07-3042-cr

To Be Argued By:
KARL METZNER

United States Court of Appeals

FOR THE SECOND CIRCUIT

Docket No. 07-3042-cr

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 THE UNITED STATES OF AMERICA

MICHAEL J. GARCIA,
United States Attorney for the Southern District of New York,
Attorney for the United States of America.

KARL METZNER,
JOHN M. HILLEBRECHT,
MARGARET GARNETT,
KATHERINE POLK FAILLA,
Assistant United States Attorneys,
Of Counsel.

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BRIEF FOR THE UNITED STATES OF AMERICA

Statement Of Subject Matter And Appellate Jurisdiction

The United States of America appeals from an opinion and order entered on July 16, 2007, in the United States District Court for the Southern District of New York, by the Honorable Lewis A. Kaplan, United States District Judge, dismissing the indictment against the thirteen defendants-appellees, which order incorporated and relied on an earlier opinion and order issued on June 26, 2006,

also by Judge Kaplan, in which the District Court concluded that the defendants-appellees had suffered violations of their rights under the Fifth and Sixth Amendments to the Constitution.

The United States filed a timely notice of appeal on July 16, 2007. The jurisdiction of this Court is invoked pursuant to Title 18, United States Code, Section 3731. The Solicitor General has authorized the prosecution of this appeal.

Statement Of Issues Presented

1. Whether the Government improperly coerced KPMG LLP ("KPMG") into conditioning or limiting its voluntary advance payment of legal fees to the defendants; whether such coercion, if it occurred, constituted a violation of the defendants' Sixth Amendment rights; and whether the Government remedied any such violation through its subsequent explicit assurances that KPMG would suffer no negative repercussions from advancing legal fees to the defendants.

2. Whether Sixth Amendment jurisprudence is the governing constitutional framework for analyzing the issues in this case, to the exclusion of the Due Process Clause of the Fifth Amendment; whether, assuming the applicability of a due process analysis, the Government's criteria for evaluating corporate criminality wrongfully infringed on a recognized fundamental right possessed by the defendants; and whether, if there is no such fundamental right, those criteria are rationally related to the essential governmental responsibility to combat crime.

3. Whether the Government's conduct in relying since 1999 on an explicit, multi-factor policy to evaluate corporate culpability that included an assessment of the entity's efforts to cooperate, and in investigating this case consistent with that policy, can fairly be said to "shock the conscience."

Statement Of The Case

Superseding Indictment S1 05 Cr. 888 (LAK) (the "Indictment") was filed on October 17, 2005, and charged nineteen defendants in forty-six counts, including one count of a *Klein* conspiracy pursuant to Title 18, United States Code, Section 371; forty-three counts of tax evasion pursuant to Title 26, United States Code, Section 7201 and Title 18, United States Code, Section 2; and two counts of obstruction of the Internal Revenue Service (the "IRS"), pursuant to Title 26, United States Code, Section 7212 and Title 18, United States Code, Section 2.[*]

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[*] The underlying indictment, 05 Cr. 888 (LAK), was filed under seal on August 24, 2005, and unsealed by order dated August 29, 2005. The principal differences between the two instruments are that the Indictment charged more defendants and added substantive tax evasion counts.

Of the nineteen defendants, thirteen have had the charges against them dismissed (and are the appellees here), two have pled guilty, and four are awaiting trial, which is currently scheduled to begin in October 2007. The thirteen defendants-appellees will generally be referred to herein simply as "the defendants," but, as all thirteen are former partners or employees of KPMG, they

In a motion dated January 12, 2006, the defendants claimed that the Government had improperly caused KPMG to cease advancing its legal fees, and so asked the District 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," or, failing that, to dismiss the indictment. (Dkt. 263 at 2) (the "Fee Motion"). On June 27, 2006, Judge Kaplan issued an Opinion and Order on the Fee Motion, *United States* v. *Stein*, 435 F. Supp. 2d 330 (S.D.N.Y. 2006) ("*Stein I*"), in which he found a violation of the defendants' Sixth Amendment right to counsel and Fifth Amendment right to substantive due process of law arising out of KPMG's decision to condition and cap the payment of legal fees for its employees and partners in connection with the criminal investigation into the tax shelters, and the Government's purported actions in relation to those decisions, including the Government's reliance on a Department of Justice memorandum entitled *Principles of Federal Prosecution of Business Organizations*, issued by former Deputy Attorney General Larry Thompson (the "Thompson Memorandum").[*]

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may also be identified as the "KPMG Defendants" when necessary for clarity.

[*] After *Stein I* was issued, defendant Smith, on behalf of himself and certain other defendants, moved to suppress statements made at proffer sessions with the Government, arguing that those statements were involuntary because of the "economic coercion" purportedly created by KPMG's (1) conditioning of legal fee payments, in part, on cooperation with a Government investigation into the firm's tax

The District Court did not dismiss the Indictment at that time, but rather attempted to assert jurisdiction over KPMG and conduct a summary proceeding to determine KPMG's legal obligations regarding the defendants' legal fees. This Court rejected those efforts as being "beyond the district court's power." *Stein* v. *KPMG, LLP*, 486 F.3d 753, 756 (2d Cir. 2007). At the District Court's invitation, the defendants then renewed their motions to dismiss the Indictment, adding a claim that the Government's conduct in its dealings with KPMG and the defendants was so egregious that it "shocked the conscience," thereby mandating dismissal to deter the Government from such behavior in the future. (Dkt. 1010). In a Memorandum and Order dated July 16, 2007, the District Court reconsidered *Stein I* in light of subsequent Government arguments, but reaffirmed its earlier findings and held in addition that the Government's conduct did indeed "shock the conscience," thereby violating the Due Process Clause. Judge Kaplan concluded that, as to the thirteen KPMG Defendants as to

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shelter activities, and (2) the firm's statements to some defendants that a refusal to cooperate might result in employment action, including possible expulsion from the firm. In a Memorandum and Order dated July 26, 2006, the District Court suppressed the proffer statements of defendants Smith and Watson, and any fruits thereof. *United States* v. *Stein*, 440 F. Supp. 2d 315 (S.D.N.Y. 2006) ("*Stein II"*). This order is the subject of a separate Government appeal. *See United States* v. *Stein (Smith and Watson)*, No. 06-3999-cr. For convenience, the Government will refer to the suppression appeal as the "*Smith* appeal" in this brief.

whom, he found, KPMG would have paid legal fees in the absence of the Government's conduct, the Indictment must be dismissed. *United States* v. *Stein*, 495 F. Supp. 2d 390 (S.D.N.Y. 2007) ("*Stein IV*").

Statement Of Facts

By order dated August 2, 2007, this Court granted the Government's motion for this appeal to be heard in tandem with the *Smith* appeal. Because the issues in that case overlap substantially with those presented here, many of the facts recounted in the Government's principal brief in *Smith* apply to this appeal as well. As a result, to avoid needless repetition, the Government relies on the Statement of Facts in the *Smith* brief, at pages 5 through 42, and in this section of the brief will only discuss those facts necessary to an understanding of the issues presented in this appeal.

A. The Offense Conduct

As this Court has already noted, this is "the largest criminal tax case in American history." *KPMG*, 496 F.3d at 756. The Indictment charges that the defendants engaged in a multi-billion-dollar conspiracy to defraud the United States using fraudulent tax shelters. "The defendants are alleged to have, *inter alia*, devised, marketed, and implemented fraudulent tax shelters that caused a tax loss to the United States Treasury of more than $2 billion." *Id.* For its role in this massive tax fraud, KPMG realized

at least $115 million in fees. (*See* Indictment ¶¶ 29-32, Smith A. 142-43).[*]

The Indictment identifies the various roles played by and positions held by the thirteen defendants-appellees. (*See* Indictment ¶¶ 8-12, 14, 15, 17-20, 22, 23, Smith A. 135-39). All were partners or employees of KPMG during some portion of the period charged in the Indictment, and several were high-level officers of the firm, including its Vice Chair and several heads of the firm's tax practice.

On August 29, 2005, more than 18 months after the Government's investigation began, KPMG entered into a deferred prosecution agreement (the "DPA") with the Government, pursuant to which the firm admitted to serious and widespread criminal wrongdoing and agreed to pay approximately $456 million in fines, restitution, and penalties.[**] In an extensive factual summary that accompa

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[*] "Smith A." refers to the Joint Appendix filed in *United States* v. *Stein (Smith and Watson)*, No. 06-3999-cr; "Stein A." refers to the Joint Appendix filed with this brief; "SA" refers to the Supplemental Appendix filed with the defendants' briefs on appeal in the *Smith* appeal; "Gov't Br." refers to the Government's brief on appeal in the *Smith* appeal; and "Gov't Reply Br." refers to the Government's reply brief on appeal in the *Smith* appeal.

[**] The DPA and its accompanying Statement of Facts appear at pages 317 and 383 of the Joint Appendix, and also are available on the website of the United States Attorney's Office for the Southern District of New York (the "USAO") at http://www.usdoj.gov/usao/nys/pressreleases/August05/kpmgdpagmt.pdf and

nied the DPA, KPMG declared that its policies concerning the advancement of legal fees were formulated "on its own initiative." (Stein A. 392). The criminal information against the firm was dismissed on January 3, 2007, after the district court found that KPMG had satisfied its obligations under the DPA. A three-year monitorship of KPMG and the other terms of the DPA are still in force.

B. The Defendants' Legal Fee Motion

On January 12, 2006, the defendants filed the Fee Motion, alleging that the Government had "improperly infringed on [their] constitutional rights to counsel and a fair trial" by pressuring KPMG to cease paying their individual legal fees.[*] The movants asked the District

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http://www.usdoj.gov/usao/nys/pressreleases/August05/kpmgstatementoffacts.pdf, respectively.

[*] The defendants contended that the Government "ha[d] put extreme pressure on KPMG to stop advancing payment for the defense of the individual defendants here." (Fee Motion at 1). However, the defendants presented no evidence that, prior to KPMG's first meeting with the Government in February 2004, the firm had voluntarily advanced legal fees to them in connection with the criminal investigation (as distinct from civil litigation or the Senate subcommittee hearings). Rather, as detailed *infra* in this brief, the evidence indicated that KPMG decided in early 2004 to advance legal fees to certain current and former employees who were subjects of the criminal investigation, subject to certain conditions, including requiring each such employee to cooperate by meeting with the Government if requested to do so,

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 [KPMG's] deferred prosecution agreement." (Fee Motion at 3). In the alternative, the defendants moved for a dismissal of the Indictment, based on "the totality of prosecutorial misconduct" as alleged in the Fee Motion and other defense pretrial motions.

On March 30, 2006, the District Court heard argument on, among other matters, whether to conduct an evidentiary hearing on the Fee Motion. Prior to that time, for a period of almost 18 months, KPMG had advanced millions of dollars in legal fees to the defendants, subject to the conditions it had set, and had specifically advised the Government of the legal fee policy it had adopted. Despite that payment of legal fees, KPMG had avoided indictment; at the end of the 18-month investigation, KPMG entered into a DPA with the Government. Still, to dispel any lingering concerns about potentially negative consequences arising from the payment of legal fees, the Government stated unequivocally during the March 30 argument that it had no objection if KPMG decided to pay the defendants' attorneys fees, and would not consider it a violation of the DPA:

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capping fees at $400,000, and terminating legal fees should the employee be indicted. KPMG had specifically advised the Government of its decision, and had advanced legal fees to nearly all of the defendants subject to the conditions it had selected.

> 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). Nonetheless, Judge Kaplan ordered discovery and an evidentiary hearing on certain factual issues raised by the Fee Motion, specifically, "whether the government, through the Thompson Memorandum or otherwise, affected KPMG's determination(s) with respect to the advancement of legal fees and other defense costs to present or former partners and employees with respect to the investigation and prosecution of this case and such subsidiary issues as relate thereto." (Dkt. 434).

The hearing took place on May 8, 9, and 10, 2006 (the "Fee Hearing"). Two prosecutors from the USAO, one agent from the IRS Criminal Investigation Division, three

attorneys from KPMG's outside counsel, and one attorney from KPMG's Office of General Counsel testified; the District Court also admitted numerous documents that had been produced by both the USAO and KPMG. The defendants, who bore the burden of proof on the motion, elected not to call either the lead prosecutor from the USAO or the lead outside counsel for KPMG, even though both were made available for the hearing.

During the pendency of the Fee Motion, the District Court solicited briefing from the parties on topics including: whether the defendants' substantive or procedural due process rights under the Fifth Amendment had been violated; whether the defendants were required to present evidence of prejudice; and, if a violation were to be found, what would be the appropriate remedy. (Smith A. 674-76).

In a Memorandum and Order dated June 26, 2006, the District Court found that: (1) the factors identified in the Thompson Memorandum, as applied and reinforced by the USAO, had "coerced" KPMG into refusing to advance legal fees voluntarily to the defendants; (2) a defendant has a fundamental right "to obtain and use in order to prepare a defense resources lawfully available to him or her, free of knowing or reckless government interference," and the Government's reasons for infringing that right could not withstand strict scrutiny under the Due Process Clause; (3) the same conduct had infringed upon the defendants' Sixth Amendment rights; but (4) no dismissal or other remedy would be appropriate until efforts to obtain the fees from KPMG were exhausted. *United States* v. *Stein*, 435 F. Supp. 2d 330 (S.D.N.Y. 2006) ("*Stein I*").

The District Court invited the defendants to file a civil suit against KPMG for advancement of legal fees under the District Court's "ancillary jurisdiction," which they did. *Stein I*, 435 F. Supp. 2d at 382. However, the District Court hinted strongly that if KPMG elected not to advance legal fees—and, more specifically, if the Government was unwilling or unable to convince the firm to advance the legal fees—the Indictment could be dismissed:

> The government has substantial influence and, almost certainly, power over KPMG by virtue of the cooperation clauses in the DPA. It may well be in its interest to use that influence or power to cause KPMG to advance the defense costs. . . . The government now may seek to use its leverage against KPMG to cause KPMG to advance defenses costs in order to avoid any risk of dismissal of this indictment or other unpalatable relief.

Stein I, 435 F. Supp. 2d at 380.[*]

On July 10, 2006, pursuant to the District Court's invitation, the defendants filed a civil complaint against KPMG seeking a declaratory judgment that KPMG was required to pay all legal fees and expenses that the defendants had incurred or would incur during the criminal

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[*] The DPA, which had been entered into nearly one year prior to the District Court's decision, contained no provision concerning the advancement (or prohibition on advancement) of legal fees.

proceeding. *See Stein, et al.* v. *KPMG LLP*, 06 Civ. 5007 (LAK). On July 26, 2006, KPMG moved to dismiss the complaint and to compel arbitration pursuant to the terms of the KPMG Partnership Agreement. Of particular significance to the instant appeal, KPMG stated that the firm "has no legal obligation to advance attorneys' fees for the *Stein* Defendants, whether pursuant to governing Delaware partnership law, the Partnership Agreement, other pertinent contracts, or KPMG's past practices." (Memorandum of Points and Authorities in Support of Motion to Dismiss the Complaint and Compel Arbitration, filed July 26, 2006 ("KPMG Mem.") at 3). By opinion and order dated September 6, 2006, Judge Kaplan denied KPMG's motion to dismiss. *See United States* v. *Stein*, 452 F. Supp. 2d 230 (S.D.N.Y. 2006) ("*Stein III*").

KPMG appealed to this Court, which dismissed the ancillary proceeding in an Opinion and Order dated May 23, 2007. *Stein* v. *KPMG, LLP*, 486 F.3d 753 (2d Cir. 2007), finding that "the prejudice to KPMG [from the ancillary proceeding] is clear, and the need for the ancillary proceeding is entirely speculative." *Id*. at 761.[*]

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[*] This Court also viewed with skepticism the District Court's suggestion that the Government should prevail upon KPMG to pay the legal fees:

> The district court acknowledged a more obvious remedy for the constitutional violations it had found—dismissal of the indictment—and explicitly left that possibility open as an incentive for the government to strongarm KPMG to advance appellees'

Shortly after this Court reversed Judge Kaplan's efforts to force KPMG into summary litigation concerning the defendants' legal fees, he returned to the issue of the appropriate remedy for the constitutional violations he had found in *Stein I* by inviting supplemental submissions on the defendants' original motion to dismiss. The defendants argued that, in addition to the grounds cited by Judge Kaplan in *Stein I*, the Indictment should also be dismissed because of "outrageous government conduct" in conducting the investigation. The Government responded that the District Court need not reach the "outrageous conduct" issue, because, "given the Court's previous rulings, it appears that the only action the Court could take consistent with those rulings would be dismissal of the Indictment." (Dkt. 1051 at 1-2). The Government added that dismissal was not appropriate as to three of the sixteen moving defendants because those three had failed to demonstrate that KPMG ever intended to pay their legal fees.

