

White Collar Practice Alert

July 11, 2006

*District Court Rules the Government's Use of the Threat of Corporate Indictment Was Unconstitutional**by Kali N. Bracey, Joseph P. Covington and Andrew Weissmann***Introduction**

On June 26, 2006, the United States District Court for the Southern District of New York struck down a portion of a Department of Justice ("DOJ") memorandum that requires consideration of whether a company is paying for the attorney's fees for its employees in determining whether to charge that corporation with a crime. *United States of America v. Jeffrey Stein, et al.*, No. S1 05 Crim. 0888 (Judge Lewis A. Kaplan) (SDNY June 26, 2006) (slip op.). The basis for the court's decision was that the provision, part of the "Thompson Memorandum," violated the employees' rights to a fair trial and effective assistance of counsel under the Fifth and Sixth Amendments of the United States Constitution.

Although the government may appeal the decision and it is not technically binding on other courts, Judge Kaplan's 80-page decision declaring the Thompson Memorandum's provision relating to legal fees, as well as the U.S. Attorney's Office's implementation of that policy, unconstitutional is a landmark opinion in the area of white collar criminal defense. Its sound rebuke of a significant provision in the Thompson Memorandum may result in a revision of DOJ policy regarding whether or how much to weigh payment of employees' legal fees in determining whether to indict a corporation. It may also cause other district courts to take a harder look at the government's manipulation of a company's interest in avoiding indictment to constrain individual's constitutional rights to a fair trial and effective assistance of counsel.

The Thompson Memorandum

On July 9, 2002, in the wake of a number of major corporate scandals, President Bush established the Corporate Fraud Task Force headed by then-United States Deputy Attorney General Larry D. Thompson. In January 2003, Mr. Thompson issued the *Principles of Federal Prosecution of Business Organizations*, commonly referred to as the "Thompson Memorandum," which obligates U.S. Attorneys to consider certain factors in determining whether to indict a business entity. The Thompson Memorandum is similar in many respects to a memorandum by the Deputy Attorney General under the Clinton administration, with the most significant alteration being that the Thompson Memorandum *requires* its provisions be followed by all federal prosecutors, while the prior memorandum's guidance was discretionary.

Among other factors, the Thompson Memorandum requires that U.S. Attorneys consider a company's advancement of legal fees, unless required by law, as a factor to be weighed in deciding whether to charge a corporation with a criminal violation. Judge Kaplan noted that Mr. Thompson was quoted in the press defending companies cutting off payment of legal fees for their employees because the employees "don't need fancy legal representation" if they were not guilty of criminal wrongdoing. *Stein* at 6, n. 13 (quoting Laurie P. Cohen, *In the Crossfire: Prosecutors' Tough New Tactics Turn Firms Against Employees*, Wall. St. J., June 4, 2004, A1). The court did not share Mr. Thompson's opinion, finding it

“misguided, to say the least,” and stating that “even the innocent need substantial resources to minimize the chance of an unjust indictment and conviction.”

Implicit Threat Regarding Legal Fees

The essential facts that led to the Kaplan decision are these. KPMG, concerned about an IRS investigation into its involvement in developing, marketing, and implementing allegedly abusive tax shelters, hired an outside law firm to devise a “cooperative approach” with the government in the hopes of avoiding indictment.^[1] During a February 25, 2004 meeting between the government and KPMG’s representatives, including outside counsel, one of the Assistant U.S. Attorneys warned that KPMG’s payment of legal fees for employees being investigated would be viewed as rewarding their “misconduct” and that if KPMG had any discretion in not paying fees, KPMG’s actions would be placed “under a microscope.” Although the government argued that KPMG’s decision to cap the legal fees it paid to employees was not made at the government’s behest, the court concluded that no one at the meeting could have failed to draw the conclusion that the U.S. Attorney’s Office wanted KPMG to limit its financial support to its employees’ legal defense.

