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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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

MEMORANDUM OF LAW IN SUPPORT OF CERTAIN DEFENDANTS' MOTION TO REMEDY THE VIOLATION OF DEFENDANTS' CONSTITUTIONAL RIGHTS TO COUNSEL AND A FAIR TRIAL RESULTING FROM THE PROSECUTORS' WRONGFUL INTERFERENCE WITH DEFENDANTS' ABILITY TO OBTAIN ADVANCEMENT OF LEGAL FEES FROM KPMG

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Defendants Jeffrey Stein, John Lanning, Richard Smith, Jeffrey Eischeid, Philip Wiesner, David Amir Makov, Larry DeLap, Steven Gremminger, Randy Bickham, Mark Watson, Carol Warley, and David Rivkin, (collectively "Defendants"), by and through their undersigned counsel, respectfully submit this memorandum of law in support of their motion to remedy the violation of defendants' constitutional rights to counsel and a fair trial resulting from the prosecutors' wrongful interference with defendants' ability to obtain advancement of legal fees from KPMG.

PRELIMINARY STATEMENT

The defendants in this case who are former partners of KPMG LLP ("KPMG") and stand indicted as a result of activities they are alleged to have undertaken on behalf of their employer firm ("KPMG defendants") ask this Court to rectify the prosecution's interference with their constitutional rights to counsel and a fair trial. This memorandum of law is submitted jointly on behalf of all the KPMG defendants.

For reasons that have to do with tactics, not substance, and which predictably – and intentionally – create gross disparities in the nature of legal representation and the ability to prepare for trial, the Government has put extreme pressure on KPMG to stop advancing payment for the defense of the individual defendants here. It has done so even though: 1) the KPMG defendants were indicted on the basis of work they did for the firm; 2) the firm had been advancing payment for defendants' legal fees up until the time of the prosecution's interference during the criminal investigation and KPMG's entry into a deferred prosecution agreement; 3) the firm has historically advanced to its partners payment of legal expenses for defense of civil, criminal and administrative matters, including proceedings brought by governmental entities, regarding acts by KPMG partners performed within their duties and responsibilities; and

4) it is the strong public policy of the state of Delaware, where KPMG is organized and registered, not only to permit but also encourage entities to advance payment for defense expenses in order to enable talented individuals to feel secure in taking responsible positions with Delaware entities and to enhance the reliability of a verdict by ensuring a level playing field.

But a level playing field is exactly what the prosecution here does not want. Why else stop KPMG from continuing to advance payment for the defense of the individual defendants? As we show below, the law clearly does not allow the prosecution to interfere unjustifiably with a defendant's relationships with his attorneys, nor does it permit the Government to interfere improperly with a defendant's business relationship with his employer. Here the Government has done both at the same time and has done so *en masse*. The facts show that the prosecution achieved its illicit goal by using both stick and carrot.

The stick has been well publicized: the prosecution famously threatened KPMG with indictment. As is now well known in the post-*Andersen* world, indictment alone would have spelled the end of the KPMG accounting firm. The carrot was contained within the Government's own internal policy, as memorialized in the Department of Justice's "Thompson memorandum", which outlines certain preconditions for an entity to escape indictment. One important precondition is the entity's willingness to cooperate with governmental authorities. Pursuant to that memorandum, the prosecution can judge cooperation by several factors, including whether the entity appears to be protecting its culpable employees through the advancing of attorneys fees. Once KPMG agreed to stop making payments towards defendants' legal fees in this case and paid the Government $256 million with the agreement to pay another $200 million later, it was granted a deferred prosecution.

The Government has improperly infringed on the KPMG defendants' constitutional rights to counsel and a fair trial. As a remedy, defendants ask the Court to direct that advance payments for their defense be provided just as they were prior to the time of the substantial interference by the prosecution and the execution of the deferred prosecution agreement. Alternatively, based on the totality of prosecutorial misconduct (the wrongful interference set forth herein, as well as the other misconduct set forth in the accompanying motion addressed to the deferred prosecution agreement), defendants ask the Court to dismiss the indictment. In addition, if the Government disputes the material facts relating to its wrongful interference or its motivation or improper means, defendants respectfully request an evidentiary hearing at the earliest opportunity in order to vindicate their legal and constitutional rights. We urgently ask for the intervention of the Court to level the drastically uneven terrain of the playing field purposefully constructed by the Government, so that defendants do not lag behind the prosecution in the laborious and costly effort of preparing for trial.

ARGUMENT

THE PROSECUTION HAS VIOLATED DEFENDANTS' CONSTITUTIONAL RIGHTS TO COUNSEL AND A FAIR TRIAL BY INTERFERING, WITHOUT PROPER BASIS OR JUSTIFICATION, WITH DEFENDANTS' ABILITY UNDER DELAWARE LAW TO OBTAIN ADVANCEMENT OF LEGAL FEES FROM KPMG

We begin our legal argument by showing that Delaware, the state under whose law KPMG operates as a limited liability partnership, has a strong public policy supporting advancement of legal fees. We then show that the prosecution wrongfully interfered with advancement of defendants' legal fees, and that such wrongful interference violated the KPMG defendants' constitutional right to counsel and a fair trial.

A. KPMG Is Organized Under Delaware Law, Which Has A Strong Public Policy Supporting Advancement Of Legal Fees To Promote The Reliability Of Verdicts And Level The Playing Field

Until the substantial interference by the Government, KPMG paid the costs of the defense for the KPMG partners under investigation, including the KPMG defendants. That was in accordance with longstanding practice. It was also in accordance with Delaware law and the public policy underlying the state law.