After hearing further argument, Judge Kaplan dismissed the Indictment as to thirteen of the defendants. *United States* v. *Stein*, 495 F. Supp. 2d 390 (S.D.N.Y. 2007) ("*Stein IV*"). He reiterated the conclusions he had made in *Stein I*, citing in support "additional evidence not

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> defense costs. [*Stein I*, 435 F. Supp. 2d] at 380. In short, having found that the government violated appellees' constitutional rights by threatening to bring one indictment, the district court sought to remedy the violation by threatening to dismiss another.

486 F.3d at 757.

previously considered" a year earlier. *Id.* at 393. Judge Kaplan also agreed with the defendants that the Government's conduct in investigating this case "shocked the conscience," thereby violating the Due Process Clause and providing an additional basis to dismiss the Indictment.

C. The Government's Investigation Of KPMG And The Defendants

1. The Thompson Memorandum

The Government's brief in the *Smith* appeal details the genesis and purpose of what has become known as the "Thompson Memorandum." (*See* Gov't Br. 15-24). The introduction to the Thompson Memorandum stated, in no uncertain terms, why it had been issued on the heels of a similar directive (known colloquially as the "Holder Memorandum") less than four years earlier:

> The main focus of the revisions is increased emphasis on and scrutiny of the authenticity of a corporation's cooperation. Too often business organizations, while purporting to cooperate with a Department investigation, in fact take steps to impede the quick and effective exposure of the complete scope of wrongdoing under investigation.

(Smith A. 1135). Thus, the Thompson Memorandum made plain for all to see—including the defense bar—that an animating concern behind its issuance was the need to evaluate the sincerity of a corporation's cooperation in deciding whether to seek criminal charges against it, and

a need for corporations to know how the Department of Justice would do that.

The Thompson Memorandum lists nine broad factors that the Justice Department would consider when contemplating criminal charges against a corporation, and then expounds at some length on how to evaluate them in a particular case. It notes that the factors "are intended to provide guidance rather than to mandate a particular result," that the nine factors "are intended to be illustrative of those that should be considered and not a complete or exhaustive list," and that the prosecutor retains "wide latitude" regarding whether to bring charges at all. (Smith A. 1137).

The fourth such factor allows consideration of "the corporation's timely and voluntary disclosure of wrongdoing and its willingness to cooperate in the investigation of its agents, including, if necessary, the waiver of corporate attorney-client and work product protection (*see* section VI, *infra*)." (Smith A. 1137). In Section VI, the Thompson Memorandum provides an extended discussion of the potential significance of a corporation's cooperation, along with a reminder to be wary of efforts to impede the investigation:

> Another factor to be weighed by the prosecutor is whether the corporation appears to be protecting its culpable employees and agents. Thus, while cases will differ depending on the circumstances, a corporation's promise of support to culpable employees and agents, either through the advancing of attorneys fees,[4] 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). Footnote four to this section reminds prosecutors that if a corporation is legally required to pay attorneys fees, then doing so is obviously not evidence of sham cooperation. Thus, footnote four in its entirety made clear that if a corporation pays lip service to cooperation while in reality taking steps to obstruct the investigation, such as by paying legal fees to the primary malefactors in an effort to buy their silence or their false adherence to the corporation's preferred version of events, the Government may properly discount the value of such "cooperation" when deciding whether to seek charges against the company.

In December 2006, Paul J. McNulty, then Deputy Attorney General, promulgated another revision to *Principles of Federal Prosecution of Business Organizations*, which (not surprisingly) is commonly referred to as the "McNulty Memorandum." (SA 78-94). The McNulty Memorandum retained the directive for prosecutors to consider "the corporation's timely and voluntary disclosure of wrongdoing and its willingness to cooperate in the investigation of its agents," as well as "the corporation's remedial actions, including any efforts to implement an effective corporate compliance program or to improve an existing one, to replace responsible management, to

discipline or terminate wrongdoers, to pay restitution, and to cooperate with the relevant government agencies" in deciding whether to bring charges. (SA 80-81). With respect to the payment of legal fees, the McNulty Memorandum provides that

> Prosecutors generally should not take into account whether a corporation is advancing attorneys' fees to employees or agents under investigation and indictment. Many state indemnification statutes grant corporations the power to advance the legal fees of officers under investigation prior to a formal determination of guilt. As a consequence, many corporations enter into contractual obligations to advance attorneys' fees through provisions contained in their corporate charters, bylaws or employment agreements. Therefore, a corporation's compliance with governing state law and its contractual obligations cannot be considered a failure to cooperate.[3] This prohibition is not meant to prevent a prosecutor from asking questions about an attorney's representation of a corporation or its employees.[4]

(SA 86-87).

Footnote three to this provision makes clear that, as the Government has maintained throughout this case, payment of legal fees may be relevant if it reflects an attempt to obstruct the investigation. In fact, the footnote cites the Government's discussion on that subject in the *Smith* brief to this Court:

> In extremely rare cases, the advancement of attorneys' fees may be taken into account when the totality of the circumstances show that it was intended to impede a criminal investigation. In these cases, fee advancement is considered with many other telling facts to make a determination that the corporation is acting improperly to shield itself and its culpable employees from government scrutiny. *See discussion in* Brief of Appellant-United States, *United States v. Smith and Watson*, No. 06-3999-cr (2d Cir. Nov. 6, 2006). Where these circumstances exist, approval must be obtained from the Deputy Attorney General before prosecutors may consider this factor in their charging decisions.

(SA 94). In addition, footnote four points out that, consistent with the Government's actions here, "[r]outine questions regarding the representation status of a corporation and its employees, including how and by whom attorneys' fees are paid, frequently arise in the course of an investigation. They may be necessary to assess other issues, such as conflict-of-interest. Such questions are appropriate and this guidance is not intended to prohibit such inquiry." (*Id.*).

2. The Inception Of The Criminal Investigation Into The KPMG Tax Shelters And KPMG's Decision To Pay Legal Fees

The USAO's criminal investigation into KPMG's tax shelter activities began in early February 2004, following substantial adverse publicity concerning both KPMG's tax shelter practices and its conduct in the face of investigations into those practices. KPMG retained Skadden Arps Slate Meagher & Flom LLP ("Skadden"), and decided to not only "clean house and change the atmosphere at the firm," but also to "cooperate fully with the government's investigation." *Stein I*, 435 F. Supp. 2d at 341. Before ever meeting with the Government, Skadden and KPMG discussed whether the firm would pay legal fees for its employees and partners in connection with the USAO investigation. (Smith A. 480-81, 484-85). Although KPMG had traditionally paid legal fees for its employees and partners in civil, criminal, and regulatory matters connected to their work for the firm, neither its partnership and other employment agreements, nor its by-laws, nor Delaware partnership law required such payments. Moreover, only once in the preceding 37 years had the firm paid legal fees for its employees post-indictment. *See* 486 F.3d at 763 n.3.

The first meeting between KPMG's representatives and the USAO took place on February 25, 2004 (the "February 25 Meeting"), and is discussed in detail in the Government's *Smith* brief. (*See* Gov't Br. 29-31). The parties dispute exactly who said what when during that meeting—which was lengthy and dealt principally with topics

other than the payment of legal fees—but the evidence at the Fee Hearing showed that:

- An AUSA inquired as to the firm's plan for paying legal fees and its obligations in that regard. (Smith A. 362, 365, 1188, 1199, 1338).
- A Skadden attorney recalled that KPMG's lead counsel asked for the Government's view on that subject, and that in reply one of the AUSAs made a reference to the firm's legal obligations and also to the provisions of the Thompson Memorandum. (Smith A. 365, 1338).
- KPMG's counsel informed the prosecutors that, while it had not made a final decision, he was "90% sure" that if the firm paid legal fees, that payment would be subject to the employee's cooperation with the USAO investigation. (Smith A. 614, 1118, 1199, 1338).
- Another Skadden attorney stated that, while KPMG had generally paid the fees of partners involved in legal proceedings, the present circumstances were "new ground," and if KPMG learned that a partner had engaged in wrongdoing they would not pay that partner's legal fees, nor would they pay if a partner "took the Fifth." (Smith A. 419, 615, 1188, 1199).
- 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 obliga-

tions and its plans. (Smith A. 412, 416-17, 615-16, 619, 1189, 1200).

In addition, the notes of both the IRS agent taking notes for the Government and an attorney from Skadden reflect a comment attributed to one of the AUSAs present regarding "misconduct" not "be[ing] rewarded." (Smith A. 1189, 1200, 1338). The two prosecutors who testified at the Fee Hearing both recalled the comment as a reference to personnel actions (specifically, any effort by KPMG to award lucrative severance packages to culpable employees), and not legal fees. (Smith A. 459, 617). And the notes of one Skadden attorney attribute to an AUSA the assertion that if KPMG had discretion whether to pay fees, the Government would "look at that under a microscope." (Smith A. 1339). But no witness—not even the lawyer who took the notes—recalled any such statement having been made. (*See* Smith A. 367-68, 425-27, 591, 618).

After the February 25 Meeting, KPMG's counsel informed the USAO that KPMG intended to pay legal fees for its partners and employees contingent upon the individual's cooperation with the investigation, and with an overall cap of $400,000. (Smith A. 1146). KPMG asked the USAO to inform KPMG if any individual was not being "cooperative" with the investigation. (Smith A. 436, 659). 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. (Smith A. 461-62, 1216). The Government did not, however, advise KPMG concerning the substance of any interviews that did take place.

D. The District Court's Decision In *Stein IV*

By July 2007, when the District Court revisited the issue of whether to dismiss the Indictment, the Government had filed its briefs in the *Smith* appeal with this Court. In its principal brief, the Government contended that several of Judge Kaplan's factual findings were clearly erroneous and unsupported by the record from the Fee Hearing. In *Stein IV*, Judge Kaplan took repeated note of the Government's appellate brief, *see* 495 F. Supp. 2d at 393 n.1, and stated that "the Court has reconsidered *Stein I* carefully in light of the government's arguments," but "remains convinced that the ruling was correct," relying in part on "additional evidence not previously considered" a year earlier. *Id.* at 393.

Stein IV again rejected the Government's argument—which it has consistently maintained from the outset of these proceedings—that the portion of the Thompson Memorandum dealing with payment of legal fees is properly read to advise corporations and their attorneys that paying such fees could reflect negatively on the corporation's efforts to cooperate with the investigation "only when the Government believed such payments were part of an effort to 'circle the wagons,' an effort to appear cooperative while protecting culpable employees." *Stein IV*, 495 F. Supp. 2d at 396 (quoting Gov't Br. 51). Judge Kaplan found that the "plain language" of the

Thompson Memorandum precluded this interpretation, and that "[a]ny competent lawyer reading the document would regard a corporate client that was under investigation as being at greater risk of indictment if it advanced legal fees to employees who might be viewed by prosecutors as culpable than if it did not advance legal fees." *Id.* at 397.

Further, Judge Kaplan found "no serious doubt" that the defense bar in general, and KPMG in particular, read the Thompson Memorandum "as discouraging payment of legal fees for company employees under investigation by holding out the prospect that doing so would increase the risk of indictment." *Stein IV*, 495 F. Supp. 2d at 397. The District Court cited several external sources in support of that proposition, including two statements made in Senate testimony after *Stein I* was issued. *See id.* at 397-99.[*] Thus, the District Court concluded that "KPMG and its counsel knew from the Thompson Memorandum, even before they first communicated with the USAO, that the payment of the legal fees of KPMG employees, in the absence of a legal obligation to do so, would increase the risk of

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[*] During the Fee Hearing and afterwards, the Government attempted to introduce evidence about public statements made by representatives of the USAO concerning the Thompson Memorandum, other investigations conducted by the USAO, and other evidence on the perceptions of the defense bar concerning the legal fees provision. The District Court refused to consider this evidence. (*See* Smith A. 608-09, 622; *Stein I*, 435 F. Supp. 2d at 342 n.46).

indictment of the firm, as prosecutors might view that action as protecting culpable employees." *Id.* at 400.

Judge Kaplan likewise dismissed the Government's argument that KPMG made its own decision, for its own reasons, to condition the payment of legal fees on cooperation with the Government, concluding that

> KPMG's decision to cut off payment of any legal expenses to anyone who was indicted—which is the critical point here—was prompted by the Thompson Memorandum and the USAO's negative reaction at the February 25 meeting to the possibility that KPMG would pay any legal fees in the absence of a legal obligation to do so.

Stein IV, 495 F. Supp. 2d at 404 (footnote omitted).

The District Court went on to reaffirm its conclusion in *Stein I* that the Thompson Memorandum, combined with the conduct of the USAO, coerced KPMG into refusing to advance all legal fees of all former employees and partners, and caused KPMG instead to cap those fees at $400,000 and condition payment on the individual's cooperation with the Government's investigation. Dismissing the Government's protests that no evidence supported such a causal connection, Judge Kaplan found "no need for direct evidence of the reasons for KPMG's decision. The evidence as a whole more than supports the Court's finding." *Id.* at 404. Indeed, although the defendants bore the burden of proof on the issue, the District Court blamed the Government for failing to prove that it did *not* cause KPMG to act as it did. *Id.* at 404-05. Judge Kaplan also

relied on his additional findings that (1) KPMG was paying attorneys fees for civil suits for many indicted defendants, which he felt supported his conclusion that KPMG would have paid the fees for those same individuals' criminal defense as well in the absence of the Thompson Memorandum and USAO conduct (*id.* at 406-07); (2) a voicemail message sent to all KPMG partners on February 18, 2004, which offered to pay for the partners' lawyers without mention of caps or cooperation, which Judge Kaplan felt supported his conclusion that KPMG would have paid the fees absent the USAO's conduct (*id.* at 407-08); and (3) the notes of a meeting between KPMG and its lawyers after the February 25 Meeting with the USAO, which Judge Kaplan interpreted to reflect KPMG's understanding that the Government's view was that paying legal fees and severance agreements would not be sign of cooperation (*id.* at 408-09). The District Court did not find, nor would the evidence of record support any finding, that KPMG's continued refusal, in 2006 and 2007, to advance legal fees to the now-indicted defendants was attributable to any conduct, much less any coercion, on the part of the Government. To the contrary, KPMG consistently maintained before the District Court that it had freely exercised its discretion not to advance legal fees.

Judge Kaplan then turned to a newly-raised defense argument that the Government's conduct violated the Due Process Clause because it "shocks the conscience." He first reaffirmed his due process analysis in *Stein I*, finding that the policy embodied in the Thompson Memorandum is the equivalent of a Government regulation, and so is evaluated like legislation, and failed the "strict scrutiny" test applied to legislation that infringes on a fundamental

right. *Id.* at 412. But then the District Court went on to hold, in the alternative, that the conduct of the USAO "shocked the conscience," which is the standard for evaluating a due process claim based on the conduct of particular executive branch officials. Judge Kaplan found that the USAO pressured KPMG to withhold legal fees, and "effectively compelled KPMG to make its personnel available for interviews by the government." *Id.* at 413. He held that the USAO's 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." *Id.* at 414. He further held that the USAO's conduct shocked the conscience even if it was merely deliberately indifferent to the defendants' constitutional rights. *Id.* at 414-15.

Finally, Judge Kaplan considered the impact of the Government's conduct on the defendants. He found that only four of the defendants had actually been deprived of their counsel of choice by KPMG's refusal to pay attorneys fees, but concluded that, in the context of this particular case, with millions of documents, the need for experts, and a lengthy trial anticipated, all thirteen KPMG Defendants had been adversely impacted. *Id.* at 415-17. Specifically, Judge Kaplan found that the limitations on the defendants' available funds "has caused them to restrict the activities of their counsel, limited or precluded their attorneys' review of the documents produced by the government in discovery, prevented them from interviewing witnesses, caused them to refrain from retaining expert

witnesses, and/or left them without information technology assistance necessary for dealing with the mountains of electronic discovery." *Id.* at 418. Because none of the 13 defendants "has the resources to defend this case as he or she would have defended it had KPMG been paying the costs, even if he or she liquidated all property owned by the defendant," the defendants' Sixth Amendment rights had been violated, necessitating dismissal of the Indictment. *Id.* at 425.

