# 07-3042-cr

*To be Argued by:*
JOHN S. MARTIN, JR.

# United States Court of Appeals

*for the*

# Second Circuit

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, RICHARD ROSENTHAL,

*Defendants-Appellees.*

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

## BRIEF FOR DEFENDANTS-APPELLEES LARRY DELAP, STEVEN GREMMINGER, CAROL G. WARLEY AND PHILIP WIESNER


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## PRELIMINARY STATEMENT

Over the course of approximately 18 months of thoughtful, carefully conducted legal proceedings, Hon. Lewis A. Kaplan, United States District Judge for the Southern District of New York, issued a series of detailed and well-reasoned decisions addressing the constitutional impact and consequences of the actions of prosecutors in the Southern District of New York in implementing the so-called Thompson Memorandum of the Department of Justice. Left with no alternative but to dismiss the indictment to right the wrongs he found, Judge Kaplan did so as to 13 former partners and employees of KPMG, LLP. The dismissal occasioned this appeal by the prosecution.

We submit this brief on behalf of four of the 13 appellees as to whom Judge Kaplan dismissed the indictment. All were partners or principals of KPMG, LLP. All but one are Certified Public Accountants. Two are also lawyers.

Larry DeLap is a Certified Public Accountant and was a tax partner at KPMG from 1974 to 2002. He was the Partner-in-charge of KPMG's Department of Professional Practice – Tax from the creation of the position in 1997 to September 2002. *Smith* A.136-37.[1]

Steven Gremminger is a lawyer. He was a principal at KPMG and an associate general counsel in its Office of General Counsel from approximately 1998 to 2005. As part of his duties in the Office of General Counsel, he was the primary contact in that office for the firm's tax practice. *Smith* A.137.

Carol Warley is a Certified Public Accountant. She was a tax partner from 1993 to December 2004. *Smith* A.138.

Philip Wiesner is a lawyer with a Master's degree in tax law and a Certified Public Accountant. He was a tax partner at KPMG for almost 25 years and served as the Partner-in-charge of Washington National Tax during the period 1991 – 1999. *Smith* A.136.

The other nine appellees are also either Certified Public Accountants, lawyers, or both.

[1] We adopt the reference prefixes to the various Appendices used by the prosecution in its Opening Brief ("Gov't Open. Br.") on this appeal at *, pg.7.

## STATEMENT OF FACTS[2]

On March 15, 2002, Arthur Andersen, one of the then five largest accounting firms in the United States, was indicted on charges relating to its conduct in connection with auditing Enron. Even though its conviction on these charges was ultimately reversed by the Supreme Court (*Arthur Andersen, LLP v. United States*, 544 U.S. 696 (2005)), Arthur Andersen was forced to go out of business shortly after its indictment and to terminate the employment of its 85,000 partners and employees.

Sometime before February 25, 2004, KPMG – one of the four remaining big accounting firms -- learned that it was the subject of a grand jury investigation being conducted by the United States Attorney's Office in Manhattan and that several of its partners and employees had been advised that they were subjects of that investigation. *Smith* A.395, 427.

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[2] The several opinions of the District Court, referred to shorthandedly as *Stein I* (*United States v. Stein*, 435 F.Supp.2d 330 (2006)), *Stein II* (*United States v. Stein,* 440 F.Supp.2d 315 (2006)), *Stein III* (*United States v. Stein,* 452 F.Supp.2d 230 (2006)) and *Stein IV* (*United States v. Stein,* 495 F.Supp.2d 390 (2007)) by the prosecution at various points in its Opening Brief in this appeal, present in detail the facts that led it to conclude that the combination of the Thompson Memorandum and the statements by various Assistant United States Attorneys coerced KPMG into abandoning its long-standing policy of paying the attorneys' fees of its partners and employees in connection with criminal matters. We limit this Statement to some of the more salient facts that support the District Court's conclusion.

For at least 30 years prior to March, 2004, it had been the practice of KPMG to advance and pay all legal fees of partners, principals and employees of the firm in any civil, criminal or regulatory proceedings involving activities arising within the scope of the individual's duties and responsibilities at KPMG. This practice was followed without regard to economic cost. On at least one occasion, KPMG paid pre- and post-indictment legal fees and expenses for a partner and employee who were convicted of violations of federal criminal law. On another occasion, KPMG paid over $20 million for legal fees of its partners and employees in connection with an investigation that had both civil and criminal aspects. *Smith* A.472. Because it was a partnership, KPMG recognized that it would be a problem to change this policy. *Smith* A.698.

On January 27, 2004 KPMG entered into a contract with defendant Stein that provided:

> Consistent with the Firm's general policy and practice, [Stein] shall be represented in all legal proceedings or actions . . . arising from and within the scope of his duties and responsibilities . . . by qualified counsel . . . and the cost of such separate counsel, and related expenses, shall be the responsibility of the Firm . . . ." S.A.6-7.

Prior to February 25, 2004, KPMG negotiated and agreed to a retention agreement with Richard Smith that provided, in terms identical to the Stein contract, that KPMG would pay Smith's defense costs. *Stein* A.942.

On February 18, 2004, Gene O'Kelly, then KPMG's chief executive officer, sent a voice mail to all partners. He announced that the firm had just learned that the United States Attorney's Office would be conducting an investigation and said "any present or former member of the firm asked to appear will be represented by competent counsel at the firm's expense." *Smith* A.1070.

At the time, KPMG and its counsel were aware that a memorandum issued by Deputy Attorney General Thompson mandated that in determining whether to indict a Corporation or other business entity, Department of Justice attorneys should consider "the corporation's timely and voluntary disclosure of wrongdoing and its willingness to cooperate in the investigation of its agents." *Smith* A.1137. The memorandum further provided that "[a]nother factor to be weighed by the prosecutor is whether the Corporation appears to be protecting its culpable employees and agents. *** 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." *Smith* A.1139. (Emphasis added.)

The initial meeting between the representatives of KPMG and the United States Attorney's Office was on February 25, 2004. In preparation for the meeting, three Assistant United States Attorneys prepared a three-page agenda, the first page of which included the question: "Is KPMG paying/going to pay the legal fees of employees? Current or former?" *Smith* A.1145, 408.

At the meeting on February 25th:

- An attorney for KPMG began by stating that the object was to save KPMG, not to protect any individuals and that an indictment of KPMG would result in the firm going out of business. *Smith* A.420-21, 612, 1184-86.

- Assistant United States Attorney Weddle asked whether KPMG was obligated to pay attorneys' fees and what their plans were. "The question was from the government whether the firm was obligated to pay fees, and Mr. Bennett [a lawyer for KPMG] asked the government what was the government's view on that subject, and Ms. Neiman's response was to take into account whatever the firm's obligations were under law, but that there was also a point that had to be considered and that was the

Thompson memorandum and the factors in that memo." *Smith* A.365.

- Counsel for KPMG explained that neither counsel nor the firm had done an internal investigation to determine whether any crime had been committed or who might be involved. *Smith* A.452, 616.

- Assistant United States Attorney Weddle returned to the question of attorneys' fees, pressing counsel for KPMG to determine what its obligations were in that regard. Assistant United States Attorney Neiman said that misconduct should not be rewarded and referred to the federal guidelines. *Smith* A.422, 1200.

- Assistant United States Attorney Weddle stated if you have discretion regarding fees "we'll look at that under a microscope." *Smith* A.1339.

On February 27, Richard Smith met with KPMG CEO O'Kelly and was told that KPMG would not execute the retention agreement previously negotiated which provided for the payment of his legal fees. *Smith* A.930.

On March 4, Saul Pilchen, an attorney for KPMG, told the attorney for Carol Warley, a KPMG partner, that Ms. Warley's legal fees would be paid only if she cooperated with the government's investigation. He explained: "KPMG wanted to pay attorney's fees; that the government did not want KPMG to pay attorney's fees; and they were . . . doing a balancing act, and they thought they would advance something--he mentioned the figure of

$200,000--provided that Ms. Warley cooperated because they were in a cooperation agreement with the government." *Smith* A.981-82. Subsequently Ms. Warley asserted her Fifth Amendment rights before the grand jury and then refused to meet with the Assistant United States Attorneys because they refused to agree to certain conditions proposed by her counsel, conditions that she considered necessary to protect the confidentiality rights of her clients. An Assistant United States Attorney reported this fact to KPMG's lawyers and as a result, KPMG ceased paying her fees and terminated her. *Smith* A.1216, 1231, 1252, 1260-61, 1579-83.

