereign Immunity

The first avenue suggested is an order directing the government to pay. But the KPMG Defendants immediately run into the doctrine of sovereign immunity.

"Absent an express waiver of sovereign immunity, money awards cannot be imposed against the United States."[214] Only Congress may waive sovereign immunity, and it may do so only through unequivocal statutory language.[215]

The KPMG Defendants first contend that monetary sanctions against the government pursuant to the Court's supervisory powers would not be money damages and therefore are not barred by sovereign immunity. But they point to no statute that specifically waives sovereign immunity from monetary sanctions imposed pursuant to supervisory power of the federal courts. They imply instead that supervisory powers automatically trump sovereign immunity, even absent

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[214] *McBride v. Coleman,* 955 F.2d 571, 576 (8th Cir. 1992); *see also Ruckelshaus v. Sierra Club,* 463 U.S. 680, 685-686 (1983); *United States v. Bodcaw Co.,* 440 U.S. 202, 203 n.3 (1979); *United States v. Waksberg,* 112 F.3d 1225, 1227 (D.C. Cir. 1997)*; Robinson v. Overseas Military Sales Corp.,* 21 F.3d 502, 510 (2d Cir. 1994).

[215] *See, e.g., United States v. King,* 395 U.S. 1, 5 (1969); *Samuels, Kramer & Co. v. Comm'r of Internal Revenue,* 930 F.2d 975, 983 (2d Cir. 1991).

a waiver.

A number of federal courts have addressed the interplay between sovereign immunity and the judiciary's power to impose monetary sanctions for litigation abuse.[216] Although the Second Circuit has not reached the precise question, the First Circuit's analysis in *United States v. Horn*[217] is instructive. There, the district court had used its supervisory powers to order the government to pay the defendants' legal fees and costs as punishment for prosecutorial misconduct. The First Circuit, however, reversed, explaining that "sovereign immunity ordinarily will trump supervisory power in a head-to-head confrontation" because

> "supervisory powers are discretionary and carefully circumscribed; [whereas] sovereign immunity is mandatory and absolute . . . In other words, unlike the doctrine of supervisory power, the doctrine of sovereign immunity proceeds by fiat: if Congress has not waived the sovereign's immunity in a given context, the courts

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[216] *See, e.g., United States v. Woodley,* 9 F.3d 774, 782 (9th Cir. 1993) (noting that courts may impose monetary sanctions on the government – notwithstanding sovereign immunity – in order to remedy the violation of a recognized right and ensure that "government attorneys maintain ethical standards," but holding that monetary sanctions were inappropriate in this case and noting that other remedies are more appropriate); *Coleman v. Espy,* 986 F.2d 1184, 1191-92 (8th Cir. 1993) (sovereign immunity bars compensatory contempt sanctions against the United States); *McBride,* 955 F.2d at 576-77 (noting that the district court's imposition of compensatory contempt sanctions against the government likely violated the doctrine of sovereign immunity, but reversing on other grounds); *Barry v. Bowen,* 884 F.2d 442, 443-44 (9th Cir. 1989) (noting that the district court's imposition of compensatory contempt sanctions against the government likely violated the doctrine of sovereign immunity, but reversing on other grounds); *Yancheng Baolong Biochemical Prods. Co., Ltd. v. United States,* 343 F. Supp. 2d 1226, 1241 (Ct. Int'l Trade 2004) (collecting cases and holding that award of attorneys' fees against the government was barred by sovereign immunity); *United States v. Prince,* No. CR 93-1073 (RR), 1994 WL 99231, *1-*2 (E.D.N.Y. Mar. 10, 1994) (withdrawing assessment of jury costs against U.S. Attorney's Office under court's supervisory power, in the face of a motion for reconsideration arguing constraints imposed by sovereign immunity); *see also Waksberg,* 112 F.3d at 1227-28 (invoking the doctrine of constitutional avoidance to defer review of the district court's finding that sovereign immunity barred the award of compensatory damages against the United States).

[217] 29 F.3d 754, 767 (1st Cir. 1994).

are obliged to honor that immunity."[218]

This Court agrees. Accordingly, monetary sanctions do not overcome sovereign immunity.

The KPMG Defendants next argue that the Federal Tort Claims Act[219] (the "FTCA") and the Administrative Procedure Act[220] (the "APA") waive sovereign immunity. Each, however, waives sovereign immunity only for certain civil actions against the government.[221] Neither deals with sanctions for prosecutorial misconduct. The KPMG Defendants point to no case law suggesting that the FTCA and APA waivers apply in this context, and the Court is aware of none. Given the Court's obligation to construe narrowly any statutory waiver of sovereign immunity,[222]

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218 *Id.* at 764.

The *Horn* court noted also that courts have means apart from monetary sanctions by which to punish prosecutorial misconduct, including public reprimand and other equitable relief. *Id.* at 767.

219 28 U.S.C. § 1346.

220 5 U.S.C. § 702.

221 The FTCA waives sovereign immunity in "civil actions on claims against the United States, for money damages, accruing on and after January 1, 1945, for injury or loss of property, or personal injury or death caused by the negligent or wrongful act or omission of any employee of the Government while acting within the scope of his office or employment, under circumstances where the United States, if a private person, would be liable to the claimant in accordance with the law of the place where the act or omission occurred." 28 U.S.C. § 1346(b).

The APA waives immunity in "action[s] in a court of the United States seeking relief other than money damages and stating a claim that an agency or an officer or employee thereof acted or failed to act in an official capacity or under color of legal authority." 5 U.S.C. § 702.

222 "Waivers of immunity must be construed strictly in favor of the sovereign and not enlarge[d] . . . beyond what the language requires." *Ruckelshaus,* 463 U.S. at 686 (internal citations and quotation marks omitted); *Lehman v. Nakshian,* 453 U.S. 156, 161 (1981). Courts must strictly construe also any limitations or conditions imposed by Congress on a particular waiver of immunity. *Id.* at 160-61.

it would be inappropriate to read the FTCA or the APA as waiving the government's immunity to monetary sanctions in this case.

Accordingly, sovereign immunity bars this Court from ordering the government to pay the KPMG Defendants' legal fees.[223] This is not the end of the analysis, however. As the First Circuit explained in *Horn,* "[t]he fact that sovereign immunity forecloses the imposition of monetary sanctions against the federal government in criminal cases does not leave federal courts at the mercy of cantankerous prosecutors. Courts have many other weapons in their armamentarium."[224] The Court therefore turns to other options, addressing first the possibility of monetary relief against KPMG.

B. Monetary Relief May Be Available Against KPMG

The KPMG Defendants urge the Court to order KPMG to advance their defense costs. KPMG, which is not formally a party here but which has been heard in any case, resists on several grounds.

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223 The KPMG Defendants attempt to avoid this conclusion by asking the Court to order the government to pay their defense costs out of the $256 million fine it already has received from KPMG or to order KPMG to pay the $200 million final installment of the fine into the registry of the Court, where so much as is required to pay the defense costs would be distributed to the KPMG Defendants and the balance to the government. They appear to argue that either remedy would be injunctive in nature and not a monetary sanction against the government. Sovereign immunity, however, "stands as an obstacle to virtually all direct assaults against the public fisc, save only those incursions from time to time authorized by Congress." *Horn,* 29 F.3d at 761. The relief the KPMG Defendants have requested here would be no less an assault on the public fisc simply because it would be addressed to a fine already received by the government or monies to which the government already is entitled. Put another way, requiring the government to pay the money from a particular account or to forego revenues to which it is entitled would not make such relief any less a monetary sanction.

224 29 F.3d at 766.

1. This Court Has Subject Matter Jurisdiction

Federal courts are courts of limited jurisdiction. They have only such judicial power as is conferred upon them by statute and, in the case of the Supreme Court, Article III of the Constitution.[225]

The Court's subject matter jurisdiction in this case rests on Section 3231 of the Criminal Code,[226] which gives "[t]he district courts of the United States . . . original jurisdiction, exclusive of the courts of the States, of all offenses against the laws of the United States." And it is well established that a district court having subject matter jurisdiction over a federal criminal case has ancillary jurisdiction over at least some related matters.[227]

Our Circuit recently addressed the scope of ancillary jurisdiction in criminal cases in *Garcia v. Teitler.*[228] The question there presented was whether a district court had jurisdiction to order an attorney who had appeared and then withdrawn as counsel for the defendants, and who was not a party to the action, to return a retainer the defendants had paid him so that the defendants could retain another attorney to defend the case. The Court held that it did, writing:

> "At its heart, ancillary jurisdiction is aimed at enabling a court to administer 'justice within the scope of its jurisdiction.' Without the power to deal with issues ancillary or incidental to the main action, courts would be unable to 'effectively dispose of the principal case nor do complete justice in the premises.' Along these lines, the Supreme Court has instructed that ancillary jurisdiction may be exercised 'for two separate, though sometimes related, purposes: (1) to permit disposition of claims that are, in varying respects and degrees, factually interdependent by a single

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225 *See, e.g., Ins. Corp. of Ireland, Ltd. v. Compagnie des Bauxites de Guinee,* 456 U.S. 694, 701-02 (1982); *W.G. v. Senatore,* 18 F.3d 60, 64 (2d Cir. 1994).

226 18 U.S.C. § 3231.

227 *See Garcia v. Teitler,* 443 F.3d 202, 208 (2d Cir. 2006).

228 *Id.*

> court, and (2) to enable a court to function successfully, that is, to manage its proceedings, vindicate its authority, and effectuate its decrees."
>
> "Whatever the outer limits of ancillary jurisdiction may be, we hold that resolving a fee dispute after an attorney withdraws . . . is within a district court's ancillary powers, as it relates to the court's ability to 'function successfully.' * * *
>
> "Although [defendants] have been able to obtain new counsel, the record reflects that they are of limited means and that the funds paid to Teitler may be needed to pay their new counsel. In order to guarantee a defendant's right to choose his own counsel where, as here, his criminal case is ongoing, and to avoid the possibility of defendants becoming indigent and requiring the appointment of counsel, a district court must be able to exercise ancillary jurisdiction to resolve a fee dispute."[229]

So too here. While the KPMG Defendants all are represented by retained counsel, the cost of mounting their defenses in this complex case is potentially very large. In order to guarantee their right to choose their own counsel, to ensure that they can afford to pay those counsel to do what they think appropriate to defend the case, and to avoid the possibility of their becoming indigent and requiring the appointment of counsel, this Court has the power to exercise ancillary jurisdiction to resolve their right to the advancement of expenses by KPMG.[230] This is confirmed by *United States v. Weissman,*[231] cited with approval in *Garcia,* in which Judge Haight exercised ancillary jurisdiction to determine whether a company that formerly employed an individual who was facing criminal charges in this Court was obliged to continue to advance the defense costs.

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[229] *Id.* at 208, 209 (internal citations omitted).

[230] The Court need not here decide whether its ancillary jurisdiction includes the power to determine whether KPMG is obliged to indemnify the KPMG Defendants or, if not, whether the KPMG Defendants would be obliged to repay any funds advanced to them. The immediate concern is with the Court's power to ensure that the KPMG Defendants, if they are entitled to it, have the means to finance the defense before this Court.

[231] 1997 WL 334966 at *9.

Accordingly, the Court holds that it has ancillary jurisdiction to determine the claims of the KPMG Defendants for advancement. As Judge Gleeson did in *Garcia,* the Court will direct the Clerk, as a matter of administrative convenience, to open a civil docket number for the claims of the KPMG Defendants against KPMG.[232]

2. Personal Jurisdiction, Even If It Does Not Already Exist, May Be Obtained Over KPMG

The fact that the Court has subject matter jurisdiction is not alone sufficient to proceed with the claims. KPMG objects that it is not a party to this action and that the Court lacks jurisdiction over its person.

KPMG of course is not a defendant in this case.[233] Nevertheless, it long has been well aware of these proceedings. It attended the hearing and submitted papers. But it never has been served with a summons and complaint seeking advancement of legal fees.

There is reason to question whether the lack of a summons and complaint, which ordinarily would be fatal in a garden-variety civil case,[234] should have that consequence in the unique circumstances here.[235] But it is unnecessary to go down that path, which in any case would

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[232] *Garcia v. Teitler,* No. 04 Civ. 0832 (JG), 2004 WL 1636982, *1 n.2 (E.D.N.Y. July 22,2004), *aff'd,* 443 F.3d 202 (2d Cir. 2006).

[233] It is a defendant in a related action in this district, that commenced by the filing of the information pursuant to the DPA. *United States v. KPMG LLP,* 05 Crim. 0903 (LAP) (filed Aug. 29, 2005).

[234] *See, e.g., OSRecovery, Inc. v. One Group Int'l, Inc.,* 234 F.R.D. 59, 60-61 (S.D.N.Y. 2005).

[235] Some states, at least in the past, held that a defendant who appeared in an action for any purpose consented to the exercise of personal jurisdiction, *See York v. Texas,* 137 U.S. 15 (1890). To amerliorate this rule, many adopted statutes or rules permitting a defendant who wished to challenge the exercise of personal jurisdiction to appear specially for that purpose alone without thereby appearing generally. *See id.* at 20; *see also, e.g., Orange Theatre*

threaten to complicate and perhaps delay the important determination that may lie within this Court's province – whether KPMG must at least advance defense costs to the KPMG defendants.

The KPMG Defendants, if so advised, may file a complaint in the civil file opened pursuant to this decision, obtain the issuance of a summons, and serve KPMG provided they do so within 14 days of the date of this decision. The complaint may contain a prayer for declaratory relief and a request for a speedy hearing,[236] which would be appropriate in any case in view of the fact that the determination of rights to advancement is made in summary proceedings[237] in order to permit

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Corp. v. Rayherstz Amusement Corp., 139 F.2d 871, 874 (3d Cir. 1944). Even in such states, any action before the court beyond challenging the exercise of jurisdiction constitutes a general appearance and waives the jurisdictional objection. *See, e.g., Regents of the Univ. of Calif. v. Golf Mktg., LLC,* 92 Conn. App. 378, 381-82, 885 A.2d 201, 203 (2005) (party who seeks relief on any basis other than a motion to quash for lack of personal jurisdiction deemed to have made general appearance and waived all objections to defects in service, process, or personal jurisdiction) (California law) (quotation marks omitted); *Davis v. Eighth Jud. Dist. of Nevada,* 97 Nev. 332, 334-36, 629 P.2d 1209, 1211-12 (1981) (opposition to motion for leave to amend waived special appearance and subjected party to personal jurisdiction), *arbrogated by statute as recognized in Hansen v. Eighth Jud. Dist. of Nevada,* 116 Nev. 650, 655-56, 6 P.3d 982, 985 (2000); *Woods v. Billy's Automotive,* 622 S.E.2d 193, 197 (N.C. App. 2005) ("[I]f a party invoked the judgment of the court for any other purpose [than contesting service of process] he made a general appearance and by so doing he submitted himself to the jurisdiction of the court whether he intended to do so or not.") (citation and internal quotation marks omitted); *Lyren v. Ohr,* 271 Va. 155, 158-59, 623 S.E.2d 883, 884-85 (2006) (appearance for any purpose other than objecting to the jurisidiction is general appearance even if denominated "special"); *Maryland Cas. Co. v. Clintwood Bank, Inc.,* 155 Va. 181, 186, 154 S.E. 492, 494 (1930) (any action by defendant, except an objection to jurisdiction, recognizing a case as in court is general appearance). The Federal Rules of Civil Procedure, and many modern state codes, go further, abolishing the distinction between general and special appearances and permitting a defendant to preserve a personal jurisdiction objection by answer or timely motion to dismiss. These rules, however, do not apply in a criminal case. It therefore is arguable that KPMG's actions before the Court constituted a general appearance and thus waived any objection to personal jurisdiction.

236 FED. R. CIV. P. 57.

237 *See* 6 WEST'S DEL. CODE ANN. § 145(k) (2006); N.Y. BUS. CORP. L. §§ 724(a), 1319(a)(4) (McKinney 2003). *See generally* Steven A. Radin, *"Sinners Who Find Religion": Advancement of Litigation Expenses to Corporate Officials Accused of Wrongdoing,* 25 REV. LITIG. 251, 263-68 (2006) (hereinafter "Radin") (summarizing Delaware cases on

the issue to be decided while the underlying case is pending.[238] Should that occur, the matter would proceed expeditiously.[239]

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summary nature of advancement proceedings).