KPMG has operated as a limited liability partnership under Delaware law. Delaware has a strong policy, evidenced in its statutes and case law, supporting advancement as well as indemnification of legal fees and expenses needed for defense in litigation. The reason for the policy is clear: to ensure that qualified people will not be deterred from working for Delaware entities by the possibility of being unable to defend themselves fully and properly against costly civil or criminal litigation arising out of their employment.

Section 17-108 of the Delaware Revised Uniform Limited Partnership Act ("DRULPA") provides as follows:

> Subject to such standards and restrictions, if any, as are set forth in its partnership agreement, a limited partnership may, and shall have the power to, indemnify and hold harmless any partner or other person from and against any and all claims and demands whatsoever.

This statute is "designed to provide contracting parties with the maximum level of contracting freedom," and is "broadly empowering." Active Asset Recovery, Inc. v. Real Estate Asset Recovery Servs., Inc., C.A. No. 15478, 1999 Del. Ch. Lexis 179, at *15, *50 (Del. Ch. Sept. 10, 1999). That contracting freedom "permits a limited partnership to indemnify a partner or other person even in the absence of a provision in the partnership agreement." *Id.* at *51.

One underlying tenet of Delaware common law is that it is sound public policy to allow advancement pursuant to indemnification provisions agreed to by the contracting parties. Morgan v. Grace, C.A. No. 20430, 2003 Del. Ch. Lexis 113, at *9, text and n. 13 (Del. Ch. Oct. 29, 2003). DRULPA does not expressly address the subject of advancement of legal fees, because it does not need to do so. Both Section 17-108 of the DRULPA, as well as the verbatim provisions of Section 18-108 of the Delaware Limited Liability Company Act ("DLCCA"), are deemed "broadly enabling", in that they empower the contracting parties to determine the extent of indemnification and advancement in contractual agreements. *Id.* at *7, text and n. 13. As the Court stated in Delphi Easter Partners Ltd. P'ship v. Spectacular Partners, Inc., C.A. No. 12409, 1993 Del. Ch. Lexis 159, at *4 (Del. Ch. Aug. 6, 1993): "Section 17-108 [of DRULPA] defers completely to the contracting parties to create and delimit rights and obligations with respect to indemnification and advancement of expenses." Moreover, Section 17-1101(c) makes clear that the underlying policy of DRULPA is "to give maximum effect to the principle of freedom of contract and to the enforceability of partnership agreements."

Delaware law does not accept the argument that partners or officers may be denied advancement of legal expenses where they "would not be entitled to be indemnified if the conduct that is alleged ... were eventually proven to be true." That argument is deemed "fallacious" because it "blurs the distinct purpose of advancement provisions." Delphi Easter Partners Ltd. P'ship v. Spectacular Partners, Inc., supra, 1993 Del. Ch. Lexis 159, at *8. As explained by the Delaware Chancery Court, advancement of legal fees is regularly allowed and is not deemed dependent on the ultimate success or failure of the underlying claim against the party seeking advancement. Morgan v. Grace, supra, 2003 Del. Ch. Lexis 113, at *9, n. 18. The distinction between indemnification and advancement was underscored recently by the Delaware

Chancery Court, which stated: "This court has consistently held that advancement and indemnification, although obviously related, are 'distinct types of legal rights' and that the right to advancement is not ordinarily dependent upon a determination that the party in question will ultimately be entitled to be indemnified." Senior Tour Players 207 Mgmt. Co. v. Golftown 207 Holding Co., C.A. No. 20116, 2004 Del. Ch. Lexis 22, at *9 (Del. Ch. Mar. 10, 2004).

Advancement of the costs of defense may be ordered as a matter of law. In Ridder v. Cityfed Fin. Corp., 47 F.3d 85, 87-88 (3d Cir. 1995), the Third Circuit reversed the lower court's denial of a mandatory injunction requiring an entity to advance payment for legal fees to its former employees. The district court had refused to require advance payment on the ground that defendants "had failed to demonstrate a likelihood of success on the merits." *Id.* On appeal, the Court of Appeals disagreed, noting that "[u]nder Delaware law, appellants' right to receive the costs of defense in advance does not depend upon the merits of the claims asserted against them." *Id.* The court emphasized that the public policy behind liberal advancement of defense costs and legal fees for former employees is an important one that cannot be ignored or second-guessed by other branches:

> The statutory provisions authorizing advancement ... reflect a legislative determination to avoid deterring qualified persons from accepting responsible positions with financial institutions for fear of incurring liabilities greatly in excess of their means, and *to enhance the reliability of litigation outcomes involving directors and officers of corporations by assuring a level playing field.* It is not the province of judges to second-guess these policy determinations.