On March 11, 2004, counsel for KPMG advised the government that it would pay the legal fees of only those partners or employees who cooperated with the government, that it would cap the fees at $400,000, and it would cut off the payment of legal fees of anyone who was indicted. *Smith* A.1214-15. AUSA Weddle urged KPMG to tell its personnel to be "totally open" with the government "even if that meant admitting criminal wrong doing," noting that this would give him good cross-examination material. *Smith* A.1344, 387-390.

On March 12, 2004, KPMG'S deputy counsel sent a memorandum to all employees urging them to cooperate with the government and advising them they had a right to be represented by counsel. *Smith*

A.1297-99. Assistant United States Attorneys Weddle and Downing expressed displeasure with this memorandum and demanded that KPMG revise it to add a statement that employees "could meet with investigators without the assistance of counsel." *Stein* A.491-92, 1300-02.

During the period from May 18, 2004 to April 1, 2005, the Assistant United States Attorneys sent at least eleven letters to counsel for KPMG stating that particular partners or employees of the firm had refused to meet with the government. *Smith* A.1216, 1226, 1228, 1230, 1231, 1235, 1236, 1239, 1242, 1252, 1255. As a result, KPMG ceased paying the attorneys' fees of the employees who refused to cooperate and in two cases, terminated their services. *Smith* A.1258-61.

On May 5, 2005 Joseph Loonan, then the Deputy General Counsel of KPMG, wrote a letter to Mr. Stein abrogating his consulting agreement and notifying him that KPMG would not honor its agreement to pay his legal fees. *Smith* A.533. Mr. Loonan later testified that he wrote this letter because he thought it would help KPMG with the government. *Smith* A.538.

As a result of the change of KPMG's policy prompted by the meeting with the Assistant United States Attorneys on February 25, 2004, KPMG refused to advance legal fees to any of its 16 former partners or

employees after they were indicted in this case. Mr. Loonan, who had become KPMG's general counsel, testified that the decision to change KPMG's policy and cease paying all the legal fees of its partners and employees in criminal cases had been based on the advice of counsel and that there had been no discussion of any potential financial savings. *Smith* A.483-84.

That economic considerations had nothing to do with KPMG's decision whether to pay the fees of its former partners in the criminal case is evident from the fact that, after the indictment, it did continue to pay the legal fees of most of them in related civil proceedings. *Smith* A.588. What is particularly noteworthy is the fact that the only condition on the payment of those fees is that the individual could not be represented in the civil proceedings by the same lawyer who is handling the criminal case. *Smith* A.1476.

After conducting extensive hearings, the Court below concluded that the combination of the Thompson Memorandum's statements concerning the payment of legal fees and the conduct of the Assistant United States Attorneys caused KPMG to abandon its prior policy of paying all of the legal fees for partners and employees in criminal matters arising from their work for KPMG.

The district court found that the government's action in this regard violated the defendants' rights under the Sixth and Fifth Amendments. The government agreed that if the court found that it had violated the defendants' rights in this regard, there was no remedy that could put the KPMG defendants in the position they would have been in had KPMG continued to follow its prior practice of paying legal fees. J.A.1406-07. The court dismissed the indictment as to 13 former KPMG partners and employees who the court found would have had their legal fees and expenses paid by KPMG had it not been for the government's interference and coercion.

This appeal by the government follows.

## ARGUMENT

## INTRODUCTION AND SUMMARY OF ARGUMENT

The essential question here is whether the government could constitutionally use the threat of indictment to prevent one of the nation's largest accounting firms from paying the legal fees of several of its professional employees, not because there would have been anything improper about the payment of the fees but simply because it served the government's purposes to reduce or eliminate the ability of those employees to retain independent counsel and to defend themselves. The net effect of the prosecution's conduct was to deprive the 13 defendant-appellees of their ability to defend against their indictment in what is claimed to be the largest tax fraud prosecution in the nation's history.

Concluding that the prosecution's conduct violated the Sixth and Fifth Amendment rights of KPMG's partners and employees, the district court – after spending a year seeking alternatives – found that the only way it could remedy the constitutional wrongs was by dismissing the indictment.

The legal issues raised by the prosecution's conduct involve three relatively recent legal developments: the standard of enterprise liability for criminal conduct (whether organized as a corporation or as, in the case of

KPMG, LLP, a Delaware limited partnership); the collateral consequences of indicting large business entities; and the Department of Justice's efforts to deal with these features of organization prosecutions through a series of policy pronouncements, e.g., the Holder Memo (in 1999), the Thompson Memo (in 2003) and the McNulty Memo (in 2007).[3]

No federal statute defines the criminal liability of business entities such as KPMG, namely large multi-national businesses with thousands of employees. The principles governing corporate criminal liability developed incrementally through judicial decisions[4] and can be set forth in three short sentences:

> Under current law, a firm faces criminal liability for virtually any criminal act by an agent. The standard is respondeat superior: the master is liable if the agent acted within the scope of employment and at least in part to benefit the master. In practice, this standard amounts to strict vicarious liability because almost any act on the job is "within the scope of

[3] The Holder, Thompson and McNulty memoranda are not regulations under the Administrative Procedure Act, 5 U.S.C. §§ 551 et seq. (APA) and were not promulgated in compliance with it. As merely internal procedures within the Department of Justice, they are not binding in any sense on this Court. Compare *Stein IV* at 412 and n. 97.

[4] The often accidental history of the development of enterprise criminal liability developing slowly from the early nineteenth century is succinctly traced in General Principles Governing the Criminal Liability of Corporations, Their Employees and Officers by Harry First, Professor of Law in 1. O. Obermaier and R. Morvillo, White Collar Crime: Business and Regulatory Offenses, at 5-4.

> employment" and because courts have all but read the "intent to benefit" element out of the law. (footnotes omitted)

S.W. Buell, *Criminal Procedure Within the Firm*, 59 Stan. L. Rev. 1613, 1662 (2007).

KPMG's criminal liability thus turned simply on whether one or more of its several thousand employees had committed a criminal offense in the course of his or her professional duties. Moreover, when KPMG, whose professional life blood is the certification of the financial statements of publicly-held companies, met with the prosecutors in February, 2004, it knew it could not even survive an indictment. It was living in the brooding shadow of the ghost of Arthur Andersen, whose sad story was summarized graphically by Professor Joseph A. Grundfest when the Supreme Court opinion reversing its conviction (*Arthur Andersen, LLP v. United States*) came down:

> [T]o Andersen, the court's ruling doesn't matter, the original trial at which it was convicted didn't matter and the verdict at any coming trial won't matter.
>
> Andersen was destroyed when it was indicted. No exoneration at trial and no ruling by the Supreme Court will cause it to rise, Lazarus-like, from the dead.

Op-Ed, *Over Before It Started*, N.Y. Times, June 14, 2005 at A23.

There can be little doubt that KPMG was compelled to strive mightily to avoid the fate of Arthur Andersen – regardless of any perception it or its counsel held as to legal innocence of any of its partners and employees. There can also be little doubt that the prosecutors were aware that they held the future of KPMG in their hands. And the record before the District Court fully supports the Court's finding that that they used that coercive power to force KPMG to abandon its long-standing practice of paying the attorneys' fees of its partners and employees in criminal proceedings.

As a result of this change, KPMG's partners and employees were told that their attorneys' fees would be paid only if they cooperated with the government. From time to time attorneys from the United States Attorney's Office would contact KPMG's counsel to advise them that a particular partner or employee had refused to meet with the U.S. Attorney's Office, knowing that the result of these calls would be that KPMG would cease paying the legal fees of the partner or employee involved and in some instances terminate that individual.

As counsel for KPMG told Deputy Attorney General James B. Comey:

> 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 and former personnel who otherwise would not have cooperated did cooperate, and those who did not had their fees cut off and, in two instances, were separated from the firm. This process exhibited 'a level of cooperation that is rarely done.' *Smith* A.1355-56.