The scope of an advancement proceeding "is limited to determining 'the issue of entitlement according to the corporation's advancement provisions and not to issues regarding the movant's alleged conduct in the underlying litigation.'" *Kaung,* 884 A.2d at 509 (Del. 2005) (quoting *Homestore, Inc. v. Tafeen,* 886 A.2d 502, 503 (Del. 2005)). "Neither indemnification nor recoupment of sums previously advanced are appropriate for litigation in a summary proceeding" and necessarily would be reserved for subsequent proceedings, possibly in another forum. Radin, 25 REV. LITIG. at 265-66. In any case, although it is unnecessary to decide the issue now, it is questionable whether the Court's ancillary jurisdiction extends beyond determining the right to advancement.

There is no jurisdictional obstacle to a federal court determining advancement under state law. *See, e.g., Truck Components Inc. v. Beatrice Co.,* 143 F.3d 1057, 1061 (7th Cir. 1998).

[238] The Federal Rules of Criminal Procedure state that they "are to be interpreted for the just determination of every criminal proceeding, to secure simplicity in procedure and fairness in administration, and to eliminate unjustifiable expense and delay." FED. R. CRIM. P. 2. Likewise, the Federal Rules of Civil Procedure, which govern "all suits of a civil nature," are to "be construed and administered to secure the just, speedy, and inexpensive determination of every action." FED. R. CIV. P. 1. Accordingly, the Court will treat the papers already filed by the KPMG Defendants as a motion for an order directing KPMG to advance the defense costs reasonably incurred and to be incurred by them from the date of the indictment forward. It will consider the papers already filed by KPMG as an opposition to that motion. KPMG may file such additional response as it wishes within 14 days after the date of service of any summons and complaint.

[239] The Court is mindful of KPMG's contention that those of the KPMG Defendants who were partners in the firm are obliged by the partnership agreement to arbitrate the issue of advancement. Assuming that the KPMG Defendants pursue relief against KPMG and that KPMG remains insistent upon its alleged arbitration remedy, the questions whether the arbitration clause properly is so construed and, if so, whether it is void as against public policy to the extent that it would foreclose an advancement determination in a criminal case by the court in which the indictment is pending will be addressed in any advancement proceeding the KPMG Defendants may bring pursuant to this decision.

C. Possible Dismissal and Other Remedies

A summary advancement proceeding is not the only means by which the KPMG Defendants might be restored to the position they would have occupied had the government not interfered improperly with their prospects for advancement of defense costs.

The government has substantial influence and, almost certainly, power over KPMG by virtue of the cooperation clauses in the DPA. It may well be in its interest to use that influence or power to cause KPMG to advance the defense costs.[240]

Nor is KPMG lacking in incentives, if it needs them, to aid the government in solving the problem the government created for itself. The government now may seek to use its leverage against KPMG to cause KPMG to advance defenses costs in order to avoid any risk of dismissal of this indictment or other unpalatable relief. Moreover, KPMG may conclude that obstruction of the efforts of its former partners and employees to obtain advancement of defense costs, or even a prompt adjudication of their right to such advancement, would not further its interest in recruiting and retaining top flight personnel.

Thus, there are at least two possibilities for resolving the issue of advancement of defense costs. KPMG, either on its own or at the government's urging or insistence, may advance the defense costs. Alternatively, the KPMG Defendants may succeed in obtaining an advancement

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[240] Among other avenues open to the government if it were disposed to seek to remedy the problem it has created might be to persuade KPMG to eliminate obstacles to prompt resolution of the advancement issue. KPMG might, for example, waive any right that it may have to compel its former partners to arbitrate, or to claim a jury trial on, the question whether the KPMG Defendants are entitled to advancement of defense costs. Such a waiver need not affect any claims by the KPMG Defendants for indemnification (as distinguished from advancement) by KPMG or any claims that KPMG may have against the KPMG Defendants, neither of which would be a proper subject of a summary advancement proceeding in any event.

order in a summary proceeding before this Court. In either event, the effect of the government's unconstitutional interference would have been remedied or, at least, mitigated substantially. Should that come to pass, the possibilities of dismissal of the indictment and other remedies likely would appear in a different light. In consequence, the Court declines to consider additional relief at this time, although it may do so in the future if KPMG does not, for one reason or another, advance defense costs.

V. Some of the Actions of the USAO in Response to the Motion Were Not Appropriate

The foregoing discussion of remedies is addressed solely to the unconstitutional interference with the KPMG Defendants' prospects of obtaining advancement of defense costs from KPMG. One matter remains – the actions of the USAO in resisting this motion.

The Court begins from a widely held premise. We long have been well-served by the United States Attorney's office for this district and by the many lawyers who have served in it with great distinction. It is a model for the nation.[241] While the office's actions in this case with respect to the advancement of attorneys' fees contributed to an unconstitutional result, they were consistent with policies established in Washington. Moreover, they occurred at a time when the propriety of those policies had not previously been addressed by any court. The Court declines to chastise the office or its members further on the basis of those actions. There is, however, one matter that should be addressed.

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[241] *See generally* Lewis A. Kaplan, *Henry L. Stimson Award Ceremony: Remarks,* 54 RECORD OF THE ASS'N OF THE BAR OF THE CITY OF NEW YORK 420 (1999).

The government was economical with the truth in its early responses to this motion. It is difficult to defend even the literal truth of the position it took in its first memorandum of law. KPMG's decision on payment of attorneys' fees was influenced by its interaction with the USAO and thus cannot fairly be said to have been a decision "made by KPMG alone," as the government represented. The government's assertion that the legal fee decision was made without "coercion" or "bullying" by the government can be justified only by tortured definitions of those terms. And while it is literally true, as Mr. Weddle wrote in his later declaration, that the government did not "instruct" or "request" KPMG to do anything with respect to legal fees, that was far from the whole story. Those submissions did not even hint at Mr. Weddle's raising of the legal fee issue at the very first meeting, at Ms. Neiman's "rewarding misconduct" comment, at Mr. Weddle's statement that the USAO would look at the payment of legal fees "under a microscope," or at the government's use of KPMG's willingness to cut off payment of legal fees to pressure KPMG personnel to waive their Fifth Amendment rights and make proffers to the government. Those omissions rendered the declaration and the brief that accompanied it misleading.

Every court is entitled to complete candor from every attorney, and most of all from those who represent the United States. These actions by the USAO are disappointing. There should be no recurrence.

Conclusion

The Thompson Memorandum's treatment of advancement of defense costs no doubt serves the government's interest in obtaining criminal convictions in complex business cases. So

too the actions of the USAO in this case. But the government's proper concern is not with obtaining convictions.

As a unanimous Supreme Court wrote long ago, the interest of the government "in a criminal prosecution is not that it shall win a case, but that justice shall be done."[242] Justice is not done when the government use the threat of indictment – a matter of life and death to many companies and therefore a matter that threatens the jobs and security of blameless employees[243] – to coerce companies into depriving their present and even former employees of the means of defending themselves against criminal charges in a court of law. If those whom the government suspects are culpable in fact are guilty, they should pay the price. But the determination of guilt or innocence must be made fairly – not in a proceeding in which the government has obtained an unfair advantage long before the trial even has begun.

The motions of the KPMG Defendants to dismiss the indictment or for other relief are granted only to the extent that:

1. The Court declares that so much of the Thompson Memorandum and the activities of the USAO as threatened to take into account, in deciding whether to indict KPMG, whether KPMG would advance attorneys' fees to present or former employees in the event they were indicted for activities undertaken in the course of their employment interfered with the rights

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[242] *Berger v. United States,* 295 U.S. 78, 88 (1935); *see also, e.g., Brady*, 373 U.S. at 87 ("Society wins not only when the guilty are convicted but when criminal trials are fair; our system of the administration of justice suffers when any accused is treated unfairly. An inscription on the walls of the Department of Justice states the proposition candidly under the federal domain: 'The United States wins a point whenever justice is done its citizens in the courts.'").

[243] The indictment of Arthur Andersen LLP resulted in the effective demise of that large accounting firm, and the loss of many thousands of jobs of innocent employees, long before the case ever went to trial.

of such employees to a fair trial and to the effective assistance of counsel and therefore violated the Fifth and Sixth Amendments to the Constitution.

2. The government shall adhere to its representation that any payment by KPMG of the defense costs of the KPMG Defendants is acceptable to the government and will not be considered in determining whether KPMG has complied with the DPA or otherwise prejudice KPMG.

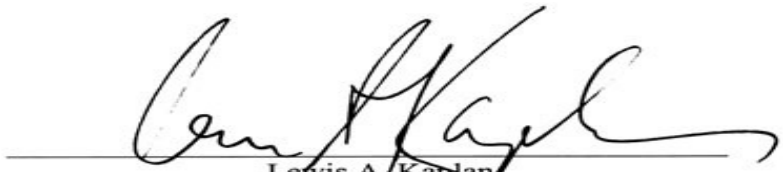
3. The Clerk shall open a civil docket number to accommodate the claims of the KPMG Defendants against KPMG for advancement of defense costs should they elect to pursue them. If they file a complaint within 14 days, the Clerk shall issue a summons to KPMG. The Court in that event will entertain the claims pursuant to its ancillary jurisdiction over this case.

The motions are denied insofar as they seek monetary sanctions against the government. The Court reserves decision as to whether to grant additional relief.

The foregoing constitute the Court's findings of fact and conclusions of law.

SO ORDERED.

Dated: June 26, 2006



Lewis A. Kaplan
United States District Judge

(The manuscript signature above is not an image of the signature on the original document in the Court file.)

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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UNITED STATES OF AMERICA,

-against- S1 05 Crim. 0888 (LAK)

JEFFREY STEIN, et al.,

Defendants.

- x

OPINION

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LEWIS A. KAPLAN, *District Judge.*

The government threatened to indict, and thus to destroy, the giant accounting firm, KPMG LLP ("KPMG"). It coerced KPMG to limit and then cut off its payment of the legal fees of KPMG employees. KPMG avoided indictment by yielding to government pressure. Many of its personnel did not. They now await trial, four of them deprived of counsel of their choice and most of the others unable to afford the defenses that they would have presented absent the government's interference.

This Court previously held that the government's interference with KPMG's payment of the legal fees of its employees and former employees violated the employees' constitutional rights. The government now concedes that thirteen of the sixteen individuals formerly employed by KPMG (the "KPMG Defendants") are entitled to dismissal, assuming that this Court's previous ruling correct. But the government does not concede the correctness of that ruling.[43] Accordingly, the Court has reconsidered *Stein I* carefully in light of the government's arguments. It remains convinced that the ruling was correct. Indeed, additional evidence not previously considered strongly supports the Court's decision. The government, however, now has focused for the first time on the specific circumstances of certain of these defendants. The Court concludes that three of the defendants have not established that KPMG would have paid their defense costs even if the government had left KPMG to its own devices. The indictment therefore will be dismissed as to thirteen of the sixteen

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[43] In an appeal from another decision in this case, the government challenges certain of the Court's factual findings as clearly erroneous and disputes its legal conclusions. Appellant's brief ("Govt. App. Br."), *United States v. Stein*, No. 06-3999 (2d Cir. filed Nov. 16, 2006) 46 *et seq.* Citations herein to "A" and "SA" refer, respectively, to the Joint Appendix and Supplemental Appendix filed with the Second Circuit in this appeal.

Citations herein to "K," "U," and "DX" refer to documents introduced into evidence at the fee hearing.

KPMG Defendants. The case will proceed to trial on the charges against the other three as well as two additional defendants who never were employed by KPMG and whose rights therefore were not violated.

I. Introduction

The indictment charges nineteen defendants, seventeen of them formerly partners or employees of KPMG, with conspiracy and tax evasion.[1] It asserts also that KPMG, which entered into a deferred prosecution agreement with the government, was an unindicted co-conspirator.

This Court held in *Stein I*[2] that the government violated the Fifth and Sixth Amendment rights of the KPMG Defendants by causing KPMG to depart from its prior practice of paying the legal expenses of KPMG personnel in all cases in which they were sued in consequence of their activities on behalf of the firm. It found that KPMG would have paid those expenses – whether legally obliged to do so or not – but for the government's improper actions. The Court, however, deferred the request of the KPMG Defendants to dismiss the indictment, reasoning that dismissal might prove inappropriate if KPMG were obligated to advance the defense costs. In that case, all or much of the harm caused and still threatened by the government's actions might be remedied or avoided. The Court held that it had ancillary jurisdiction over the KPMG Defendants' claims against KPMG for advancement of defense costs and permitted the assertion of those claims in this case.[3] The Court of Appeals,

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[1] Three defendants are charged also with obstruction in violation of 26 U.S.C. § 7212 and 18 U.S.C. § 2.

One of the nineteen, a former KPMG employee, has pleaded guilty.

[2] *United States v. Stein*, 435 F. Supp. 2d 330 (S.D.N.Y. 2006).

[3] *Id.* at 377-78.

however, recently held that this Court lacks ancillary jurisdiction with respect to the fee advancement claims against KPMG.[4] Other efforts to resolve this question have failed.[5] In consequence, the matter is before the Court on the renewed applications of the KPMG Defendants to dismiss the indictment on the basis of the government's violations of their constitutional rights. Before proceeding to the question of remedy, however, the Court first addresses the government's principal attack on *Stein I*, its claim that the decision rests on clearly erroneous findings of fact.

II. The Factual Bases of the Court's Constitutional Holdings

The government challenges three pivotal factual findings upon which *Stein I* rests, viz.:

- "[T]he 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 [United States Attorney's Office ("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."[6]

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[4] *Stein v. KPMG, LLP*, 486 F.3d 753 (2d Cir. 2007).

[5] The Court months ago referred KPMG and the KPMG Defendants to the Honorable Miriam Goldman Cedarbaum for the purpose of exploring the possibility of settling the claims of the KPMG Defendants against KPMG for advancement of their defense costs in this case. That effort was unsuccessful. The Court nevertheless is grateful to Judge Cedarbaum for her characteristically gracious, skilled and determined effort.

[6] *Stein I*, 435 F. Supp. 2d at 352.

- "[T]he USAO did not give KPMG the comfort it sought. To the contrary, it deliberately . . . 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. [Assistant United States Attorney ("AUSA")] Weddle raised the issue [at the February 25, 2004 meeting] 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. [AUSA] Neiman's statement, in response to a comment about payment of legal fees by KPMG, that misconduct should not be rewarded quite reasonably was understood in the same vein, whatever its intent. And Mr. Weddle's colorful warning that the USAO would look at any discretionary payment of fees by KPMG 'under a microscope' drove the point home."[7]
- "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

[7] *Id.* at 352-53.

employees both prior to and after indictment, without regard to cost."[8]

A. The Thompson Memorandum

The government argues first that the Court misinterpreted the Thompson Memorandum. The Memorandum did not, the government contends, discourage payment of legal fees for company employees by increasing the risk of indictment of a company under investigation that chooses to make such payments.[9] The Court disagrees. Not only is the Court's reading of the document correct, and in any case certainly well within the bounds of its role as fact finder,[10] but it is a reading shared by the Bar in general and KPMG's counsel in particular.

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[8] *Id.* at 353.

The Court, although it would have reached the same result and made the findings summarized above in *Stein I* in any case, found also that "the government," as evidenced in part by the Thompson Memorandum as well as certain actions by the USAO, "conducted itself in a manner that evidenced a desire to minimize the involvement of defense attorneys." *Id.* The Court has reconsidered that finding in light of the government's recent arguments and adheres to it.

[9] *See* Govt. App. Br. at 47-56.

[10] Even if the document were ambiguous, and it is not, the resolution of that ambiguity would present a question of fact committed to the trial judge. *See K. Bell & Assocs., Inc. v. Lloyd's Underwriters*, 97 F.3d 632, 637 (2d Cir. 1996) ("Where there are alternative, reasonable constructions of a contract, *i.e.*, the contract is ambiguous, the issue 'should be submitted to the trier of fact.'") (quoting *Consarc Corp. v. Marine Midland Bank, N.A.*, 996 F. 2d 568, 573 (2d Cir. 1993)); *Easton v. Pub. Citizens, Inc.*, No. 91 Civ. 1639 (JSM), 1991 WL 280688, at *2 (S.D.N.Y. Dec. 26, 1991) ("[I]f the Court finds that the wording in the [documents] is ambiguous, then the finder of fact must determine how to interpret it.") (citing *Davis v. Ross*, 754 F.2d 80, 82-83 (2d Cir.1985)).