Id. at p. 87 (emphasis supplied). It determined that the defendants were "entitled to have their costs of defense advanced to them, as a matter of law," and directed that an injunction issue

requiring the former employer "to advance such defense costs as the parties by agreement, or the district court upon further proceedings, determines to be reasonable." *Id.*

Here, the Government's interference is more insidious than the decision of the district court in Ridder. There the court "second-guessed" a policy determination in a decision that was clear for all to see and the appellate court to reverse. Here, by contrast, the prosecution unilaterally pre-empted the policy determination not only of the legislature but also of KPMG itself. By making clear that KPMG's survival as an entity could depend, even in part, on abandoning its practice – grounded in state law and public policy – to advance legal fees to employees who had acted on its behalf, the Government has uncomfortably expanded its role. It has gone from an investigator/prosecutor to a bullying behemoth, who demands as tribute the sacrifice of individuals and uses any means at its disposal to stifle opposition to its awesome power to prosecute individuals. In so doing, the Government has violated law and policy. It has undermined the public policy and legal admonitions of the state of Delaware; it has improperly interfered with the contractual relationship between KPMG and its partners; and it has also unjustifiably and intentionally hampered the KPMG defendants' ability to defend themselves in this case.

The fact that this is a criminal case does not change the analysis. The basis for Delaware's policy of encouraging advancement of the costs of defense does not change because the nature of the litigation is criminal rather than civil.

This public policy is equally applicable where an officer or director of a corporation or a partner in a limited liability partnership has been indicted in a criminal prosecution brought by federal prosecutors. Courts in this district and in Delaware have ordered advancement of

defense costs and legal fees in criminal cases. In Homestore, Inc. v. Tafeen, No. 223, 2005 Del. Lexis 217 (Sup. Ct. Del. June 8, 2005), aff'd, No. 233, 2005 Del. Lexis 462 (Sup. Ct. Del. Nov. 17, 2005), the Supreme Court of Delaware directed that an entity advance legal fees to enable a former employee to continue his defense of federal criminal charges and related civil litigation. It upheld the Chancery Court's determination that a stay delaying advance payment of legal fees "would be inimical to the public policy of this State of affording advancement." It found that failure to provide advancement would irreparably harm the criminal defendant by reducing his ability to defend himself against criminal charges, but, by contrast, would not harm the entity at all:

> Tafeen's criminal trial has been set to begin on July 12, 2005, and the government has estimated that it will take at least two months to put on its case. A stay, which would prevent [the corporation's] advancement payment from reaching Tafeen in time to pay for his defense, would serve not only to deny Tafeen the very money that this Court believes he is contractually entitled to, but also would force Tafeen, who is severely short of funds, to selectively defend these various actions, a harm that could never be undone.
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> * * *
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> Clearly, to be of any value to the executive or director, advancement must be made promptly, otherwise its benefit is forever lost because the failure to advance fees affects the counsel the director may choose and litigation strategy that the executive or director will be able to afford.

Id. at *8-10.

Similarly, a court in this district directed advancement of defense costs in a criminal case. In United States v. Weissman, S2 94 Cr. 760, 1997 U.S. Dist. Lexis 12975 (S.D.N.Y. Aug. 28, 1997), the court applied New York law and directed a corporation to make advance payment of

legal fees incurred by a former officer in defense of a criminal prosecution until a final adjudication of his guilt, namely, the resolution of defendant's post-trial motions challenging the jury's verdict. In upholding advancement of legal fees in defense of a criminal prosecution, Judge Haight relied on Ridder and took special note of the purpose and policy served by advancement:

> [A]dvancement provisions ensure that qualified officers will not be deterred from accepting employment by the possibility of civil or criminal litigation arising out of their employment .... Moreover, advancement clauses "enhance the reliability of litigation outcomes involving directors and officers of corporations by assuring a level playing field."

Id. at *28 (*quoting* Ridder v. Cityfed Fin. Corp., supra, 47 F.3d at 87). As in Tafeen, the court in Weissman noted that a defendant may be irreparably harmed from effectively pursuing a defense if he is unfairly denied the advancement of legal fees on which he had a right to rely in pursuing his duties on behalf of his former employer. On that point, the court quoted from an Official Comment in the Model Business Corporation Act:

> It is often critically important to a director who is made a party to a complex proceeding that the corporation he served have power to make advances for expenses at the beginning of and during the proceeding. Adequate legal representation and adequate preparation of a defense may require substantial payments of expenses before a final determination, and unless the corporation may make advances for expenses, a defendant may be unable to finance his own defense.

Id. at * 29, *quoting* Model Act §8.53 Official Comment at 252 (cited in Practicing Law Institute, Indemnification and Insurance of Corporate Officials, 415 PLI/Comm 45, *58 (March 1, 1987)).[1]

In sum, KPMG's longstanding practice of advancing payment to partners to defend against allegations of violations committed in the performance of their duties and obligations at KPMG is consistent with Delaware law. The policy underlying Delaware law and KPMG's practice is remedial in nature: it is meant to ensure that entities such as KPMG do not lack for qualified officers and partners, who might be fearful of the expenses of civil, criminal or administrative litigation. The policy is intended to benefit the entity by making employees and officers feel they fulfill their duties and responsibilities secure in the recognition that they could afford to defend themselves against all types of ruinous litigation. The policy does not have the intent or effect of harming any governmental agencies. Nonetheless, as shown below, the Government has interfered to prevent this practice which causes it no harm. Its improper interference has undermined the entire remedial purpose of Delaware's law and public policy favoring advancement of legal fees.

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[1]The court further stated that a "corporation may, of course, determine that other concerns outweigh the goals promoted by advancing expenses, and that advancement should be made optional, or should not be permitted at all. Empire did not make this choice." *Id*. at *29-30. As we show next, KPMG did not exercise that freedom of choice in the case at bar. Instead the prosecutors intentionally interfered with the contracting parties' freedom of choice, as protected by Delaware's public policy and partnership law, and wrongfully induced and caused KPMG not to advance legal fees to any former partner indicted on criminal charges brought by the prosecutors.