KPMG Limited Employees Legal Fees

While KPMG had a long history of voluntarily advancing and paying its employees legal fees, in an effort to avoid indictment the company heeded the government’s warning and limited legal fees it would pay to an employee to \$400,000 and further limited the payment, requiring that the employee “cooperate” fully with the government or face having support withdrawn (failure to cooperate was understood to include, among other actions, invoking the Fifth Amendment privilege against self-incrimination). KPMG also made clear that it would cut off all support if an employee were charged by the

government with criminal wrongdoing. KPMG also steered its employees to attorneys who would cooperate with the government investigation, as opposed to fighting it.

On August 29, 2005, KPMG entered into a deferred prosecution agreement with the government, thereby avoiding a criminal indictment, absent breach of the agreement. Shortly after this agreement was reached, a number of KPMG employees were criminally indicted.

Finding of Unconstitutional Interference with the Payment of Legal Fees

The opinion issued on June 26 was in response to the employees’ motion to dismiss the indictment or for payment of fees on the ground that the government had improperly interfered with their right to receive KPMG’s support in the form of advancement of attorney’s fees. The court held that the Thompson Memorandum’s requirement that U.S. Attorneys consider payment of legal fees in making charging decisions violates the Constitution’s Fifth Amendment Due Process clause. The court did allow that consideration of the payment of legal fees where the payments were made solely as part of a scheme to obstruct an investigation could be permissible, opening the door to a revision of the legal fees provision of the Thompson Memorandum. The Court also concluded that the U.S. Attorney’s Office “compounded the [due process] problem that the Thompson Memorandum created” with regard to legal fees by placing the issue of KPMG’s payment of its employees’ legal fees near the top of its agenda in discussions with KPMG’s counsel and making clear it would not be looked upon favorably.

In addition, the court agreed with the defendants that the government’s implementation of the Thompson Memorandum infringed their Sixth Amendment right to counsel, stating:

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.^[2]

After a lengthy discussion of the appropriate relief in which the court declined to dismiss the indictments and determined sovereign immunity prevented it from ordering that the United States pay the defendants' legal fees, the court stated that KPMG, which was not a party to the criminal case but which had appeared voluntarily, could either agree to pay the defendants or the defendants could file a civil complaint against KPMG within 14 days requesting a summary proceeding in which the court could order KPMG to advance the fees.

Conclusion

This ground-breaking decision places important limitations on the government's power to influence corporate policy by explicit or even implicit threats of indictment. Interestingly, it came in the same week

that the Supreme Court ruled the Department of Defense's procedure for trying prisoners held in Guantanamo Bay was illegal, and could be part of a larger trend towards stricter judicial review of Executive Branch actions.

Endnotes

[1] An amicus brief submitted by The Securities Industries Association pointed out that no major financial services firm had ever survived criminal indictment.

[2] The court took issue with KPMG's recommendation to its employees to use lawyers "who understood that cooperation with the government was the best way to proceed." The court stated:

[Outside counsel'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.

For more information, please contact:

Kali N. Bracey

Partner

Tel: 202 639-6871

Email: kbracey@jenner.com

Joseph P. Covington

Partner

Tel: 202 639-6035

Email: jcovington@jenner.com

Andrew Weissmann

Partner

Tel: 212 891-1650

Email: aweissmann@jenner.com

©Copyright 2005 Jenner & Block, LLP, One IBM Plaza, Chicago, IL 60611. Jenner & Block is an Illinois Limited Liability Partnership including professional corporations. Under professional rules, this communication may be considered advertising material. The material contained in this document has been authored or gathered by Jenner & Block for informational purposes only. It is not intended to be and is not considered to be legal advice. Transmission is not intended to create and receipt does not establish an attorney-client relationship. Legal advice of any nature should be sought from legal counsel. The attorneys responsible for this publication are Kali N. Bracey, Joseph P. Covington and Andrew Weissmann. Cover image from the Collection of the Supreme Court of the United States.