1. The Text

The Thompson Memorandum, before it was superseded following *Stein I*,[11] made cooperation with a government investigation a factor to be considered in deciding whether to indict a corporation or other business entity. It stated that "[i]n gauging the extent of the corporation's cooperation, the prosecutor may consider the corporation's willingness to identify the culprits within the corporation, including senior executives; to make witnesses available; to disclose the complete results of its internal investigation; and to waive attorney-client and work product protection."[12] It then went on to say:

> "Another factor to be weighed by the prosecutor is whether the corporation appears to be protecting its culpable employees and agents. Thus, while cases will differ depending on the circumstances, a corporation's promise of support to culpable employees and agents, *either through the advancing of attorneys fees*, through retaining the employees without sanction for their misconduct, or through providing information to the employees about the government's investigation pursuant to a joint defense agreement, may be considered by the prosecutor in weighing the extent and value of a corporation's cooperation."[13]

The Thompson Memorandum thus made clear that advancing attorneys' fees to personnel of a

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[11] On December 12, 2006, the Department of Justice ("DOJ") issued a revised version of the Thompson Memorandum, known as the McNulty Memorandum. Under the guidelines set forth in the McNulty Memorandum, "[p]rosecutors generally should not take into account whether a corporation is advancing attorneys' fees to employees or agents under investigation and indictment," with exceptions to occur only in "extremely rare cases." McNulty Memorandum at 11 & n.3, *available at* http://www.usdoj.gov/dag/speeches/2006/mcnulty_memo.pdf.

[12] Thompson Memorandum at 6, *available at* http://www.usdoj.gov/dag/cftf/business_organizations.pdf.

[13] *Id.* at 7-8 (emphasis added, footnote omitted).

It contained also the following footnote: "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." *Id.* at 8 n.4.

business entity under investigation, except where such advances were required by law, might have been viewed by the government as protection of culpable individuals and thus contribute to a government decision to indict the entity.

The government nevertheless argues that there was no evidence that the Thompson Memorandum discouraged companies from paying employees' legal fees by increasing the perceived risk of indictment for companies that did so.[14] It suggests that there was no reason to believe that the defense bar – including KPMG's counsel – ever read the Thompson Memorandum to convey such a threat.[15] Indeed, it argues that "none of the prosecutors read the Thompson Memorandum in this way."[16] They construed the document, the government says, to mean that "the payment of legal fees [wa]s considered only when the Government believed such payments were part of an effort to 'circle the wagons,' an effort to appear cooperative while protecting culpable employees."[17]

The Thompson Memorandum is inconsistent with the government's argument. It says clearly that, "depending on the circumstances, a corporation's . . . advancing of attorneys fees" could be viewed as "protecting its culpable employees and agents." The government's "circle the wagons" gloss simply is not in the text. Any competent lawyer reading the document would regard a corporate client that was under investigation as being at greater risk of indictment if it advanced legal fees to employees who might be viewed by prosecutors as culpable than if it did not advance legal

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[14] Govt. App. Br. 47-48.

[15] *See id.* at 52-53.

[16] *Id.* at 51.

[17] *Id.*

fees. That is the plain meaning of the language.[18] The Justice Department itself undoubtedly recognized this when, following *Stein I*, it changed it in the McNulty Memorandum.[19] But this reading of the plain language of the document is supported by far more.

2. The Bar's Understanding of the Thompson Memorandum

There can be no serious doubt that the Bar, as the Court properly inferred from the text of the Thompson Memorandum and the testimony of KPMG's then-deputy general counsel,[20] read the Thompson Memorandum as discouraging payment of legal fees for company employees under investigation by holding out the prospect that doing so would increase the risk of indictment. This view is supported by an abundance of published statements and literature, including

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[18] This appears to be the view taken by the only other decision to have addressed the question, where the district court, though finding no constitutional violation on the facts, stated that its determination was "in no way an endorsement of the Thompson Memorandum policy directive with respect to an organization's payment or advancement of attorney fees for employees who are targets or subjects of criminal investigations. Indeed, that policy is unquestionably obnoxious in general and is fraught with the risk of constitutional harm in specific cases." *United States v. Rosen*, 487 F. Supp. 2d 721, 737 (E.D. Va. 2007).

[19] *See* supra note 11.

[20] Joseph Loonan testified as follows:

"Q. Okay. From the time when you first got involved in the investigation and began at KPMG, did you have an understanding that KPMG was going to need to cooperate in the government's investigation in order to have a chance of avoiding indictment? A. It was my understanding that the government's guidelines expected entities to cooperate in investigations.

"Q. Did you understand that that was one of the factors that the Department of Justice would consider in deciding whether to indict KPMG? A. Yes.

"Q. Did you understand that one aspect of cooperation that was specifically spelled out in the Thompson memo was the company's attitude toward payment of legal fees for persons who were accused by the government of wrongdoing? [colloquy omitted] A. Yes." Tr., May 8, 2006 (Loonan) 134:2-18.

(a) Former U.S. Attorney General Edwin Meese III:

"Even if no prosecutor ever mentions [waiving attorney-client privilege and cutting off payment of employees' attorney fees] to a company, the fact that the Thompson Memorandum requires federal prosecutors to take all nine of its factors into consideration when deciding whether to indict a business organization necessarily places great pressure on the company to take these two steps. As the Thompson Memorandum itself emphasizes, a 'prosecutor generally has wide latitude in determining when, whom, how, and even whether to prosecute' a business organization. The company and its counsel know that the prosecution team will eventually go through each of the nine factors point by point. Any outright 'No' in response to whether the company has cooperated with one of the factors will be glaringly apparent."[21]

(b) KPMG Lead Counsel Robert Bennett:

"[T]he Thompson memorandum makes clear that corporations that cooperate in the prosecution of employees stand a greater chance of avoiding corporate indictment.

* * *

"Where . . . it appears that criminal conduct occurred, it generally is advisable to not advance fees. Indeed, to do so may be construed by the government as a lack of cooperation by the corporation, an impediment to its investigation, and an indication of a failure of corporate responsibility."[22]

(c) ABA President Karen J. Mathis:

"[T]he Thompson Memorandum encourages prosecutors to deny cooperation credit to companies and other organizations that assist or support their so-called 'culpable

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[21] Edwin Meese III, Statement Before the United States Senate Committee on the Judiciary Regarding the Thompson Memorandum's Effect on the Right to Counsel in Corporate Investigations (Sept. 12, 2006) ("Meese Senate Statement"), *available at* http://judiciary.senate.gov/testimony.cfm?id=2054&wit_id=5741.

[22] Robert S. Bennett et al., *The Role of Internal Investigations in Defending Corporations Against Charges of Foreign Bribery* (Skadden, Arps, Slate, Meagher & Flom LLP, Washington, D.C.), 2005 at 17, 19, *available at* http://skaddenpractices.skadden.com/fcpa/index.php?documentID=28&sectionID=32.

employees and agents' who are the subject of investigations by . . . providing or paying for their legal counsel."[23]

(d) The American College of Trial Lawyers:

"Defense counsel and their clients increasingly find government resistance to corporate efforts to advancing attorneys' fees to individual employees once a government investigation has been commenced. Although individuals under investigation or charged by the government are entitled to obtain qualified, independent counsel without interference from the government, federal prosecutors frequently object to a corporation providing counsel for its employees and penalizes [sic] the company for not cooperating with the government investigation.

* * *

"[T]he guidance recently issued to federal prosecutors in the Holder Memo Standards[24] could, and does, generate interference with the principle that non-government employees facing government investigation or prosecution are entitled to qualified, competent representation. Today, it is common for defense counsel to be confronted by a federal prosecutor who believes that a corporation is not fully cooperating with the government in a federal criminal investigation solely because the corporation is paying the legal fees for an officer, director or employee."[25]

(e) The United States Chamber of Commerce:

"Federal investigators often object to the payment by corporations of the legal fees for their employees. The Thompson memorandum specifically identifies advancement of legal fees to employees as a negative factor when deciding whether a company has cooperated with the government. This policy deals a serious blow

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[23] Karen J. Mathis, Statement Before the Committee on the Judiciary of the United States Senate Concerning the Thompson Memorandum's Effect on the Right to Counsel in Corporate Investigations (Sept. 12, 2006), *available at* http://judiciary.senate.gov/testimony.cfm?id=2054&wit_id=5742.

[24] The part of the Holder memorandum addressed here was identical to the corresponding part of the Thompson Memorandum. Tr., May 9, 2006 (Neiman) 266:7-11.

[25] American College of Trial Lawyers, *The Erosion of the Attorney-Client Privilege and Work Product Doctrine in Federal Criminal Investigations*, 41 DUQ. L. REV. 307, 331, 335 (2003).

> to the ability of employees to vindicate their legal rights without suffering financial ruin."[26]

(f) Law Review Articles:

Law review articles echo this understanding of the Thompson Memorandum. One article, written shortly after the Thompson Memorandum issued, bluntly framed the dilemma facing corporations:

> "The renewed emphasis [of the Thompson Memorandum] on total, quick, and effective cooperation leaves little doubt that any corporation posturing itself for leniency in the form of non-prosecution should consider a contingency plan early on in the process of an internal investigation that contemplates . . . carefully examining governing law on indemnification of legal representation expenses and the advancing of attorneys fees to employees that become subjects of the government's inquiry . . . .
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> * * *
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> "The Thompson Memo seems to create an uncomfortable choice for the corporation: cooperate (i.e., turn over all witness interviews and other evidence gathered during the course of the internal investigation, make employees available to the government for witness interviews, desist from entering into joint defense agreements with employees, *refrain from advancing legal fees to employees that may have violated [the] law*, and discipline employees that may have violated the law) and hope to escape indictment, or close ranks and prepare the defense. *The four corners of the policy leave little room for compromise between these bipolar extremes.*"[27]

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[26] United States Chamber of Commerce, Testimony Before the American Bar Association Task Force on Attorney-Client Privilege (Feb. 22, 2005), *available at* http://www.abanet.org/buslaw/attorneyclient/publichearing20050211/testimony/chamberofcommerce.pdf.

[27] Lawrence D. Finder, *Internal Investigations: Consequences of the Federal Deputation of Corporate America*, 45 S. TEX. L. REV. 111, 116-17 (2003) (emphasis added); *see also* Peter J. Henning, *Targeting Legal Advice*, 54 AM. U. L. REV. 669, 699 (2005) (noting that the Thompson Memorandum's fee advancement factor means "a corporation that does not immediately turn on a potentially culpable employee has not cooperated and may suffer an indictment itself"); Petra M. Reinecke & Douglas R. Schwartz, *The Perils, Pitfalls and Possible Demise of the Joint Defense Agreement in the Context of Shipboard Criminal Investigations and Prosecutions*, 17 U.S.F. MAR. L.J. 29, 40-41 (2005) ("Both the Holder and Thompson Memoranda specifically authorize a prosecutor to view the advancement of

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In sum, KPMG and its counsel knew from the Thompson Memorandum, even before they first communicated with the USAO, that the payment of the legal fees of KPMG employees, in the absence of a legal obligation to do so, would increase the risk of indictment of the firm, as prosecutors might view that action as protecting culpable employees. So the Court turns to the government's next contention, viz. that KPMG conditioned and then cut off payment of legal fees entirely on its own, "not cowed by" the Thompson Memorandum and the actions of the USAO.

B. The Thompson Memorandum and the USAO's Actions Caused KPMG to Limit and Then Cut Off Payment of Fees

The government argues that KPMG formulated its own policy on payment of attorneys fees – the government had nothing to do with it. "*KPMG*," it asserts, "began the [February 25, 2004] meeting by volunteering that the firm had decided to change course and now intended to cooperate fully and completely, and later announcing its intention to 'not pay legal fees for

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> legal fees for 'culpable' employees as lack of cooperation by the company, and to factor this into the decision as to whether to charge the company. Since a decision to retain counsel and advance legal fees to its [employees] often must be made long before there is a sufficient factual basis upon which to assess the individual's 'culpability,' the prosecutorial standards unfairly prejudice the company, impermissibly chill the individual's right to independent counsel, and directly contravene statutes enacted by the vast majority of states expressly authorizing, or even requiring, advancement of legal fees to corporate agents and employees.") (footnotes omitted); Carmen Couden, Note, *The Thompson Memorandum: A Revised Solution or Just a Problem?*, 30 J. CORP. L. 405, 420 (2005) ("[T]he Thompson Memorandum poses difficulties for employees who contracted for the company's payment of their legal fees in the event of a lawsuit. . . . Once the company is forced to withdraw its support, its employees are left to fend for themselves in any ensuing legal battles that may develop.") (footnotes omitted).

employees who declined to cooperate with the Government,' but to pay otherwise."[28] In other words, "even assuming that the USAO communicated . . . 'that it did not want KPMG to pay legal fees,' the evidence is uncontested that KPMG, apparently not cowed by any such communication, ignored that desire and went ahead and paid the fees, subject to terms and conditions of its own devising."[29] The government's argument is unpersuasive.

1. The Thompson Memorandum Influenced KPMG Even Before the February 25, 2004 Meeting Took Place

As an initial matter, the contention that the Thompson Memorandum had no effect on KPMG's actions cannot be squared with the evidence or with the government's concession to this Court.

The record fully establishes KPMG's specific and entirely understandable desire to do whatever it could to come within the Thompson Memorandum's definition of a cooperative company.[30] As KPMG's new chief legal officer, former U.S. District Judge Sven Erik Holmes, testified in a civil deposition received in evidence in the fee hearing, he thought it indispensable "to be able to say, at the right time with the right audience, we're in full compliance with the Thompson

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[28] Govt. App. Br. at 57 (emphasis in original).

[29] *Id.*

[30] Among other things, despite the fact that KPMG had entered into a severance agreement with defendant Stein that expressly obligated the firm to pay his defense costs, DX 6, ¶ 13 [SA6-7]; *Stein I*, 435 F. Supp. 2d at 339, it ultimately cut off payments because, according to Joseph Loonan, then KPMG's deputy general counsel, KPMG "thought it would help [the firm] with the government." Tr., May 9, 2006 (Loonan) 196:13-23; *see also Stein I*, 435 F. Supp. 2d at 347-48. There was no evidence of anything that might have given KPMG that idea except the Thompson Memorandum and the actions of the USAO.

Guidelines."[31] Anything less, as former Attorney General Meese told the Senate Judiciary Committee, "might well have constituted legal malpractice."[32] It therefore is hardly surprising that the government expressly conceded in its closing argument at the fee hearing that the Thompson Memorandum influenced KPMG's decisions on legal fees:

> "[AUSA] WEINSTEIN: I don't think anybody is disputing that the Thompson memo as a whole had an influence on their [i.e., KPMG's] decisions with respect to the legal fees.
>
> * * *
>
> "So if we are asking whether there was an influence from the Thompson memo, of course, because the company was doing anything it could to cooperate."[33]

2. KPMG Made No Decisions Until After the February 25, 2004 Meeting

The government argues that the USAO's actions, as distinguished from the Thompson Memorandum alone, had nothing to do with KPMG's limitation and cutoff of legal fees because KPMG decided on its course before the initial February 25, 2004 meeting with the USAO. It contends, in other words, that KPMG formulated its own position, free of the USAO's influence. But there are fundamental flaws in its argument.

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[31] Stein Mem. [dkt. item 544] Ex. B, at 74-75.

[32] Meese Senate Statement.

[33] Tr., May 10, 2006, at 399:16-19, 400:9-11.

(a) KPMG Made No Decisions Before the Meeting Even as to Costs of Representing Employees During the Investigation

The government's challenge to the findings about the February 25 meeting rests on its assertion that "*KPMG* began the meeting by volunteering that the firm had decided to change course and now intended to cooperate fully and completely, and later announcing its intention to 'not pay legal fees for employees who declined to cooperate with the Government,' but to pay otherwise."[34] The implication is that KPMG had made up its mind even before it first met with the USAO. But the government's account of the meeting is misleading, and its implication is incorrect.

It is quite true, as the government argues,[35] that KPMG's attorney, Mr. Bennett, began the meeting by saying that KPMG had decided to change course and cooperate fully. Contrary to the government's suggestion, however, those remarks were directed to KPMG's high-level personnel changes and the importance of avoiding indictment of the firm. Mr. Bennett said nothing at that point about payment of legal fees. So the implication that KPMG opened the meeting by volunteering that it had decided upon a new course with respect to payment of legal fees is incorrect. The subject of legal fees first was raised by AUSA Weddle, acting according to the plan the prosecutors made before the meeting.