SUMMARY OF ARGUMENT

The District Court found that "[t]he constitutional violation here was the government's improper interference with the payment of the KPMG Defendants' defense costs," through the Thompson Memorandum and the Government's conduct. *Stein IV*, 495 F. Supp. 2d at 420. But even assuming that this "interference" (a) actually existed and (b) could support a finding of a constitutional violation (two issues that the Government refutes at length *infra*), the record is clear that any such "interference" ended no later than March 30, 2006, when the Government, on the record in open court, stated unequivocally that it had no objection to KPMG paying the defendants' attorneys fees. KPMG had executed the DPA in August 2005, and thus was assured of avoiding indictment unless the USAO claimed that KPMG was in violation of the agreement. The USAO statement of March 30, 2006, completely eliminated that possibility in connection with the payment of attorneys fees, making it clear that KPMG was free to exercise its business judgment as to whether to advance fees to the defendants. By that time, the defendants had been under indictment for no more than seven

months. If and to the extent that their Sixth Amendment rights were violated during that period, the proper remedy was not dismissal, but rather additional time to prepare for trial. Albeit unintentionally, the District Court has already provided precisely that relief.

The fact remains, however, that the Government did not unconstitutionally coerce KPMG into deciding to condition and limit payment of attorneys fees. The Government did not tell KPMG not to pay legal fees to its personnel. Rather, the most that the record will support is that KPMG decided that, in light of the Thompson Memorandum and its discussions with the USAO at the February 25 Meeting, and given KPMG's belief that, as a result of the extensive and scathing Senate report, the firm risked serious criminal exposure, it would be in its own best interests to condition and cap payment of those fees. This was not unconstitutional coercion by the Government, any more than an individual defendant's decision to plead guilty or cooperate can be said to be coerced. KPMG's decision thus cannot be considered "state action" attributable to the Government, and so cannot provide the basis for a Sixth Amendment violation.

Because the defendants had no legal right to receive legal fees from KPMG, any Government involvement in KPMG's decisionmaking did not violate the defendants' Sixth Amendment rights. The outer limit of Sixth Amendment protection encompasses a criminal defendant's right to use his own funds to finance his defense, but the Supreme Court has explicitly rejected the notion that a defendant has a similar right to funds from third parties.

The District Court also erred when it engaged in a Fifth Amendment substantive due process analysis of the Thompson Memorandum in *Stein I*. The "fundamental right" identified by the District Court in *Stein I* "to obtain and use in order to prepare a defense resources lawfully available to him or her, free of knowing or reckless government interference"—if found anywhere—falls within the Sixth Amendment right to counsel. And the Supreme Court has instructed that where a particular Amendment provides an explicit textual source of constitutional protection against a particular sort of government behavior, that Amendment, not the more generalized notion of substantive due process, must be the guide for analyzing such claims.

Moreover, the District Court's substantive due process analysis was itself flawed. The District Court erroneously identified the right to use resources "lawfully available" for one's defense free from knowing or reckless Government interference as a "fundamental right" deeply rooted in American tradition and values, on par with the rights to marry, to have children, to direct the education and upbringing of one's children, to marital privacy, to use contraception, to bodily integrity, and to abortion. Whatever its importance, the right to use an employer's resources for one's defense is not "objectively, deeply rooted in this Nation's history and tradition, and implicit in the concept of ordered liberty, such that neither liberty nor justice would exist if [it was] sacrificed." As a result, to the extent that the Thompson Memorandum is evaluated as legislation, it must meet only a rational basis test, which it does easily.

Finally, the promulgation of the Thompson Memorandum, and the Government's discussions with KPMG concerning the payment of legal fees, cannot rationally be said to constitute "outrageous Government conduct" that "shocks the conscience." Such activity is widely understood to be limited to physical or psychological torture, or at most deliberate, improper, and egregious investigative techniques, such as using a defendant's own lawyer against him. In advising KPMG that the authenticity of its cooperation would be evaluated pursuant to the Thompson Memorandum, in informing KPMG when its personnel refused to meet with the Government under the protections of a proffer agreement, and in making accurate factual representations to the District Court in connection with the Fee Motion, the Government did not, by any reasonable definition, "shock the conscience."

ARGUMENT

POINT I

Any Sixth Amendment Violation Was Cured No Later Than March 30, 2006, And Has Already Been Remedied

The Government's conduct in this case did not violate the defendants' Sixth Amendment rights. (*See* Point II, *infra*). But this Court need not resolve that question, because, even assuming that a violation did occur, it was unequivocally cured by the Government, leaving KPMG free to decide, without influence from the Government, whether to pay the defendants' legal fees in advance of trial.

Throughout both *Stein I* and *Stein IV*, the District Court identified the harm caused by the Government here as its supposed pressure on KPMG to not pay legal fees for its employees. *See, e.g.*, *Stein I*, 435 F. Supp. 2d at 336 ("KPMG refused to pay because the government held the proverbial gun to its head. Had that pressure not been brought to bear, KPMG would have paid these defendants' legal expenses."); *id.* at 352 ("As a direct result of the threat to the firm inherent in the Thompson Memorandum, [KPMG] sought an indication from the USAO that payment of fees in accordance with its settled practice would not be held against it."); *id.* at 353 ("KPMG's decision to cut off all payments of legal fees and expenses to anyone who was indicted and to limit and to condition such payments prior to indictment upon cooperation with the government was the direct consequence of the pressure applied by the Thompson Memorandum and the USAO."); *Stein IV*, 495 F. Supp. 2d at 393 ("The government . . . coerced KPMG to limit and then cut off its payment of legal fees of KPMG employees."); *id.* at 396 ("The Thompson Memorandum thus made clear that advancing attorneys' fees to personnel of a business entity under investigation, except where such advances were required by law, might have been viewed by the government as protection of culpable individuals and thus contribute to a government decision to indict the entity."); *id.* at 404 ("KPMG's decision to cut off payment of any legal expenses to anyone who was indicted . . . was prompted by the Thompson Memorandum and the USAO's negative reaction at the February 25 meeting to the possibility that KPMG would pay any legal fees in the absence of a legal obligation to do so."). All of the District Court's conclu-

sions regarding the Sixth Amendment flow from this premise.

Put another way, according to the District Court, the Sixth Amendment harm in this case came about because the USAO did not advise KPMG that, if KPMG wished to pay the legal fees of its personnel, the Government would not hold that against it. But on March 30, 2006, the Government did exactly that:

> 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; *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 Prosecu-

tion Agreement for KPMG to change its decision and voluntarily pay legal fees for these indicted defendants.")). This unconditional declaration from the USAO, which by this time had entered into the DPA with KPMG and was thus responsible for its interpretation in the first instance, lifted any express or implied "threat," as the District Court put it, that payment of the defendants' legal fees would cause KPMG any problems with the Government.

In *Stein I*, the District Court concluded that the lifting of this "threat" was not an adequate remedy for the deprivation to that point:

> It ignores altogether the Court's finding that KPMG would have advanced defense costs absent the government's interference. It ignores KPMG's possible interest in not being seen to reverse course and thus as admitting that it caved in to government pressure in this respect at the expense of individual members and employees of the firm. It ignores also the fact that circumstances have changed dramatically since KPMG, under government pressure, decided in 2004 to cut off anyone who was indicted. KPMG has yielded to the government's demand that the firm pay a fine of $456 million. The individual defendants have been indicted on charges the full scope of which may not previously have been foreseeable to KPMG. Thus, the defense costs that KPMG is being asked to advance perhaps are larger than might earlier have been

> foreseeable. The resources available to pay them have been reduced. Accordingly, the Court is not persuaded that the damage the government has done can be remedied by now leaving KPMG to do as it pleases.

Stein I, 435 F. Supp. 2d at 374. But these conclusions fly in the face of the harm as identified by the District Court.

The District Court premised its dismissal of the Indictment under the Sixth Amendment on the idea that KPMG would have paid the defendants' legal fees but for the threat of adverse consequences from the Government. Accordingly, the key issue, as identified by the District Court and as argued by the defendants in their original motion, was KPMG's freedom of choice to do what it wished with respect to attorneys fees. And even if KPMG had been paying the defendants' fees, that decision was not irrevocable; KPMG could have changed its mind at any time. Indeed, the "changed circumstances" identified by the District Court—KPMG's payment of $456 million, the revelation of the full scope of the defendants' criminal conduct as alleged in the Indictment, and the high costs of paying for their defense—were all factors that KPMG, in the exercise of its business judgment, could have properly considered in deciding whether to discontinue paying fees had it previously been doing so. Further, the District Court's concern that KPMG would not want to appear to have "reversed course" only emphasizes KPMG's free will: Although KPMG might have chosen to not pay fees at that point for any number of reasons, that was nevertheless its choice to make.

Even assuming that KPMG—absent what the Court viewed as Government "interference"—would have decided initially to pay the defendants' legal fees without condition, there is no basis to conclude that they would have continued to do so indefinitely, and particularly after indictment. In fact, the evidence in the record supports the opposite conclusion. At the Fee Hearing, KPMG's General Counsel, Joseph Loonan, testified that KPMG's historical practice of paying attorneys fees was voluntary and subject to revision by the firm:

> In every discussion I've ever had with counsel for a withdrawing member from the firm, I have made it very clear that the firm does not have an obligation to pay for their attorneys' fees. I point out that there is no obligation in the partnership agreement, and I point out that on the Delaware limitied liability partnership law, there is no obligation. What I have also said to people is that the firm has a practice in the past of paying for attorneys' fees, but that I also indicate that that is no guarantee that that practice will continue.

(Smith A. 515-16; *see also id.* at 521 ("we have in the past changed policies of representing people as situations have changed")).

At the same hearing, which took place more than a month after the Government's assurance that KPMG would suffer no ill effects if it paid the defendants' fees, KPMG's outside counsel explained the partnership's decision:

> And what's happened, your Honor, is that to the extent that this very serious issue, people wanting to be paid, lawyers— clients needing to pay lawyers, etc., I don't miss for a second how important that is. My client doesn't miss for a second how important it is, but they have made a conscientious business decision regarding the thousands of people that work for them, the work that they're doing. I don't know how many other partners there are who, thank God for them, are not involved in this, had no involvement with it, and they made that decision.

(Smith A. 770). In another hearing in July 2006, KPMG's attorney emphasized that "KPMG has no, in our judgment, legal obligation to pay these fees; KPMG has no intention of paying these fees." (Smith A. 780). The same attorney noted one of the reasons for KPMG's decision: "We have paid over $12 [million] in legal fees, and these defendants have cost this company well in excess of $500 million by breaches of fiduciary duties." (Smith A. 784).

These sentiments were likewise reflected in KPMG's submissions in support of its motion to dismiss the ancillary proceeding. For example, in its opening brief, KPMG made plain to the District Court that

> The Court's declaration of ancillary jurisdiction, and the Complaint itself, rest almost entirely on one such unsupported finding: that "[a]bsent the Thompson Memorandum and the actions of the [United States Attorneys' Office], KPMG would

have paid the legal fees and expenses of all of its partners and employees both prior to and after indictment, without regard to cost." In fact, no witness in the criminal proceeding was asked the hypothetical question of what KPMG would have done "[a]bsent the Thompson Memorandum and the actions of" the United States Attorneys' Office. Nor is there any evidence in the record from which one could fairly draw a conclusion at this point. . . .

Moreover, by law and by contract, KPMG is free to decide on a case-by-case basis whether and in what circumstances it will advance legal fees to present and former personnel. Therefore, the relevant question is not a hypothetical one about what KPMG would have done two years ago under different circumstances. *The determinative question is how it chooses today to exercise the discretion it clearly has with respect to advancement of fees*.

Had evidence been adduced on this point, it would show that, post-indictment, KPMG would not in any event advance legal fees for the criminal defense of individuals who breached their fiduciary duties to the partnership and were indicted, thereby putting the future of the firm and its assets at risk. KPMG has determined that it is not in the best interests of the firm to advance

> post-indictment attorneys' fees to the Defendants in the *Stein* prosecution, and no civil claim by the Defendants should be allowed to alter this determination.

(KPMG Mem. at 4-5 (emphasis added) (internal citations and footnote omitted) (bracketed material in original)). In its reply memorandum, KPMG further evinced the unfettered exercise of its business discretion:

> This whole [ancillary] proceeding is premised on an assumption—unsupported by any facts—that but for government pressure KPMG's partners would have paid unlimited amounts for the defense of sixteen former partners or employees following their indictment, no matter what the charges, the number of the defendants, or the nature of their alleged misconduct—including allegations by the United States government that several of them stole funds from their partners. There is, however, one problem with this assumption: it is false, and there is no evidence in the record to support it. KPMG would not have committed itself, two years before any indictment was issued, to an open-ended obligation to pay millions of dollars of legal fees to an unknown number of defendants without regard to the ultimate facts or the charges that would be issued by the grand jury and without being able to foretell the impact the investigation would have on the firm. Indeed, no respon-

> sible organization would have foreclosed the possibility of terminating the advancement of fees in the face of such an unlimited commitment. *Moreover, today, the KPMG partnership, exercising the discretion afforded it under Delaware law, has determined not to advance legal fees to these Defendants*.

(KPMG Reply Mem., dated August 26, 2006, at 4-5 (emphasis added) (footnote omitted)).Thus, the record establishes that KPMG, free from any influence from the Government, made a business decision to not pay these defendants' legal fees, at least once the full scope of the defendants' misconduct and cost to the firm became known.

The Sixth Amendment right to counsel, whatever the scope of its protections, does not attach until the initiation of formal judicial proceedings, "whether by way of formal charge, indictment, preliminary hearing, information, or arraignment." *Kirby* v. *Illinois*, 406 U.S. 682, 689 (1972) (plurality opinion); *McNeil* v. *Wisconsin*, 501 U.S. 171, 175 (1991); *United States* v. *Holmes*, 44 F.3d 1150, 1159-60 (2d Cir. 1995); *In re Doe*, 781 F.2d 238, 244 (2d Cir. 1986) (*en banc*). Six of the thirteen defendants here were indicted in August 2005; the remaining seven were indicted in October 2005. As a result, any Sixth Amendment violation caused by the Thompson Memorandum and the USAO's conduct at the February 25 Meeting lasted no more than five to seven months, until the Government's March 30, 2006 statement that KPMG was free to do as it pleased regarding legal fees.

"Cases involving Sixth Amendment deprivations are subject to the general rule that remedies should be tailored to the injury suffered from the constitutional violation and should not unnecessarily infringe on competing interests. . . . Our approach has thus been to identify and then neutralize the taint by tailoring relief appropriate in the circumstances to assure the defendant the effective assistance of counsel and a fair trial. More particularly, absent demonstrable prejudice, or substantial threat thereof, dismissal of the indictment is plainly inappropriate, even though the violation may have been deliberate." *United States* v. *Morrison*, 449 U.S. 361, 364-65 (1981). Under this standard, the District Court's first responsibility was to "identify and then neutralize the taint." The "taint" here was the Government's purported pressure on KPMG regarding payment of the defendants' legal fees, which, to the extent it existed, was "neutralized" once and for all no later than March 30, 2006.

Second, the District Court was obligated to impose the narrowest possible remedy to address the violation it found. The District Court noted the broad scope of this prosecution, which involves millions of documents and numerous complicated tax transactions. However, the defendants received the effective assistance of counsel throughout the relevant time period. KPMG had paid the legal fees of all but two of the defendants during the pre-indictment period, and all of the defendants were represented by competent counsel during the pendency of the criminal proceeding. Assuming that the defendants had had greater resources to assist in their defense for those five or seven months, they would have been able to conduct more extensive review of the documents, and to

spend more time with defense counsel discussing the facts and their legal strategy. Pursuant to *Morrison*, the most narrowly-tailored remedy would have been to adjourn the trial to allow the defendants more time to review the documents and consult with counsel.

In addition, the District Court ordered the Government to make a number of accommodations in advance of trial, which would further serve to ameliorate any harms to the defendants purportedly caused by the Government's conduct. Among other things, the Government was ordered to produce its exhibit list and list of trial witnesses on July 1, 2006, and would be permitted to add to those lists only for good cause shown. The Government produced the majority of its Jencks Act material on November 9, 2006. The Government was also required to produce, well in advance of any trial date, designated portions of any depositions that it intended to introduce at trial. Finally, as a result of substantial encouragement from the District Court, the Government arranged for the construction of an Internet-accessible database, which contained approximately 22 million pages of discovery that had been produced by the Government. This database was made available to the remaining trial defendants in September 2007.