B. The Prosecution Wrongfully Interfered With Advancement Of Defense Costs

In this matter, the prosecution has taken a policy with a remedial, beneficial purpose and treated it as evidence of criminality – or, at least, of non-cooperation. Worse still, it has prevented KPMG from continuing with its remedial practice of advancing defense costs to individuals who have been charged with wrongdoing while acting on behalf of KPMG and who should be entitled to advancement under past practice and state law. In short, the Government is misusing its considerable power by trying to handicap the KPMG defendants who seek to contest the charges against them.

The manner in which the Government has sought to muzzle the defense derives from an internal memorandum often referred to as the "Thompson Memo". On January 20, 2003, the U.S. Department of Justice issued a memorandum from Larry D. Thompson, then Deputy Attorney General, to all Heads of Department Components and to all United States Attorneys. *See* Memorandum on Principles of Federal Prosecution of Business Organizations ("Thompson Memorandum"), Exhibit A, annexed to the declaration submitted in support of this motion. Organizations were defined to include partnerships as well as corporations. Exhibit A, at p. 1, n. 1. The principles set forth in the "Thompson Memo" were designed to provide guidance to federal prosecutors deciding whether to seek criminal charges against a business organization. One of the nine basic factors prosecutors must consider is the business entity's remedial actions, including any efforts "to discipline or terminate wrongdoers" and "to cooperate with the relevant government agencies." *Id*. at p. 3. In assessing the business entity's cooperation, a key factor to be weighed by prosecutors is whether the business entity "appears to be protecting its culpable employees and agents." *Id*. at p. 7. In this regard, the memorandum specifically notes that a

business organization's "promise of support to culpable employees and agents ... through the advancing of attorneys fees ... may be considered by the prosecutor in weighing the extent and value of a [business organization's] cooperation." *Id.* at pp. 7-8.

In short, the Thompson Memo makes clear the Government's abiding dislike for payment of legal fees for those employees whom the prosecution deems to be "culpable". For KPMG, a large accounting firm, indictment was not an option. As evidenced by the swift demise of Arthur Andersen immediately after indictment, a formal federal criminal charge spelled immediate death for an accounting firm. Accordingly, in its effort to convince the Government to exercise its discretion not to indict, KPMG had no choice but to agree to the conditions imposed by the Government that enabled it to avoid indictment. Simply put, to avoid indictment, KPMG was required to cooperate with the prosecution under the tenets of the "Thompson Memo", including denial of advancement of legal fees to the KPMG defendants.

Upon information and belief, based on the collective information of the KPMG defendants (some of whom held high-level positions with KPMG) and press articles, the relevant facts with respect to KPMG's practice with respect to advancement and indemnification of legal fees include the following[2]: (1) KPMG historically has advanced and paid legal fees to its current or former partners in connection with the defense of civil, criminal and administrative matters arising from their conduct while acting on behalf of KPMG, including actions and proceedings

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[2]These facts are asserted upon information and belief because, undoubtedly due in substantial part to restrictions emanating from KPMG's cooperation with the government and the deferred prosecution agreement, the defense has not been able to obtain from KPMG even basic documents relating to advancement and indemnification of attorneys' fees. KPMG has even refused to provide copies of insurance policies relevant to payment of attorneys' fees incurred by KPMG partners.

brought by governmental entities; (2) in such civil and administrative matters, KPMG has also paid the amounts of settlements entered into by its current and former partners, as well as judgments rendered against such partners; (3) with the exception of the criminal case at bar, KPMG has continued these historical practices involving advancement and payment of legal fees in civil, criminal and administrative matters, and with respect to payment of settlements and judgments in civil and administrative matters, even after it was induced to refuse to advance legal fees in the instant criminal prosecution; (4) with the exception of the criminal case at bar, KPMG has never refused to follow these historical practices; (5) the SEC's continuing investigation and proceedings against KPMG and several of its current or former partners in the Xerox matter is a prime example of a case in which KPMG has followed these historical practices (advancement and payment of legal fees incurred by, and payment of settlements entered into by, its current and former partners) both before and after its refusal to advance legal fees in the instant criminal prosecution; (6) as part of its cooperation with the prosecutors in the case at bar, KPMG was induced (a) to refuse to make payment for legal fees incurred by current or former partners during the pre-indictment investigation, unless they agreed to "cooperate" with the government, including being interviewed by the prosecutors concerning the subject matter of the investigation, and (b) with respect to any such partner who was "cooperating" with the prosecutors, to refuse to make payment for legal fees if the partner were indicted on criminal charges brought by said prosecutors.

Press articles make clear that when seeking to avoid indictment KPMG was "fighting for its life" and therefore caved to the pressure of Government conditions, particularly by "following the tenets of the so-called Thompson memo," in order to prove itself sufficiently compliant to

obtain the Holy Grail: a deferred prosecution. (Exhibit B, article in New York Law Journal, at p. 2.) As further noted in the press, KPMG has been "forced to cut all financial ties to these defendants – all this without the government even having to prove that the claimed tax losses were improperly taken." (Exhibit C, Robert Weisberg and David Mills, *A Very Strange Indictment*, Wall Street Journal, October 12, 2005, at page A16.) The government has used the "power of prosecution" to try to deny the KPMG defendants a full-fledged defense in court "by cutting them off from the support of their firm through the threat of a death-sentence indictment of KPMG itself." Exhibit D, *KPMG in Wonderland*, Wall Street Journal, October 6, 2005, at page A14.

