The Metropolitan Corporate Counsel®

www.metrocorpcounsel.com

Volume 14, No. 10 October 2006

Compliance Readiness – Law Firms

The Real Message of *Stein*: Corporate Cooperation Does Not Require Capitulation

Mark S. Olinsky

SILLS CUMMIS EPSTEIN & GROSS P.C.

Two recent decisions by Southern District Judge Lewis A. Kaplan in *United States v. Stein* invite the Justice Department to reconsider the more draconian aspects of its approach to the investigation of corporations and corporate executives. In *Stein I*, 2006 WL 1735260 (S.D.N.Y. June 26, 2006), Judge Kaplan held that it was unconstitutional for the government to pressure accounting firm KPMG to deny advancement of litigation costs to former employees now under indictment in connection with allegedly illegal and abusive tax shelters. In *Stein II*, 2006 WL 2060430 (S.D.N.Y. July 25, 2006), Judge Kaplan suppressed statements by two of the KPMG defendants because their proffers were coerced by KPMG's threat to fire these employees, a threat the court found to be attributable to the government.

***Mark S. Olinsky** is a Member of Sills Cummis Epstein & Gross P.C. focusing on corporate investigations, business crimes defense, and complex civil litigation. He is a former Assistant United States Attorney for the District of New Jersey and a member of the Special Committee on the Attorney-Client Privilege and Work Product Protection of the Association of the Federal Bar of the State of New Jersey.* *Mr. Olinsky thanks David Scharfstein, a law student at The George Washington University Law School, for his assistance.* *The views and opinions expressed in this article are those of the author and do not necessarily reflect those of Sills Cummis Epstein & Gross P.C.*

Mark S. Olinsky

Stein I and *II* were a sharp rebuke to the Justice Department's recent approach to corporate investigations as a whole. The government's actions rested upon the presumption that investigation equals guilt, so corporations that want to be viewed as cooperative instead of obstructive should be willing to punish employees before trial – either by withholding defense fees or threatening to terminate employees who are not willing to provide statements to the government. The real message of *Stein* is that it is up to the courts, not prosecutors, to determine guilt, that a strong defense by effective counsel does not equal obstruction, and that corporate cooperation does not require capitulation.

The Holder And Thompson Memorandums

The prosecutorial tactic condemned in *Stein I* has its roots in the June 1999 memorandum entitled *Federal Prosecution of Corporations*, issued by Deputy Attorney General Eric Holder. In determining whether to indict a company, the Holder Memorandum stated that one consideration was the corporation's "willingness to cooperate in the investigation of its agents" and that, except where required by law, "a corporation's promise of support to culpable employees and agents … through the advancing of attorneys fees … may be considered by the prosecutor in weighing the extent and value of a corporation's cooperation."

In January 2003, Deputy Attorney General Larry D. Thompson issued a memorandum entitled *Principles of Federal Prosecution of Business Organizations*, which carried forward without change the language of the Holder Memorandum regarding corporate cooperation and advancement of legal fees to employees. The difference, observed Judge Kaplan, was that the Thompson Memorandum was made binding, thus requiring prosecutors to consider voluntary advancement of fees "as at least possibly indicative of an attempt to protect culpable employees and as a factor weighing in favor of indictment of the entity."

Stein I: Government Pressure To Cut Off Defense Costs Is Unconstitutional

In *Stein I*, the KPMG defendants claimed that although KPMG bylaws and partnership agreements did not require advancement, KPMG's practice had long been to pay for the legal defense of its personnel,

Please email the author at molinsky@sillscummis.com with questions about this article.

regardless of cost and regardless of whether its personnel were charged with crimes. In this case, they contended, KPMG had changed its practice because of government pressure.

The court agreed. The Thompson Memorandum caused KPMG to consider departing from its long-standing policy and to seek an indication whether continuation of its settled practice would be held against it. Instead of providing the comfort KPMG sought, the U.S. Attorney's Office ("USAO") reinforced the threat inherent in the Thompson Memorandum: as one prosecutor put it to KPMG, the USAO would view any discretionary payment of fees "under a microscope." Judge Kaplan also noted that the way the USAO conducted itself demonstrated its desire to minimize the involvement of defense attorneys for those it viewed as guilty: "Had the government been less concerned with punishing those it deemed culpable right from the outset, it would not have accepted KPMG's word [that it had no legal obligation to advance fees]."