When Mr. Weddle did raise the issue, KPMG did not initially respond by volunteering that it would pay fees only for employees who cooperated with the government. Rather, Mr. Bennett met Mr. Weddle's question with a question. He asked for the government's view on

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[34] Govt. App. Br. 57 (emphasis in original).

[35] *Id.* at 29.

the subject.[36] The notes of Mr. Pilchen, a Skadden Arps lawyer at the meeting, demonstrate this clearly:

> "Weddle - wants p'ship agreement, bylaws. Are u paying fees for partners/ees? Are you obligated
> "RCB [Mr. Bennett] - ur view on the subject?"[37]

It is not difficult to see what was going on here. Mr. Bennett and KPMG well understood the Thompson Memorandum and the risk that the government would regard payment of employee legal fees as protection of culpable individuals. They thus knew that payment of legal fees for individuals could increase the risk of indictment of the firm. But refusal to pay legal fees was problematic for KPMG. The government stipulated:

> "Prior to February 2004, . . . it had been the longstanding voluntary practice of KPMG to advance and pay legal fees, without a preset cap or condition of cooperation with the government, for counsel for partners, principals, and employees of the firm in those situations where separate counsel was appropriate to represent the individual in any civil, criminal or regulatory proceeding involving activities arising within the scope of the individual's duties and responsibilities as a KPMG partner, principal, or employee."[38]

Moreover, as Mr. Bennett later explained to the government, departing from this practice "would be a big problem" for KPMG because the firm was a partnership.[39] The inference is compelling that Mr. Bennett's response to Mr. Weddle was an attempt to sound out the USAO as to whether payment

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[36] Tr., May 8, 2006 (Pilchen) 23:8-12.

[37] K313 [A1338] (emphasis in original).

[38] *Stein I*, 435 F. Supp. 2d at 340.

[39] U30 [A1146].

> The implication was that management had to be at least somewhat responsive to the voting partners of the firm, many of whom might have viewed cutting off fees to their colleagues with disfavor because it would set a precedent that was a potential threat to every member of the firm.

of legal fees by KPMG for employees caught up in the investigation would be held against the firm.

It is undisputed also that the government gave KPMG no comfort. To the contrary, Ms. Neiman rejected Mr. Bennett's feeler, saying "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."[40] Only then did KPMG say anything about paying legal fees only for employees who cooperated with the government, itself a partial retreat from its "common practice" of paying in all cases. Even that was a trial balloon, not the announcement of a decision. The Skadden lawyers emphasized that no decisions had been made.[41] But Ms. Neiman and Mr. Weddle were not favorably disposed. Ms. Neiman said that "'misconduct' should not or cannot 'be rewarded,'" and Mr. Weddle followed up by emphasizing that any payment of legal fees would be "look[ed] at . . . under a microscope."[42]

Mr. Pilchen's notes show all this. After noting Mr. Bennett's comment about paying fees only for those who cooperated, they say:

> "SP [Mr. Pilchen] – *No decisions made.* No counsel have been recommended. We have had discussions @ what the firm does in typical situations – but *no final decisions made.*
>
> "SN [Ms. Neiman] – *misconduct shdn't be rewarded.*
>
> "JW [Mr. Weddle] – <u>if u have discretion re fees – we'll look at that under a microscope</u>."[43]

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[40] *Stein I*, 435 F. Supp. 2d at 341.

[41] Tr., May 8, 2006 (Okula) 79:25-80:10, 107:2-7, 124:19-23; U116, ¶ 26 [A1199]; K313 [A1338].

[42] *Stein I*, 435 F. Supp. 2d at 342-44.

[43] K313-14 [A1338-39] (italics supplied, underscoring in original).

The logical inference, and the one the Court drew and draws, is that KPMG came into the meeting hoping to continue its past practice of paying employee legal fees. Anything else, in Mr. Bennett's words, would have been "a big problem" because KPMG was a partnership. In view of the Thompson Memorandum, however, KPMG understandably was reluctant to do so without an indication from the USAO that such payments would not be held against the firm. Ms. Neiman declined to give that indication. So KPMG tentatively suggested a possible fallback position – payment of legal fees only for employees who cooperated with the government by, among other things, waiving the Fifth Amendment – while emphasizing that it had made no decisions.[44] Even that, however, did not receive a warm reception from the USAO, which asked KPMG to get back to it once it determined what its obligations were,[45] a reference to the Thompson Memorandum's statement that payment of legal fees beyond a company's legal obligations could be viewed as a lack of "cooperation." There is no credible evidence that KPMG made any decisions at all about payment of employee legal expenses before the February 25 meeting ended.[46]

Mr. Bennett first got back to the government on March 2 to give what AUSA Weddle

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It bears mention that Mr. Weddle never denied having made the statement.

[44] Indeed, Mr. Bennett tried to sell this idea to the government on the theory that it would be helpful to the prosecutors, stating that "[h]e would recommend law firms [for individual employees] that were familiar with these types of proceedings and who understood that cooperation with the government was the best way to proceed." *See* U119, ¶ 56 [A1202].

[45] U106 [A1189].

[46] Of course, as *Stein I* noted, Skadden representatives made statements about what they would do or were considering doing with respect to fees. But the evidence is clear, as Mr. Okula testified, that they also stated no final decision had been made. Tr., May 8, 2006 (Okula) 79:25-80:10; *see also* supra note 41.

described in a contemporaneous e-mail as KPMG's "*preliminary view* on legal fees."[47] He said that KPMG was "planning on . . . putting a cap on fees" and conditioning their payment for any given partner or employee on that individual "cooperating fully with the company and the government."[48] But AUSA Weddle stated under oath that Mr. Bennett told him on this occasion that no final decision had been reached.[49]

In short, KPMG's statements at the February 25 meeting about a possible new policy concerning legal fees were not announcements of decisions already made, let alone decisions that the firm had made free of government interference. KPMG was bidding against itself in an auction in which the Thompson Memorandum set out the rules, the USAO was both the seller and the auctioneer, and the lot on the block was avoidance of an indictment of the firm. The decisions all were made after the February 25 meeting.

(b) The Decision Not to Pay the Defense Costs of Any Employees Who Were Indicted Came Even Later

KPMG's definitive response on attorneys' fees came on March 11, 2004, when Skadden's Mr. Rauh sent the government a sample form letter to KPMG employees. 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,

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[47] U30 [A1146] (emphasis added); *see also* Tr., May 8, 2006 (Okula) 89:12-90:9.

[48] U30 [A1146] .

[49] Weddle Decl. [dkt. item 435] ¶ 3.

and truthful."[50] Most importantly, the letter added something new, something that had not even been mentioned at the February 25 meeting. It said that "*payment of . . . legal fees and expenses will cease immediately if . . . [the recipient] is charged by the government with criminal wrongdoing.*"[51] This was the first mention to the government, so far as the record reveals, of any intention to cut off payment of legal fees to anyone who was indicted.[52]

The Court finds that KPMG's decision to cut off payment of any legal expenses to anyone who was indicted – which is the critical point here[53] – was prompted by the Thompson Memorandum and the USAO's negative reaction at the February 25 meeting to the possibility that KPMG would pay any legal fees in the absence of a legal obligation to do so. The record thus does not bear out the government's argument that KPMG, "apparently not cowed by any [indication that the government did not want KPMG to pay legal fees], ignored that desire and went ahead and paid the fees, subject to terms and conditions of its own devising."[54]

The fact that KPMG paid legal fees of its employees and former employees during

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[50] K15 [A1214].

[51] K16 [A1215] (emphasis added).

[52] As will appear, the very first mention of the possibility of cutting off payment of legal fees to anyone who was indicted came in a meeting at KPMG following its attorneys' first meeting with the USAO on February 25, 2004. *See infra* page 28.

[53] *Stein I* held that the constitutional violation pertinent to possible dismissal of the indictment was the government's role in KPMG's action in cutting off payment of legal fees for those who were indicted as distinct from the limitations on payment of legal fees during the investigative stage. *See* 435 F. Supp. 2d at 373. In *United States v. Stein*, 440 F. Supp. 2d 315 (S.D.N.Y. 2006) ("*Stein II*"), the Court held also that the government coerced proffers made by defendants Smith and Watson by inducing KPMG to pay pre-indictment legal fees only for employees who cooperated with the government and waived the Fifth Amendment and, in the case of Smith, threatening to fire him.

[54] Govt. App. Br. 57.

the pre-indictment investigation – as long as they did what the government asked and waived the Fifth Amendment – does not support the government. The government ultimately was perfectly happy to have KPMG do so because the threat of cutting off even those payments gave KPMG, and therefore the government, leverage over the recipients. As the government said in summation at the fee hearing:

> "[T]here are two ways the company could get their people in. One is they could hold over their head their job. The other is they could cut off their legal fees. If it's a former employee, the first one isn't even relevant. So regardless of whether there is a reference in the Thompson memo for legal fees, that is all the company can do to get its people in."[55]

But the critical fact remains that KPMG refused to pay the fees of these defendants *after they were indicted* as a result of the Thompson Memorandum and the actions of the USAO.

The government nevertheless persists in arguing that the Court's causation finding was clearly erroneous because no one from KPMG said that the Thompson Memorandum and the USAO's actions precipitated the decision.[56] This argument too is unpersuasive.

There was no need for direct evidence of the reasons for KPMG's decision. The evidence as a whole more than supports the Court's finding. Moreover, the government was on ample notice that the reasons that KPMG acted as it did were to be tried at the hearing.[57] Yet it called no witnesses to testify as to when, how, and why KPMG made the decisions it did. The

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[55] Tr., May 10, 2006, at 400:2-8.

[56] Govt. App. Br. 63-66.

[57] The order that set the evidentiary hearing that preceded *Stein I* stated that "[t]he issues for consideration [at the hearing would be] *whether the government, through the Thompson memorandum or otherwise, affected KPMG's determination(s) with respect to the advancement of legal fees and other defense costs to present or former partners and employees with respect to the investigation and prosecution of this case* and such subsidiary issues as relate thereto." Order, Apr. 13, 2006 [dkt. item 436] 2 (emphasis added).

reason it did not do so is the elephant in the room that the government tries to ignore.

In a letter to the Court three days before the start of the hearing, KPMG represented:

> "categorically that the Thompson memorandum *in conjunction with the government's statements relating to payment of legal fees* 'affected KPMG's determination(s) with respect to the advancement of legal fees and other defense costs to present or former partners and employees . . . .' In fact, KPMG is prepared to state that the Thompson memorandum substantially influenced KPMG's decisions with respect to legal fees . . . ."[58]

In view of this statement, it is not surprising that the government adduced no evidence to challenge the defense contention that the Thompson Memorandum and the USAO's conduct *both* influenced KPMG's decisions on legal fees. Indeed, it did not contest the point at the fee hearing.

3. There Was Ample Evidence that KPMG Would Have Paid the Fees of Most of these Defendants Absent Government Interference

Finally, the government contends that the Court's "key finding – that KPMG would have paid the defendants[]' legal fees absent the Thompson Memorandum and the conduct of the USAO – is wholly belied by the evidence of record."[59] It suggests that the Court erred in inferring that KPMG would have paid its employees' defense costs here because KPMG had paid post-indictment defense costs in only one prior case and because the government has hypothesized other reasons why a firm in KPMG's position might have declined to pay.[60] But the government stipulated that KPMG had a long standing practice of paying the legal fees of its personnel "in any civil, criminal or regulatory proceeding involving activities arising within the scope of the individual's

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[58] Letter, Charles A. Stillman, May 5, 2006 [dkt. item 985] 3 (emphasis added).

[59] Govt. App. Br. 42.

[60] *Id.* at 63-66.

duties and responsibilities as a KPMG partner, principal, or employee."[61] It conceded that KPMG's legal fee decision was influenced by the Thompson Memorandum.[62] And there was considerably more evidence at the fee hearing than the bare words of the stipulation and the government's concession.

The government ignores the fact that KPMG, as of January 27, 2004 – less than a month before the February 25 meeting, entered into an express contract with defendant Stein in which it agreed to pay his defense costs in "*all* legal proceedings or actions . . . brought against [Stein] arising from and within the scope of his duties and responsibilities . . ." – in other words, to adhere to its prior practice.[63] It ignores the fact that KPMG lawyers told the government at the February 25, 2004 meeting that no decisions had been made concerning payment of legal fees. It ignores their inquiry as to the government's view and distorts their tentative suggestion of a policy to avoid dealing with the fact that these were parts of an effort to see how far KPMG could go in adhering to its prior practice and its agreement with Stein without risk to the firm. It ignores the fact that KPMG's lawyers told the government on February 25, 2004 that KPMG's "common practice" was to pay such fees – a statement that suggests that KPMG wished to, or at least was entertaining the possibility that it might, pay all employee defense costs in this matter. It ignores Mr. Bennett's statement that departing from its common practice of paying these expenses "would be a big problem" for KPMG because the firm was a partnership.[64] It ignores the fact that KPMG, in addition

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[61] *Stein I*, 435 F. Supp. 2d at 340.

[62] Tr., May 10, 2006, at 399:16-19.

[63] DX 6, ¶ 13 [SA6-7] (emphasis added).

[64] U30 [A1146].

to paying post-indictment defense costs in a case years ago, much more recently had paid over $20 million in individual defense costs in the Xerox matter, which included a criminal investigation.[65] And it ignores Mr. Loonan's testimony, which strongly suggested that cost was not a factor in KPMG's decision here.[66] In short, the government ignores extensive evidence showing that KPMG was a partnership that historically had stood – and hoped in this case to stand – behind its partners and employees, regardless of cost and regardless of whether the exposure they faced was criminal or civil, because the nature of the firm made it "a big problem" to do anything else. And it ignores as well something else that is telling.

In a little-noticed comment at the fee hearing, KPMG's general counsel mentioned that KPMG was paying the defense costs of many of the individuals indicted in this case in civil cases relating to these tax shelters.[67] The circumstances and full extent of its actions, however,

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[65] Tr., May 8, 2006 (Loonan) 129:23-130:18.

[66] Mr. Loonan testified that he was present at meetings at which the change in KPMG's practice was discussed, that no one at those meetings ever expressed the view that the firm should not spend the money required to pay individuals' defense costs, and that the decision-makers' explanation of the change in policy was based on undisclosed legal advice as to which Mr. Loonan invoked attorney-client privilege. Tr., May 8, 2006 (Loonan) 137:20-143:3. Thus, Mr. Loonan essentially ruled out cost as a factor and, though clearly limited by privilege considerations in the degree of detail he gave, left the unmistakable impression that KPMG made the decision based on purely legal, not economic or other business, considerations.

KPMG's ability to pay is not in question for several reasons. First, the fee hearing specifically focused on whether KPMG would have paid these defendants' legal fees, yet the government offered no evidence of any inability on the part of KPMG to pay. Second, as noted, KPMG's Mr. Loonan testified in substance that cost was not a factor in the decision to refuse payment. Third, KPMG reported combined revenue of $16.9 billion, of which almost $6 billion was derived from the Americas, in fiscal year 2006. KPMG International Annual Review 2006 57 (2006), *available at* http://www.kpmg.com/NR/rdonlyres/80866830-14B9-4C72-B174-8B5A653D7E1C/0/KPMGIAR2006v11.pdf (last visited July 13, 2007).

[67] Tr., May 9, 2006 (Loonan) 216:19-22, *see also* Tr., July 2, 2007, at 24:11-25:22.

became clear only in response to a recent question by the Court.

It now is undisputed that KPMG has been paying the defense costs of at least eleven of the sixteen KPMG Defendants[68] in civil cases relating to the tax shelters here at issue and also the defense costs of eight of them in regulatory inquiries relating to the conduct in question in this case.[69] The precise amount of these payments to date is not of record, but it exceeds $3.4 million.[70] Moreover, it is striking that KPMG has paid these costs subject to the requirement that the individuals be represented in the civil matters by attorneys who are not involved in defending this criminal case.[71]

The fact that KPMG is paying civil defense costs, regardless of amount, is consistent with its uniform practice over many years. What makes the criminal case different is only the Thompson Memorandum and the USAO's actions. Indeed, the fact that KPMG has been paying the civil defense costs on condition that the defendants' lawyers in those matters be different than their lawyers in the criminal case – a condition that is at war with any consideration of economy or efficiency – demonstrates with astonishing clarity that the different treatment of the criminal case defense costs has been driven from the outset by the fear that the government would view any

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[68] The exceptions are Messrs. Greenberg, Larson, Pfaff, Rosenthal and Smith. Smith has submitted documents indicating that KPMG paid his fees also. Smith Decl. [dkt. item 1103] ¶¶ 5-8 & Ex. B.