The defendants had approximately 16 months, *i.e.*, from the Government's statement at the March 30, 2006 hearing until the District Court's July 16, 2007 order dismissing the Indictment as to them, to prepare for trial and consult with counsel. Under the circumstances, assuming the Indictment is reinstated, the District Court's rulings and efforts to bring KPMG into the case have had

the unintended effect of giving the defendants precisely the remedy appropriate for any infringement on their resources for a few months: more time to prepare for trial. No other sanction was appropriate or necessary.[*]

The Supreme Court's opinion in *United States* v. *Gonzalez-Lopez*, 126 S. Ct. 2557 (2006), does not suggest a different remedy. In that case, the violation stemmed from the district court's erroneous refusal to allow the defendant's preferred counsel to appear *pro hac vice*. *See id.* at 2560. The Court held that the violation of the defendant's right to counsel of choice—which, by definition, continued through the entire trial—was not subject to harmless error review, and so ordered a new trial without

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[*] In *Stein IV*, the District Court makes much of the fact that the Government stated, in connection with the renewal of the defendants' motion to dismiss, that the defendants were "entitled to dismissal, assuming that this Court's previous ruling was correct." *Stein IV*, 495 F. Supp. 2d at 393; *see also id*. at 409-10. The District Court acknowledged that "the government does not concede the correctness of that ruling." *Id*. at 393. It neglected to mention, however, that the Government's position was largely informed by the District Court's prior decision, in *Stein I*, rejecting the Government's argument that any violation was remedied by the Government's informing KPMG that it could pay legal fees to the defendants without adverse consequences under the DPA. (*See* Gov't Opp. to Defs' Renewed Motion to Dismiss, June 22, 2007, at 6 (discussing District Court's rejection of that proposed remedy), Dkt. 1051).

obligating the defendant to prove prejudice from going to trial with a different lawyer. *Id.* at 2564-65. But in this case, none of the defendants has yet faced trial, and any Government responsibility for the defendants' alleged lack of resources ceased no later than March 30, 2006. Just as *Gonzalez-Lopez* remanded the case for a new trial with the impediment to the defendant's counsel of choice removed, here the proper remedy (assuming a violation) was to allow the defendants to hire their counsel of choice using whatever resources that KPMG was willing to give them, if any, free from Government influence. The defendants have been given that opportunity.

POINT II

The Government Did Not Unconstitutionally Deprive The Defendants Of Any Sixth Amendment Rights

The District Court held that the Thompson Memorandum, reinforced by the USAO's statements at the February 25 Meeting, coerced KPMG into conditioning its willingness to pay the attorneys fees of its personnel on their cooperation with the Government's investigation, limiting the total payment per individual to $400,000, and cutting off fees upon indictment. But the coercion inherent in any Government investigation of crime does not unconstitutionally taint the decisions made by the subjects of those investigations. Even accepting the District Court's version of events, KPMG made deliberate, informed choices that it hoped would convince the Government not to indict it. Those choices, and the effect of those choices on the defendants, did not violate the defendants' constitutional rights.

A. The Thompson Memorandum And The USAO's Conduct Did Not Impermissibly Coerce KPMG

Although the District Court found that the Government "coerced" KPMG into deciding to condition and limit its attorneys fees payments, coercion in the constitutional sense requires conduct beyond the dictionary definition of that word, because otherwise virtually every action taken by a potential defendant in a criminal case would be "coerced" based on the threat of prosecution or conviction. Simply because the subject of an investigation takes steps that it hopes will prevent its indictment does not mean that the Government has coerced those actions.

Courts assess "coercion" in a variety of circumstances, but when Government action is at issue, invariably more is required than simply the potential exercise of governmental authority, be it to arrest, charge, or legislate. For example, the coercive pressures associated with interrogation or being under suspicion do not alone render a criminal suspect's confession involuntary; the interviewing officers must have so pressured the defendant as to overbear his free will. *See, e.g.*, *Arizona* v. *Fulminante*, 499 U.S. 279, 287-88 (1991) (excluding confessions obtained by means of violence or where "there was a credible threat of physical violence"); *cf. Illinois* v. *Perkins*, 496 U.S. 292, 296-97 (1990) (confession admissible when made under circumstances that lack compulsion or coercion, even when it results from ploy to mislead suspect). Similarly, a confession obtained through a promise of lenient treatment is not considered coerced, notwithstanding the incentive. *See, e.g., United States* v.

Ruggles, 70 F.3d 262, 265 (2d Cir. 1995). And the "coercion" inherent in plea bargaining does not render a resulting guilty plea involuntary. *See United States* v. *Mezzanatto*, 513 U.S. 196, 209-10 (1995) ("The plea bargaining process necessarily exerts pressure on defendants to plead guilty and to abandon a series of fundamental rights, but we have repeatedly held that the government may encourage a guilty plea by offering substantial benefits in return for the plea.") (quotation omitted); *Bordenkircher* v. *Hayes*, 434 U.S. 357, 363 (1978) ("Defendants advised by competent counsel and protected by other procedural safeguards are presumptively capable of intelligent choice in response to prosecutorial persuasion, and unlikely to be driven to false self-condemnation.").

In *United States* v. *Juncal*, 245 F.3d 166 (2d Cir. 2001), this Court explained the distinction between legally impermissible coercion and the layman's understanding of that term:

> Appellant's plea was not coerced "by physical force or threat of physical force" or "the improper use of economic power to compel another to submit to the wishes of one who wields it." Black's Law Dictionary 252 (7th ed. 1999) (defining "coercion"). Nor do his circumstances suggest a guilty plea that might be considered involuntary because it was induced by what the Supreme Court has termed "mental coercion," such as being "gripped by fear of the death penalty or hope of leniency" such that a defendant "could not, with the help of counsel, ratio-

> nally weigh the advantages of going to trial against the advantages of pleading guilty." *Brady* v. *United States*, 397 U.S. 742, 750 (1970). Nor does defense counsel's blunt rendering of an honest but negative assessment of appellant's chances at trial, combined with advice to enter the plea, constitute improper behavior or coercion that would suffice to invalidate a plea.

Id. at 172 (citations omitted). But this Court reversed the lower court's finding that the defendant had perjured himself by claiming that his guilty plea was "coerced," noting that "[g]uilty pleas are generally the result of a weighing of highly undesirable—coercive—alternatives rather than a soul-cleansing urge to confess," *id.* at 173, and that it is common

> that a defendant will feel "coerced" in the lay sense of the word by an attorney's recommendation to plead guilty rather than proceed to trial. Such recommendations often come with predictions of almost inevitable conviction at trial followed by a long jail sentence. A feeling of duress is hardly an unusual outcome of such deliberations.

Id. at 174. In other words, a defendant may feel that his decisionmaking was "coerced" by his circumstances, but that does not make his actions involuntary or the Government's conduct unconstitutional.

In the Fee Motion, the defendants did not claim that they were coerced, but that a third party, KPMG, was

coerced by the Government in a manner that infringed on their constitutional rights. Parallels to other contexts are difficult to find, but a somewhat similar situation arises when the Government promises leniency to a defendant in return for truthful testimony against an accomplice. The accomplice might never have been prosecuted at all in the absence of that arrangement, yet he cannot complain that the Government's deal with the witness violated his constitutional rights. *See United States* v. *Singleton*, 165 F.3d 1297, 1301 (10th Cir. 1999) (en banc).

Another analogous context involves federal mandates to state governments, which impact the lives of the citizens of those states. Often the state objects that the federal government is "coercing" it to take some action, such as lowering the speed limit or changing the legal drinking age, to which the state's citizens object. Although the federal government cannot directly order a state to take a particular legislative action, the Supreme Court has recognized that many methods of persuasion, even though they might smack of coercive tactics, are permissible. Congress may attach conditions on the receipt of federal funds that may influence a state's legislative choices. Or Congress may offer states the choice of regulating an activity according to federal standards or having state law pre-empted by federal regulation. As long as the state retains the ultimate decisionmaking authority, even if noncompliance can carry adverse consequences, the federal policy is constitutional. *See New York* v. *United States*, 505 U.S. 144, 166-68 (1992). "Congress may urge a State to adopt a legislative program consistent with federal interests, and it cannot be constitutionally determinative that the federal regulation is likely to move the

States to act in a given way, or even to coerce the States into assuming a regulatory role by affecting their freedom to make decisions in areas of integral governmental functions." *United States* v. *Milstein*, 401 F.3d 53, 68 (2d Cir. 2005) (quotations and citations omitted); *see also Caulfield* v. *Board of Education*, 583 F.2d 605, 614-15 (2d Cir. 1978) (rejecting claim that federal agency coerced city into agreement, even where "threat of potential fund termination lurked in the background since without such leverage voluntary compliance might possibly never be achieved").

These cases all stand for a similar principle: The Government does not act unconstitutionally when it strongly encourages certain conduct, even though it possesses superior bargaining power, and even where adverse consequences could result from noncompliance, as long as the ultimate decision is left to the individual. The District Court failed to apply this rule properly to the interactions between the Government and KPMG. As Judge Weinstein has discussed in the context of plea bargaining,

> [a] pristine rule of "no coercion" would preclude many plea agreements. Requiring plea negotiations to be free from "any coercion" would contradict the basic notions of bargaining. Contract law theory suggests that no bargaining process is completely devoid of coercion in some form. The problem is one of discerning what level of coercion is so inappropriate as to render a plea agreement invalid.

United States v. *Speed Joyeros, S.A.*, 204 F. Supp. 2d 412, 423 (E.D.N.Y. 2002). Properly stated, the question is whether the Government, through the promulgation of the Thompson Memorandum and the USAO's conduct at the February 25 Meeting, applied *improper* coercion to KPMG to overcome its supposed desire to pay voluntarily the legal fees of its employees and partners.

The teachings from the Supreme Court on this issue make clear that it did not.

> Determining what constitutes unconstitutional compulsion involves a question of judgment. . . . The criminal process, like the rest of the legal system, is replete with situations requiring the making of difficult judgments as to which course to follow. Although a defendant may have a right, even of constitutional dimensions, to follow whichever course he chooses, the Constitution does not by that token always forbid requiring him to choose.

McKune v. *Lile*, 536 U.S. 24, 41 (2002) (plurality opinion) (quotation omitted).

The Thompson Memorandum, as reaffirmed by the USAO, explains that, if a corporation under criminal investigation wishes to cooperate in the hopes of avoiding indictment, the Government will consider several criteria in assessing the value and sincerity of that cooperation. (*See* Smith A. 1135-44). That a firm might rely on those factors in deciding to take certain actions, such as disclosing the results of an internal investigation, reorganizing a

problematic division, or adding compliance and oversight controls, does not mean that it was "coerced" into action. Rather, the firm's motivation comes from a desire to display corporate responsibility in the face of allegations of wrongdoing, which could help it in discussions with prosecutors as well as in other ways important to many business entities, such as public perception, client relations, and employee morale. Even though the company might not have done any of those things in the absence of the investigation, ultimately the decision remained its own.

There is nothing the slightest bit improper in publicly identifying nine different factors that the Government will consider when assessing corporate culpability, with each factor accompanied by extensive commentary elucidating its concepts, and, in the course of noting that the Government will scrutinize "whether the corporation appears to be protecting its culpable employees and agents," stating that "advancing of attorneys fees" could enter into that analysis, depending on the circumstances. This is a far cry from the defendants' implication that the Thompson Memorandum set up a direct and explicit linkage between the decision to indict and the payment of legal fees to individuals, *i.e.*, "if you pay these defendants' attorneys fees, you will be indicted." No reasonable reading of the Thompson Memorandum, with its multitude of factors and caveats, leads to that conclusion, nor did the USAO's conduct at the February 25 Meeting suggest any such correlation.

Even the District Court, which was (to put it mildly) displeased with the Government's policies, did not go that far. Judge Kaplan held only that KPMG (and the criminal

defense bar) read the Thompson Memorandum to say that paying legal fees to individuals under investigation could increase the risk of indictment. *See, e.g.*, *Stein I*, 435 F. Supp. 2d at 338 (Thompson Memorandum directs USAO to consider advancement of fees "as at least possibly indicative of an attempt to protect culpable employees and as a factor weighing in favor of indictment"); *Stein IV*, 495 F. Supp. 2d at 397 ("Any competent lawyer reading the document would regard a corporate client that was under investigation as being at greater risk of indictment if it advanced legal fees to employees who might be viewed as culpable than if it did not advance legal fees."). Yet even this interpretation—which is at once oversimplified and exaggerated—does not make the Thompson Memorandum impermissibly coercive, because a corporation retains the free will to evaluate that risk, compare it to the significance of the other enumerated factors given its particular factual circumstances, and decide for itself how to proceed.

The record in this case reflects a specific example of the actual effect of the Government learning that a corporate subject is paying fees. An AUSA testified at the Fee Hearing that, during the same investigation, he inquired of counsel for another business entity whether the company was paying the legal fees of its employees. The company's lawyer responded that, yes, it was. The impact on the company? None whatsoever.

> [T]he subject was dropped. Nothing happened after that. They told us they were paying fees, and I subsequently learned that they had no obligation in their by-laws or

> charter to do so, but they paid the fees anyway. . . . We let it be. Nothing happened. They ended up with a deferred prosecution.

(Smith A. 454). As the Government has maintained from the outset, whether payment of attorneys fees for individuals will be viewed negatively depends on context.

It is no indictment of the Government to conclude that a corporation under investigation may very well wish "'to be able to say at the right time with the right audience, we're in full compliance with the Thompson Memorandum.'" *Stein I*, 435 F. Supp. 2d at 364 (quoting deposition of Sven Eric Holmes, KPMG's chief legal officer). Indeed, the very purpose of publicly promulgating the Thompson Memorandum, as with its predecessor and successor, was to advise corporations and defense attorneys of the factors that the Government would take into consideration during a criminal investigation of a corporation. But advising corporations of the Department of Justice's approach to evaluating corporate misconduct is a far cry from coercing their conduct. The Thompson Memorandum did not coerce KPMG into deciding to condition and limit the payment of the defendants' attorneys fees.

B. KPMG's Decision To Terminate Fee Payments For Indicted Defendants Did Not Violate The Sixth Amendment

The District Court held that the Government, through the Thompson Memorandum and the USAO's conduct in enforcing its provisions, improperly influenced KPMG's decision to condition and limit its payment of the defendants' legal fees, thereby violating the defendants' Sixth

Amendment right to access to funds for their defense. But the Government did not improperly coerce KPMG's decision, or otherwise dictate or direct it, so KPMG's conduct cannot be ascribed to the Government.

1. Standard Of Review

In considering appeals from judicial rulings in criminal cases, this Court reviews "issues of law *de novo*, issues of fact under the clearly erroneous standard, mixed questions of law and fact either *de novo* or under the clearly erroneous standard depending on whether the question is predominantly legal or factual, and exercises of discretion for abuse thereof." *United States* v. *Thorn*, 446 F.3d 378, 387 (2d Cir. 2006); *see also United States* v. *Selioutsky*, 409 F.3d 114, 119 (2d Cir. 2005). Factual findings are viewed "in the light most favorable to the prevailing party." *United States* v. *Harrell*, 268 F.3d 141, 145 (2d Cir. 2001). A finding of fact is clearly erroneous only if, after reviewing all of the evidence, this Court is left "with the definite and firm conviction that a mistake has been committed." *Anderson* v. *Bessemer City*, 470 U.S. 564, 573 (1985).

The District Court's findings regarding the underlying facts, *e.g.*, what was said, what the speaker meant, and how a hearer would reasonably interpret it, are reviewed for clear error. But this Court reviews the legal significance of those facts as found *de novo*. *See, e.g.*, *United States* v. *Bliss*, 430 F.3d 640, 646 (2d Cir. 2005) (in reviewing obstruction of justice sentencing enhancement, court reviews for clear error sentencing court's findings as to what acts were performed, but reviews *de novo* conclusion that facts constitute obstruction).

2. Burden Of Proof

The defendants bear the burden of proving a Sixth Amendment violation associated with Government conduct, at least with respect to non-evidentiary issues. *See, e.g.*, *United States* v. *Jackman*, 46 F.3d 1240, 1245-46 (2d Cir. 1995) (defendant bears burden to demonstrate unconstitutional composition of jury venire); *see also Duren* v. *Missouri*, 439 U.S. 357, 364 (1979) (same); *United States* v. *Blount*, 291 F.3d 201, 212 (2d Cir. 2002) (defendant must show prejudice from attorney's purported conflict of interest); *United States* v. *Desena*, 287 F.3d 170, 176 (2d Cir. 2002) (defendant claiming violation of Compulsory Process Clause must show that witness would have provided favorable, noncumulative testimony); *United States* v. *Danielson*, 325 F.3d 1054, 1071 (9th Cir. 2003) (defendant required to show communication of defense strategy to undisclosed informant acting affirmatively to intrude into attorney-client relationship).