In his constitutional analysis in *Stein I*, Judge Kaplan held that the Thompson Memorandum and the USAO's conduct were subject to strict scrutiny under the Fifth Amendment, *i.e.*, the challenged government action must be narrowly tailored to achieve a compelling government interest. The court identified three government interests purportedly justifying the Thompson Memorandum's policy that payment of legal fees for employees under investigation or indictment may support indictment of the organization: (1) to facilitate just charging decisions concerning business entities by focusing on a consideration pertinent to gauging their degrees of cooperation; (2) to strengthen the government's ability to investigate and prosecute corporate crime by encouraging companies to pressure their employees to aid the government; and (3) to punish those whom prosecutors deem culpable, *i.e.*, depriving employees of corporate aid by characterizing such aid as "protecting… culpable employees and agents."

Judge Kaplan strongly criticized the government's third justification because it confused the proper role of the prosecutor with that of the court. "The job of prosecutors is to make the government's best case to a jury and to let the jury decide guilt or innocence. Punishment is imposed by judges subject to statute. The imposition of economic punishment by prosecutors, before anyone has been found guilty of anything, is not a legitimate government interest – it is an abuse of power." Accordingly, the government could not equate advancement of defense costs with protecting – or denial of advancement with punishing – the guilty.

As to the first two asserted interests, the court acknowledged that a willingness to cooperate and a company's obstruction of an investigation – what the government called "circling the wagons" – are both appropriate considerations in a charging decision. The problem with the Thompson Memorandum, however, is that it does not provide that advancement of defense costs should cut in favor of indictment *only* if used to obstruct. "If the government means to take the payment of legal fees into account in making charging decisions only where the payments are part of an obstruction scheme – and thereby narrowly tailor its means to its ends – it would be easy enough to say so. But that is not what the Thompson Memorandum says."

Judge Kaplan then went beyond the text of the Thompson Memorandum to state that it is problematic whether payment of legal fees is even relevant in gauging a corporation's cooperation. "There is no necessary inconsistency between an entity cooperating with the government and, at the same time, paying defense costs of individual employees and former employees." He observed that a company may advance defense costs because it believes the practice aids in keeping and hiring competent and honest employees or in recognition that an employee subject to investigation or criminal charges has a legitimate claim to corporate assistance even if lacking a legal right to it. "In either case, however, a company may pay at the same time that it does its best to bare its corporate soul, stands at the government's beck and call to provide information and witnesses, and does a myriad of other things to aid the government and clean the corporate house." In short, a corporation should be able to cooperate with the government's investigation and support its employees' defense at the same time – without inviting indictment under the Thompson Memorandum.

In his analysis of the Sixth Amendment right to counsel, Judge Kaplan echoed these same concerns. In balancing the government's law enforcement interests against the defendants' interests in having the necessary resources to defend themselves, the court found that the Thompson Memorandum often prevents companies from providing employees with the resources they need to exercise their constitutional rights – "even where companies obstruct nothing and, to the contrary, do everything within their power to make a clean breast of the facts to the government and to take responsibility for any offenses they may have committed."

Stein II: Government Pressure To Threaten Employee Termination Is Also Unconstitutional

A month after *Stein I*, Judge Kaplan issued *Stein II*, which addressed whether KPMG employees made proffers to the government specifically because of KPMG's threat to fire the employees if they refused to do so. Judge Kaplan suppressed statements by two of the KPMG defendants because they were coerced by actions that were held to be attributable to the government, in violation of the Fifth Amendment privilege against self-incrimination. The government pressured KPMG to threaten employees with termination "in order to secure waivers of constitutional rights that the government itself could not obtain."

The Real Meaning Of Cooperation

At a point when the attorney-client and work product protections are under attack, and deferred prosecution agreements provide an easy way for prosecutors to put corporations on probation without ever having to prove their case, the *Stein* decisions provide timely reminders that investigation does not amount to conviction and a strong defense by effective counsel is a constitutional right. This observation applies as much to corporations as it does to individuals. A corporation can assist a government investigation by providing witnesses, documents, and information, but should still be able to assert privilege and to engage the government in a candid dialogue as to whether a crime has actually been committed or deserves to be prosecuted – without being deemed uncooperative under the Thompson Memorandum.

In a letter dated September 5, 2006 to Attorney General Alberto Gonzales, a bipartisan group of ten former senior Justice Department officials – three former Attorneys General, three former Deputy Attorneys General, and four former Solicitors General – urged that Department policy be revised to state that waiver of attorney-client and work product protections should not be considered as a factor in determining whether a corporation has cooperated with an investigation. A week later, on September 12, prominent bar and business representatives testified before the Senate Judiciary Committee and called for Congress to exercise its oversight capacity and seek modification of Justice Department policy. So far the Department is sticking to its position that the Thompson Memorandum strikes a fair balance between the needs of law enforcement and the rights of individuals and corporations. The Justice Department should treat the *Stein* decisions and the mounting criticism of the Thompson Memorandum as an opportunity to rethink its approach and to recognize that cooperation needs to be a two-way street.