Under these circumstances there can be no reasonable doubt that, as part of its cooperation with the prosecutors, KPMG was induced to do the following: (1) it refused to make payment for legal fees incurred by current and former KPMG partners during the pre-indictment investigation unless they agreed to be interviewed by the prosecution concerning the matters under investigation; and (2) it refused to provide advancement of legal fees to the KPMG defendants once they were indicted on criminal charges brought by the prosecutors. If, however, the Government disputes the material facts in this regard, defendants seek an evidentiary hearing to establish the Government's inexorable condition for a deferred prosecution that KPMG could no longer fund defense costs for the individual KPMG defendants, notwithstanding the fact that the actions of which the prosecution complained were undertaken on behalf of KPMG and were part of the defendants' duties and responsibilities as KPMG partners.

In sum, this interference by the prosecutors with defendants' legitimate entitlement to contracting freedom of choice concerning advancement of legal fees is coercive and unjustified.

The Government has no legitimate interest in stopping an employer from continuing to advance funding that enables its former employees and partners to defend themselves against charges that relate to actions taken in the performance of their duties and responsibilities on behalf of KPMG. Nor does the Government have a legitimate interest in adversely affecting the ability of KPMG defendants to mount a full and effective defense to the criminal charges. As we show below, the Government's coercive misconduct violates defendants' constitutional rights to counsel and a fair trial.

C. The Prosecution's Wrongful Interference With Advancement Of Defendants' Legal Fees Violated The Constitutional Right To Counsel And A Fair Trial

Once it is established, by evidentiary hearing or otherwise, that the prosecutors substantially interfered with the contracting freedom of choice of KPMG and its partners, thereby inducing KPMG to stop advancing the costs of defense to the individual KPMG defendants, two legal issues arise. The first is that the Government tortiously interfered with the business relationship between KPMG and its employee-partners, specifically the ability of the KPMG defendants to continue to obtain advancement of attorneys fees in the defense of this criminal prosecution. The second and more critical issue before the Court on this motion is that the Government's effort to rig the outcome of this criminal case by impairing the KPMG defendants' ability to defend themselves is not just unseemly and reeking of chicanery, it fails the fundamental measure of fairness in our legal system: it infringes on defendants' constitutional rights to counsel and a fair trial.

1. The Government's Tortious Interference with Business Relations

We begin by pointing out that if the conduct at issue herein had been committed by private actors, the conduct would be wrongful under the common law tort of interference with business and prospective contractual relations. Typically, where a party intentionally and improperly interferes with another's business or actual or prospective contractual relations with a third party, by inducing or causing the third party not to enter into or continue the contract or the relationship, the interfering party is subject to liability for the pecuniary harm resulting from the loss to the injured party of the benefits of the contract or relationship. Restatement of the Law, Second, Torts, §§ 766, 766B, 767 (1979). In determining whether the interference is improper, consideration is given to several factors, including: 1) whether the conduct is "in violation of statutory provisions or contrary to established public policy"; 2) whether the conduct involves the use of economic pressure; and 3) whether there is adequate justification for the conduct. *See id.*, § 767 and comments thereto. One of the many bases for liability includes the use of improper economic pressure directed at a third party with whom the injured party has or seeks to have business or prospective contractual relations, or where the pressure extends beyond the "legitimate" business activity of the actor. *See e.g.*, Carvel Corp. v. Noonan, 3 N.Y.3d 182, 190-94 (2004) (wrongful means includes "extreme and unfair" pressure on third party); Scutti Enters., LLC v. Park Place Entm't Corp., 322 F.3d 211, 216-17 (2d Cir. 2003) (improper means include use of economic pressure for no legitimate purpose or in a manner not related to a valid business purpose); Brokerage Concepts, Inc. v. U.S. Healthcare, Inc., 140 F.3d 494, 529-33 (3d Cir. 1998) (wrongful means include use of economic pressure on third party in matters outside the legitimate competitive market to coerce the third party's decision in the competitive market).

Cases involving interference with the attorney-client relationship are very instructive when trying to determine whether the interfering conduct is beyond the legitimate activity of the actor or whether the use of economic pressure is without justification or legitimate purpose. Particularly apt are the cases involving a situation where: (1) a client engaged an attorney to represent him in obtaining a recovery for personal injuries, (2) the insurance company then induced or caused the client to terminate relations with his attorney, and (3) the insurance company later settled the personal injury claim directly with the client. Where the insurer refused compensation or was recalcitrant regarding settlement unless the client terminated relations with his attorney, the courts have long held that the insurance company wrongfully interfered with attorney-client relations and is liable for tortious interference. The insurer's own interest in obtaining a settlement is not deemed to justify threats or economic pressure that induce interference with the attorney-client relations. Nor does the absolute right of a client to terminate his attorney at will justify wrongful interference by a third party. *See e.g.*, Lurie v. New Amsterdam Casualty Co., 270 N.Y. 379 (1936); Pompeyo Roa Realuyo v. Diaz, 98 Civ. 7684, 2000 U.S. Dist. Lexis 3686, at *12-13 (S.D.N.Y. Mar. 23, 2000) (claim for tortious interference with attorney-client relations sustained where "third party induces the attorney's client to repudiate a retainer agreement as a precondition for negotiating a settlement"); Marks v. Struble, 347 F. Supp. 2d 136, 144-45 (D.N.J. Nov. 18, 2004) (collecting cases); Skelly v. Richman, 10 Cal. App. 3d 844, 1970 Cal. App. Lexis 1896, at *33 (1970) (court found third party interference with attorney- client relations through economic pressure rather than mere persuasion to be unjustified, noting "[t]he right of a client to terminate the attorney-client relationship at will does not justify breach inducement by a third party").