On the basis of the extensive and detailed record, the District Court found that the government's conduct violated the Sixth and Fifth Amendment rights for those individuals who, but for the conduct of the government, would have had their attorneys' fees paid by KPMG. Additionally, the Court found that the United States Attorney's Office violated the Fifth Amendment rights of certain of the defendants who would not have made proffers to the government had it not been for the fact that they knew that their legal fees would be cut off if they exercised their Fifth Amendment rights.

What is most shocking in this whole scenario is that even to this day the government refuses to acknowledge that it was improper for it to pressure KPMG not to pay attorney fees for its partners and employees and to

take an active role in the process by which KPMG cut off the legal fees of those who exercised their Fifth Amendment rights to decline to speak to government investigators.

Indeed, on this appeal, it carries its position even further:

> "Nothing *** indicates that the Sixth Amendment prevents Government interference with a third party's purely voluntary decision to pay the legal fees of a criminal defendant."

(Gov't Open. Br. 64)

The government's arguments seem premised on the view that the Sixth and Fifth Amendments are designed to protect the guilty from being properly punished for their misconduct and that the government therefore has an interest in taking what it considers reasonable steps to prevent subjects of its investigations from taking advantage of these constitutional protections. This attitude is unworthy of the premier U.S. Attorney's Office in the nation.

We demonstrate below that the government's strenuous efforts to induce KPMG to abandon its long-standing practice of paying all the legal fees of its personnel in criminal cases, and to ensure that KPMG personnel who invoked their Fifth Amendment rights would immediately have their attorney's fees canceled (and in some cases lose their job), blatantly violated the Sixth and Fifth Amendment rights of the defendant-appellees.

Alternatively, this Court could avoid reaching the constitutional questions and simply uphold the dismissal of the indictment as an appropriate exercise of its supervisory powers.

## POINT I

## THE GOVERNMENT VIOLATED THE CONSTITUTIONAL RIGHTS OF THESE DEFENDANTS BY UNJUSTIFIABLY INTERFERING WITH KPMG'S POLICY OF PAYING THE LEGAL FEES OF ITS PARTNERS AND EMPLOYEES

The government's argument that it did not violate the constitutional rights of these defendants rests primarily on its disagreement with the factual findings of the District Court. While the government usually appears before this Court as an appellee, entitled to have all inferences from the available evidence drawn in its favor, it is an appellant here and is required to demonstrate that the factual findings of the District Court are clearly erroneous. *United States v. Moran Vargas*, 376 F.3d 112 (2d Cir. 2004). This it has not done and cannot do.

The District Court found as a fact that "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 [United States Attorney's Office]." *Stein IV* at 409; *see Stein I* at 353. That finding, amply supported by the extensive record

before the District Court, clearly establishes a violation of the defendants' Sixth Amendment rights.

What the government fails to acknowledge at any point is that, whether or not KPMG would pay the attorneys' fees of its partners and employees was simply none of the government's business, and that to warn KPMG that a decision to pay such fees would be taken into account in determining whether or not KPMG would be indicted was outrageous conduct.[5]

Despite the government's repeated denials of any intent to influence KPMG's decision with respect to attorneys' fees, the clear message conveyed to KPMG by the Thompson Memorandum and the statements of the Assistant United States Attorneys was that, if KPMG paid the legal fees, it might well face indictment.

One may well ask, if the government did not intend to influence KPMG's decision with respect to attorneys' fees: why was the attorney fee question near the top of the government's agenda for the February 25th

[5] Even if one accepts the Government's argument that it has the right to tell a corporate defendant that it will hold its payment of the legal fees of its employees against the corporation if it thinks the defendants are "circling the wagons", the AUSAs who testified at the post-indictment proceedings conceded that they never had the belief that KPMG was using its fee advancement policy to shield culpable employees. *Smith* A.657.

meeting; why did the first question of substance raised by Assistant United States Attorney Weddle relate to KPMG's payment of legal fees; why did the Assistant United States Attorneys keep reminding KPMG "misconduct cannot be rewarded"; and why did the Assistant United States Attorneys continue to return to the subject of legal fees during the meeting and make a specific request that KPMG report back to the government what the firm's final decision was with respect to the payment of legal fees? What other inference could KPMG's attorneys draw from Assistant United States Attorney Weddle's comment that "if u have discretion re fees – we'll look at that under a microscope"? *Smith* A.1339.

Apparently recognizing the significance of Mr. Weddle's comment -- a clear threat to KPMG if it paid the attorneys' fees of its partners and employees -- the government refuses to accept the District Court's well-supported factual finding on the matter, *Stein I* at 344, n. 52; *Stein IV* at 395, and flatly denies that the comment was made. The government's Statement of Facts sets forth various assertions by KPMG's attorneys at the February 25th meeting and then makes the outlandish claim: "No one from the USAO commented on those assertions or expressed a view regarding them, other

than stating that KPMG's counsel should inform the government as to the firm's obligations and its plans." Gov't Open. Br. 21-22.[6]

It is distressing that the office of the United States Attorney for the Southern District of New York would make that representation to this Court when the notes and memorandum of an Internal Revenue Service agent who attended that meeting contain the following:

- "BB [a Skadden lawyer] he feels it is in the best interest of KPMG for its people to get attorneys that will cooperate with the G. Want to save the firm.

  SN [Shirah Neiman [--] Fees – under federal guidelines

  '—misconduct c/n be rewarded.'"

- "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 cannot be rewarded." *Smith* A.1189, 1200.

[6] The government was also less than candid with the District Court during the pre-hearing proceeding when it responded to a question from the Court asking whether the government had any discussion with KPMG about legal fees by saying that it asked KPMG what its rules were but there was "no judgment by the government expressed that you should or should not do that." *Smith* A.240. In light of the IRS agent's notes of the February 25th meeting, Judge Kaplan found this lack of candor troubling. *Stein I* at 381.

While the government's brief argues that the statement about misconduct not being rewarded referred to KPMG providing lucrative severance packages to culpable employees (Gov't Open. Br. 22), that argument is inconsistent with the context in which the statement appears in the IRS notes. Moreover, it ignores the facts that the IRS agent's notes reflect no discussion of severance packages. *Smith* A.638. And the IRS notes, linking the "misconduct cannot be rewarded" comment to the issue of legal fees, are consistent with the notes made by Skadden lawyer Saul Pilchen at the same meeting which state:

> "SP – no decision made. No counsel have been recommended – we have had discussions @ what the firm does in typical situations – but no final decision made.
>
> "SN – misconduct shdn't be rewarded." *Smith* A.1338.

In any event, the government's "Statement of Fact" is directly at odds with the District Court's well-documented findings concerning the statements made by the AUSAs at the February 25th meeting, including the factual determination that Mr. Weddle made the "microscope" comment. *Stein I* at 344, n. 52; *Stein IV* at 395. That finding was amply supported by the evidence in the record, including Mr. Pilchen's notes containing the "microscope" statement – which notes the government agreed could be

received in evidence as reflecting the witness's understanding of what occurred at the February 25th meeting. *Smith* A.361. Despite the government's protestations that the statement was never made, it is inconceivable that an attorney would write down " if u have discretion re fees – we'll look at that under a microscope." with the word "microscope" underscored if no such statement had been made.

There is no reason for this Court to reject the District Court's findings that the Thompson Memorandum and the statements of the Assistant United States Attorneys were what caused KPMG to change its long-standing policy and cease paying the legal fees of all of its partners and employees in criminal matters relating to their work for the firm. The District Court's factual findings concerning the February 25th meeting and the events surrounding it are entitled to the deferential standard of review which this Court has, as recently as December 28, 2007, applied to factual findings by a District Court Judge. *See United States v. Quinones,* Slip Op. No. 04-5554-cr (2d Cir. Dec. 28, 2007) at 28-29 ("[T]he deferential standard of review for factual findings [of the District Court] based on oral testimony and documentary evidence is grounded in the 'belief that district courts have a good deal of 'expertise' when it comes to fact-finding.'") (citing *Zervos v. Verizon New York, Inc.,* 252 F.3d 163, 168 (2d Cir. 2001) which in turn cites

*Anderson v. City of Bessemer City, N.C., supra*)). Although citing *United States v. Bliss*, 430 F.3d 640 (2d Cir. 2005), the government ignores an important point made by the Court there: a district court's findings as to "how a listener would reasonably interpret" words spoken is subject to clearly erroneous review. *Id*. at 646.