3. KPMG's Decision Regarding The Defendants' Attorneys Fees Was Not State Action

The Supreme Court has long recognized that the Sixth Amendment right to assistance of counsel includes a corollary right to be represented by the counsel of the defendant's choosing. *United States* v. *Gonzalez-Lopez*, 126 S. Ct. at 2561; *Wheat* v. *United States*, 486 U.S. 153, 159 (1988). "[T]he Sixth Amendment guarantees the defendant the right to be represented by an otherwise qualified attorney whom that defendant can afford to hire, or who is willing to represent the defendant even though he is without funds." *Caplin & Drysdale, Chartered* v.

United States, 491 U.S. 617, 624-25 (1989). However, "the right to counsel of choice is circumscribed in several important respects." *Gonzalez-Lopez*, 126 S. Ct. at 2561 (quotation omitted). The defendant does not have an absolute right to insist on counsel who is unavailable to try the case as reasonably scheduled, who is not qualified under the court rules of the jurisdiction, or who has a conflict of interest. *Wheat* v. *United States*, 486 U.S. at 159. "Because the right to counsel of one's choice is not absolute, a trial court may require a defendant to proceed to trial with counsel not of defendant's choosing; although it may not compel defendant to proceed with incompetent counsel." *United States* v. *Schmidt*, 105 F.3d 82, 89 (2d Cir. 1997). In this fashion, the right to counsel of choice (and any subsidiary right that may arguably exist, such as the right found by the District Court to freedom from interference with access to funds to pay for a defense) differs from the right to effective assistance of counsel, which is an irreducible minimum under the Sixth Amendment.

Where a defendant claims that the Government has infringed on his Sixth Amendment rights, he must prove that the conduct in question is attributable to the Government, *i.e.*, that it constitutes "state action." *See Thompson* v. *Mississippi*, 914 F.2d 736, 738 (5th Cir. 1990) (victim's pretrial viewing of defendant at jail not attributable to state, so no violation of Sixth Amendment right to counsel). In ineffective assistance of counsel cases, the conduct of the trial itself constitutes state action. *See Cuyler* v. *Sullivan*, 446 U.S. 335, 343 (1980). But because the right to counsel of choice can be overridden by various factors, merely proceeding to trial without preferred counsel

cannot itself be a Sixth Amendment violation. There must be some conduct attributable to the Government, making it responsible for the defendant's inability to have the counsel of his choice (or the resources he would like to use for his defense), before a constitutional violation can be found.

For substantially the same reasons articulated in the Government's brief in *Smith* at pages 72 to 80, state action is absent here. KPMG's decision to condition legal fee payments on cooperation, while undoubtedly influenced by the Thompson Memorandum, was not coerced or directed by the Government, and so cannot be a Sixth Amendment violation.

"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 Ins. 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 Sav. & Loan Ass'n*, 396 F.3d 178, 187 (2d Cir. 2005) (internal quotation omitted).

As the Supreme Court has instructed, "examples may be the best teachers" for assessing state action, *Brentwood*

Academy v. *Tennessee Secondary School Athletic Ass'n*, 531 U.S. 288, 296 (2001), and those examples demonstrate that KPMG, the subject of the Government's investigation, was not simultaneously its alter ego:

- A state-paid public defender, as the state's adversary, cannot be deemed to act for the state. *Polk County* v. *Dodson*, 454 U.S. 312, 323 (1981).

- A state interscholastic athletic regulatory body, the relevant personnel of which were "all . . . public school administrators," was a state actor. *Brentwood Academy* v. *Tennessee Secondary School Athletic Ass'n*, 531 U.S. 288 (2001).

- An electrical utility that filed termination procedures with the Public Utility Commission, which, by not disapproving them, technically "approved" them, was not a state actor. *Jackson* v. *Metropolitan Edison Co.*, 419 U.S. 345, 357 (1974).

- Decisions by nursing homes to transfer patients to different levels of care were not state action, even though state regulations encouraged efficiency-motivated downward transfers, state medical review teams could conduct reviews and order discharges or transfers, other regulations allowed the state to penalize nursing homes for failing to make appropriate discharges or transfers, and the state was obliged to approved or disapprove continued payment in response to a decision to discharge or trans-

fer a patient. *Blum* v. *Yaretsky*, 457 U.S. 991, 1008-10 (1982).

- A coordinated investigation between the NASD and the Department of Justice did not convert compelled NASD interviews into violations of the Fifth Amendment self-incrimination clause, even though failure to submit to interviews would result in the individual's loss of license. *D.L. Cromwell Investments, Inc.* v. *NASD Regulation, Inc.*, 279 F.3d 155, 156-57 (2d Cir. 2002).

- A union elections officer's decision to bar a candidate from a union election was not state action, even though the officer's salary was paid entirely by the Government, his position was created by virtue of a Consent Decree that was a direct result of the Government's actions, the United States Attorney's Office provided the officer with the essential evidence leading to the candidate's disqualification, and the district court lent "its coercive power to the [officer's] investigation." *United States* v. *International Brotherhood of Teamsters*, 156 F.3d 354, 359 (2d Cir. 1998).

- Regulations that "removed all legal barriers" to breath and urine tests of railroad employees, made clear the Government's strong preference for testing and "desire to share the fruits of such intrusions," and mandated that railroads not bargain away the authority to perform tests were "clear indices of the Government's en-

> couragement, endorsement, and participation" and so court could not conclude that "tests conducted by private railroads in reliance on [those regulations] will be primarily the result of private initiative," such that the tests constituted state action. *Skinner* v. *Railway Labor Executives Ass'n*, 489 U.S. 602, 614-16 (1989).

These decisions establish that, even in the context of private decisions taken in accordance with direct governmental regulation, there will be no finding of state action absent involvement such that "it can be said that the State is *responsible* for the specific conduct at issue." *Brentwood Academy*, 531 U.S. at 295. Here, KPMG's decision was taken not pursuant to a governmental directive, but, as found by the District Court, only in response to KPMG's understanding of internal Department of Justice guidelines that federal prosecutors consult in exercising prosecutorial discretion. As explained above, the Government did not coerce KPMG in the constitutional sense into deciding to condition and limit their payment of the defendants' attorneys fees. The Thompson Memorandum imposes no obligations on any private entity; it is simply a checklist of factors to be considered by prosecutors, with each given such weight as is appropriate under the circumstances. This is not to suggest that the Thompson Memorandum does not provide information that a firm might use in making a decision; of course it does. But even if the Thompson Memorandum could be read to discourage corporations from paying attorneys fees regardless of the circumstances—which it cannot—that would not make their decisions the equivalent of those of the Government:

> There is a basic difference between direct state interference with a protected activity and state encouragement of an alternative activity consonant with legislative policy. Constitutional concerns are greatest when the State attempts to impose its will by force of law; the State's power to encourage actions deemed to be in the public interest is necessarily far broader.

Maher v. *Roe*, 432 U.S. 464, 475-76 (1977) (footnote omitted).

One district court has already rejected the argument that the Thompson Memorandum alone converts a corporation under investigation into an arm of the Government. In *United States* v. *Graham*, No. 03-CR-089-RB, 2003 WL 23198793 (D. Colo. Dec. 2, 2003), the defendant argued that Qwest, his former corporate employer, "had an agency relationship with the government" because of the Holder and Thompson Memoranda's encouragement of corporate cooperation with Government investigations, which he claimed created "a substantial inducement for corporations to obtain information for the government." *Id.* at *2. As a result, the defendant sought to suppress statements he had made to interviewers from Qwest as having been obtained in violation of the Fifth Amendment.

The district court flatly rejected the idea that Qwest was transmuted into an agent of the Government simply because of the existence of the Holder and Thompson Memoranda:

> These memos are generalized statements of a policy directed specifically to United States Attorneys, not private parties. With regard to Graham's interviews by Qwest, there is no indication that the government solicited, initiated or guided these efforts, or that the government was acting surreptitiously through Qwest. Further, there is no indication that the government promised Qwest any benefit or quid pro quo for obtaining Graham's statements. Based on the Holder and Thompson memos, Qwest may very well have had a general hope that it might receive favorable treatment from the government based on its unsolicited, proactive cooperation with a government investigation. However, such a tacit, general understanding is not sufficient to create an agency relationship of constitutional significance between Qwest and the government.

Id. at *3. The district court's reasoning in *Graham* applies with equal force here. The USAO did not "solicit, initiate, or guide" KPMG's decision to condition fees on cooperation and cap payment of those fees at $400,000; at most, it simply reaffirmed the Thompson Memorandum's advice that the payment of legal fees could be taken into account when assessing KPMG's cooperation. The mere existence of a general policy directive cannot convert KPMG from a subject of a Government investigation into the Government's foot-soldier. "The state-action doctrine does not convert opponents into virtual agents." *Brentwood Academy*, 531 U.S. at 304. KPMG's decision regarding the

payment of present and former employees' legal fees was private action, and so did not violate the defendants' Sixth Amendment rights.

4. Any Pressure On KPMG From The Government Did Not Violate The Sixth Amendment Because The Defendants Did Not Have A Right To KPMG's Funds

As explained above, the Sixth Amendment right to counsel of one's choosing is subject to various limitations, and "while the right to select and be represented by one's preferred attorney is comprehended by the Sixth Amendment, the essential aim of the Amendment is to guarantee an effective advocate for each criminal defendant rather than to ensure that a defendant will inexorably be represented by the lawyer whom he prefers." *Wheat*, 486 U.S. at 158-59. In *Caplin & Drysdale, Chartered* v. *United States*, 491 U.S. 617 (1989), the Supreme Court emphasized that

> Whatever the full extent of the Sixth Amendment's protection of one's right to retain counsel of his choosing, that protection does not go beyond the individual's right to spend his own money to obtain the advice and assistance of . . . counsel. A defendant has no Sixth Amendment right to spend another person's money for services rendered by an attorney, even if those funds are the only way that that defendant will be able to retain the attorney of his choice.

Id. at 626 (citations and quotations omitted). Accordingly, the Court found "no constitutional principle that gives one person the right to give another's property to a third party, even where the person seeking to complete the exchange wishes to do so in order to exercise a constitutionally protected right." *Id.* at 628; *see also id*. at 631-32 (rejecting suggestion that the "Government could never impose a burden on assets within a defendant's control that could be used to pay a lawyer"; noting that both taxes and "jeopardy assessments," by which the IRS seized assets to secure potential tax liabilities, were found to be constitutional, even though they deprived a defendant of resources that could be used to hire an attorney). Likewise, a pretrial restraining order against potentially forfeitable property does not "arbitrarily interfere with a defendant's fair opportunity to retain counsel." *United States* v. *Monsanto*, 491 U.S. 600, 616 (1989) (internal citations and quotation marks omitted).

Nothing in these cases 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. Indeed, the Government appropriately inquiries into third-party payment of legal fees in certain circumstances. In *United States* v. *Locascio*, 6 F.3d 924, 931-34 (2d Cir. 1993), for example, this Court affirmed the disqualification of the defendants' counsel based, in part, on defendant John Gotti's transmission of "benefactor payments" to these attorneys to serve as "house counsel" to Gambino Organized Crime Family members. In addition to the obvious concerns about the conflict of interest such payments raised, this Court also noted that evidence of Gotti's payment of legal fees could be used by

the Government to prove the existence of the criminal enterprise. *Id*. at 932-33. The point is not that KPMG and its partners and employees could be considered the equivalent of an organized crime family, but rather that if the Government can properly treat the payment of the legal fees of an associate as strong evidence of the existence of a criminal enterprise involving the payor and the associate without violating the Sixth Amendment, then surely the Government can treat such payments, to the extent they are deemed to undermine a corporation's professed desire to cooperate, as a factor to consider in its discretionary charging decision concerning the payor.

Throughout the course of this litigation, the defendants have been unable to demonstrate that they had any right to receive legal fees from KPMG. The record reflects unambiguously that KPMG's past practice of making such payments was voluntary, evidencing a purely donative intent, and subject to change at any time. Indeed, this Court has already noted that, if the defendants eventually pursue civil claims against KPMG for their legal fees, their success is "far from certain," given their stipulation below that KPMG's past practice of paying fees was "voluntary." *KPMG*, 486 F.3d at 762 n.3; *see also id.* at 764 (noting that the defendants took "none of the available steps to enforce their alleged contracts with KPMG until well after the indictment when the district court raised the possibility of an ancillary proceeding and indicated its willingness to exercise jurisdiction over it"). Notably, in the five months that have passed since this Court issued the writ of mandamus dismissing the ancillary proceeding against KPMG, not one of the defendants has filed an

arbitration proceeding against KPMG for payment of the legal fees to which he or she claims entitlement.

In the absence of a right to receive fees from KPMG, the Supreme Court's holding in *Caplin & Drysdale* that "[a] defendant has no Sixth Amendment right to spend another person's money for services rendered by an attorney, even if those funds are the only way that that defendant will be able to retain the attorney of his choice," 491 U.S. at 626, defeats the defendants' Sixth Amendment claims.

POINT III

The Government Did Not Violate The Defendants' Rights Under The Due Process Clause Of The Fifth Amendment

A. The District Court Should Not Have Conducted Its Substantive Due Process Analysis In *Stein I*

In *Stein I*, the District Court conducted an extensive discussion of the implications for what it found to be the Government's conduct on the defendants' rights under the substantive component of the Due Process Clause. *See Stein I*, 435 F. Supp. 2d at 356-65. This analysis, which the Government submits was erroneous, never should have been conducted in the first place, and should not be considered by this Court.

The District Court characterized the right it was analyzing as the "right to fairness in the criminal process," and, after reviewing a number of Supreme Court decisions in the area of criminal procedure, concluded that the

Supreme Court's "jurisprudence thus makes clear that defendants have the right, under the Due Process Clause, to fundamental fairness throughout the criminal process." *Id.* at 360. But in assessing the scope of the protection provided by the substantive component of the Due Process Clause, the District Court declined to conclude that such a broadly-stated right fell within the category of "fundamental rights" deemed to be guaranteed by substantive due process, stating that "it is not necessary or, in this Court's view, appropriate, to go that far in order to decide this case." *Id.* at 361. Instead, the District Court defined the right at issue as the "right to obtain and use in order to prepare a defense resources lawfully available to him or her, free of knowing or reckless government interference." *Id.* So defined, the District Court held that "such a right is basic to our concepts of justice and fair play. It is fundamental." *Id.* at 362.

Having found the existence of a fundamental right, the District Court then deemed the Thompson Memorandum and the USAO's conduct to be analogous to legislation, and so reviewed them under the "strict scrutiny" standard applied by the Supreme Court for legislative enactments infringing on fundamental rights. *Id.* Judge Kaplan found that the portion of the Thompson Memorandum regarding the Government's potential consideration of the payment of legal fees for defendants was not narrowly tailored to achieve a compelling objective, and so failed strict scrutiny and was unconstitutional. *Id.* at 363-65.

This Court should not consider the District Court's substantive due process analysis of the Thompson Memorandum and the USAO's conduct in *Stein I*. Any such

"right to obtain and use in order to prepare a defense resources lawfully available to him or her" stems from the Sixth Amendment's right to counsel, and the Supreme Court has instructed that where the protections of a specific Amendment cover allegations relating to particular government behavior, that Amendment, not substantive due process, must be used to assess the claim.

Because the Supreme Court has "always been reluctant to expand the concept of substantive due process," it held in *Graham* v. *Connor*, 490 U.S. 386 (1989), "that where a particular Amendment provides an explicit textual source of constitutional protection against a particular sort of government behavior, that Amendment, not the more generalized notion of substantive due process, must be the guide for analyzing these claims." *County of Sacramento* v. *Lewis*, 523 U.S. 833, 842 (1998) (quotation omitted); *see also Pabon* v. *Wright*, 459 F.3d 241, 253 (2d Cir. 2006). Although the "right to use available resources in defending a criminal case" has not been widely recognized or discussed, to the extent that it exists, it is traceable to the Sixth Amendment. *See United States* v. *Rosen*, 487 F. Supp. 2d 721, 727 n.8 (E.D. Va. 2007) (noting that the right's specific source is "unclear," but all possibilities stem from the Sixth Amendment).