Interference with attorney-client relations is also not tolerated by disciplinary rules that prevent a lawyer from undermining an adversary by speaking directly to her client. N.Y. Code of Professional Responsibility DR 7-104(a)(1), N.Y. CLS Jud Appx Code Prof Resp DR7-104 (2005) ("a lawyer shall not . . . communicate or cause another to communicate on the subject of the representation with a party the lawyer knows to be represented by a lawyer in that matter," unless the party's lawyer consents, or the communication otherwise is "authorized by law.") Prosecutors are bound by this rule, *see* United States v. Hammad, 858 F.2d 834, 837-42 (2d Cir. 1988). Nor is such interference tolerated in cases where a party similarly tries an end-run around an adversary in order to prevent the attorney "from performing his professional duties or if the performance of the professional duties is simply made more difficult." Callis, Papa, Jenson, Jackstadt & Halloran, P.C. v. Norfork Southern Corp., 292 Ill. App. 3d 1003, 1997 Ill. App. Lexis 753, at *9, 11-20 (1997) (where employee was represented by an attorney in dispute with employer, and employer interfered with the law firm's representation of employee by requiring the employee under penalty of dismissal to answer questions in disciplinary proceeding outside presence of his attorney, conduct constituted tortious interference with attorney-client relations, absent a legally protected right by the employer to engage in such conduct) ("Callis I"); Callis, Papa, Jenson, Jackstadt & Halloran, P.C. v. Norfork & W. Ry., 195 Ill. 2d 356, 2001 Ill. Lexis 477 at *22, 26-27 (2001) (modifying Callis I on point not material herein). In short, the prosecution's conduct in interfering with payment for the defense costs of the KPMG defendants is unquestionably improper pursuant to the principles underlying the common law tort of interference with business or prospective contractual relations because: (1) the conduct is contrary to Delaware's strong public policy regarding advancement of attorneys fees and the

freedom of choice by a partnership and its partners with respect to the terms thereof; (2) the conduct has involved the use of extreme economic pressure against KPMG that was unfairly and unjustifiably designed to adversely affect the ability of the KPMG defendants to obtain advancement of attorneys fees to mount a defense in this mammoth criminal prosecution; and (3) the Government had no legitimate interest in curtailing the ability of the KPMG defendants to obtain advancement of the costs to defend themselves against the criminal charges in this case.

2. The Prosecution's Interference Violates the KPMG Defendants' Constitutional Rights

The noxious nature of the prosecution's misconduct is compounded by the fact that the interference here at issue was effected by law enforcement officials, not private actors. It has long been held that where state officials acting under color of state law interfere with the exercise of the constitutional right to counsel by a defendant in a criminal case, and where interference with the attorney-client relationship was "either wrongfully motivated or without adequate justification," the client has established an infringement of his constitutional right to counsel. Via v. Cliff, 470 F.2d 271, 274-75 (3d Cir. 1972) (prisoner entitled to sue for deprivation of constitutional right to counsel where interference by prison officials with prisoner's ability to consult with counsel was either wrongfully motivated or without adequate justification).

The fact that KPMG may have been legally entitled to choose whether to provide advancement of legal fees to the KPMG defendants did not give the Government license to pressure the firm improperly and infringe on the constitutional rights of the firm's partners.

Although the prosecution's interference in this matter may present a question of first impression, there is analogous case law that illustrates the fundamental impropriety of the prosecution's conduct here.

It is well established that "substantial government interference" with a defense witness' "free and unhampered choice" to testify constitutes a violation of a defendant's due process rights. United States v. Vavages, 151 F.3d 1185, 1188 (9th Cir. 1998) (conviction reversed where prosecution used improper tactics to prevent defense witness from offering testimony relating to alibi); United States v. Pinto, 850 F.2d 927, 932 (2d Cir. 1988) (collecting cases: prosecutorial conduct infringes a defendant's due process rights where the "conduct interfered substantially with a witness' 'free and unhampered choice' to testify"); United States v. Morrison, 535 F.2d 223, 224-28 (3d Cir. 1976) (interference by prosecutor with witness' "free and unhampered choice" to testify, including threats of prosecution or other intimidating conduct, violated defendant's right to due process); State v. York, 291 Ore. 535, 1981 Ore. Lexis 1040, at *5-6 (1981) (the prosecutor may not frustrate, by improper means, the legitimate efforts of accused to defend case and may not interfere with defendant's access to witnesses by instructing or suggesting they not talk to defense attorney).

Also instructive are the two cases in which the Government restrained and forfeited funds that defendants intended to use to pay lawyers to defend them in the criminal case underlying the forfeiture. Significantly, the principles set forth in the cases regarding forfeiture and pretrial restraint of attorneys fees in criminal cases make clear that the Government's aggressive conduct here in cutting off funds for the defense of the KPMG defendants constitutes an impermissible

burden on the Sixth Amendment right to counsel and a violation of the Fifth Amendment right to a fair trial.