How KPMG interpreted the comments of the Assistant United States Attorneys can not be disputed. The notes of a KPMG executive of a meeting with KPMG's attorneys immediately after the February 25th meeting state:

> "take everything in our power not to charge the firm
>
> Paying legal fees) not a sign of cooperation"

J.A.1072.

Within two days of the meeting, KPMG reneged on its agreement to sign Smith's retention agreement, which provided for the payment of his legal fees.

Within a week of the February 25th meeting, one of KPMG's attorneys who had attended that meeting told Ms. Warley's lawyer: "KPMG

wanted to pay attorneys fees; that the government did not want KPMG to pay attorneys fees . . . ." *Smith* A.981, 1341.[7]

Although Joseph Loonan, KPMG's General Counsel, invoked the attorney-client privilege as to the exact reason KPMG changed its policy, he testified that the decision was based on legal advice and not on economic considerations. In a letter sent to the court three days prior to the May 8, 2006, hearing, counsel for KPMG represented: "categorically that the Thompson memorandum in conjunction with the government statements relating to payment of legal fees affected KPMG's determination with respect to the advancement of legal fees and other defense costs to present or former partners and employees . . ." *Stein IV* at 405.

The government's claim that KPMG decided to change its long-standing policy concerning the payment of legal fees "independent of anything that the AUSAs said or did at the February 25th meeting." (Gov't Open. Br. 82) cannot be reconciled with the facts that before February 25th: (1) KPMG had signed a contract with Stein agreeing to pay all of his fees in

[7] The attorney's testimony concerning this statement was corroborated by notes of the conversation taken by a Skadden associate present while Mr. Pilchen was speaking to counsel which contain the following notations:

SP – upset by that policy, but this is Ashcroft (even before)
Gov't implied it'd prefer K not to pay fees here
[therefore] cooperate, but K does what it feels it must

*Smith* A.1341-42.

connection with the criminal case; (2) KPMG had agreed to a similar provision in Smith's retention agreement, and (3) KPMG CEO O'Kelly had informed all of KPMG's partners that they would be represented "by competent counsel at the firm's expense." Moreover, it was clearly in KPMG's interest to pay the legal fees in the criminal case, since a finding that any of the defendants engaged in criminal wrongdoing would have a devastating impact on the pending civil cases. Indeed the fact that, to this day, KPMG is paying the fees of these defendants in the civil cases demonstrates how important it is to KPMG that they be exonerated of wrongdoing. Only the desire to curry favor with the government can explain why KPMG would pay the defendants' legal fees in the civil case but not permit them to be represented by the lawyer who is representing them in the criminal case.

While the government conceded that the Thompson Memorandum had some impact on KPMG's change of policy with respect to legal fees, it contends that, standing alone, the Memorandum does not violate an employee's right to counsel. Yet although a cogent Sixth Amendment challenge can be raised against the Memorandum, this Court need not reach that issue, since the District Court did not rest its finding of a Sixth Amendment violation on the Thompson Memorandum alone, but found that it

was a combination of the Thompson Memorandum and the conduct of the Assistant United States Attorneys that unconstitutionally interfered with defendants' right to counsel.

The Thompson Memorandum states that, when determining whether a corporation or other business entity should get credit for cooperating in the investigation, a "factor to be weighed by the prosecutor is whether the corporation appears to be protecting its culpable employees and agents . . . either through the advancing of attorneys fees, through retaining the employees without sanction for their misconduct. . . ." *Smith* A.1139. There can be no doubt that the clear message is that there is something wrong with a corporation's paying the attorneys' fees of any employee the government considers culpable.

Apparently recognizing that the plain meaning of the Thompson Memorandum's reference to the payment of attorneys' fees raises serious constitutional issues, the government argued in the District Court that the Memorandum refers only to the situation where the payment of legal fees is part of a strategy "to circle the wagons." However, the District Court properly rejected that argument, noting "that the Thompson Memorandum does not say the payment of legal fees may cut in favor of indictment *only if* it is used as a means to obstruct an investigation." *Stein I* at 363.

In this Court, the government argues that the Thompson Memorandum would only apply to the "support of culpable employees through advancing their legal fees . . ." Gov't Open. Br. 80. However, KPMG's attorneys told the government that KPMG had not conducted any investigation to determine who, if anyone was guilty of any wrongdoing. *Smith* A.452, 616. Thus, the government is arguing, in effect, that it has the right to determine who is a culpable employee whose right to counsel fees should be terminated.

But in our system of justice, culpability is supposed to be determined after a trial at which the accused is represented by counsel. As Judge Kaplan observed:

> 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.

*Stein I* at 363.

Since the clear intent of the Thompson Memorandum's provisions relating to a corporation's payment of the legal fees of its employees is to deny certain defendants the ability to retain competent counsel, it can not be justified as advancing any legitimate government

interest. As the Supreme Court observed in *Escobedo v. Illinois,* 378 U.S. 478, 490 (1964):

> 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 [his constitutional] rights. If the exercise of constitutional rights will thwart the effectiveness of a system of law enforcement, then there is something very wrong with that system.

In any event, as noted above, Judge Kaplan held that it was the combination of the Thompson Memorandum and the conduct of the Assistant United States Attorneys that caused KPMG to change its practice. *Stein IV* at 400-01. While the United States Attorney's Office continues to deny that any statements made by the Assistant United States Attorneys at the February 25 meeting played any role in KPMG's decision to change its policies with respect to attorneys' fees, that argument can only be sustained by ignoring the well-supported findings of the District Court and accepting the logic of the Queen of Hearts that "My words mean what I say they mean." The government ignores a basic rule of evidence that it regularly asks district courts to include in their charges to the jury: "A person is presumed to intend the natural and probable consequences of his acts."

The government argues at great length that the defendants did not have a right to have KPMG pay their legal fees. And it cites the statement

in *Caplin & Drysdale Chartered v. United States*, 491 U.S. 617 (1989), that "A criminal defendant has no Sixth Amendment right to spend another person's money for services rendered by an attorney . . . ." However, that statement was in response to an argument that a criminal defendant had the right to use money that belonged to the government under a forfeiture statute to fund his defense. As the Fourth Circuit observed in *United States v. Farmer*, 274 F.3d 800, 804 (2001):

> While *Caplin* made absolutely clear that 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. *See, e.g., Caplin,* 491 U.S. at 624-25; *Powell v. Alabama*, 287 U.S. 45, 53 (1932).

We do not contend that the defendants had a constitutional right to have KPMG pay their legal fees. What we do contend is that the "Sixth Amendment right to counsel . . . includes 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," *United States v. Inman*, 483 F.2d 738, 739-40 (4th Cir. 1973) (emphasis added) and that the government may not "through its actions unreasonably and unnecessarily interfere" with that right. *See In re Grand Jury Subpoenas Served Upon Doe*, 781 F.2d 238, 259 (2d Cir. 1986) (en banc). *See In Re*

*Caplin & Drysdale, Chartered*, 837 F.2d 637, 644, 647 (4th Cir. 1988) *(en banc), aff'd,* 491 U.S. 617 (1989) (recognizing constitutional right to use legitimate funds for retention of counsel from resources of defendant, family and friends, "free of government interference"). *See also United States v. Rosen*, 487 F.Supp.2d 721, 733-34 (E.D.Va. 2007).