The district court in *Rosen*, considering the identical argument made by the defendants here, recognized that substantive due process principles do not apply. There, the court noted that the defendants' "imaginative" argument "founders on a fundamental principle of constitutional law," citing the Supreme Court's directive in *County of*

Sacramento. *Id.* at 736. Putting aside the defendants' description of the right, the court found that

> [d]istilled to its essence, defendants' due process claim is that the government treated them unfairly because it interfered with their liberty or property interest to expend their own funds towards their defense. Clearly, whatever protection that right receives derives from the Sixth Amendment, and in accordance with *City of Sacramento*, the claim must be measured by that Amendment's standards.

Id. As a result, "[t]here is no need to undertake a separate inquiry addressing substantive due process when the right is protected, to whatever extent it is protected, by another constitutional text." *Id.*

In *Stein IV*, the District Court recognized the infirmity of its substantive due process analysis in *Stein I*. In a footnote, the District Court professed to be "well aware" of the limitations on substantive due process claims recognized in *Graham*, and so opined that "[t]he finding of substantive due process violations in *Stein I* constitutes an alternative holding that would be material in the event that a reviewing court disagreed with the Court's Sixth Amendment analysis." *Stein IV*, 495 F. Supp. 2d at 409 n.80. This is incorrect. To the extent that the right is grounded in the Sixth Amendment, whether the Government has violated that right is evaluated exclusively under Sixth Amendment principles; if the claims fail, they are *not* then reconsidered under the Due Process Clause as an "alternative" holding. *See Russo* v. *City of Bridgeport*, 479

F.3d 196, 209 (2d Cir. 2007) ("since the Fourth Amendment provides a more explicit textual source of constitutional protection, in light of *Graham*, the Fourth Amendment, *rather than substantive due process*, should serve as the guide for analyzing these claims") (emphasis added) (quotations omitted). Substantive due process principles simply do not apply to the "fundamental right" analysis conducted by the District Court in *Stein I*.

B. The Thompson Memorandum Does Not Infringe Upon A Recognized Fundamental Right And Is Rationally Related To A Legitimate Governmental Interest

Assuming *arguendo* that it was proper for the District Court to consider whether the Government had infringed on a "fundamental right" protected by the Due Process Clause, the District Court nonetheless erred when it identified the right to use "lawfully available" resources for one's defense as being such a "fundamental right." Because the right identified by the District Court is not, in fact, fundamental, to the extent that the Thompson Memorandum is evaluated as legislation, it must meet only a rational basis test, which it does easily.

1. Applicable Law

"Under the Due Process Clause of the Fifth Amendment of the Constitution, '[n]o person shall . . . be deprived of life, liberty, or property, without due process of law.' This clause has been interpreted as a protection of the individual against arbitrary action of government, which has both a procedural component protecting against

the denial of fundamental procedural fairness, as well as a substantive component guarding the individual against the exercise of power without any reasonable justification in the service of a legitimate governmental objective." *Lombardi* v. *Whitman*, 485 F.3d 73, 78-79 (2d Cir. 2007) (citations and quotations omitted).

The Supreme Court has repeatedly emphasized its reluctance to expand the scope of substantive due process protections

> because guideposts for responsible decision-making in this unchartered area are scarce and open-ended. By extending constitutional protection to an asserted right or liberty interest, we, to a great extent, place the matter outside the arena of public debate and legislative action. We must therefore exercise the utmost care whenever we are asked to break new ground in this field, lest the liberty protected by the Due Process Clause be subtly transformed into the policy preferences of the Members of this Court.

Washington v. *Glucksberg*, 521 U.S. 702, 719 (1997) (quotations and citations omitted). As a result, the substantive reach of the Due Process Clause encompasses only "those fundamental rights and liberties which are, objectively, deeply rooted in this Nation's history and tradition, and implicit in the concept of ordered liberty, such that neither liberty nor justice would exist if they were sacrificed." *Id.* at 720-21 (quotations and citations omitted).

Not surprisingly, only a few rights have been deemed "fundamental" under this standard. They include "the rights to marry; to have children; to direct the education and upbringing of one's children; to marital privacy; to use contraception; to bodily integrity; and to abortion." *Id.* at 720 (citations omitted). In addition, the Court has "assumed, and strongly suggested, that the Due Process Clause protects the traditional right to refuse unwanted lifesaving medical treatment." *Id.*

2. Discussion

The District Court erred by "taking the momentous step of proclaiming a new fundamental right." I Laurence Tribe, *American Constitutional Law* 1372 (3d ed. 2000). The right defined by the District Court here—"to obtain and use in order to prepare a defense resources lawfully available to him or her, free of knowing or reckless government interference"—does not meet the standard for recognized fundamental rights. To begin with, the Supreme Court has held that although "[t]he Constitution guarantees a fair trial through the Due Process Clauses . . . it defines the basic elements of a fair trial largely through the several provisions of the Sixth Amendment." *Strickland* v. *Washington*, 466 U.S. 668, 684-685 (1984). The Sixth Amendment ensures that every criminal defendant has the right to be represented by a constitutionally effective attorney. If a defendant does not have the resources to hire an attorney, the Government will pay for one, and also for any reasonable expenses associated with defending a case, such as investigators and experts. And, as discussed above, the Sixth Amendment also provides a limited right to representation by a defendant's counsel of

choice. But the District Court's "right to third-party resources to pay for counsel of choice" is two steps removed from the core protections of the Sixth Amendment, and has never, before *Stein I*, been held to be protected by that amendment. Because this right arguably falls outside the scope of the Sixth Amendment, it cannot reasonably be interpreted as one of the fundamental rights so "deeply rooted in this Nation's history and tradition, and implicit in the concept of ordered liberty, such that neither liberty nor justice would exist if they were sacrificed," and thus worthy of protection under the Due Process Clause.

In *Caplin & Drysdale*, the Court rejected a Due Process Clause challenge to the forfeiture statute, first noting *Strickland*'s observation that any such claim might well be co-extensive with the Sixth Amendment. 491 U.S. at 633. Nonetheless, assuming that the Fifth Amendment "provide[d] some added protection not encompassed by the Sixth Amendment's more specific provisions," 491 U.S. at 633, the Court rejected the claim in the absence of prosecutorial misconduct. *Id*. at 634. This decision confirms that a right to funds to pay for one's counsel of choice is not a fundamental right. After all, had such a right been deemed "fundamental," it would have been immune from infringement absent a compelling state interest.

Because the challenged portion of the Thompson Memorandum does not infringe upon any fundamental right, it must—accepting the District Court's approach and treating the Thompson Memorandum as the equivalent of legislation—only be rationally related to a legitimate state

interest to survive scrutiny. *Washington* v. *Glucksberg*, 521 U.S. at 728.

As the District Court recognized, the Government's "interest in investigating and fairly prosecuting crime is compelling." *Stein I*, 435 F. Supp. 2d at 363. The legal fees provision of the Thompson Memorandum, as characterized by the District Court, "is intended to facilitate just charging decisions concerning business entities by focusing on a consideration pertinent to gauging their degrees of cooperation." *Id.* The payment of legal fees to employees can, in rare cases, be one aspect of a corporation impeding an investigation where the corporation "circles the wagons" by, among other things, essentially muffling relevant corporate witnesses and controlling the flow of information to the Government in the course of a criminal investigation. To the extent a corporation seeks to shield the truth from the Government by, in part, paying the fees of its employees to keep its employees in line, the Government may consider that in weighing the authenticity of the entity's purported cooperation efforts. Thus, in circumstances where an entity seeks credit for assisting the Government's investigation, it is fair and appropriate for the Government to conduct inquiries to ascertain the *bona fides* of the entity's cooperation efforts—just as the Government would do with individual defendants seeking to cooperate. Moreover, in the event it later becomes necessary to ascertain whether the Government's investigation has been hampered because an entity has "circled the wagons" or impeded the criminal investigation under the guise of cooperation, it is fair and appropriate for the Government to inquire into the entity's obligations and

intentions concerning the payment of legal fees for culpable employees.

The District Court complained that the legal fees provision was not narrowly tailored, because the "circle the wagons" interpretation consistently applied by the Government to that provision (and, the Government submits, apparent from the context) does not explicitly appear in the text. *See id.* at 364. But "narrow tailoring" is an aspect of strict scrutiny review; the regulation need only be "rationally related" to the Government's interest to withstand rational basis review. Similarly, the District Court opined that using the payment of legal fees as a cooperation evaluation factor is "problematic," because a corporation may simultaneously pay its employees' legal fees and fully cooperate with the investigation. *See id.* But it is precisely because a corporation can do both things simultaneously that, as the Thompson Memorandum makes clear, the application of this and each of the other factors depends on context. Because, in some contexts, corporations may attempt to protect culpable employees by advancing their legal fees, this consideration rationally relates to the Government's interest in investigating corporate wrongdoing.

Regardless of the District Court's views of the wisdom or desirability of the legal fees provision of the Thompson Memorandum, it improperly recognized a new fundamental right under the Due Process Clause. "[S]ubstantive due process liability should not be allowed to inhibit or control policy decisions of government agencies, even if some decisions could be made to seem gravely erroneous in retrospect." *Lombardi* v. *Whitman*, 485 F.3d at 84. The

Thompson Memorandum does not violate the Due Process Clause.

C. The Government's Investigation And Prosecution Of KPMG And Its Partners And Employees Did Not "Shock The Conscience"

Neither the promulgation of the Thompson Memorandum, nor the Government's purported conduct with respect to KPMG's decision to pay legal fees in this case, can rationally be said to constitute "outrageous Government conduct" that "shocks the conscience." Such activity is widely understood to be limited to physical or psychological torture, or at most deliberate, improper, and egregious investigative techniques, such as using a defendant's own lawyer against him. In advising KPMG that the authenticity of its cooperation would be evaluated pursuant to the Thompson Memorandum, in informing KPMG when its personnel refused to meet with the Government under the protections of a proffer agreement, and in making entirely accurate factual representations to the District Court in connection with the Fee Motion, the Government did not, by any reasonable definition, "shock the conscience."

1. Applicable Law

"To prevail when challenging executive action that infringes a protected right, a plaintiff must show not just that the action was literally arbitrary, but that it was arbitrary in the constitutional sense. Mere irrationality is not enough: only the most egregious official conduct, conduct that shocks the conscience, will subject the

government to liability for a substantive due process violation based on executive action." *O'Connor* v. *Pierson*, 426 F.3d 187, 202-03 (2d Cir. 2005) (citations and quotations omitted); *see also County of Sacramento* v. *Lewis*, 523 U.S. at 846 ("[O]nly the most egregious official conduct can be said to be arbitrary in the constitutional sense, thereby recognizing the point made in different circumstances by Chief Justice Marshall, that it is a constitution we are expounding.") (quotations and citations omitted). "In order to shock the conscience and trigger a violation of substantive due process, official conduct must be outrageous and egregious under the circumstances; it must be truly brutal and offensive to human dignity." *Lombardi*, 485 F.3d at 81 (quotations omitted); *see also Pabon* v. *Wright*, 459 F.3d at 250 (collecting cases); *Pena* v. *DePrisco*, 432 F.3d 98, 112 (2d Cir. 2005) (same). The conduct must be "so outrageous that common notions of fairness and decency would be offended were judicial processes invoked to obtain a conviction against the accused." *United States* v. *Schmidt*, 105 F.3d at 91.

"The paradigm examples of conscience-shocking conduct are egregious invasions of individual rights. Especially in view of the courts' well-established deference to the Government's choice of investigatory methods, the burden of establishing outrageous investigatory conduct is very heavy." *United States* v. *Rahman*, 189 F.3d 88, 131 (2d Cir. 1999) (citations omitted). This Court has recognized that "[o]rdinarily such official misconduct must involve either coercion, *Watts* v. *Indiana*, 338 U.S. 49, 55 (1949) (six days of intense interrogation of accused), or violation of the defendant's person, *Rochin* v.

California, 342 U.S. 165, 172 (1952) (forcible extraction of accused's stomach contents). Absent such extreme misconduct, relief in the form of reversal of a conviction is rare." *Schmidt*, 105 F.3d at 91. Indeed, given this high standard, courts "have almost never found such a violation." *United States* v. *Berkovich*, 168 F.3d 64, 69 (2d Cir. 1999).

"A motion to dismiss an indictment alleging outrageous governmental conduct is a question of law directed to the trial judge and review of rulings thereon is *de novo*." *United States* v. *Williams*, 372 F.3d 96, 112 (2d Cir. 2004) (quotation omitted).

2. The District Court's Factual Findings

In the *Smith* brief, the Government argues that the record does not support several of the District Court's factual findings regarding the Thompson Memorandum, the February 25 Meeting, and KPMG's decision to condition and limit payment of the defendants' attorneys fees, and that those findings are therefore clearly erroneous. (*See* Gov't Br. 46-72). Although the District Court made additional factual findings in *Stein IV*, the Government stands by and incorporates those arguments here. Specifically, in *Stein IV*, the District Court took the unusual step of revisiting some of its factual findings from *Stein I* after reviewing the Government's arguments in the *Smith* brief; ultimately, the District Court adhered to its original findings, and then sought to bolster these findings by offering rebuttals to the Government's arguments in the *Smith* brief and by citing additional evidence that had been presented to the District Court in connection with the defendants' renewal of their motions to dismiss, which

took place nearly one year after *Stein I* was issued. As detailed in the remainder of this section, even after reconsideration, some of the District Court's conclusions cannot be squared with the record.

a. The Thompson Memorandum

In *Stein IV*, the District Court again rejected the Government's argument that the most natural reading of the Thompson Memorandum's reference to the payment of legal fees is that it may be a factor if, as the sentence that precedes it notes, the company "appears to be protecting its culpable employees and agents." (Smith A. 1139). The District Court interpreted the Thompson Memorandum as saying that a corporation *always* increases its risk of indictment by paying the legal fees of its employees, because the prosecutors "might" view such payments as protecting culpable employees, which the Government then might use to discount the company's efforts at cooperation, which in turn could "contribute to a government decision to indict the entity." *Stein IV*, 495 F. Supp. 2d at 396. The District Court supported its reading by citing to a number of external sources associated with the criminal defense bar, which Judge Kaplan found "read the Thompson Memorandum as discouraging payment of legal fees for company employees under investigation by holding out the prospect that doing so *would increase the risk of indictment*." *Id.* at 397 (emphasis added).

But this interpretation removes the most significant factor from the analysis: context. The same sentence of the Thompson Memorandum that mentions legal fees emphasizes that "cases will differ depending on the circumstances." (Smith A. 1139). Consequently, all the Thomp-

son Memorandum says is that, depending on the context, support of culpable employees through advancing their legal fees could be viewed negatively, if the corporation appeared to be protecting those culpable employees. In certain circumstances, then, advancement of legal fees could very well indicate an effort to obstruct the investigation, and therefore quite properly be held against the company. But this provision cannot be reasonably interpreted as setting up a direct and invariable relationship between the payment of attorneys fees and the increased risk of indictment.

It is true that, at the beginning of an investigation, corporations and defense lawyers will not know for certain how the Government will view the payment of legal fees (nor will the Government, for that matter). But any concern over this uncertainty ignores the reality that the Government's decision whether to seek an indictment comes at the end of the investigation, not at the beginning. If the corporation under investigation is sincerely cooperating—and it knows from the beginning if it is—the payment of legal fees to individuals will not be a negative factor, because the company's *bona fide* cooperation will be abundantly clear by the end of the investigation, when the charging decisions are made.

This is borne out by the one specific example in the record, which stands in sharp contrast to the broad, unsupported claims made by the sources on which the District Court relied in *Stein IV*, 496 F. Supp. 2d at 397-99. As testified to at the Fee Hearing, "early in the investigation," the Government asked a different corporation involved in the same investigation whether it was paying

fees. The corporation said that it was. But the company was not indicted; it ultimately accepted a deferred prosecution agreement, just as KPMG did here. (Smith A. 454). There is not the slightest suggestion that the payment of attorneys fees by that corporation increased its risk of indictment, or had any negative consequences to the firm whatsoever.