In two landmark 5-4 decisions, the Supreme Court addressed issues arising from the impact of the federal criminal drug forfeiture statute on funds that the criminal defendant intended to use to pay attorneys fees in defense of the criminal prosecution. In Caplin & Drysdale, Chartered v. United States, 491 U.S. 617, 632-33 (1989), the Court held that neither the Fifth nor the Sixth Amendment requires Congress, when enacting a forfeiture statute, to permit a defendant to use "assets adjudged forfeitable" to pay his or her legal fees. In United States v. Monsanto, 491 U.S. 600, 615 (1989), the Court held that the forfeiture statute, as enacted, allows assets in a defendant's possession to be restrained prior to trial provided that there is first a "finding of probable cause to believe that the assets are forfeitable." These cases provide considerable guidance because, while the Court ruled in each case, by a narrow margin, that the prosecution's actions there were not unconstitutional, the analysis in both cases shows why, by contrast, the Government's actions here are impermissible.

In both forfeiture cases there were key factors that are notably not present here. First, there was statutory authorization for the government's conduct in seeking to restrain and forfeit the funds that defendants sought to use to pay attorneys fees in defense of the criminal charges in those cases. Not surprisingly, there is no statutory authorization for the Government's wrongful conduct in using the extreme economic pressure arising from the threat of indictment as a means of coercing KPMG into refusing to continue to advance the defense costs of the KPMG defendants. Indeed, not only is there no statutory authorization for the prosecution's conduct, but such conduct is contrary to Delaware law and public policy.

Second, the statutory forfeiture scheme at issue in the forfeiture cases gave the Government a property right in the very funds that defendants wanted to use for attorneys fees. The right came from a relation-back provision in the federal forfeiture statute that vested in the Government all right, title and interest in the property at issue from the time the criminal acts were committed. Caplin & Drysdale, *supra,* 491 U.S. at 627. By contrast, here, unlike there, the prosecution has absolutely no property interest whatsoever in any funds that it has required KPMG to stop paying out for defense costs for its former partners.

Third, the prosecution in Caplin & Drysdale and Monsanto relied on an important policy argument that, like the property interest, is not present here. It identified "a strong governmental interest in obtaining full recovery of all forfeitable assets," Caplin & Drysdale, *supra*, 491 U.S. at 629. Here, however, the Government cannot claim the high ground of a public policy argument as a basis for trying to prevent KPMG from advancing to its former partners the funds with which to defend themselves against criminal charges. On the contrary, as shown previously, the public policy of the state in which KPMG is organized and registered supports such payments.

Finally, the issue in Monsanto was whether and under what circumstances the Government could obtain a pretrial restraining order precluding a defendant from using funds to pay attorneys fees in defense of the criminal case. The Supreme Court determined that it was constitutionally permissible to sequester funds, even if earmarked for legal defense fees, provided that any pretrial restraint of assets is based on a finding of probable cause to believe the assets were subject to forfeiture . Monsanto, *supra*, 491 U.S. at 615, 616. Here, by contrast,

there is no probable cause finding – nor could there be – that the KPMG advancement policy was in any way wrongful or subject to seizure or forfeiture.

When ruling in favor of forfeiture, the Supreme Court did not give the Government *carte blanche* to restructure the legal playing field to its own advantage by using unfair or arbitrary measures to impact adversely on a defendant's ability to defend himself. The majority specifically recognized that the impact of the forfeiture statute on payment of attorneys fees and the balancing of forces between prosecutors and the defense "can be devastating when used unjustly," but ruled that "due process claims alleging such abuses are cognizable only in specific cases of prosecutorial misconduct ... or when directed to a rule that is inherently unconstitutional." Caplin & Drysdale, *supra,* 491 U.S. at 634-35. Here, where the Government has used its considerable powers and pressure to stop KPMG from advancing payment to the many individual KPMG defendants, the prosecution's unwarranted actions amount to brazen misconduct. The Government's strategy of handicapping the defendants at the outset would be unseemly in any case, but it is particularly egregious here where the costs of defending a case involving millions of documents and a lengthy trial are staggering.

In the forfeiture cases, the Fifth and Sixth Amendment implications that concerned all nine Supreme Court justices were underscored by the opinion of the four dissenting justices, who firmly believed that the governmental interests were outweighed by the more fundamental issues of fairness protected by the Sixth Amendment right to counsel and the Fifth Amendment right to a fair trial. The dissenting opinion, which applied to both cases, began with the following observation, which is apropos to the defense of the instant complex case: "it is unseemly and

unjust for the Government to beggar those it prosecutes in order to disable their defense at trial." Caplin & Drysdale, *supra*, 491 U.S. at 635.

The dissent went on to vocalize the tremendous discomfort it felt with the notion that the Government felt it had a legitimate interest in depriving an accused "'of economic power ... to retain counsel of choice.'" It found that approach "more than just 'somewhat unsettling,' as the majority suggests;" it deemed it "constitutionally suspect." *Id*. at 640, n. 7. It noted the important and "distinct role of the right to counsel of choice in protecting the integrity of the judicial process." In words very clearly applicable to what the Government has done here, it emphasized that the

> right to retain private counsel also serves to assure some modicum of equality between the Government and those it chooses to prosecute. The Government can be expected to "spend vast sums of money ... to try defendants accused of crime" [citation omitted], and of course will devote greater resources to complex cases in which the punitive stakes are high.... Where cases are complex, trials long, and stakes high .... [w]ithout the defendant's right to retain private counsel, the Government too readily could defeat its adversaries simply by outspending them.