[69] Letter, John M. Hillebrecht, July 9, 2007 [dkt. item 1128]; *see also* Spears Decl. [dkt. item 1100] Ex. A.

[70] Spears Decl. [dkt. item 1100] ¶ 6 & Ex. B.

[71] Arkin Decl. [dkt. item 1088] ¶¶ 2-6 & Exs. B, C; DeLap Decl. [dkt. item 1118] ¶ 12; Letter, Diana D. Parker, July 10, 2007 [dkt. item 1131]; Gremminger Decl. [dkt. item 1083] ¶¶ 2-3; Lanning Decl. [dkt. item 1119] ¶ 3; Ritchie Decl. [dkt. item 1097] ¶¶ 2-3; Rule Decl. [dkt. item 1104] ¶¶ 5-6; Smith Decl. [dkt. item 1103] ¶ 5 & Ex. A; Watson Decl. [dkt. item 1099] ¶¶ 11-16 .

assistance in defending against the indictment as a black mark against KPMG. KPMG cut off payment of defense costs to anyone who was indicted for one reason and one reason alone – the Thompson Memorandum and the related actions of the USAO. In their absence, KPMG would have paid every penny, just as it always had done before.

4. New Evidence that KPMG Would Have Paid Absent Government Interference

Three additional pieces of evidence – one of which was discovered only recently in the more than 22 million pages of discovery turned over to the defense, a second that was not previously of record, and the third only recently produced to the defense by KPMG – confirm the Court's finding that the Thompson Memorandum and the USAO's actions caused KPMG to change its policy, for this case only, with respect to payment of legal fees.

The first is a voicemail message on February 18, 2004 – immediately after KPMG learned of the criminal referral but before the February 25 meeting with the USAO – from Gene O'Kelly, then KPMG's chief executive officer, to all partners.[72] It announced that the firm just had learned that the USAO would be commencing an investigation. It went on to say that "[a]ny present or former members of the firm asked to appear will be represented by competent council [sic] *at the firm's expense*." There was no mention of conditioning KPMG's payment on cooperation, no mention of any cap on legal expenses, and no mention that the firm would stop paying in the event of indictment. The voicemail concluded by stating:

"Finally, you should expect that I and other members of leadership will work

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[72] A transcript of this voicemail was produced some time ago amidst the more than 22 million documents turned over in discovery. Defendants only recently found it. Defs. Mem. [dkt. item 1010] 7 n.14; Govt. Mem. [dkt. item 1051] 14 n.3.

> diligently to bring this matter to a successful conclusion, *provide you with all the necessary support* and keep you updated on a periodic basis. *In closing, I ask that you exhibit the resolve that you've shown throughout the Xerox investigation which defines what makes us a great firm.*"[73]

The Xerox investigation, it will be recalled, was the criminal and SEC investigation in which KPMG spent over $20 million on the individual defenses of four of its personnel.

The second relates to the contract that KPMG negotiated with Richard Smith prior to February 25 and then refused to sign. The fact of the agreement and KPMG's refusal to sign were known previously. The Court did not know previously that the Smith contract contained a clause, substantively identical to that in the Stein contract,[74] that explicitly would have required KPMG to pay Smith's defense costs. Nor did the Court know previously that Smith and KPMG chairman O'Kelly had scheduled a meeting for February 27, 2004 to execute it. Following the February 25 meeting between KPMG and the USAO, however, KPMG refused to sign the contract to which it had agreed.[75]

The reason for KPMG's sudden change of heart is made clear by the final piece of new evidence – recently produced notes taken by Greg Russo, a senior KPMG executive, at the meeting at which the Skadden lawyers reported back to KPMG on their February 25 meeting with the USAO.[76] Near the beginning of the notes, Russo wrote:

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[73] Spears Decl. [dkt. item 1025] Ex. C (emphasis added).

[74] *Compare* Smith Aff. [dkt. item 1017], Ex. C ¶ 8, *with* DX 6, ¶ 13 [SA6-7].

[75] Smith Aff. [dkt. item 1017] ¶¶ 1-14.

[76] These notes were not available at the fee hearing because KPMG declined to produce them pursuant to subpoena on privilege grounds. They first were produced by KPMG on May 17, 2007. Spears Decl. [dkt. item 1025] ¶ 5.

"– Paying legal fees }
} not a sign
"– Severance } of cooperation"[77]

After noting the nature of the possible charge against KPMG – "[c]onspiracy to defraud the US Treasury" – the notes go on:

"① uphill battle - Neiman } potential
} action
"② no one has a get out of jail free card } against
– Weddle } the firm
}
"③ shams – Sullivan }"

Near the end, the notes state:

> "➡Attorneys fees for individuals as long as they cooperate, up to indictment w/ a cap
>
> "➡Severance a problem (Smith's pending agreement)"[78]

These three items of evidence sharpen the picture that emerged at the fee hearing. Mr. O'Kelly's voicemail supports the Court's finding that KPMG went into the February 25, 2004 meeting wishing to pay the defense costs of its personnel (not doing so "would be a big problem"), but apprehensive in light of the Thompson Memorandum that doing so would increase the risk that the firm would be indicted. So too does the fact that KPMG, only days before the February 25 meeting, reached an agreement with Mr. Smith on a contract that explicitly would have obligated the firm to pay his legal fees. It therefore is not surprising that Mr. Bennett on February 25 parried the prosecutors' inquiry about payment of legal fees and attempted to elicit the government's view. He did so in order to see whether KPMG could adhere to its usual practice, or something

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[77] Spears Decl. [dkt. item 1025] ¶ 5 & Ex. D.

[78] *Id.*

approaching it, without increasing the risk of indictment of the firm. The Russo notes, however, confirm that Skadden Arps reported back to KPMG after the meeting that the government was "angry," that Ms. Neiman had led Skadden to believe that avoiding an indictment of the firm would be an "uphill battle," that Mr. Weddle had stressed that "no one has a get out of jail free card," and that paying legal fees and entering into severance agreements would "not [be] a sign of cooperation." In other words, payment of legal fees and entering into severance agreements would increase the chance that KPMG would be indicted. It was only after that report that KPMG decided to (1) pay pre-indictment expenses up to $400,000 only for employees who cooperated with the government and waived the Fifth Amendment, (2) cut off legal expense payments to anyone who was indicted, and (3) make an abrupt about face and refuse to sign the Smith contract that it had agreed to only days earlier.

KPMG would have paid the legal expenses of thirteen of the defendants (and signed Smith's contract) had the government not interfered both by the Thompson Memorandum and the actions of the USAO. As will appear below, however, the Court, upon consideration of matters not previously focused upon by the parties, is not so persuaded as to three defendants.

III. The Due Process Arguments[79]

Both sides discuss whether the government's conduct in this case shocks the conscience, a term that carries special significance in the context of substantive due process analysis. The KPMG Defendants urge that the government's inducement of KPMG's cut off of defense costs was part of a broader pattern of government misconduct that shocks the conscience and violated their right to substantive due process. They argue that this constitutes a separate constitutional violation, independent of those found in *Stein I*.[80] They contend further that a finding that the government's actions shock the conscience would make deterrence of future misconduct a pertinent consideration in determining the remedy and independently warrant dismissal.[81]

The government concedes that a finding that its actions shock the conscience is not an element of a substantive due process violation in the circumstances of this case – i.e., where there is no adequate remedy short of dismissal.[82] In consequence, it urges the Court not to consider

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[79] In *Stein I*, the Court found violations of the KPMG Defendants' Sixth Amendment and substantive due process rights. Although the parties have not raised this issue, the Court is well aware that where an Amendment "provides an explicit textual source of constitutional protection . . . that Amendment, not the more generalized notion of 'substantive due process,' must be the guide for analyzing [the] claims." *Graham v. Connor*, 490 U.S. 386, 395 (1989); *see also Pabon v. Wright*, 459 F.3d 241, 253 (2d Cir. 2006). The finding of substantive due process violations in *Stein I* constitutes an alternative holding that would be material in the event that a reviewing court disagreed with the Court's Sixth Amendment analysis.

[80] *E.g.*, Tr., July 2, 2007, at 8:2-16, 8:23-9:7.

[81] *E.g.*, *id.* at 16:18-17:6.

[82] *E.g.*, *id.* at 85:12-90:6.

As will appear, the Court agrees with the government's conclusion that a finding that its actions shock the conscience is not indispensable here. It finds the government's rationale for its position, however, illogical, as it appears to confuse the question whether there was a constitutional violation with the availability of particular remedies.

defendants' argument.[83] But it is reasonably plain that the government's concession with respect to dismissal, whether so motivated or not, is a prelude to an appeal. It therefore is appropriate for the Court to consider the defendants' argument because it may prove significant to a reviewing court.

A. The KPMG Defendants' Pattern Argument

The KPMG Defendants argue that the government not only coerced KPMG into cutting off payment of legal fees, but improperly coerced some of them to make statements to prosecutors, coerced KPMG into admitting to an unduly one-sided Statement of Facts as part of the deferred prosecution agreement, improperly joined nineteen defendants in a single indictment and resisted any severance for the purpose of coercing guilty pleas by the threat of an unmanageable and costly trial, and dissembled to the Court in the fee proceedings.[84]

The Court already has ruled on certain elements of this argument. In its decision on certain defendants' motions to suppress, the Court found that the government improperly used its

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[83] Govt. Mem. [dkt. item 1051] 11 ("[G]iven that the Court has already held that the Government has violated the Fifth and Sixth Amendment rights of the defendants, and given that neither the Government nor the defense has been able to suggest a remedy that addresses the violation as defined by the Court, we respectfully submit that the Court need not consider the defendants' arguments as to outrageous misconduct.")

[84] Defs. Mem. [dkt. item 1010] 7-23.

The KPMG Defendants, on the basis of documents that only recently have come to light, maintain also that the Internal Revenue Service and the Department of Justice engaged in improper and possibly criminal misconduct by disclosing and receiving, respectively, tax return information in violation of 26 U.S.C. § 6103. *See* Smith Reply [dkt. item 1075] 4-15. As this contention first was raised in their reply papers, the Court is treating that contention as a separate motion and has established a separate briefing schedule.

leverage over KPMG to induce KPMG to coerce proffers by certain defendants.[85] It found previously that the USAO was "economical with the truth" in its effort to avoid an evidentiary hearing on the defendants' motion with respect to the fee issues.[86] From a factual perspective, nothing else need be said on these points.

The argument concerning the Statement of Facts is, at least in part, a recycling of an argument previously rejected.[87] In summary, it boils down to the contention that the government largely dictated the terms of the Statement of Facts to which KPMG was forced to assent in order to avoid indictment, while at the same time forbidding KPMG from conducting an internal investigation to determine exactly what had transpired. The government, the argument goes, did so, at least in some degree, because it wanted to use the extensive admissions of wrongdoing that it demanded against "taxpayers and other professional service providers, such as E&Y [Ernst & Young], Sidley [Austin LLP and] Deutsche Bank."[88] But this would add little if anything to the KPMG Defendants' position, even if it were entirely accurate, a point the Court need not reach. For even if the government's actions vis-a-vis the Statement of Facts were reprehensible, they would not have affected these defendants.

The argument concerning the government's tactics with respect to joinder and

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[85] *See Stein II*, 440 F. Supp. 2d 315. The Court concluded that the government was guilty of improper pressure with respect to all nine moving defendants. It denied suppression as to seven, however, on the ground that those defendants had failed to establish that they would not have proffered without regard to the pressure exerted by KPMG at the government's instigation. *Id.* at 326-30, 333.

[86] *Stein I*, 435 F. Supp. 2d at 381.

[87] *United States v. Stein*, No. S1 05 Crim. 0888 (LAK), 2006 WL 1063295 (S.D.N.Y. Apr. 5, 2006).

[88] Spears Decl. [dkt. item 1025] Ex. N, at 4.

severance has substance to the extent that it now seems that the government never expected or intended to try together anything approaching the nineteen defendants named in the indictment.[89] It mistakenly expected a substantial number of guilty pleas. Nevertheless, the government until very recently stoutly resisted any severance, a course that, as defendants argue, may have increased the pressure on them to enter guilty pleas. Defendants therefore impute to the government a motive to coerce guilty pleas. But this argument is readily answered.

While the return of indictments with so many defendants is not favored,[90] it is not forbidden. Common experience, moreover, teaches that the vast majority of criminal defendants plead guilty regardless of the number of individuals included in the instruments in which they are charged. On the face of it, the government's joinder of these nineteen defendants and its opposition to severance, which always were subject to the Court's power to grant a severance if that were warranted, cannot be faulted. In the absence of evidence that the joinder and the government's litigation posture were specifically intended to pressure individuals to enter guilty pleas, the Court finds no impropriety notwithstanding that the government's tactics perhaps were ill-advised.

In the last analysis, then, the KPMG Defendants' contention that the government has engaged in a conscience-shocking pattern of misconduct stands or falls on the findings that the Court made in *Stein I* and *Stein II*: that the government improperly coerced KPMG into refusing to pay the KPMG Defendants' defense costs, was less than candid with the Court in its effort to avoid a hearing on that issue, and improperly used KPMG to coerce proffers from KPMG personnel.

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[89] Tr., Oct. 3, 2006, 43:15-44:10, 48:8-12; Govt. Mem. [dkt. item 745] 1-2.

[90] *See United States v. Casamento*, 887 F.2d 1141, 1151-52 (2d Cir. 1989).

B. The Legal Standard

The substantive component of the Due Process Clause protects the individual against "the [government's] exercise of power without any reasonable justification in the service of a legitimate governmental objective."[91] In *County of Sacramento v. Lewis*, the Supreme Court held that "criteria to identify what is fatally arbitrary differ depending on whether it is legislation or a specific act of a governmental officer that is at issue."[92] Where the challenged government action is legislation, the question is whether a fundamental liberty interest was infringed and, if so, whether the legislation survives strict scrutiny. Where, however, the challenged government action is the conduct of a particular government employee or official, *County of Sacramento* held that the question is whether the conduct "shocks the conscience."[93]

It is not clear that the Supreme Court still adheres to the *County of Sacramento* framework.[94] The Second Circuit has done so in some cases and, it appears, departed from it in

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[91] *County of Sacramento v. Lewis*, 523 U.S. 833, 845-46 (1998).

[92] *Id.* at 846.

[93] *Id.* at 846-47.

[94] In *Chavez v. Martinez*, 538 U.S. 760 (2003), the plaintiff brought a § 1983 suit against a police officer for coercive interrogation methods. Although a majority of the Court did not reach the merits of plaintiff's substantive due process claim, Justice Thomas, in an opinion joined by the Chief Justice and Justice Scalia, analyzed the claim under both the "shocks the conscience" test and the fundamental liberty interest test. *Id.* at 774-76. Justice Stevens, in a separate opinion, also identified the two tests as alternative means for analyzing a substantive due process claim and noted that "unusually coercive police interrogation procedures" had been found often to violate the second standard. *Id.* at 787. Finally, Justice Kennedy, in an opinion joined by Justices Stevens and Ginsburg, stated that "use of torture or its equivalent in an attempt to induce a statement violates an individual's fundamental right to liberty of the person." *Id.* at 796; *see also Conn v. Gabbert*, 526 U.S. 286, 291-92 (1999) (analyzing substantive due process claim against prosecutors' conduct without reference to"shocks the conscience" test).

others.[95] Given the uncertainty, it is appropriate to consider the substantive due process question under the *County of Sacramento* rubric notwithstanding the parties' agreement that a finding that the government's actions shock the conscience is not essential to the conclusion that the government violated the defendants' rights to substantive due process.

Stein I discussed two closely related matters: the Thompson Memorandum itself and the actions of the USAO. The Thompson Memorandum in substance was a regulation.[96] The Second Circuit has held that regulations fall into the legislative category.[97] In consequence, a substantive due process challenge to the Thompson Memorandum properly is analyzed first by determining whether it impinged upon a fundamental right and, if it did, by then considering whether it was narrowly tailored to serve a compelling governmental interest. *Stein I* employed exactly this analysis and thus conformed precisely to *County of Sacramento* and its Second Circuit progeny.[98] It is unnecessary to consider whether the Thompson Memorandum shocked the conscience.