The District Court took a nuanced, multifaceted policy designed to advise corporations of the numerous factors that the Government would consider when making prosecutive decisions and read it as an invariable directive intended by the Government as an improper effort to deprive individual defendants of resources for their defense. That forced reading cannot withstand careful scrutiny, and certainly cannot support the conclusion that the mere existence of that aspect of the Thompson Memorandum is so "egregious," "brutal," and "offensive to human dignity" that it shocks the conscience.[*]

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[*] As noted by the Government in its reply brief in the *Smith* appeal, the Government's interpretation is in no way undermined by the promulgation of the so-called "McNulty Memorandum" in December 2006. (*See* Gov't Reply Br. 50-54). To the contrary, the McNulty Memorandum confirmed that prosecutors could consider a corporation's payment of legal fees to culpable employees in those "extremely rare cases. . . when the totality of the circumstances show that it was intended to impede a criminal investigation." (SA 87, 94). Moreover, the McNulty Memorandum explicitly stated that "[t]his prohibition is not meant to prevent a prosecutor from asking questions

b. KPMG's Decisionmaking

i. KPMG's Decision To Condition Legal Fee Payments On Cooperation

The District Court disputed the Government's argument in the *Smith* brief that, to the extent that KPMG decided to condition and limit its payment of attorneys fees, it made that decision independent of anything the AUSAs said or did at the February 25 Meeting. *See* Gov't Br. 56-57; *Stein IV*, 495 F. Supp. 2d at 401-03. The record supports the Government's interpretation.

Under the District Court's construction of events—with which the Government takes issue—at that meeting:

- An AUSA asked whether KPMG would be paying attorneys fees for their partners.
- KPMG's lead attorney asked for the Government's views on that subject.
- In response, another AUSA referred to the Thompson Memorandum as a point that had to be considered.
- KPMG's attorney then stated that KPMG's intention was to pay legal fees only for employees who cooperated with the investigation, but that it had not yet made any final decisions.

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about an attorney's representation of a corporation or its employees." (*Id.*).

- An AUSA made a comment along the lines that misconduct should not be rewarded, and another said that the Government would look at any discretionary attorneys fees payments under a microscope.

Nothing in this series of events suggests that the USAO had anything to do with KPMG's stated intention to condition its payment of legal fees.

According to the District Court, the KPMG attorneys came into the meeting with the fervent desire to pay the attorneys fees of the firm's employees, but terrified that to do so could increase the risk of the firm's indictment. *See Stein IV*, 495 F. Supp. 2d 401-02. Yet, with so much supposedly riding on that decision, none of KPMG's highly experienced and successful attorneys asked the Government a simple question: "KPMG wants to pay the attorneys fees of its people. Would you hold that against the firm if it did?" When the KPMG attorneys announced their proposed plan to pay fees only for employees who cooperated—which the District Court disparaged as merely a "trial balloon"—again, no one bothered to ask the Government what was supposedly the burning question of the moment: "Would you have a problem with that?" But even in the absence of any such questions, the District Court nevertheless found—via a "logical inference"—that "KPMG came into the meeting hoping to continue its past practice of paying employee legal fees," that the Thompson Memorandum made KPMG "reluctant to do so without an indication from the USAO that such payments would not be held against the firm," and that the USAO (despite having never been asked) "declined to give that

indication." *Stein IV*, 495 F. Supp. 2d at 402-03. The District Court characterized the KPMG proposal as a tentative "fallback position," one that also failed to "receive a warm reception from the USAO" (even though, once again, the KPMG lawyers never asked the USAO's opinion on the matter).

It is undisputed that neither the Thompson Memorandum nor the USAO said anything about paying attorneys fees only for employees who cooperated with the investigation, or about placing a cap on any such payments. In the Statement of Facts attached to KPMG's deferred prosecution agreement, KPMG stated that it determined to implement this condition of cooperation "on its own initiative." (*See* Stein A. 392).

This is entirely consistent with the representations made by KPMG's counsel in a letter to the District Court shortly before the Fee Hearing, on which the District Court placed great reliance in *Stein IV*, 495 F. Supp. 2d at 405. In that letter, KPMG's attorneys advised the District Court that no KPMG witnesses should be required to testify at the upcoming hearing, because KPMG had offered to stipulate "that the Thompson memorandum in conjunction with the government's statements relating to payment of legal fees 'affected KPMG's determination(s) with respect to the advancement of legal fees'" and "that the Thompson memorandum substantially influenced KPMG's decisions with respect to legal fees as well as other important issues in the case." (Stein A. 793). But to say that the events of the February 25 Meeting may have "affected" KPMG's decisionmaking is a far cry from concluding that the USAO specifically encouraged KPMG to adopt an "un-

precedented" policy of conditioning attorneys fees payments on cooperation, limiting them to $400,000, and terminating them upon indictment. KPMG no doubt was "affected" by the USAO's view at the February 25 Meeting of the damning facts as to KPMG's conduct already in the public record—facts that independently led KPMG to conclude that it needed to "save the firm" (Smith A. 613)—and by the USAO's confirmation that it would look to the Thompson Memorandum (including its legal fees provision) to evaluate KPMG's cooperation, but there is simply no evidence that the USAO commented upon, let alone dictated, the policy KPMG considered and ultimately reached.

In light of the evidence actually in the record, as opposed to speculation or surmise, the only reasonable conclusion is that KPMG came to the February 25 Meeting fully realizing that it was facing an unprecedented crisis calling for drastic action. It decided, of its own volition, to condition its voluntary payment of legal fees on the recipients' cooperation with the investigation, to thereby encourage them to meet with the Government, and so to demonstrate KPMG's cooperation with the investigation. The Government did not suggest, encourage, or in any way promote KPMG's decision, and so the events of the February 25 Meeting cannot support the conclusion that the Government's conduct "shocked the conscience." That KPMG took the actions it did in part because it hoped

those actions would be viewed favorably by the Government changes nothing.*

ii. KPMG's Decision To Terminate Legal Fees For Indicted Defendants

The District Court acknowledged that KPMG's decision to terminate legal fee payments to any indicted individuals came after the February 25 Meeting, and was first communicated to the Government by letter of March 11, 2004. *Stein IV*, 495 F. Supp. 2d at 403-04. Yet the District Court remarkably concluded that, notwithstanding the utter absence of support in the record,

> KPMG's decision to cut off payment of any legal expenses to anyone who was indicted—which is the critical point here—

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* In the course of its discussion, the District Court inaccurately and unfairly claimed that the Government's account of the February 25 Meeting in the *Smith* brief is "misleading." *Stein IV*, 495 F. Supp. 2d at 401. It is not. The Government correctly stated the chronology of events: KPMG began the meeting by volunteering that it had decided to change course and cooperate fully. Later on in the meeting, KPMG announced its intention to not pay legal fees for employees who declined to cooperate with the Government. (Gov't Br. 57). The Government made no "implication," as the District Court found, "that KPMG opened the meeting by volunteering that it had decided upon a new course with respect to payment of legal fees." *Stein IV*, 495 F. Supp. 2d at 401.

> was prompted by the Thompson Memorandum and the USAO's negative reaction at the February 25 meeting to the possibility that KPMG would pay any legal fees in the absence of a legal obligation to do so.

Id. at 404 (footnote omitted). As a preliminary matter, this conclusion contradicts the District Court's earlier findings. If, as the District Court found, KPMG's attorneys were convinced that paying *any* legal fees could heighten the firm's risk of indictment, and that the USAO had a "negative reaction" to the idea at the February 25 Meeting, KPMG would not have proceeded to pay those fees, even with conditions and limits. Regardless, the conclusion supported by the record is that KPMG simply did not want to pay the legal fees of individuals charged with criminal offenses in connection with these events, which had already brought KPMG congressional and judicial condemnation and strong adverse publicity. Ascribing this decision to the few statements by the USAO at the February 25 Meeting strains credulity, particularly given the tenuous record support for the statements on which the District Court relies.

The proper time frame for evaluating the decision not to pay legal fees for indicted individuals is not March 2004, but August 2005, when the Grand Jury returned the first indictment against the defendants and that condition was triggered. By that time, KPMG had already admitted substantial criminal wrongdoing and suffered other serious direct consequences to the firm (*e.g.*, a massive criminal fine, the imposition of a corporate monitor). After KPMG signed the DPA, with its statement of wrongdoing and

other consequences, the full scope of KPMG's liability and exposure had become clear to the partnership. It contradicts reason and common sense to suggest that, when faced with such consequences to the firm as a result of criminal wrongdoing by many individuals, and where the firm itself admitted extensive criminal conduct,[*] the remaining partners at KPMG would have chosen to pay the legal fees for indicted defendants but for the Thompson Memorandum. KPMG's counsel's statement at the Fee Hearing drove that point home:

> My client doesn't miss for a second how important it is, but they have made a conscientious business decision regarding the thousands of people that work for them, the work that they're doing. I don't know how many other partners there are who, thank God for them, are not involved in this, had no involvement with it, and they made that decision.

(Smith A. 770). The statement suggests that, even if the Thompson Memorandum "substantially influenced KPMG's decisions with respect to legal fees" during the investigation, by the time KPMG executed the DPA and the defendants were indicted, other factors were paramount to the firm's decision—including the egregious

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[*] For example, KPMG admitted such criminal conduct was "deliberately approved and perpetrated at the highest levels of KPMG's tax management, and involved dozens of KPMG partners and personnel." (Stein A. 383).

nature of the defendants' wrongdoing and its substantial costs to the firm.

The District Court, dismissing the need for "direct evidence" of KPMG's decisionmaking, blamed the Government for failing to prove a negative:

> Moreover, the government was on ample notice that the reasons that KPMG acted as it did were to be tried at the hearing. Yet it called no witnesses to testify as to when, how, and why KPMG made the decisions it did. The reason it did not do so is the elephant in the room that the government tries to ignore.

Id. at 404-05 (footnote omitted). Colorful metaphors aside, the burden at the hearing was at all times on the defendants to prove that the Government was responsible for KPMG's decisions regarding fee payments, which they failed to do. *See*, *e.g.*, *United States* v. *Jackman*, 46 F.3d at 1245-46. The Government was not obligated to prove exactly why KPMG decided as it did, although the record does establish that KPMG's desire to demonstrate its cooperation with the Government—with all the salutary consequences the firm hoped would flow from that decision—is the reason.[*]

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[*] The District Court implied that demonstrating KPMG's motivations would have required nothing more than calling a witness from KPMG. It would not have been that simple. KPMG's "ultimate decision-maker" on this issue was, according to KPMG, firm Chairman Eugene

iii. The Government's Impact On KPMG's Decisionmaking

In its *Smith* briefs, the Government explains at length how the record demonstrates that, although KPMG certainly took the factors identified in the Thompson Memorandum into consideration—as would any responsible corporation under criminal investigation—KPMG decided to condition and limit its payment of the defendants' attorneys fees because it determined that it was in the firm's best interests to do so. (*See* Gov't Br. 63-70; Gov't Reply Br. 35-43). In *Stein IV*, the District Court disparaged these arguments, claiming that the Government "ignores" numerous facts and that new evidence supported the District Court's conclusions in *Stein I*. *See Stein IV*, 495 F. Supp. 2d at 405-09. The Government stands by its arguments.

Space does not permit a point-by-point rebuttal, but a few examples demonstrate the error of the District Court's conclusion. For example, the Government did not "ignore" the severance agreement of defendant Jeffrey Stein. In fact, as KPMG's General Counsel, Joseph Loonan, testified, the severance agreement provided that any payment of attorneys fees would be "consistent with the firm's general policy and practice," which, he explained, could change and had changed over time. (Smith A. 173, 179). The Government also did not "ignore" the fact that

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O'Kelly, who had passed away. (Stein A. 795). And KPMG refused to waive its attorney-client privilege as to any questions relating to KPMG's decisionmaking involving its attorneys. (*Id.*).

KPMG's lawyers said at the February 25 Meeting that no final decisions had been made with respect to legal fees, that they inquired as to the Government's view on fee payments generally, and that they advised the Government of their intention to condition fee payments on cooperation. The sum total of the Government's responses to these points at the meeting—even on the District Court's version of the facts—was to reinforce the Thompson Memorandum, which discussed the payment of legal fees only in the context of protecting culpable employees.

The Government did not "ignore" KPMG's counsel's statements about its common practices to pay fees, any "problem" KPMG might have with departing from those practices, or KPMG's payment of fees in the Xerox matter. Rather, as explained in the *Smith* briefs, KPMG faced an "unprecedented" situation in February 2004. It had been excoriated by a committee of the United States Senate, referred to the Department of Justice for its failure to comply with IRS summonses, castigated in a Special Master's report, and inundated with negative publicity. (*See* Gov't Br. 25-26).The tax shelter matter was plainly a horse of a different color.

Nor did the Government "ignore" the fact that KPMG has been paying the defendants' legal fees for related civil cases. KPMG, like many corporations, carries professional liability indemnification insurance. But that insurance does not cover attorneys fees for criminal matters. (Smith A. 559). Inexplicably, the District Court rejected this eminently practical reason for the distinction, finding instead that the payment of legal fees in the civil cases showed "with astonishing clarity that the different treatment of the

criminal case defense costs has been driven from the outset by the fear that the government would view any assistance in defending against the indictment as a black mark against KPMG." *Stein IV*, 495 F. Supp. 2d at 407. The Government submits that its interpretation is more consistent with the financial reality of operating a partnership. Furthermore, KPMG is a co-defendant in each of the civil suits at issue, providing an obvious motive for it to coordinate with its co-defendants.

The new evidence cited by the District Court does not affect the analysis. A voicemail message sent to the partnership on February 18, 2004, by Mr. O'Kelly, advised the partners of the Department of Justice investigation, and stated that "[a]ny present or former members of the firm asked to appear will be represented by competent [counsel] at the firm's expense." (Stein A. 1070). The District Court concluded that because Mr. O'Kelly did not mention any limitations or conditions on fee payments in that message, that somehow proved that KPMG intended to pay them unconditionally. However, in the very next breath, Mr. O'Kelly told the partnership that "[w]e will assure the government that we intend to fully cooperate," foreshadowing the policy that KPMG would explicitly adopt. Moreover, the voicemail message is nearly identical to the language in a memorandum that went to a wide group of KPMG partners and employees on March 12, 2004—*after* KPMG had reached its decision regarding paying legal fees subject to a cap and certain conditions—which stated that KPMG would "be responsible for the payment of reasonable fees and related expenses in connection with . . . representation regarding this investigation," without any explicit limitation or conditions. *Stein*

I, 435 F. Supp. 2d at 346 n.62 (quoting Smith A. 1298, and noting that "[t]he failure to indicate that payment of legal fees would cease if the recipient were charged or to refer to the $400,000 cap apparently is attributable to the fact that those limitations were contained in letters sent to counsel for persons who already had received subject letters from the government while the advisory memorandum went to a broader group"). Finally, Joseph Loonan (KPMG's general counsel) testified at the Fee Hearing that the discussions he had with then-Chairman O'Kelly and others regarding how and whether KPMG would pay fees for the tax shelter investigation took place *before* the February 25 Meeting with the Government. (Smith A. 484-85). In any event, an informal voicemail notification is a far cry from a formal, written declaration of policy. Advising the partners that KPMG was willing to pay their legal fees in general was not inconsistent with the decision to place conditions on those payments, and, more significantly, does not suggest that the Government was responsible for that choice.

Similarly, the negotiation of the proposed retention agreement between KPMG and defendant Richard Smith reflects only what the Government, through the Thompson Memorandum, has maintained all along: that the payment of overly generous severance packages to the principal wrongdoers is a reflection of an ineffective compliance program that nurtures a corporate culture where the message to employees is that misconduct and wrongdoing will be rewarded. The Smith Affidavit states that Mr. O'Kelly advised defendant Smith "that he could not sign a retention agreement with me until the United States Attorney's Office for the Southern District of New York

had ended its investigation into KPMG and various of its employees and former employees, including me." (Stein A. 930). It makes no mention of the legal fees payment provisions being an issue. The notes of Greg Russo, a KPMG executive, from a meeting with KPMG's lawyers after the February 25 Meeting with the Government, on which the District Court also relied, specifically tie defendant Smith's pending agreement to the idea that "severance [is] a problem." (Stein A. 1073). Based on this evidence, the presence of a legal fee payment provision in defendant Smith's proposed retention agreement does not appear to have been KPMG's primary concern. Rather, it was concerned with the appearance of approving multi-million dollar contracts with the very individuals whose conduct had precipitated the Government's investigation.

c. The Government's Submissions And Representations In Connection With The Fee Motion

At the end of its opinion in *Stein I*, the District Court criticized the Government's responses to the defendants' Fee Motion:

> The government was economical with the truth it its early responses to this motion. It is difficult to defend even the literal truth of the position it took in its first memorandum of law. KPMG's decision on payment of attorneys' fees was influenced by its interaction with the USAO and thus cannot fairly be said to have been a decision "made by KPMG alone," as the government represented. The government's assertion that the

> legal fee decision was made without "coercion" or "bullying" by the government can be justified only by tortured definitions of those terms. And while it is literally true, as [an AUSA] wrote in his later declaration, that the government did not "instruct" or "request" KPMG to do anything with respect to legal fees, that was not the whole story. Those submissions did not even hint at [a supervisory AUSA's] "rewarding misconduct" comment or at [an AUSA's] statement that the USAO would look at the payment of legal fees "under a microscope." In addition, they soft-pedaled the government's use of KPMG's willingness to cut off payment of legal fees to pressure KPMG personnel to waive their Fifth Amendment rights and make proffers to the government. Those omissions rendered the declaration and the brief that accompanied it misleading.