Id. at 645-47.

Citing Judge Feinberg's concurrence in the Second Circuit, the four dissenting justices made clear that it is constitutionally improper for the Government to seek to win by hobbling the defense: "'[W]eakening the ability of an accused to defend himself at trial is an advantage for the government. But it is not a legitimate government interest that can be used to justify invasion of a constitutional right.'" *Id.* at 651-52, *citing* United States v. Monsanto, 852 F.2d 1400, 1403 (1988) (Feinberg, C.J., concurring). The dissent noted that even with the property interest

granted by the forfeiture statute, the interests asserted by the Government were far too weak and lacking in legitimacy to justify erosion of the defendant's Sixth Amendment rights. *Id.* at 652.

In sum, here there is no statutory authorization for the Government's conduct, the Government has no property right (let alone a vested one) whatsoever in the funds that would be used for advancement, and there is no legitimate public policy justifying its conduct (indeed, the prosecution's conduct is contrary to public policy). The prosecution has no legitimate interest – not even a weak one – to justify its gross interference with KPMG's advancement of attorneys fees to the KPMG defendants. Accordingly, we respectfully submit that an analysis of the legal principles enunciated in both the majority and dissenting opinions in Caplin & Drysdale and Monsanto, virtually compels the conclusion that the prosecution's conduct herein violates defendants' constitutional rights to counsel and a fair trial.

As Justice Black noted in the seminal case of Gideon v. Wainwright, 372 U.S. 335, 344 (1963), the Government spends "vast sums of money to establish machinery to try defendants accused of crime." If the Government itself engages high quality lawyers because they are "essential to protect the public's interest in an orderly society," *id.*, then our constitutional sense of fair play, as embodied in the Fifth and Sixth Amendments, requires that defendants not be arbitrarily or unfairly deprived of the means of hiring lawyers of the same or similar quality. Moreover, a significant purpose of the public policy favoring advancement is to provide a level playing field between the Government and defendants in complex criminal prosecutions involving former officers or partners of business organizations, as in the case at bar.

The Supreme Court has stated that prosecutors 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). In Moulton that meant the prosecution could not indirectly interfere with the defendant's representation by sending in an informant to elicit admissions after the defendant's right to counsel had attached. A violation of the Sixth Amendment right to counsel can also result from interference with the attorney-client relationship where the conduct is "designed to give the prosecution an unfair advantage at trial." United States v. Irwin, 612 F.2d 1182, 1187 (9th Cir. 1980). *See* United States v. Marshank, 777 F. Supp. 1507, 1521, 1526 (N.D.Cal. 1991) (finding that the prosecution's conduct was "designed to and would give the prosecution an unfair advantage at trial").

Here the interference was directly aimed at the attorney-client relationship: it was plainly designed to deprive the KPMG defendants of advancement of attorneys fees for use in mounting a full and effective defense of the criminal charges in this complex criminal prosecution, thereby undermining the Delaware public policy of assuring a level playing field in criminal prosecutions of former corporate or partnership officials. But prosecutors are obligated "to refrain from unreasonable interference with the individual's desire to defend himself in whatever manner he deems best, using every legitimate resource at his command." Boulas v. Superior Court, 188 Cal. App. 3d 422, 1986 Cal. App. Lexis 2392, at *15 (1986) (appellate court found dismissal to be the appropriate sanction where the prosecutor had interfered with a defendant's right to counsel by requiring, as a precondition to plea bargaining, dismissal of defendant's current attorney and substitution of counsel from a very small approved list). Moreover, the issue of whether prosecutorial conduct violated the constitutional right to counsel is to be determined in light of the prosecutors' affirmative obligation "not to act in a manner that circumvents and thereby dilutes the protection afforded by the right to counsel." United States v.

Marshank, supra, 777 F. Supp. at 1526 (quoting from Supreme Court's decision in Maine v. Moulton, supra). In words that are apropos here, the Court in *Marshank* held:

> [I]t is beyond cavil that the government failed to fulfil its *affirmative* obligation as described in Moulton. There can be no question but that the government in this case circumvented and diluted the protections guaranteed to the defendant by the Sixth Amendment right to counsel.

Id. at 1526.

In sum, the prosecutors wrongfully interfered with the KPMG defendants' ability to obtain advancement of attorneys fees from KPMG for use in the defense of this criminal prosecution, thereby violating said defendants' constitutional rights to counsel and a fair trial. As a result, it is incumbent upon the Court to remedy this violation.

In United States v. Morrison, 449 U.S. 361, 364-65 (1981), the Supreme Court held that Sixth Amendment violations "are subject to the general rule that remedies should be tailored to the injury suffered from the constitutional violation," and absent at least a substantial threat of prejudice, dismissal of the indictment is not warranted. Here it appears that it is not too late to remedy the injury from the prosecutors' unconstitutional interference with advancement of attorneys fees by an order directing advancement of legal fees be provided to the KPMG defendants.[3] At all events, the Court can remedy the violation either by directing that advancement of legal fees be provided to defendants in the defense of this criminal prosecution

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

or, upon a consideration of the additional misconduct set forth elsewhere in defendants' motion papers, by dismissing the indictment based on the totality of prosecutorial misconduct.

CONCLUSION

For the reasons set forth herein, the KPMG defendants' motion to remedy the prosecutors' unconstitutional interference with advancement of attorneys fees should be granted.

Dated: January 12, 2006 Respectfully submitted,

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