Stein I concluded also that individual AUSAs unjustifiably acted in a manner that

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[95] *Compare Pabon v. Wright*, 459 F.3d at 250-51; *O'Connor v. Pierson*, 426 F.3d 187, 202-03 (2d Cir. 2005), *with Poe v. Leonard*, 282 F.3d 123, 137-39 (2d Cir. 2002) (finding substantive due process violation for police officer conduct sufficiently alleged where officer's conduct infringed fundamental right to privacy and, "independently," because officer's conduct shocked the conscience); *Kia P. v. McIntyre*, 235 F.3d 749 (2d Cir. 2000) (analyzing substantive due process claim against social worker's action without reference to "shocks the conscience" test).

[96] It was a Justice Department policy binding on United States Attorneys. *Stein I*, 435 F. Supp. 2d at 338.

[97] *Leebaert v. Harrington*, 332 F.3d 134, 140 & n.2 (2d Cir. 2003) (applying the fundamental right standard to a regulation, noting "[w]e read *Sacramento* to apply broadly to governmental regulation and not to be limited to legislation") (citing *Immediato v. Rye Neck School Dist.*, 73 F.3d 454, 460-61 (2d Cir. 1996)).

[98] *See Stein I*, 435 F. Supp. 2d at 362-65 & n.170.

improperly impinged on the KPMG Defendants' right to fairness in the criminal process.[99] Given the relationship between their actions and the Thompson Memorandum,[100] the Court sees their conduct as more analogous to regulatory action than to the action of an individual officer reacting to an unanticipated situation. In consequence, the analysis in *Stein I* is sufficient to conclude that their actions were part and parcel of the deprivation of the KPMG Defendants' rights to substantive due process that was inherent in the Thompson Memorandum. Nevertheless, the Court recognizes that this perhaps is unfamiliar ground and that a determination whether their actions independently shock the conscience in the constitutional sense may prove significant for one or more purposes.

C. The Actions of the USAO "Shock the Conscience"

The "shocks the conscience" standard, sometimes referred to as the "outrageous government conduct" standard, is "necessarily imprecise."[101] Justice Scalia has criticized it as being the "*ne plus ultra* . . . of subjectivity."[102] Nevertheless, it remains a part of our constitutional jurisprudence.

At the extremes, the test is comparatively easy of application. "[L]iability for negligently inflicted harm is categorically beneath the threshold of constitutional due process" while "conduct intended to injure in some way unjustifiable by any government interest is the sort of

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[99] *Id.* at 365.

[100] *See id.* at 365 ("The individual prosecutors in the USAO acted pursuant to the established policy of the DOJ as expressed in the Thompson Memorandum.").

[101] *O'Connor v. Pierson*, 426 F.3d 187, 203 (2d Cir. 2005).

[102] *County of Sacramento*, 523 U.S. at 861 (Scalia, J., concurring in judgment).

official action most likely to rise to the conscience-shocking level."[103] The closer questions occur between these extremes – where government officials act neither for the purpose of inflicting injury nor negligently.

In this case, the USAO pressured KPMG to withhold payment of legal fees. As *Stein I* found, the prosecutors understood "that the threat inherent in the Thompson Memorandum, coupled with their own reinforcement of that threat, was likely to produce exactly the result that occurred – KPMG's determination to cut off the payment of legal fees for any employees or former employees who were indicted and to limit and condition their payment during the investigative stage."[104]

The actions of the prosecutors with respect to legal fees may be considered also in light of their actions with respect to obtaining proffers from KPMG employees under suspicion, all of whom had a Fifth Amendment right to decline to speak to the government. The prosecutors knew that the Thompson Memorandum effectively compelled KPMG to make its personnel available for interviews by the government. They knew, as the government said at the fee hearing, that "there are two ways the company could get their people in. One is they could hold over their head their job. The other is they could cut off their legal fees." They therefore understood that KPMG would threaten to fire or cut off payment of legal fees for employees and former employees whom prosecutors reported were not cooperating – i.e., who were refusing to submit to interviews with the government.[105] Yet the prosecutors identified such persons to KPMG anyway. These actions are

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[103] *Id.* at 849.

[104] 435 F. Supp. 2d at 365.

[105] In summing up following the fee hearing, government counsel said:

> "I don't think anybody is disputing that the Thompson memo as a whole had an influence on their decisions with respect to the legal fees. They have couched it in reference to, the

significant not only in themselves, but also for the insight they provide into the prosecutors' actions with respect to payment of legal fees. For they demonstrate a willingness by the prosecutors to use their life and death power over KPMG to induce KPMG to coerce its personnel to bend to the government's wishes notwithstanding the fact that the Constitution barred the government from doing directly what it forced KPMG to do for it.

Just as prosecutors used KPMG to coerce interviews with KPMG personnel that the government could not coerce directly, they used KPMG to strip any of its employees who were indicted of means of defending themselves that KPMG otherwise would have provided to them. Their actions were not justified by any legitimate governmental interest. Their deliberate interference with the defendants' rights was outrageous and shocking in the constitutional sense because it was fundamentally at odds with two of our most basic constitutional values – the right to counsel and the right to fair criminal proceedings. But the Court does not rest on this finding alone. It would reach the same conclusion even if the conduct reflected only deliberate indifference to the

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> reference to legal fees in the Thompson memo versus under the Thompson memo, or any guidelines frankly, whether the Thompson memo was there or not, if a company wants to attempt to cooperate as opposed to be charged, one of the things they needed to do is get their people in to give the information. The company can't talk, only the people can talk.
>
> "Whether or not the Thompson memo made reference to legal fees, *there are two ways the company could get their people in. One is they could hold over their head their job. The other is they could cut off their legal fees. If it's a former employee, the first one isn't even relevant. So regardless of whether there is a reference in the Thompson memo for legal fees, that is all the company can do to get its people in.*" Tr., May 10, 2006, at 399:17-400:8 (emphasis added).
>
> What the government admitted with respect to the Thompson Memorandum applies equally to the actions of the AUSAs in (1) telling KPMG, with respect to payment of legal fees, that misconduct should not be rewarded and that any such action would be looked at "under a microscope" and (2) reporting to KPMG the identities of KPMG employees who declined to make statements to prosecutors or whose responses to such "requests" did not meet with prosecutors' approval.

defendants' constitutional rights as opposed to an unjustified intention to injure them.

The question whether deliberately indifferent government conduct is outrageous or shocking depends on the circumstances.[106] In a high-speed police chase, for example, an officer has but a moment to decide how to respond. In that context, an officer's conduct "shocks the conscience" only if there is an actual intent to cause harm, principally because there is no time for sober reflection on the possible consequences of the officer's actions.[107] To take another example, a governmental actor's thoughtful choice between equally compelling competing obligations is unlikely to be shocking. "In the apparent absence of harmless options at the time decisions must be made, an attempt to choose the least of evils is not itself shocking."[108]

Conversely, where a government agent has "time to make unhurried judgments, upon the chance for repeated reflection, largely uncomplicated by the pulls of competing obligations," deliberate indifference to a person's rights can be shocking.[109] As the Second Circuit has noted, "*County of Sacramento* strongly suggests that in those circumstances when actual deliberation is possible, a showing of deliberate indifference will establish Fourteenth Amendment liability."[110]

In this case, the AUSAs had ample time for deliberation and in fact deliberated before acting. They met privately before the February 25, 2004 meeting with KPMG and decided to inquire as to whether KPMG intended to pay legal fees of its personnel. It is entirely likely, and the Court

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[106] *County of Sacramento*, 523 U.S. at 850 ("Deliberate indifference that shocks in one environment may not be so patently egregious in another.").

[107] *Id.* at 853-54.

[108] *Lombardi v. Whitman*, 485 F.3d 73, 82 (2d Cir. 2007).

[109] *County of Sacramento*, 523 U.S. at 853.

[110] *Pabon v. Wright*, 459 F.3d at 251.

finds, that they then decided the substance of their intended reaction to KPMG's possible responses. Nevertheless, they made clear that any discretionary payment of legal fees by KPMG would be looked at "under a microscope" and responded to a comment concerning payment of legal fees by emphasizing that misconduct should not be rewarded – threats if ever there were any.

In any case, KPMG made clear when it left the meeting that it had made no decisions concerning legal fees and did not get back to the government even with its preliminary view until March. The AUSAs therefore had even more time – time in which to reflect upon what had transpired at the meeting and to make the USAO's views entirely clear if any ambiguity or misimpression had been left at the meeting. They easily could have called KPMG and said, for example, that payment of legal fees would not affect the USAO's view of whether to indict KPMG unless it became clear that it was part of a scheme to obstruct the investigation – the view they claim to have held of when consideration of payment of legal fees would have been appropriate in deciding when to indict a business entity. But they did not. Nor did they tell KPMG in March, when its lawyers called to convey the firm's decision on payment of legal fees, that KPMG had gone further than the government thought was necessary or appropriate. They did not do so because they did not want KPMG to assist its employees. Indeed, AUSA Okula frankly admitted that he did not think KPMG should pay for attorneys for its personnel.[111]

The government's actions with respect to legal fees were at least deliberately indifferent to the rights of the defendants and others. In all the circumstances, this behavior shocks the conscience in the constitutional sense whether prosecutors were merely deliberately indifferent

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[111] "Q. So as you went into the meeting, it was your view that if they had discretion, they shouldn't pay the fees to the subjects. Is that right? A. My personal view? Yes." Tr., May 8, 2006 (Okula) 69:1-4.

to the KPMG Defendants' rights or acted more culpably.

IV. The Impact on the KPMG Defendants

A. Deprivation of Counsel of Choice

It now is clear, and the Court finds, that four defendants have been deprived of counsel of their choice, quite apart from any other consequences of the government's actions.

As an initial matter, the government does not dispute that defendants Hasting and Watson engaged counsel prior to indictment, wished to be defended by those attorneys after indictment, but were forced to terminate these attorneys following or on the eve of indictment because KPMG cut off payment of their legal fees and these defendants could not otherwise afford them.[112]

Mr. Gremminger's position is virtually identical. While he still was employed by KPMG, he hired the Jones Day firm. KPMG paid the fees until Mr. Gremminger was told by the USAO that he had become a target of the investigation, at which point KPMG fired him effective immediately and reneged on a previous promise to pay the severance package to which he was entitled as a KPMG partner,[113] just as KPMG had reneged on Mr. Stein's contract and refused to sign the contract that it had agreed upon with Mr. Smith. At that point, Jones Day "was far too expensive" for Mr. Gremminger, so he replaced it with his present counsel (at approximately half the hourly rate).[114]

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[112] Hasting Am. Decl. [dkt. item 1046] at 2; Watson Decl. [dkt. item 1009] ¶¶ 2-12.

[113] Gremminger Decl. [dkt. item 1110] ¶¶ 3-4, 7.

[114] *Id.* ¶ 7.

Mr. Ritchie is in a comparable but slightly different position. In 2004, he retained Cadwalader Wickersham & Taft ("CWT") to defend him in the government's investigation.[115] Once the indictment was returned, he wished to continue the services of CWT through trial.[116] He hired also Arguedas, Cassman & Headley, a much smaller firm, as co-counsel.[117] KPMG's refusal to pay his defense costs, however, left him with insufficient resources to pay both firms despite the fact than another employer is advancing half of his legal expenses. Accordingly, he terminated CWT.[118] He now is represented only by the Arguedas firm and a solo practitioner.

Mr. Greenberg makes a similar claim. He initially was represented by Arent Fox LLP and after indictment retained also the New York office of Goodwin Procter as well as a trial attorney from Denver, Pamela Mackey. He ultimately decided in light of the expense, he says, to terminate both Arent Fox and Ms. Mackey and avers that he would not have done so if KPMG had been funding his defense.[119]

Mr. Greenberg resigned from KPMG in February 2003, effective August 31, 2003, and gave KPMG a release.[120] While he requested in 2004, after retaining Arent Fox, that KPMG pay his legal fees, KPMG immediately refused.[121] He first retained Ms. Mackey after he was indicted

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115 Ritchie 2d Supp. Decl. [dkt. item 1113] ¶ 5.

116 *Id.* ¶ 10.

117 *Id.* ¶ 12.

118 *Id.* ¶¶ 13-15.

119 Greenberg Decl. [dkt. item 1120] ¶ 16.

120 Pitofsky Decl. [dkt. item 763] Ex. B, ¶¶ 1, 8

121 Letter, Margaret Garnett, June 26, 2007 [dkt. item 1123].

in 2005.[122] He terminated Arent Fox as counsel on or about February 13, 2006,[123] more than four months after he was indicted and after Arent Fox lost a motion to release Mr. Greenberg on bail.[124] Thus, Mr. Greenberg first hired Ms. Mackey after he knew that KPMG would not pay his fees and continued the services of Arent Fox for more than a year after KPMG made its intentions toward him plain. Moreover, the termination of Arent Fox may well have been a product of its loss of the bail application. In all the circumstances, the Court is not persuaded that Mr. Greenberg was deprived of counsel of his choice by the government's actions.[125]

B. The Other Practical Consequences

None of the other KPMG Defendants claims to have been deprived of counsel of his or her choice. That is not to say, however, that the government's actions have not impacted the ability of any of them to defend themselves. In order to appreciate that impact, it first is necessary to understand the exceptional demands that this case places on the defendants.

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[122] Greenberg Decl. [dkt. item 1120] ¶ 16.

[123] Price Decl. [dkt. item 359] ¶ 10.

[124] *United States v. Stein*, No. S1 05 Crim. 0888 (LAK), 2005 WL 3071272 (S.D.N.Y. Nov. 15, 2005).

Mr. Greenberg was released on bail pursuant to a subsequent application. The reply memorandum in support of his motion [dkt. item 344] was not signed by Arent Fox.

[125] Mr. Stein also claims that he was deprived of his counsel of choice, asserting that KPMG's repudiation of his contract was among the factors that led him to decide to replace the lead counsel he initially chose with his present attorney. Stein Decl. [dkt. item 1121] ¶ 12(e). In view of the equivocal nature of the assertion and the Court's conclusion that the indictment should be dismissed as to Mr. Stein for another reason, it is unnecessary to determine this point.

1. The Scope and Nature of this Case

(a) Discovery

The volume of documents produced by the government in this case is enormous. By November 11, 2006, it had turned over more than 22 million pages of material either in electronic or tangible form,[126] and production has continued through recent months.[127] This volume is large even when compared to other complex, white collar prosecutions.[128] Moreover, the discovery continues. Despite an October 2005 discovery deadline, over 1 million pages have been produced since June 1, 2007,[129] and it appears that the end has not been reached.[130]

To be sure, a good deal of this material has been produced in the form of digital files produced by optical scanning of physical documents. While this in theory might have been very helpful, three circumstances have lessened its utility.

First, the electronic production has been made in various formats and, to some extent, in the form of separate hard drives containing multiple databases. Defendants thus have been forced either to combine all of this material into a single data base to permit single searches of the entire electronic production or to conduct multiple identical searches in different databases.[131]

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126 Lefcourt Aff. [dkt. item 821] ¶¶ 4-5 (15 million pages produced by June 20, 2006 and more than 7 million additional pages produced by November 11, 2006).

127 Madigan Decl. [dkt. item 1007] ¶ 5.

128 *See* Defs. Mem. [dkt. item 1010] 26 n.32.