The concept that one may not unreasonably interfere with another party's receipt of benefits, even if that party has no contractual right to the benefits, was not invented by Judge Kaplan.[8] *See generally Kirch v. Liberty Media Corp.,* 449 F.3d 388, 399-400 (2d Cir. 2006); *Israel v. Wood Dolson Co.,* 1 N.Y.2d 116, 151 N.Y.S.2d 1, 134 N.E.2d 97 (1956). Indeed, under New York Penal Law § 135.60, the crime of coercion is committed when a person "induces a person to engage in conduct which the latter has a legal right to abstain from engaging in, or to abstain from engaging in conduct in which he has a legal right to engage, by means of instilling in him a fear that, if the demand is not complied with, the actor or another will . . . cause criminal charges to be instituted against him." Here, these defendants had a legitimate expectation – perhaps even a contractual right -- to have their legal fees paid by KPMG in accordance with its long-established practice without

[8] As Judge Kaplan's opinion in *Stein I* elaborates, there is a strong argument that KPMG was legally obligated to advance the legal fees of the appellees. *Stein I* at 355-56.

interference from the government, and there was more than ample evidence to support the District Court's conclusion that the government coerced KPMG to change that practice. *See People v. Spatarella*, 34 N.Y.2d 157, 162 (1974) (advantageous business relationship involving an "at will" arrangement protected under extortion statute).

Because the government itself interfered with defendants' Sixth Amendment rights, there is no need to "attribute" KPMG's actions to the government for "state action" purposes. But one certainly can. Indeed, the District Court's findings concerning the government's involvement in KPMG's decision to end its practice of paying the defense costs of its partners and employees are more than sufficient to charge the government with the responsibility for KPMG's action under the very authorities it cites. Page 57 of the government brief contains the following quotation from two of this Court's decisions, to which we add only emphasis of the underscored portions:

> "For the conduct of a private entity to be fairly attributable to the state, there must be such a close nexus between the State and the challenged action that seemingly private behavior may be fairly treated as that of the State itself." *Cranley v. National Life Insurance Co.*, 318 F.3d 105, 111 (2d Cir. 2003) (internal quotations omitted). "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 Savings and Loan Association* 396 F.3d 178, 187 (2d Cir. 2005) (internal quotations omitted) (emphasis added) (Gov't Open. Br. 57)

Here, the District Court found that the government did "exercise coercive power" and did provide "the private actor with significant encouragement, either overt or covert." Once one accepts the District Court's factual findings, there can be no doubt that the government violated the defendants' Sixth Amendment rights. 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, 171 (1985); *see United States v. Morrison*, 449 U.S. 361, 364 (1981) (since the right to counsel is fundamental to our system of justice, "[o]ur cases have accordingly been responsive to proved claims that governmental conduct has rendered counsel's assistance to the defendant ineffective."); *see also Strickland v. Washington*, 446 U.S. 668, 686 (1984) ("Government violates the right to effective assistance when it interferes in certain ways with the

ability of counsel to make independent decisions about how to conduct the defense.").

As Justice Blackmun observed in *Caplin & Drysdale*:

> [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.

491 U.S. at 651-52 (quoting Judge Feinberg's concurring opinion in *United States v. Monsanto*, 852 F.2d 1400, 1403 (1988) *(en banc), rev'd,* 491 U.S. 600 (1989).

In this case, the prosecutors deliberately and consistently sought to deny the KPMG partners and employees their right to counsel. First, they repeatedly threatened KPMG that it would not be considered to be cooperating if it paid the attorneys' fees. Next they insisted that KPMG revise a memo advising employees of their rights to counsel to include a statement that they could meet with the government investigators without counsel. Finally they repeatedly and enthusiastically caused KPMG to cease paying the legal fees of people who exercised their constitutional rights not to speak to government investigators by writing a total of eleven letters to

KPMG's counsel reporting the refusal of various individuals to meet with them.[9]

As Judge Kaplan observed:

> 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.

*Stein IV* at 414.

Even were this Court to find that denying defense counsel the resources needed to represent his client was not a deprivation of the right to

[9] Among the more cynical statements in the governments brief is the following: "Because it would be unfair for the Government to discount a corporation's cooperation efforts for failing to make its personnel available if the company did not know that those individuals had refused to meet with the Government, the USAO sent letters to KPMG's counsel when individuals either refused to be interviewed or placed unacceptable conditions on those interviews beyond the USAO's standard proffer agreement." Gov't Open. Br. 22-23.

Is there any legitimate reason for the government to discount a corporation's cooperation efforts because an individual decides to exercise his or her constitutional rights when there is no evidence that the corporation played any role in that decision? The government is saying, in effect, that a corporation must coerce its employees into abandoning their constitutional rights if the corporation wants to be given credit for cooperation.

counsel guaranteed by the Sixth Amendment, it would nonetheless be compelled to find a violation of the defendants' Fifth Amendment due process rights to a fair trial. *See Caplin & Drysdale, supra,* 491 U.S. at 634. (recognizing that wrongful governmental interference with payment of legal fees can be "devastating" and that due process claims alleging such abuses are cognizable in specific cases of prosecutorial misconduct).

As this case involves the government's interference not just with the defendants' ability to pay for counsel but to pay for the professional services of private investigators, forensic accountants, tax law experts and information technology assistance,[10] the deprivation here easily fits within the due process analysis of cases like *Ake v. Oklahoma*, 470 U.S. 68, 70, 77 (1985), where the Supreme Court held that an indigent defendant in a capital case is entitled to have the state provide access to a "psychiatric examination and assistance necessary to prepare an effective defense based on [the defendant's] mental condition." In the course of his majority opinion, Justice Marshall observed: "[A] criminal trial is fundamentally unfair if the State

[10] Such professional services are clearly encompassed by advancement of legal fees and expenses under Delaware law (see, e.g., *Dunlap v. Sunbeam Corp.,* 1999 WL 1261339 (Del. Ch.) at 6; 1999 Del. Ch. Lexis 126, at *19 (Del. Ch. July 9, 1999) (holding that professional expenses incurred by former executives for forensic accounting services were reasonable and necessary to their defense, and awarding advancement for such expenses)).

proceeds against an individual defendant without making certain that he has access to the raw materials integral to the building of an effective defense." Subsequent cases have extended *Ake* and its due process rationale to other types of expert and investigative assistance: *Little v. Armontrout*, 835 F.2d 1240, 1243-44 (8th Cir. 1987) (*en banc*) (in applying *Ake*, there is "no principled way to distinguish between psychiatric and nonpsychiatric experts"); *Moore v. Kemp*, 809 F.2d 702, 709-10, text and n. 6 (11th Cir. 1987) (*en banc*) (in determining whether a defendant's constitutional rights were violated by denial of motion for appointment of expert, court utilizes due process analysis employed in *Ake* rather than other Sixth Amendment or equal protection arguments raised by defendant).

In employing the due process rationale that fundamental fairness requires that the state not deny defendants "an adequate opportunity to present their claims fairly within the adversary system" (citation omitted), the *en banc* Eleventh Circuit Court in *Moore v. Kemp* observed:

> An expert can assist a criminal defendant in marshaling his defense in two essential ways. First, he can gather facts, inspect tangible evidence, or conduct tests or examinations that may aid defense counsel in confronting the prosecution's case, including its expert witnesses, or in fashioning a theory of defense. Second, the expert can provide opinion testimony to rebut prosecution evidence or to establish an affirmative defense.... In a given

> case, the assistance of an expert could be so important to the defense that without it an innocent defendant could be convicted or, at the very least, the public's confidence in the fairness of his trial and its outcome could be undermined.

As the Ninth Circuit in *Pawlyk v. Wood*, 248 F.3d 815, 822 (9th Cir. 2001) said: "As applied to all defendants, fundamental fairness ensures that they have 'access to the raw materials integral to the building of an effective defense'" (citing and quoting from *Ake*). The claim is not that all criminal defendants have a due process right to the best possible defense, whether they can afford it or not. Rather, it is that where a defendant would otherwise be able to afford legal and other assistance that would be of critical use to him in defending himself at trial, the government violates his Fifth Amendment (due process) right when it prevents him from doing so.

This would not be the only case in which this Court looked to the "due process right to present a defense" in a situation that might equally be addressed through a Sixth Amendment analysis. Notwithstanding the explicit guarantee of the Compulsory Process Clause, it and other courts "have held that judicial or prosecutorial intimidation that dissuades a potential defense witness from testifying for the defense can, under certain circumstances, violate the defendant's right to present a defense." *United States v. Williams*, 205 F.3d 23, 29 (2d Cir. 2000) (citing cases); *see also United States v. Pinto*,

850 F.2d 927, 933-34 (2d Cir. 1988). Indeed, the readiness of courts to condemn such prosecutorial interference with the decisions of third parties who legally are free to deny the assistance sought by a criminal defendant is quite pertinent here.