Stein I, 435 F. Supp. 2d at 381. Shortly after the District Court issued *Stein I*, the Government asked it to reconsider its language, in light of the evidence that, although the District Court had disagreed with the Government's positions, no one had misled the court. (Stein A. 891-98). In response, the District Court amended its opinion slightly, but adhered to the language quoted above. (Stein A. 899-900).

As the Government explained in its letter requesting reconsideration, the District Court unfairly accused the

USAO of being less than candid, when in reality the District Court simply disagreed with the USAO's characterization of events and their significance.

First, the District Court's conclusion that "KPMG's decision on payment of attorneys' fees was influenced by its interaction with the USAO and thus cannot fairly be said to have been a decision 'made by KPMG alone,' as the government represented," does not suggest that the Government failed to acknowledge that its evaluation of KPMG would be guided by the Thompson Memorandum, or that KPMG was well aware of the Thompson Memorandum's provisions. Just as an individual defendant "alone" makes the decision to plead guilty or cooperate, even if that decision is influenced by conversations with the Government, so too here KPMG's decision remained its own. As the Statement of Facts attached to the DPA confirms, KPMG made the ultimate decision regarding its payment of the defendants' legal fees. The Government can hardly be faulted for relying on this representation in the Statement of Facts—the truth of which was sworn to by KPMG's chief legal officer in open court (Smith A. 203-04, 209)—which dovetailed with the Government's own recollections of its discussions with KPMG and its representatives. Moreover, the Government clearly stated in its briefing and during oral argument on the Fee Motion that KPMG's decision was likely influenced by the firm's desire to curry favor with prosecutors. (*See, e.g.*, Smith A. 741).

Second, although the District Court found that the Government "coerced" KPMG's decision regarding legal fees, the Government's disagreement with that conclu-

sion—which it maintains on this appeal—does not constitute a lack of candor. The USAO acted in accordance with Department of Justice policy, and so does not consider its conduct to have been "bullying" or "coercive." As the Government's request for reconsideration stated, the District Court "has every right to expect the Government and every other party to accurately state the facts, but it cannot expect a party (even the Government) to adopt its adversary's characterization of those facts unless it agrees with that characterization." (Stein A. 896).

Third, the District Court criticized the Government's submissions for failing to "even hint at [a supervisory AUSA's] 'rewarding misconduct' comment." Although the District Court is technically correct, the Government's failure to mention the comment in its prehearing briefs did not reflect a lack of candor, because the comment was not germane to the legal fees issue. Both the AUSA who made the "rewarding misconduct" comment, as well as another AUSA who attended the February 25 Meeting at which the comment was made, testified during the Fee Hearing that the comment referred to personnel action by KPMG—and, more specifically, KPMG's decision to enter into a lucrative severance agreement with a target of the USAO investigation—and not the payment of legal fees. (*See* Smith A. 617 ("I was addressing the issue of how someone was let go and whether they were getting severance payments."); *see also* Smith A. 459 ("I understood [the AUSA's] comment to be, you can't reward misconduct by

sending people away, basically, with a golden parachute.")).[*]

Fourth, the District Court complained that the Government failed to advise it of the purported "under a microscope" comment. This is perhaps the most unfair accusation, as not a single witness at the Fee Hearing—including the author of the notes in which the statement appears—recalled the statement actually having been made. (Smith A. 367-68, 425-27, 591, 618).[**] Indeed, the extensive notes (handwritten and typewritten) of the IRS agent who attended the February 25 Meeting contain no

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[*] Indeed, the District Court specifically credited the AUSA's testimony from the Fee Hearing. *See Stein I*, at 435 F. Supp. 2d at 343 n.45 ("The Court assumes that this was what went through her mind and does not question the sincerity of the testimony."). It defies logic, therefore, to accuse the Government of a lack of candor for failing to foresee that a comment that all of the Government representatives at the February 25 Meeting understood to refer to personnel actions would later be found by the District Court to have been misconstrued by KPMG's attorneys as referring to legal fees—particularly since none of the attorneys for KPMG who attended the meeting testified that he understood the comment to refer to the payment of legal fees.

[**] The author of the notes testified that they set forth, "to the best of [his] ability . . . [his] impressions and recollections of what was being said" (Smith A. 361), but that he did not recall the comment being made (Smith A. 367).

reference to an "under the microscope" comment being made, and the only set of notes in which those words appear were not provided to the Government until after the Government's brief and declaration had been filed. The District Court's conclusion that, nonetheless, the statement was in fact made did not warrant a finding that the Government had misled the District Court about making it. Put simply, the Government did not advise the District Court in its pre-Fee Hearing correspondence about the "under a microscope" comment because it did not believe then—and it does not believe now—that the AUSA in question made any such comment.[*]

Fifth, the District Court accused the Government of "soft-pedal[ing] the government's use of KPMG's willingness to cut off payment of legal fees to pressure KPMG personnel to waive their Fifth Amendment rights and make proffers to the government." In fact, the Government

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[*] In this regard, the District Court faults the Government for not calling the AUSA who supposedly made the "under the microscope" comment as a witness during the Fee Hearing to deny making the comment. *See Stein IV*, 495 F. Supp. 2d at 402 n.44. Once again, however, the District Court confused the burden of proof on the issue. Moreover, during the oral argument component of the Fee Hearing, the Government observed that "[n]ot one person" had testified about the comment being made, but then offered to call the AUSA for the express purpose of having him testify that he had not made the statement. (Smith A. 759). The District Court responded: "Let's just go on." (*Id*.).

advised the District Court of KPMG's request that the Government tell KPMG if any of KPMG's personnel refused to meet with the Government, and that the Government did so with respect to nine individuals. (Smith A. 1563-64). The defendants advised the District Court of their communications with KPMG, which demonstrated that KPMG threatened to cut off payment of legal fees to those defendants who did not agree to meet with the Government. As a result, the District Court was fully apprised of the factual background related to the defendants' cooperation. To the extent that the Government's position—then and now—is that there was nothing inappropriate about the "pressure" KPMG placed on its current and former personnel to cooperate with the Government's investigation, that argument cannot fairly be characterized as "soft-pedaling" the issue, and certainly cannot bespeak a lack of candor.

3. Discussion

The District Court relied on three factual conclusions in finding that the Government's conduct "shocked the conscience" and thus required dismissal of the indictment against thirteen defendants: "the government improperly coerced KPMG into refusing to pay the KPMG Defendants' defense costs, was less than candid with the Court in its effort to avoid a hearing on that issue, and improperly used KPMG to coerce proffers from KPMG personnel." *Stein IV*, 495 F. Supp. 2d at 411. As explained above and in the Government's briefs in the *Smith* appeal, none of these conclusions withstands scrutiny. But even accepting the District Court's characterizations, a comparison with other cases finding governmental conduct sufficiently

"outrageous" demonstrates that the Government's promulgation of a list of factors that it will consider when making charging decisions regarding corporations that includes a reference to payment of legal fees when used to protect culpable employees, and any alleged reinforcement of or reference to that factor by Government prosecutors, cannot possibly "shock the conscience."

The most common examples of conscience-shocking behavior that qualifies as "outrageous Government conduct" involve improper physical violations of a defendant's person. Thus, in the paradigmatic case of *Rochin* v. *California*, 342 U.S. 165 (1952), police officers entered the defendant's home and found him sitting on a bed, with two capsules on a nightstand next to him. When the defendant tried to swallow the pills, "[a] struggle ensued, in the course of which the three officers 'jumped upon him' and attempted to extract the capsules. The force they applied proved unavailing against Rochin's resistance. He was handcuffed and taken to a hospital. At the direction of one of the officers a doctor forced an emetic solution through a tube into Rochin's stomach against his will. This 'stomach pumping' produced vomiting. In the vomited matter were found two capsules which proved to contain morphine." *Id.* at 166. The Supreme Court held that the police officers' forcible and involuntary evacuation of the defendant's stomach contents so shocked the conscience as to require reversal of the defendant's conviction. *Id.* at 172-73. Similar conduct has likewise been held to "shock the conscience." *See, e.g.*, *Hemphill* v. *Schott*, 141 F.3d 412, 419 (2d Cir. 1998) (allegations that police officers gave civilian a gun, brought civilian along with them on chase after suspect, and allowed civilian to shoot suspect

sufficient to state claim that officers' conduct shocked conscience); *Huguez* v. *United States*, 406 F.2d 366, 381-82 (9th Cir. 1968) (officers forcibly removed packets containing narcotics from defendant's rectum).

In egregious circumstances, non-physical violations can also rise to the level of "conscience-shocking." In *Watts* v. *Indiana*, 338 U.S. 49 (1949), for example, the defendant was incarcerated and continuously interrogated, without the opportunity to speak to a lawyer or appear before a judge, over a six-day period until he confessed. *See id.* at 53-54 (plurality opinion); *see also Pena* v. *DePrisco*, 432 F.3d at 112-14 (implicit authorization by law enforcement for colleague to drive while intoxicated without fearing arrest, resulting in death of pedestrians struck by colleague's car, shocks conscience under "state-created-danger" principle); *United States* v. *Cuervelo*, 949 F.2d 559, 568 (2d Cir. 1991) (remanding for fact-finding where there was an "alleged sexual relationship between a principal undercover agent and a person who [was] thereafter charged").

Recently, this Court held that allegations that the federal Environmental Protection Agency made deliberate misleading statements and omissions regarding air quality at the World Trade Center site following the September 11, 2001, attacks did not rise to the level of "conscience-shocking" under the Due Process Clause. *See Lombardi* v. *Whitman*, 485 F.3d 73 (2d Cir. 2007). Recognizing that imposition of "broad constitutional liability" could "tend to inhibit EPA officials in making difficult decisions about how to disseminate information to the public in an environmental emergency," this Court held that "substantive

due process liability should not be allowed to inhibit or control policy decisions of governmental agencies." *Id.* at 84. Likewise here, a finding that a Department of Justice policy that had been in effect since 1999 was so "brutal" and "egregious" as to "shock the conscience" would inhibit prosecutive policy decisions, which are uniquely within the prerogative of the Executive Branch. *See, e.g.*, *United States* v. *Alameh*, 341 F.3d 167, 173 (2d Cir. 2003) ("As we have noted, the decision as to whether to prosecute generally rests within the broad discretion of the prosecutor. This broad discretion is proper because the decision to prosecute is particularly ill-suited to judicial review.") (citation and quotation omitted).[*]

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[*] Not surprisingly, numerous other cases from this court have rejected claims that the Government conduct in question "shocked the conscience." *See, e.g.*, *United States* v. *Williams*, 372 F.3d at 111-12 (no due process violation where defendant represented by attorney who had conflict of interest known to Government); *United States* v. *Jackson*, 345 F.3d 59, 67 (2d Cir. 2003) (no violation where informant asked defendant to sell her drugs numerous times, gave defendant clothes, and let defendant use informant's car); *United States* v. *Rahman*, 189 F.3d at 131 (no violation where informant allegedly "lent direction, technical expertise, and critical resources" to bombing plot); *United States* v. *Berkovich*, 168 F.3d at 68-69 (no violation from use of informant to facilitate defendant's conduct); *Schmidt*, 105 F.3d at 91-92 (no violation from sting where undercover agents posed as hit men, even though Government's involvement "extensive"); *United States* v. *Chin*, 934 F.2d 393, 398-99 (2d Cir. 1991)

Before the District Court, the defendants sought to compare the Government's conduct here to that held to be sufficiently outrageous in three other cases, but a comparison between those cases and this one reveals no relevant similarities. In *United States* v. *Marshank*, 777 F. Supp. 1507 (N.D. Cal. 1991), the Government used the defendant's own lawyer to identify, indict, locate, and prosecute him. This is no exaggeration; the attorney provided the Government "with substantive evidence against Marshank," *id.* at 1517, and even testified in the grand jury against his own client, *id.* at 1518. "The government collaborated with Marshank's attorney to build a case against him, to effect his arrest, and to ensure that he would cooperate with the government rather than contest the charges against him." *Id.* at 1519. And the attorney "stood to gain millions of dollars if Marshank's property was seized as a result of his prosecution." *Id.* at 1520. Under the "bizarre circumstances" of the case, in which "the fruit of the prosecutor's transgression [was] the indictment itself," the court found "no means other than dismissal of the indictment to remedy the due process violation." *Id.* at 1523.

Similarly, in *United States* v. *Sabri*, 973 F. Supp. 134 (W.D.N.Y. 1996), the defendant's immigration lawyer, acting at the Government's direction, initiated a telephone conversation with her client, recorded that conversation at the Government's behest, and steered the conversation to the topic of violence, eliciting the statements that resulted

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(no violation from "psychological manipulation" by undercover agent).

in her client's indictment on charges of threatening to kill federal officials. *Id.* at 138, 147.

In *United States* v. *Stringer*, 408 F. Supp. 2d 1083 (D. Or. 2006), *appeal pending*, No. 06-30100 (9th Cir.), the court found that the prosecution used a long-term civil SEC investigation to gather evidence for a criminal case that it had already decided to bring. On facts that it found amply established an explicit "strategy to conceal the criminal investigation from defendants," the court found that the prosecution "spent years hiding behind the civil investigation to obtain evidence, avoid criminal discovery rules, and avoid constitutional protections." *Id.* at 1088-89.

Simply describing the facts of these cases makes plain that they are grossly dissimilar to the conduct found by the District Court here. Here, the Government promulgated a list of factors that it would consider when evaluating corporate culpability, and identified the "protection of culpable employees"—which could include the advancement of legal fees to those individuals—as a potential negative factor. At the February 25 Meeting, the USAO did no more than follow those policies. When asked by KPMG to advise them if one of their employees refused to meet with the Government, the Government did so. And, when faced with the defendants' Fee Motion in this case, the Government fairly set forth the facts and circumstances of the events that had transpired.

The Government's conduct, far from being "outrageous," was entirely consistent with appropriate and legitimate Department of Justice investigative policy. To the extent that KPMG, because of its own assessment of its culpability and desire to appear cooperative, chose to

condition legal fee payments on cooperation and terminate them upon indictment, that decision was its own. The District Court's conclusion that the USAO's conduct "shocked the conscience" unfairly tarnishes the reputations of devoted public servants whose only objective was, and is, to protect society from the predations of criminals, whether they wield a gun or a pen. The Government sought only to find the truth and hold accountable those responsible for defrauding the United States of billions of dollars. The investigation was conducted well within the bounds of law and ethics, and the defendants' constitutional rights were respected throughout. The District Court's conclusion that the investigation "shocks the conscience" should be reversed.

CONCLUSION

The order dismissing the Indictment should be reversed, and the Indictment should be reinstated as to the defendants-appellees.

Dated: New York, New York
October 10, 2007

Respectfully submitted,

MICHAEL J. GARCIA,
United States Attorney for the Southern District of New York, Attorney for the United States of America.

KARL METZNER,
JOHN M. HILLEBRECHT,
MARGARET GARNETT,
KATHERINE POLK FAILLA,
Assistant United States Attorneys, Of Counsel.

CERTIFICATE

Pursuant to Rule 32(a)(7)(C) of the Federal Rules of Appellate Procedure, the undersigned counsel hereby certifies that this brief does not comply with the type-volume limitation of Rule 32(a)(7)(B). As measured by the word-processing system used to prepare this brief, there are 25,690 words in this brief. A motion for leave to file an overlength brief is being submitted herewith.

MICHAEL J. GARCIA,
United States Attorney for the
Southern District of New York

By: KARL METZNER,
Assistant United States Attorney

ANTI-VIRUS CERTIFICATION

Case Name: U.S. v. Stein

Docket Number: 07-3042-cr

I, Louis Bracco, hereby certify that the Appellant's Brief submitted in PDF form as an e-mail attachment to **briefs@ca2.uscourts.gov** in the above referenced case, was scanned using CA Software Anti-Virus Release 8.3.02 (with updated virus definition file as of 10/10/2007) and found to be VIRUS FREE.

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Dated: October 10, 2007