129 Letter, George D. Niespolo, July 6, 2007 [dkt. item 1133]; *see also* Glavin Decl. [dkt. item 1051] ¶¶ 2-3.

130 Tr., Dec. 20, 2006, at 6:6-24.

131 Lefcourt Aff. [dkt. item 821] ¶ 20; Anderson Decl. [dkt. item 561] ¶ 16; Guthrie Decl. [dkt. item 562] ¶¶ 7-9.

Second, the optical character recognition ("OCR") technology used to convert physical documents into electronic images has significant limitations. It does not recognize handwriting, and it often does not produce a usable electronic image if the physical source document is of poor quality, as for example in the case of a poor copy. While these problems can be remedied with human input, the process is time consuming and, on this scale, either extremely costly or impracticable.[132]

Third, there have been numerous technical problems with the electronic materials produced by the government. These have included incorrect descriptive information, inactive links to documents, multiple copies of single documents, and poor quality disks requiring additional labor to render them searchable.[133]

In addition, it bears noting that the documents produced in tangible form occupy hundreds of boxes that are available only in a warehouse or by purchasing copies at great expense.[134]

The Court recognizes that the government recently and commendably agreed to build, at its expense, a searchable electronic database containing many of the documents that have been produced in discovery for use by the defendants. Although this comes very late in the day and will be subject to substantial limitations, it doubtless will be of some help. But it will not come close to eliminating the difficulties of dealing with a case in which there are over 22 million documents. Nor does it address the facts that many defendants lack the resources to pay their counsel to review many

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[132] Anderson Decl. [dkt. item 561] ¶ 25; Guthrie Decl. [dkt. item 562] ¶ 16.

[133] Lefcourt Aff. [dkt. item 821] ¶ 21; Anderson Decl. [dkt. item 561] ¶¶ 17-20; Ma Aff. [dkt. item 622] ¶ 5.

[134] Rule Decl. [dkt. item 1018] ¶ 7; Anderson Decl. [dkt. item 561] ¶¶ 45-66.

of the documents and that it will not address the need to access the paper documents.[135]

(b) Motion Practice

The Court commented long ago that defendants in the opening stage of this case filed 26 motions supported by memoranda of law totaling approximately 1,100 pages.[136] Intensive motion practice has continued since then. The full scope is apparent from the docket sheet. An indication lies in the fact that Westlaw contains twenty-four decisions in this case.

(c) Trial

As previously noted, the government has designated nearly 70 witnesses and 2,000 exhibits totaling more than 150,000 pages for its case in chief.[137] It estimates that presentation of its case-in-chief will take approximately four months. The anticipated overall length of the trial is between six and eight months.[138]

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[135] *See* Rule Decl. [dkt. item 1018] ¶ 9.

[136] *United States v. Stein*, 424 F. Supp. 2d 720, 723 (S.D.N.Y. 2006).

[137] Govt. Mem. [dkt. item 745] at 5; Kaley Decl. [dkt. item 1001] ¶ 4; Tr., Mar. 12, 2007, at 16:10-17.

The regular trial exhibits amount to approximately 36,000 pages. The government intends to offer an additional 126,000 pages as containing the data included in summary exhibits. Tr., Mar. 12, 2007, at 16:10-17; *see* FED. R. EVID. 1006.

[138] Tr., Jul. 13, 2006, at 134:3-4, 135:5-15.

(d) Subject Matter

Finally, it must be noted that the subject matter of the case presents unusual challenges. The nature of the tax shelter transactions, the transactional documents, and the tax law that is pertinent to the case all are extremely complex.[139] It is difficult to imagine an attorney whose expertise is trial practice properly defending this action without the active participation of a tax specialist steeped in the kinds of transactions at issue here. The need for trial counsel to understand this difficult material will greatly add to the cost of preparing for trial.

2. The Limitations on the Defense

All of the KPMG Defendants as to whom the government concedes dismissal to be the proper remedy 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.[140] The

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[139] A modest indication of the complexity of the tax shelters involved in this case is *Klamath Strategic Inv. Fund, LLC v. United States*, 472 F. Supp. 2d 885 (E.D. Tex. 2007), which involved only certain aspects of one of the types of transactions involved here and did so only from the perspective of the taxpayer.

[140] Niespolo Decl. (Bickham) [dkt. item 1003] ¶ 4 (adopting statements of counsel for DeLap); Wing Aff. (DeLap) [dkt. item 1011] ¶ 4; DeLap Decl. [dkt. item 1118] ¶¶ 15-17; Arkin Decl. (Eischeid) [dkt. item 1117] ¶¶ 13-18; Kaley Decl. (Gremminger) [dkt. item 1001] ¶¶ 6-7; Gioiella Decl. (Hasting) [dkt. item 1095] at 3-4; Madigan Decl. (Lanning) [dkt. item 1091] ¶ 17; Ritchie Decl. [dkt. item 1014] ¶ 3]; Ritchie 2d Supp. Decl. [dkt. item 1113] ¶¶ 10, 15; Rosenthal Aff. [dkt. item 1116] ¶ 8; Rosenthal Aff. [dkt. item 1045] ¶ 8; Rule Decl. (Smith) [dkt. item 1018] ¶¶ 9-10, 12; Smith Decl. [dkt. item 1108] ¶¶ 15-16; Spears Decl. (Stein) [dkt. item 1071] ¶¶ 13-24; DeVita Decl. (Warley) [dkt. item 998] ¶ 5; Watson Decl. [dkt. item 1009] ¶¶ 21-26; DePetris Decl. (Wiesner) [dkt. item 1064] ¶¶ 6-7; Wiesner Decl.

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 of administrative requirements typically imposed by corporate law departments on outside counsel fees.[141]

V. The Remedy

Dismissal of an indictment on the grounds of prosecutorial misconduct is an "extreme and drastic sanction"[142] that should not even be considered unless it is otherwise "impossible to restore a criminal defendant to the position that he would have occupied" but for the misconduct.[143] Moreover, "remedies should be tailored to the injury suffered from the constitutional violation and should not unnecessarily infringe on competing interests."[144] Notwithstanding the government's current position that the case should be dismissed as to thirteen defendants, the Court therefore is obliged to consider independently whether dismissal now is appropriate and, if so, whether that remedy is appropriate as to each defendant. It is necessary to deal first, however, with a preliminary

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[dkt. item 1109] ¶ 5.

[141] *See* Tr., May 8, 2006 (Loonan) 128:18-130:18.

[142] *United States v. Rubio*, 709 F.2d 146, 152 (2d Cir. 1983) (internal quotation marks omitted); *see also United States v. Morrison*, 449 U.S. 361, 365-66 & n.3 (1981) (citing *United States v. Blue*, 384 U.S. 251, 255 (1966)); *United States v. Estrada*, 164 F.3d 619, 1998 WL 716074, at *2 (2d Cir. 1998); *United States v. Fields*, 592 F.2d 638, 647-48 (2d Cir. 1978), *cert. denied*, 442 U.S. 917 (1979).

[143] *United States v. Artuso*, 618 F.2d 192, 196-97 (2d Cir.) (quoting *United States v. Fields*, 592 F.2d at 647-48), *cert. denied*, 449 U.S. 879 (1980).

[144] *United States v. Morrison*, 449 U.S. at 364.

matter.

A. The Government's CJA Argument

The government's memorandum states that it "previously argued . . . [that], to the extent that a given defendant establishes that he has suffered actual prejudice, in that he or she lacks sufficient funds to adequately defend the case, the appropriate remedy is an application under the Criminal Justice Act ["CJA"]."[145] It nevertheless concedes that dismissal is the appropriate remedy with respect to thirteen of the KPMG Defendants, assuming that *Stein I* stands. These positions appear to be inconsistent. Although the government does not expressly seek to reconcile them, the implication seems to be that the Court previously rejected a government contention that appointment of counsel under the CJA would be the appropriate remedy for the constitutional violations and, given that rejection, that dismissal is the only remaining option.

The government is incorrect in suggesting that the Court has passed on this argument. What occurred was this. The KPMG Defendants argued, among other things, that the Court should order that the government pay defendants' legal fees out of the fines that KPMG paid and, at that time, still owed to the government pursuant to its deferred prosecution agreement. The government responded that the Court lacked statutory authority to do so and that the remedy that the defendants had suggested was not authorized by the CJA.[146] It did not argue that appointment of CJA counsel would be the appropriate remedy if the Court found constitutional violations, so the Court had no

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[145] Govt. Mem. [dkt. item 1051] 6 (citing Govt. Mem. [dkt. item 873] 6-7).

[146] Govt. Supp. Mem. [dkt. item 459] 19-21.

occasion to pass on that question.[147] Nevertheless, it will do so now.

We begin by focusing on the precise issue raised by this suggestion. The constitutional violation here was the government's improper interference with the payment of the KPMG Defendants' defense costs. The question therefore is whether the availability of CJA appointments for defendants who have or will become financially eligible would place those defendants in the position they would have been in had the government not interfered.

Had KPMG not changed its policy on payment of defense costs in response to the government's threats, the KPMG Defendants would have had their legal fees and related expenses paid by KPMG. The overall cost would not have been an issue.[148] Among other things, KPMG, as noted, not long ago paid over $20 million in defense costs for four partners involved in the Xerox matter.

There are important differences between the position the KPMG Defendants would have occupied had KPMG paid and the positions they now are in.

First, CJA funds may be expended only on behalf of financially eligible persons.[149] The Court's plan for the administration of the CJA makes eligibility turn on whether an applicant's "net financial resources and income are insufficient to enable the person to obtain qualified counsel," a determination to be made with regard to "the cost of providing the person and his or her dependents

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147 In response to a motion to withdraw by counsel for Mr. Hasting, the government asserted that the CJA would provide appropriate relief if Hasting could not afford to pay defense counsel. It did not, however, suggest that this was an appropriate remedy for the constitutional violation. *See* Govt. Mem. [dkt. item 873] 6-7.

148 *Supra* note 66.

149 18 U.S.C. § 3006A(a).

with the necessities of life."[150] While this does not require a showing of indigency,[151] the retention of assets in excess of those essential to provide "the necessities of life" would be disqualifying. Thus, a defendant who is not financially eligible at the outset of a criminal prosecution must spend down his or her assets in order to qualify under the CJA. A CJA appointment for any defendant who had material resources at the date of indictment therefore would not be the equivalent of what that defendant would have had absent the government's interference with KPMG.

Second, the CJA establishes a $7,000 maximum fee for the representation of felony defendants.[152] While the Chief Judge of the Court of Appeals or his designee may and, in more routine cases, generally does approve higher fees, upon certification by the district judge of their necessity, any such request must be justified.[153] Although this Court would certify that this case is extended and complex and the Circuit surely would agree, the large financial demands that this case could place on the funds available would create a risk that the activities of CJA-appointed counsel would be restricted.[154] Counsel aware of that possibility might well limit their activities to avoid the risk of non-payment. This too would compare unfavorably with the defendant's situation if KPMG were paying the defense costs in accordance with its prior practice, as it would have done absent

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150 United States District Court, Southern District of New York, *Revised Plan for Furnishing Representation Pursuant to the Criminal Justice Act* (effective Oct. 1, 2005) (the "Plan") § VI(A).

151 *E.g.*, *United States v. Parker*, 439 F.3d 81, 96 (2d Cir. 2006).

152 18 U.S.C. § 3006A(d)(2).

153 Plan § IX(B).

154 The Court has been advised by the Administrative Office of United States Courts that this district's total expenditures for CJA counsel in recent years have been significantly lower than $20 million per year.

government interference.[155]

Thus, availability of CJA appointments to financially eligible defendants could not fully remedy the damage done by the government's actions. It would not prevent defendants from being wiped out financially simply by the fact of the indictment, something that would not have occurred had the government not coerced KPMG into cutting off payment of their fees. In addition, appointed counsel could be limited in their ability to mount the defenses that their clients otherwise would have presented in consequence of the need to justify expenditures to both this Court and the Court of Appeals and the risk that sufficient funds would not be available even to pay the well below market maximum hourly rates permitted under the CJA.[156]

This is not to say that attorneys appointed under the CJA inevitably could not provide the minimally effective defense that the Constitution requires. That is unclear, one way or the other. But it is to say that defendants would be wiped out financially as a result of the government's actions before they became eligible for CJA representation and that the representation they would receive in that event would be constrained in ways that would not have obtained absent the government's interference. While CJA relief would be better than nothing, it would not be the substantial equivalent of what these defendants lost as a result of the government's constitutional violations.

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[155] Nor would recourse to the CJA be equivalent as respects the defendants' interests in choosing their own counsel. Were the Court to relieve their present attorneys and appoint others, defendants would be deprived of counsel of their choosing. Were it to exercise its power to appoint their present attorneys over their attorneys' objections, as it has done in one recent case, *United States v. Stein*, – F. Supp. 2d –, 2007 WL 1765613 (S.D.N.Y. June 20, 2007), there almost inevitably would be tension borne of the understandable desire of counsel who ordinarily charge far higher rates than the maximum permitted under the CJA to minimize the time devoted to these clients' defenses.

[156] CJA counsel in non-capital cases may be paid no more than $94 per hour. *See* Press Release, United States District Court, Southern District of New York (May 21, 2007), *available at* http://www1.nysd.uscourts.gov/pr07_0521_cja.php.

Accordingly, the Court turns to the impact of the government's violations on the individual defendants.

B. Defendants Deprived of Counsel of Choice

Messrs. Gremminger, Hasting and Watson have been deprived by the government's actions of the counsel they chose. As a result of those actions, they simply lack the resources to engage the lawyers of their choice,[157] lawyers who had represented them as long as KPMG was paying the bills.

Mr. Ritchie was deprived by the government's actions of the services of CWT, which was to have played an integral role in his defense.[158] The fact that he still is represented by the Arguedas firm does not render immaterial the loss of CWT. As *Stein I* held, and as the Supreme Court and the Second Circuit have recognized, a criminal defendant has a constitutional right "to control the presentation of his defense."[159] "Inherent in a defendant's right to control the presentation of his defense is the right to choose the counsel who presents it."[160] This includes the right to a

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157 Gremminger Decl. [dkt. item 1110] ¶¶ 2, 5, 7; Hasting Am. Decl. [dkt. item 1046] at 1-2; *United States v. Stein*, – F. Supp. 2d –, 2007 WL 1765613, at *1-2; Watson Decl. [dkt. item 1009] ¶¶ 15-17.

158 Half of Mr. Ritchie's defense costs are being advanced by another employer. Nevertheless, he is unable to fund even half of the cost of the defense that he would have mounted had KPMG paid his expenses. Ritchie 2d Supp. Decl. [dkt. item 1113] ¶¶ 9, 16.

159 *Lainfiesta v. Artuz*, 253 F.3d 151,154 (2d Cir. 2001) (citing *Herring v. New York*, 422 U.S. 853, 857 (1975)), *cert. denied*, *Lainfiesta v. Greiner*, 535 U.S. 1019 (2002).

160 *Id.* (citing *Caplin & Drysdale, Chartered v. United States*, 491 U.S. 617, 624 (1989) (acknowledging "defendant's right 'to select and be represented by one's preferred attorney'") (quoting *Wheat v. United States*, 486 U.S. 153, 159 (1988)); *Faretta v. California*, 422 U.S. 806, 819 (1975) (holding defendant has right to represent himself at trial)).

second lawyer or law firm if the defendant can afford it, either from his own resources or from resources lawfully available to him from others.[161]

As the Supreme Court held only last year in *United States v. Gonzalez-Lopez*,[162] the unjustified denial of the right to counsel of one's choice violates the Sixth Amendment without regard to considerations of prejudice:

> "Where the right to be assisted by counsel of one's choice is wrongly denied, . . . it is unnecessary to conduct an ineffectiveness or prejudice inquiry to establish a Sixth Amendment violation. Deprivation of the right is 'complete' when the defendant is erroneously prevented from being represented by the lawyer he wants, regardless of the quality of the representation he received. To argue otherwise is to confuse the right to counsel of choice – which is the right to a particular lawyer regardless of comparative effectiveness – with the right to effective counsel – which imposes a baseline requirement of competence on whatever lawyer is chosen or appointed."[163]

To be sure, *Gonzalez-Lopez* was a case in which a new trial, with the defendant represented by his chosen attorney, was entirely feasible, so the matter was remanded. Here, however, there are no funds to pay for these defendants' counsel of choice. Accordingly, the indictment must be dismissed as to these defendants because they have been deprived of counsel of their choice, independent of the existence of other grounds.[164]

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[161] *See, e.g.*, *Lainfiesta*, 253 F.2d at 154-56; *Stein I*, 435 F. Supp. 2d at 367.

[162] 126 S.Ct. 2557 (2006).

[163] *Id.* at 2563.

[164] The Court notes that *Lainfiesta* rejected the contention that the temporary denial of a second attorney of choice, specifically the trial court's refusal to permit one of the defendant's two attorneys to conduct a cross-examination of a forensic expert witness, was a structural error and applied harmless error analysis. This does not suggest a similar approach to this case.