Once it recognizes the constitutional deprivations here, this Court must next decide whether defendants here even need to show prejudice. In *United States v. Gonzalez-Lopez*, 126 S. Ct. 2557 (2006), the Court explained why the deprivation of the right to counsel of one's choice must be deemed a "structural error" and without any inquiry into prejudice of the sort required where deprivation of the right to the "effective assistance of counsel" has been alleged. Unlike those errors whose "effect may 'be quantitatively assessed in the context of other evidence presented in order to determine whether [they were] harmless beyond a reasonable doubt,'" deprivation of the right to counsel of one's choice has "consequences that are necessarily unquantifiable and indeterminate." 126 S.Ct at 2563-65 (citations omitted). The court noted:

> 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 these 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.

*Id*. at 2564-65.

The Supreme Court's reasoning in *Gonzalez –Lopez* is fully applicable here, given that defendant Gremminger lost the counsel of his choice, Jones Day, as a direct result of KPMG having been coerced by the government to abandon its long-standing policy of paying attorneys fees.[11] While our remaining clients, Messrs. DeLap and Wiesner and Ms. Warley, did not lose a specific attorney as a result of the cut off of the legal fees, the impairment of their Sixth Amendment right is as clear. Judge Kaplan found:

> 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

[11] The government has never disputed Judge Kaplan's finding that Mr. Gremminger lost the services of Jones Day as a result of KPMG's change of policy. *Stein IV* at 415.

> activities of their counsel, limited or precluded their attorneys' review of the documents produced by the government in discovery, prevented them from interviewing witnesses, caused them to refrain from retaining expert witnesses, and/or left them without information technology assistance necessary for dealing with the mountains of electronic discovery. The government has not contested these assertions. The Court therefore has no reason to doubt, and hence finds, that all of them have been forced to limit their defenses in the respects claimed for economic reasons and that they would not have been so constrained if KPMG paid their expenses subject only to the usual sort of administrative requirements typically imposed by corporate law departments on outside counsel fees. (footnotes omitted)

*Stein IV* at 418-19.

As a direct result of the government's conduct, all of the KPMG defendants were left with counsel whose ability to defend them was substantially impaired by a lack of financial resources. Whether one characterizes the violation of these defendants' rights as arising under the Fifth or Sixth Amendment, here, as in *González –López*, an attempt to quantify the harm suffered by these defendants "would be a speculative inquiry into what might have occurred in an alternative universe." No amount of pretrial or post-trial proceedings could determine what question counsel failed to ask or what strategy counsel failed to pursue because counsel did not have adequate time and resources to review more than 23 million pages of

documents produced to date, or to attempt to interview all of the 70 government-designated trial witnesses or the 110 witnesses identified by the government as having exculpatory evidence or to investigate their backgrounds, or to retain attorneys specializing in tax law or forensic accountants to assist in understanding and developing a defense with respect to complex tax shelter transactions. As in *González –Lopez*, "It is impossible to know what different choices . . . counsel would [make], and then to quantify the impact of those different choices on the outcome of the proceedings." *Ibid*.

It is especially appropriate to apply the reasoning of *Gonzalez-Lopez* here because the constitutional violation resulted from *governmental* interference with the right to the assistance of counsel. *See Strickland* at 696 (1984) (prejudice is legally presumed for various kinds of *governmental* interference with the right to assistance of counsel); *Shillinger v. Haworth*, 70 F.3d 1132, 1141-42 (10th Cir. 1995) (holding that a presumption of prejudice is particularly appropriate where prosecutor interferes with defendant's right to assistance of counsel without a legitimate law enforcement purpose). In any case, as Judge Kaplan found based on the uncontroverted evidence presented on the dismissal motion below, the showing made by defendants

would satisfy any requirement of actual prejudice. *Stein IV* at 416-19, 423-25.

## POINT II

## THE DISMISSAL OF THE INDICTMENT MAY BE AFFIRMED THROUGH THE EXERCISE OF THIS COURT'S SUPERVISORY POWER

Although the government did indeed violate the constitutional rights of the KPMG defendants, the special circumstances of this case and the egregious nature of the government's conduct could easily allow this Court to not reach the constitutional issues raised by this appeal but instead to affirm the decision below as an exercise of this Court's supervisory power over the administration of criminal justice within this Circuit. *See McNabb v. United States*, 318 U.S. 332 (1943) (holding that incriminating statements obtained in violation of the requirement that a defendant be promptly taken before a committing magistrate were inadmissible in federal courts "[q]uite apart from the Constitution.").

The Second Circuit, like other Circuits, has invoked its supervisory powers to ensure the integrity of judicial proceedings within the Circuit in a variety of factual settings. See, e.g., *United States v. Freeman*, 357 F.2d 606 (2d Cir. 1966); *United States v. Estepa*, 471 F.2d 1132 (2d Cir.

1972); *United States v. Jacobs*, 547 F.2d 772 (2d Cir. 1976); *United States v. Mohabir*, 624 F.2d 1140 (2d Cir. 1980) (compare *Patterson v. Illinois,* 487 U.S. 285 (1988)); *United States v. Hogan*, 712 F.2d 757 (2d Cir. 1983); *United States v. Perez*, 904 F.2d 142, 148 (2d Cir. 1990), *cert. denied* 498 U.S. 905 (1990); *United States v. Ming He*, 94 F.3d 782, 792 (2d Cir. 1996); *United States v. Nelson*, 277 F.3d 164, 208 (2d Cir. 2002). *Cf. United States v. Archer*, 486 F.2d 670 (2d Cir. 1973).

Some forty years after *McNabb*, the Supreme Court articulated the rationales for this power in *United States v. Hasting*, 461 U.S. 499, 505 (1983):

> The purposes underlying use of the supervisory powers are threefold: to implement a remedy for violation of recognized rights, *McNabb, supra,* 318 U.S. at 340; *Rea v. United States,* 350 U.S. 214, 217 1956); to preserve judicial integrity by ensuring that a conviction rests on appropriate considerations validly before the jury, *McNabb, supra,* 318 U.S., at 345; *Elkins v. United States,* 364 U.S. 206, 222 (1960); and finally, as a remedy designed to deter illegal conduct, *United States v. Payner,* 447 U.S. 727, 735-736, n. 8 (1980).

All three of these rationales are implicated by the conduct of the prosecution in this case. Accordingly, the exercise of this Court's supervisory power would be most appropriate here.

The District Court found an unconstitutional interference with the defendant-appellees' right to the advice of counsel, a right characterized as "by far the most pervasive" right of the accused, by Justice Walter V. Schaefer of the Supreme Court of Illinois, in *Federalism and State Criminal Procedure,* 70 Harv. L. Rev. 1, 8 (1956):

> Of all of the rights that an accused person has, the right to be represented by counsel is by far the most pervasive, for it affects his ability to assert any other rights he may have. . . . [Procedural rules] are designed for those who know [them], and they can become a source of entrapment to those who do not. Substantive criminal law also presents difficulties to the uninitiated."

No Supreme Court opinion has addressed the Holder or Thompson memoranda. But a fair reading of Supreme Court case law makes plain that the government can not interfere with resources that would otherwise be available to a defendant to pay for his defense. In fact, the prosecution allows its advocacy to overwhelm its judgment when it extrapolates the absence of a specific contrary Supreme Court holding into the proposition that the Sixth Amendment does not "prevent Government interference with a third party's purely voluntary decision to pay the legal fees of a criminal defendant." Gov't Open. Br. 64.

The District Court recognized, while the prosecution did not, the danger of permitting an adversary to participate in selecting its counterpart -- as inappropriate in litigation as in sports. The temptation is virtually irresistible that one would attempt to select a weaker opponent – whether innately weaker by lesser talents or made weaker by lesser resources. There is no role for an adversary to play in the process of selecting counsel – even when that adversary is the prosecution. The Thompson Memo and its implementation in this case are accordingly unique.

The trial of the 46-count superseding indictment is expected to take six to eight months. Pre-trial discovery has involved an estimated 23 million pages of documents, either in electronic or tangible form, more than one million of which have been produced since June 1, 2007, and production continues. The prosecution has designated nearly 70 witnesses and 2,000 exhibits totaling more than 150,000 pages for its case-in-chief. *Stein IV* at 417-18. The subject matter – tax shelters – is complexity itself. Even Assistant United States Attorneys have difficulty understanding the structures of the four different tax shelters involved – referred to by the acronyms FLIP ("Foreign Leveraged Investment Program"), OPIS ("Offshore Portfolio Investment Strategy"), BLIPS ("Bond Linked Issue Premium Structure"), and SOS ("Short Option Strategy"). Judge Kaplan brought out that very point on

October 12, 2007, in the course of pre-trial proceedings involving several non-appellee defendants. He noted how the government itself, in sealed proceedings, had pointed to the inability of two Assistant United States Attorneys to "understand the transactions sufficiently to comprehend what [a] witness" had told them. The government had observed:

> "With all respect to [the AUSAs], they don't know anything about these transactions. They don't know anything about what would be significant about what was said in a meeting. And for them to be able to have a nuanced understanding of the significance of what [the witness] told them . . . , is asking too much of anybody who hasn't tried to figure these things out."

*United States v. Stein*, 2007 WL 3025658 at 2-3.

Eliminating an institutional source for legal fees and expert witness fees quite simply puts the necessary professional assistance out of reach of the defendants here.

There is little risk that judicial intervention in the name of adversarial fairness will interfere with the Justice Department's legitimate efforts to pursue white collar crime. The prosecution's conduct at issue here would never be appropriate, and it was premised on a memorandum that was superseded by the Department by the McNulty Memorandum following the opinion in *Stein I*. Any opinion by this Court would be of limited

precedential force since the McNulty Memorandum is now the governing document. Moreover, while there may be cases in which an entity uses the provision of counsel to its minions as a way of "circling the wagons" and protecting the guilty, this was not one, as the government conceded. And, as a general matter, there is no reason to believe – although the prosecutors in this case may have – that defendants with independent counsel funded by their employers will not fairly consider the benefits of cooperating with the government.

Given the absence of any improper intent by KPMG in providing legal fees and expenses to its professional employees, the government's approach in this case displayed a heavy-handedness that should play no role in effective law enforcement in the Southern District of New York. As Professor Kenneth Culp Davis in Discretionary Justice, A Preliminary Inquiry 3 (University of Illinois Press 1971) observed:

> "***Where law ends, discretion begins, and the exercise of discretion may mean either beneficence or tyranny, either justice or injustice, either reasonableness or arbitrariness."

Given Judge Kaplan's findings of injustice and arbitrariness, the exercise of this Court's supervisory power is called for here.

## POINT III

## AN OFF-HAND COMMENT OF 39 WORDS WAS NEITHER CAPABLE OF CURING NOR DID IT CURE THE CONSTITUTIONAL TRANSGRESSIONS FOUND BY THE DISTRICT COURT

Apparently seeking to escape its parlous legal and factual dilemmas, the prosecution cynically asserts as its first Point on this appeal that the 39 words which follow, spoken by an Assistant United States Attorney on March 30, 2006, "cured" the constitutional transgressions of the prosecution:

> THE COURT: . . . Is the government prepared at this point to commit that the government has no objection whatsoever to KPMG exercising its free and independent business judgment as to whether to advance defense costs to these defendants and that if it were to elect to do so the government would not in any way consider that in determining whether it had complied with the DPA?
>
> [AUSA]: That's always been the case, your Honor. That's fine. We have no objection to that.
>
> THE COURT: That's always been the case?
>
> [AUSA]: 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. (*Smith* A.249-50)

The 39 words are buried in the 130-page transcript (*Smith* A.213-342) of the March 30th hearing. The quoted statement appears at page 37 of

the transcript. The transcript would go for another 93 pages with no further argument or even discussion of the so-called "cure."[12]

The basic flaw in the government's "cure" argument is that the question now is not whether KPMG did or did not feel free after March 30, 2006 to reverse the decision it made two years earlier to deny counsel fees to its former partners and employees. Rather, the issue is whether, absent government interference, KPMG would have abandoned its long-standing policy of paying attorney's fees on its own initiative. There is no evidence that it would have and the government never attempted to prove it.

The government's resurrection of these 39 words is but a belated and misguided attempt to persuade this Court that it made a good faith effort to remedy any possible violation of the defendants' constitutional rights. That

[12] The government's April 27, 2006 post-hearing brief contained only a brief reference to the statement made in court and then stated that this inquiry by the Court "correctly framed the remedy" in the event that a Sixth Amendment violation were found by the court. This paragraph concluded as follows: "If KPMG decides, for reasons separate and apart from the conduct or influence of the Government, to advance legal fees to the defendants, any prejudice the defendants may have suffered would appear to be remediated.... If KPMG elects not to advance fees, by contrast, no Sixth Amendment violation on the part of the Government could be said to exist, because the decision was reached independent of any Governmental involvement." (Docket Entry No. 459, *Stein* A.96) Significantly, the government did not contend then, nor did it assert after *Stein I* nor during the additional proceedings relating to the remedy of dismissal in June-July 2007, that KPMG ever in fact made a new "independent" decision (subsequent to the allegedly curative statement) relating to the payment of fees.

the claimed "cure" is but an appellate "hail mary" pass becomes clear in the government's Opening Brief, where the government purports to quote from a supposed letter to the District Court in April 2006

> (*Smith* A.249-50; accord Gov't Ltr to Court, Apr. 11, 2006):
>
> ("[T]he Government has stated unequivocally that it would not find it to be a violation of the Deferred Prosecution Agreement for KPMG to change its decision and voluntarily pay legal fees for these indicted defendants.") (Emphasis supplied)

(Gov't Open. Br. 33-34)

There was no such statement in the letter submitted. The quotation was in a draft, but deleted from the letter before delivery to the District Court. The prosecution acknowledged its error in its subsequent letter of October 29, 2007 to this Court.[13] The reasons for the deletion from

[13] The letter in its entirety reads: "The Government respectfully submits this letter to advise the Court of an error in the Government's principal brief in this case, which was filed on October 10,2007. On page 33 of that brief, a quotation from the record is followed by an *"accord"* citation to a letter submitted by the Government to the District Court on April 11, 2006. The citation is accompanied by a parenthetical enclosing a quotation. After being alerted by an inquiry from defense counsel, the Government determined that the quotation in the parenthetical does not appear in the April 11, 2006, submission. Further investigation revealed that the quotation appears in a preliminary draft of that submission, but was not included in the version submitted to the District Court. As a result, the Government requests that the Court disregard the *"accord"* citation and quotation that appears at the bottom

the actual April 2006 letter to Judge Kaplan remain a prosecution secret. The most logical inference, however, is that the government did not want KPMG to believe itself free to pay the legal fees of these defendants.

At no point during the hearing on March 30, 2006, or subsequently did the prosecution request the opportunity to attempt to prove that KPMG would now feel free to revert to its policy of paying the defendants' legal fees or that such a change in policy would undo the harm that had been done. Moreover, even though in supplemental proceedings in June and July 2007 the District Court offered all of the parties an opportunity to supplement the record, the Government never offered any proof to support its cure argument. The statements of KPMG's counsel referenced in the government's brief (Gov't Open. Br. 37-40) are simply arguments of counsel in the ancillary proceeding. The government never offered proof on this issue.

Since the government never offered to prove in the District Court that its 39 words cured its violation of the defendants' constitutional rights, it is precluded from asserting the cure claim on appeal. *See Steagald v. United States*, 451 U.S. 204, 209 (1981) (holding that government loses its right to

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of page 33 of the Government's brief and carries over to page 34. The Government regrets the error."

raise factual issues on appeal "when it has failed to raise such questions in a timely fashion during the litigation"); *United States v. Canova*, 412 F.3d 331, 358 (2d Cir. 2005) (government's failure to object to ground for district court's ruling waived the argument on appeal); *United States v. Nee*, 261 F.3d 79, 86-87 (1st Cir. 2001) (applying "cardinal principle that 'issues not squarely raised in the district court will not be entertained on appeal,'"); *United States v. Canady*, 126 F.3d 352, 359-60 (2d Cir. 1997) ("because the government failed to raise its procedural default defense in the district court, it is precluded from doing so" on appeal).