The *Lainfiesta* panel applied harmless error analysis rather than presuming prejudice under the structural error doctrine because (1) "the error affected only the cross-examination of a single witness," (2) defendant's chosen lead counsel conducted the cross-examination with the second attorney sitting at counsel table, and (3) the second attorney was not totally

C. The KPMG Defendants as to Whom the Government Concedes Dismissal

The government, given *Stein I*, concedes that the indictment should be dismissed also against nine other defendants: Messrs. Bickham, DeLap, Eischeid, Smith, Rosenthal, Lanning, Stein, Warley, and Wiesner. Its "given *Stein I*" hedge, however, suggests that it may renew on appeal its contention that the KPMG Defendants were obliged to demonstrate prejudice. It is unnecessary to address this point further in light of the discussion in *Stein I.* Nevertheless, the Court's finding, based on this expanded record, that all of these defendants, as well as Messrs. Gremminger, Hasting, Ritchie and Watson, have been forced by KPMG's cutoff of payment of defense costs to curtail the defenses they would have mounted had KPMG paid those costs would satisfy any requirement of prejudice.

One additional point merits brief mention. At oral argument, the Court raised, as a conceptual matter, the fact that persons facing criminal prosecution may limit the amount they spend for at least two reasons. Some lack the funds to pay for the defenses they desire. Others have the funds, but choose to spend them on other things. Hence, it perhaps would be arguable that a defendant of the second type – one who has sufficient funds to defend – should not obtain a dismissal even if the government wrongfully has prevented a third party from paying the defendant's defense costs. The injury in that case perhaps could be said to be monetary alone rather than one that would affect the ability to mount a defense of choice. But this inquiry ultimately has proved in this case to be of only academic interest.

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unavailable to defendant because he "was accessible to [lead counsel] for consultation at all times and was never prevented from sharing his 'broader knowledge' of forensic science with him." 253 F.3d at 157-58. *Lainfiesta*'s holding on this point therefore has no bearing on this case, where Mr. Ritchie has been deprived entirely of the services of CWT and the consequences of that deprivation cannot be known.

The Court, in ruling on another motion, has found that Mr. Hasting is insolvent.[165] Mr. Watson has assets of approximately $80,000, owes his lawyers approximately $1 million, and has no regular source of income.[166] Mr. Bickham has remaining assets of less than $300,000, owes his lawyers over $600,000, and is threatened by his attorneys with a motion for leave to withdraw. Although he apparently has been able to earn significant income as a self-employed accountant, his ability to earn would be seriously compromised by the need to participate in a lengthy trial.[167] None of them can afford to defend this case at any meaningful level.

The other ten defendants as to whom the government concedes dismissal are in better financial circumstances. Their net assets range from something less than $1 million to something more than $5 million, with most being in the $1 to $3 million range.[168] There is no denying the fact that this is a great deal of money to most people. But there also is no denying that it is not sufficient for any of them to defend this case as they would have defended it absent the government's actions.

As an initial matter, some of the defendants' submissions disclose the fees and expenses, paid and unpaid, that they have incurred to date in defending this case. They range from a low of around $500,000 to a high of $3.6 million. They average roughly $1,700,000 per defendant

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165 ___ F. Supp. 2d ___, 2007 WL 1765613, at *1-2.

166 Watson Decl. [dkt. item 1009] ¶¶ 16-17, 19.

167 Bickham Decl. [dkt. item 1003] ¶¶ 7, 9-11.

168 DeLap Decl. [dkt. item 1118] ¶ 5; Eischeid Decl. [dkt. item 1117], Att.; Gremminger Decl. [dkt. item 1110] ¶ 2; Lanning Decl. [dkt. item 1119] ¶ 7 & Sch. A; Ritchie 2d Supp. Decl. [dkt. item 1113] ¶ 16; Rosenthal Aff. [dkt. item 1116] ¶ 4; Smith Decl. [dkt. item 1108] ¶¶ 5-8; Stein Am. Decl. [dkt. item 1121] ¶ 3; Warley Aff. [dkt. item 1114] ¶¶ 9-18; Weisner Decl. [dkt. item 1109] ¶¶ 7-8.

so far.[169] And the most expensive part of the case – a six to eight month trial – lies ahead.

More broadly, experienced counsel have submitted estimates of the cost of defending this case, assuming that KPMG or a comparable company were paying the defense costs. These have been based both on the actual costs of prior complex white collar criminal cases in which they have been involved, albeit none so large and complex as this, and on published reports of the defense costs in other such cases. These estimates are instructive.

First, prior to oral argument, one of the defendants' attorneys submitted a declaration stating the actual cost of his defense of a much smaller white collar criminal case involving a much shorter trial and far fewer documents than this one was $3.3 million.[170] The government agreed that $3.3 million would be "a very conservative estimate" of what it would cost to defend this case.[171] The same defense attorney later estimated that the cost of defending his client in this case as he would have defending him were KPMG paying the bills would have been more than $10 million.[172] Other defense attorneys put that figure in the range of $7 to $24 million each, with the average figure being around $13 million.[173]

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169 Bickham Decl. [dkt. item 1003] ¶ 7; Arkin Decl. (Eischeid) [dkt. item 1117] ¶ 7 (discloses only fees already paid without stating fees incurred since Sept. 2006); Gremminger Decl. [dkt. item 1110] ¶ 7; Hasting Am. Decl. [1046] at 2; Lanning Decl. [dkt. item 1119] ¶ 2; Rosenthal Aff. [dkt. item 1116] ¶ 6; Smith Decl. [dkt. item 1108] ¶ 4; Stein Am. Decl. [dkt. item 1121] ¶ 2; Warley Aff. [dkt. item 1114] ¶ 6; Watson Decl. [dkt. item 1009] ¶ 15; Wiesner Decl. [dkt. item 1109] ¶ 7.

170 Spears Decl. [dkt. item 1071] ¶¶ 3-10.

171 Tr., July 2, 2007, at 58:5-13.

172 Spears Decl. [dkt. item 1100] ¶¶ 7-8.

173 *See* Arkin Decl. [dkt. item 1117] ¶ 12; Gioiella Decl. [dkt. item 1095], at 1; Bauer Decl. [dkt. item 1094] ¶ 27; Necheles Decl. [dkt. item 1102] ¶ 16; Rule Decl. [dkt. item 1104] ¶ 9.

Second, both defendants and the government have pointed to press reports concerning defense costs in a number of recent high profile white collar prosecutions, all of which involved far fewer documents and far fewer defendants and most of which involved far shorter trials than this case will require. These have included costs of $14.9 million (Kumar - Computer Associates), $17.7 million and $8 million for each of two trials (Kozlowski - Tyco), $24 million (Shelton - Cendant), $25 million (Rigases - Adelphia), $32 million (Scrushy - HealthSouth), and $25 and $70 million (Lay and Skilling, respectively - Enron).[174]

The government was given the opportunity to comment both on defendants' estimates and on the published reports. Apart from its agreement that $3.3 million would be a "very conservative estimate" of the cost of defending this case, it has not done so. It declined also to provide its own estimate.[175] Thus, the government has elected not to contest any of the information before the Court.

The Court of course understands that the estimates of defendants' counsel are subject to bias, that published reports may be inaccurate, and that any estimate inherently is uncertain. But district judges pass on fee applications all the time. They of necessity are knowledgeable about the

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[174] Strassberg Decl. [dkt. item 1105] ¶ 15.

[175] Letter, John M. Hillebrecht, July 9, 2007 [dkt. item 1127]; Tr. July 2, 2007, at 58:20-59:10; Order, July 3, 2007 [dkt. item 1079].

The government's protestation of inability to do so is unconvincing. The USAO and the Department of Justice prepare budgets every year. They frequently are involved in litigation concerning attorneys' fee applications. The criminal defense bars in this and other cities are filled with former AUSAs who have intimate knowledge of the costs of defending large, document intensive criminal cases that they doubtless would have been happy to share with the government. The government, however, was within its rights in declining as a matter of policy to offer an estimate, although it of course must live with the consequences of that decision.

cost of litigation.[176] Without adopting any specific figure, the Court, based on its intimate familiarity with this case, the costs actually incurred to date, the scope of the task that lies ahead, and its awareness of the market for legal services, finds that none of the thirteen KPMG Defendants as to whom the government concedes dismissal has the resources to defend this case as he or she would have defended it had KPMG been paying the cost, even if he or she liquidated all property owned by the defendant.[177]

This is not to say that the Constitution guarantees anyone charged with a crime representation by a "Dream Team" or a multimillion dollar defense. But, as *Stein I* held, it does guarantee those who can afford it the right to spend their money for the best (or, what is not always the same thing, the most expensive) defense that money can buy, free of unjustified interference by the government. It also, as a general matter, prevents the government from interfering if a criminal defendant is fortunate enough to have someone who is willing to give the defendant the money to

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[176] For example, under fee-shifting statutes "[i]t remains for the district court to determine what fee is 'reasonable.'" *Hensley v. Eckerhart*, 461 U.S. 424, 433 (1983). This determination entails excluding "hours that were not 'reasonably expended'" and may involve considering "(1) the time and labor required; (2) the novelty and difficulty of the questions; (3) the skill requisite to perform the legal service properly; (4) the preclusion of employment by the attorney due to acceptance of the case; (5) the customary fee; (6) whether the fee is fixed or contingent; (7) time limitations imposed by the client or the circumstances; (8) the amount involved and the results obtained; (9) the experience, reputation, and ability of the attorneys; (10) the 'undesirability' of the case; (11) the nature and length of the professional relationship with the client; and (12) awards in similar cases." *Id.* at 430 n.3, 434.

[177] All of the figures, including that which the government agrees would be "a very conservative estimate" of the cost of defending this case, are astonishingly large, not in the sense that they are not credible, but for what they say about the cost of justice in our society and about the disparity between those with means and those without. Both are subjects that warrant careful attention by anyone concerned with the overall fairness, accessability and legitimacy of our judicial system. In deciding a given case, however, any court must deal with the reality that exists.

pay for a defense, even a very expensive one. The vice of the government's actions here was that the government improperly interfered with the payment of defense costs that KPMG otherwise would have paid, just as KPMG paid for a $20 million defense for four of its personnel in the Xerox case.

D. The Defendants as to Whom the Government Resists Dismissal

Notwithstanding its concession that dismissal is the only appropriate remedy for most of the KPMG Defendants, the government resists dismissal as to Messrs. Larson, Pfaff and Greenberg.

1. Defendants Pfaff and Larson

The government argues that Messrs. Pfaff and Larson, who left KPMG some time ago, did not ask KPMG to pay their defense costs until May 2006. This, the government maintains, shows that these defendants were not affected by the government's actions.[178] While the fact that the demand came late in the day is not persuasive, the government's argument draws attention to significant facts.

Messrs. Pfaff and Larson left KPMG in 1997 and formed a limited liability company,[179] Presidio, that played a central role in transactions at issue here. While the government acknowledges that the indictment embraces some conduct in which Pfaff and Larson allegedly

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[178] *See* Tr., July 2, 2007, at 52:5-54:19.

[179] Superseding indictment [dkt. item 57] ¶ 13.

engaged while still at KPMG, it asserts that a majority took place after they had left the firm.[180] Pfaff and Larson do not dispute this although they point out that the allegations of their post-KPMG employment activities relate back to a conspiracy allegedly formed earlier and that they are responsible in law for the acts of co-conspirators still employed by KPMG after Pfaff and Larson left.[181]

While an insurer has a duty to defend an insured against the entirety of an action in which the complaint asserts any claim that potentially is covered by the policy,[182] it has not been determined whether KPMG had a contractual or other legal obligation to defend. It is even less clear that it would have paid Pfaff's and Larson's defense costs, as a matter either of grace or of obligation, given that Pfaff and Larson left the firm so long ago and that a majority of their alleged conduct occurred after they left the firm. In consequence, Messrs. Pfaff and Larson have failed to establish a likelihood that the government's actions interfered with their ability to defend themselves.

2. Defendant Greenberg

Mr. Greenberg is differently situated from all of the other KPMG Defendants. He parted with the firm two years before the indictment in strained circumstances, entered into a settlement agreement pursuant to which he received a substantial payment, and gave KPMG a release.[183]

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[180] Govt. Mem. [dkt. item 1051] 39.

[181] Pfaff-Larson Reply Mem. [dkt. item 1061] 6-7.

[182] *Buss v. Superior Court*, 16 Cal. 4th 35, 47-48, 939 P.2d 766, 774-75 (1997). (Pfaff and Larson worked in KPMG's San Francisco office).

[183] Pitofsky Decl. [dkt. item 763] Ex. B, ¶¶ 2, 8.

Greenberg released KPMG "from any and all causes of action, . . . *contracts,* . . . claims, liabilities, . . . and demands, known or unknown, suspected to exist or not suspected to exist, anticipated or not anticipated, . . . which Greenberg ha[d] or may have against [it] . . . by reason of any and all acts, omissions, events or facts occurring or existing prior to the date hereof as it relates to Greenberg's membership in KPMG and his resignation from that partnership . . . ."[184] This clearly and unambiguously released any claim by Greenberg that KPMG was obligated to indemnify him or advance his defense costs pursuant to any contract, express or implied, that arose in connection with his employment.[185]

To be sure, the release did not foreclose the possibility that Mr. Greenberg, absent the government's interference, would have sought payment from KPMG, either as a matter of grace or pursuant to California statutes.[186] Given the circumstances of his departure,[187] however, the Court is not persuaded that KPMG would have paid his defense costs even in the absence of government

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[184] *Id.* at ¶ 8 (emphasis added).

[185] This issue was fully briefed and ripe for decision on a motion by KPMG in the ancillary proceeding for partial summary judgment dismissing, among other things, Mr. Greenberg's contract claim for advancement of defense costs. The decision granting that aspect of the motion was on the verge of being filed when the Second Circuit stayed that proceeding.

[186] CAL. LAB. CODE § 2802(a) (requirement of indemnification); CAL. CIV. CODE § 2778 (indemnification includes defense costs); *Jacobus v. Krambo Corp.*, 78 Cal. App. 4th 1096, 93 Cal. Rptr. 2d 425 (Cal. Ct. App. 2000) (LAB. CODE § 2802 requires employer to defend or pay defense costs); *Alberts v. Am. Cas. Co.*, 88 Cal. App. 2d 891, 899, 200 P.2d 37, 42-43 (Cal. Ct. App. 1948) (indemnitee may be entitled to recover as soon as it becomes liable). Under CAL. LAB. CODE § 2804, the release Greenberg signed was not effective to release his statutory rights.

[187] KPMG distrusted Mr. Greenberg. *See* Pitofsky Decl. [dkt. item 763] Ex. G; Greenberg Rule 56.1 St. [dkt. item 763-10] ¶ 11. The settlement agreement, moreover, evidences a desire on the part of KPMG to be done with Mr. Greenberg, once and for all.

interference.[188]

VI. Conclusion

For the reasons set forth above and in previous opinions, the motions of defendants Bickham, DeLap, Eischeid, Gremminger, Hasting, Lanning, Ritchie, Rosenthal, Smith, Stein, Warley, Watson, and Wiesner to dismiss the indictment are granted. The motions of defendants Greenberg, Pfaff and Larson are denied.

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.[189] But there are limits on the permissible actions of even the best prosecutors. As the Supreme Court wrote long ago, a prosecutor

> "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 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

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[188] It is unnecessary to determine whether this conclusion means that the constitutional rights of Messrs. Greenberg, Pfaff and Larson were not violated or only that dismissal is not an appropriate remedy.

[189] *See generally* Lewis A. Kaplan, *Henry L. Stimson Award Ceremony: Remarks*, 54 RECORD OF THE ASS'N OF THE BAR OF THE CITY OF NEW YORK 421 (1999).

> 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."[190]

The Department of Justice, in promulgating the aspects of the Thompson Memorandum here at issue, and the USAO in the respects discussed above and in *Stein I*, deliberately or callously prevented many of these defendants from obtaining funds for their defense that they lawfully would have had absent the government's interference. They thereby foreclosed these defendants from presenting the defenses they wished to present and, in some cases, even deprived them of counsel of their choice. This is intolerable in a society that holds itself out to the world as a paragon of justice. The responsibility for the dismissal of this indictment as to thirteen defendants lies with the government.

The foregoing supplements the findings of fact and conclusions of law previously made in this matter.

SO ORDERED.

Dated: July 16, 2007

Lewis A. Kaplan
United States District Judge

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[190] *Berger v. United States*, 295 U.S. 78, 88 (1935).