In any event, Judge Kaplan was correct when, on the record before him, he held in *Stein I* at 374, that "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."

The government's argument that its 39-word statement constituted a "cure" ignores the fact that it bears a heavy burden to show that the defendants were not prejudiced by its conduct. *See United States v. Danielson*, 325 F.3d 1054, 1070-72 (9th Cir. 2003) (where the prosecution

"improperly intrud[ed] into the attorney-client relationship" it must present sufficient evidence to meet its heavy burden to prove lack of prejudice).

The government's alleged cure on March 30, 2006 could not cure the violation of the Sixth Amendment rights of Mr. Gremminger, who had already lost the counsel of his choice.[14]

Nor could it reasonably have been expected to have had any impact on KPMG, which by this time had become the handmaid of the government. The claimed "curing" quality of the prosecution's 39-word statement is at variance with the realities of the proceedings at the time of its making. The March 30, 2006, statement was made two years after the prosecution's violative conduct began in early 2004, seven months after KPMG entered into a Deferred Prosecution Agreement (DPA) on August 29, 2005 in which it acknowledged wrongdoing and after the former KPMG partners and employees had been indicted.

Hearing from Mr. Weddle's mouth the statement that it was free "as has always been the case" to pay the attorney fees of its partners could hardly have had any impact on KPMG since Mr. Weddle was continuing to deny that the government had ever pressured KPMG to change its policy and

[14] *Stein IV* at 421.

was denying that he ever told KPMG "if u have discretion re fees will look at that under a microscope."

Notwithstanding the prosecution's pious piffle that KPMG could do as it wished in 2006, the DPA of 2005 which KPMG so assiduously sought and for which the prosecution exacted such a heavy toll is not consistent with the now-claimed 39-word absolution gratuitously conferred by the prosecution itself in March 2006.

The terms of the DPA demonstrate that the prosecution itself hardly contemplated that KPMG could do as it wished with respect to paying the legal fees of the indicted former partners and employees. The DPA provided that KPMG had an ongoing obligation to cooperate fully with the United States Attorney's Office. Would KPMG have taken the risk that the payment of the defendant's legal fees would not be taken into consideration if a question ever arose concerning its cooperation? What disclosures would KPMG be required to make to the government concerning, for example, requests by the defendant-appellees for documents in view of KPMG's expansive cooperation requirements in the DPA?[15]

[15]E.g., "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

Additionally, KPMG was unlikely to begin in 2006 to assert initiatives on its own behalf. It had been made the handmaiden of the prosecution for several years. When one analyzes the monetary obligations to which KPMG agreed in the DPA, its supine status becomes apparent. For

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IRS, and with any other agency of the government designated by the Office ('Designated Agencies') regarding any matter relating to the Office's investigation about which KPMG has knowledge or information.

"8. KPMG agrees that its continuing cooperation with the Office's investigation shall include, but not be limited to, the following:

"(a) Completely and truthfully disclosing all information in its possession to the Office and the IRS about which the Office and the IRS may inquire, including but not limited to all information about activities of KPMG, present and former partners, employees, and agents of KPMG;

* * *

"(d) Assembling, organizing, and providing, in responsive and prompt fashion, and, upon request, expedited fashion, all documents, records, information, and other evidence in KPMG's possession, custody, or control as may be requested by the Office or the IRS;

"(e) Not asserting, in relation to the Office, any claim of privilege (including but not limited to the attorney-client privilege and the work product protection) as to any documents, records, information, or testimony requested by the Office related to its investigation . . . [; and]

"(f) Using its reasonable best efforts to make available its present and former partners and employees to provide information and/or testimony as requested by the Office and the IRS, including sworn testimony before a grand jury or in court proceedings, as well as interviews with law enforcement authorities . . .

"9. KPMG agrees that its obligations to cooperate will continue even after the dismissal of the Information, and KPMG will continue to fulfill the cooperation obligations set forth in this Agreement in connection with any investigation, criminal prosecution or civil proceeding brought by the Office or by or against the IRS or the United States relating to or arising out of the conduct set forth in the Information and the Statement of Facts and relating in any way to the Office's investigation." J.A.1225-1252.

example, KPMG agreed to pay the enormous sum of $456 million. It was represented by one of the country's leading law firms in all its dealings with the United States Attorney's Office. Yet when serious questions were raised as to the legality of the criminal penalty of $128 million to which KPMG had agreed,[16] KPMG remained silent. It raised no issue with respect to the legality of the fine on its own behalf.

KPMG also raised not a whimper when its treatment of its former employees came under criticism by Judge Kaplan in *Stein II* at 323-24:

> In a November 2, 2004 letter to the USAO, which obviously was intended to demonstrate that KPMG should not be indicted because, among other things, it had cooperated with the government, Skadden [counsel to KPMG] wrote:
>
> > "KPMG has repeatedly directed all current and former personnel to cooperate with the investigation and has conditioned payment of attorney's fees upon prompt, complete, and truthful cooperation with the government's inquiry. Whenever your Office has notified us that individuals have not rendered prompt, complete, and truthful cooperation, KPMG has promptly and without question encouraged them to cooperate and threatened to cease payment of their attorney fees and (if applicable) to take

[16] *See Declaration of Marion Bachrach,* dated June 7, 2007, United States District Court for the Southern District of New York, No. S1 05 Crim. 0888 (LAK), Docket Entries 996 and 997.

> personnel action, including termination. *In certain instances, KPMG's action has led previously non-cooperating individuals to meet with your Office.* In other instances, KPMG has ceased payment of fees and expenses."
>
> At later meetings, and in a so-called "White Paper" that argued against indictment of the firm, Mr. Bennett "noted that KPMG had 'hinged attorneys fees on whether people would talk to [the government]'" and "that KPMG had cut off fees for several individuals for non-cooperation and had terminated two partners for non-cooperation," including for "*asserting . . . [the] 5th Amendment right not to testify."* A memorandum of a June 13, 2005 meeting with the DOJ discloses that Mr. Bennett argued that "We [KPMG] said we'd pressure – although we didn't use that word – our employees to cooperate" and when employees did not cooperate, "Justin [AUSA Weddle] or Stan [AUSA Okula] would tell us," and the firm then cut off fee payments and/or fired the individual. Indeed, KPMG's final submission to the DOJ argued that it had fully cooperated by, among other things, "pressuring current and former personnel to cooperate fully with the investigation." (Emphasis in original) (footnotes omitted)

It is difficult to imagine that the words uttered on March 30, 2006 would transmogrify KPMG's accommodating attitude towards the prosecution to one of independence. Those 39 words – especially when considered in isolation, but also when considered in conjunction with KPMG's conduct over several years – did not come even close to curing the

effect of the Faustian bargain under which the prosecution compelled KPMG to live.

## POINT IV

## THE APPELLEES DELAP, GREMMINGER, WARLEY AND WIESNER JOIN IN THE BRIEFS OF THE OTHER APPELLEES AND THE AMICI TO THE EXTENT THAT THEY ARE NOT INCONSISTENT WITH THE POINTS MADE AND AUTHORITIES CITED HEREIN

## CONCLUSION

The exhaustive record below makes plain that the defendant-appellees, at the time when they were most in need of forceful advocacy by experienced, independent and adequately financed counsel, were deprived of just that as a result of unjustified governmental interference.

Judge Kaplan spent a year attempting to return the defendant-appellees to their pre-February 25, 2004 status. When his efforts proved unsuccessful, he dismissed the indictment as a last resort. That dismissal should be affirmed.

Dated: January 11, 2008

Respectfully submitted,

_____

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## CERTIFICATE OF COMPLIANCE

Pursuant to Rule 32(a)(7)(C) of the Federal Rules of Appellate Procedure, I hereby certify that according to the word count feature of the word processing program used to prepare this brief, the brief contains 13,981 words and complies with the type-volume limitations set forth in Federal Rules of Appellate Procedure 29(d) and 32(a)(7)(B).

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I, , being duly sworn, depose and say that deponent is not a party to the action, is over 18 years of age and resides at the address shown above or at

**On January 11, 2008**

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**Sworn to before me on January 11, 2008**

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