

White Collar Practice Alert

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*Two Significant Developments Concerning White Collar Criminal Investigations: Second Circuit Affirms Dismissal of Indictment of Former KPMG Employees, and DOJ Revises Charging Guidelines**by Robert R. Stauffer and Andrew Weissmann*

On August 28, 2008, two long-awaited developments occurred that promise to shape the next stage in the debate over how prosecutors interact with defendants and their counsel in white collar criminal investigations.

1. Second Circuit Affirms the Dismissal of Charges Against Former KPMG Employees.

The U.S. Court of Appeals for the Second Circuit affirmed the ruling in *U.S. v. Stein, et al*, 495 F. Supp.2d 390 (S.D.N.Y. 2007), dismissing charges against former KPMG partners and employees because of prosecutorial misconduct. Relevant background is set forth in our prior Client Advisory, [District Court Dismisses Charges Against 13 Former KPMG Employees](#) (July 23, 2007). The case originated from a criminal investigation into the promotion of allegedly illegal tax shelters. DOJ policy reflected in the "Thompson Memorandum" allowed prosecutors to withhold cooperation credit from companies that advanced legal fees to employees or refused to waive privilege.

U.S. District Judge Lewis Kaplan found that as a result of the Thompson Memorandum and pressure from prosecutors, KPMG cut off payment of attorneys' fees for employees who refused to cooperate in the government's investigation. Judge Kaplan found that KPMG's conduct was attributable to the government and thus was state action, and that it therefore violated the defendants' Sixth Amendment right to counsel, among other things.

The Second Circuit agreed. The court rejected government challenges to Judge Kaplan's factual findings, including the key finding that absent the Thompson Memorandum and the conduct of the prosecutors, KPMG would have advanced fees to the employees without any condition or cap. The court then rejected the government's argument that any Sixth Amendment violation had been cured when prosecutors told Judge Kaplan that KPMG was free to exercise "business judgment"; the court agreed with Judge Kaplan that even after this statement by the prosecutors, it was unrealistic

to expect KPMG to reverse course and exercise uncoerced judgment as if it had never been pressured by prosecutors in the first place.

Notably, the court rejected the government's argument that KPMG's conduct was private action, to which the Sixth Amendment did not apply; the court found that the government had forced KPMG to cut off fees and that KPMG's conduct amounted to state action. The court agreed with Judge Kaplan that even though the prosecutors' conduct occurred prior to the indictment, it affected post-indictment legal services and thus triggered the Sixth Amendment's protections, which do not attach until a prosecution is commenced. Finally, the court found that dismissal was the appropriate remedy, as opposed to merely delaying the trial so that well-paid counsel could prepare for trial.

2. DOJ Modifies Guidelines for Investigating and Prosecuting Corporate Crimes

Ironically, also on August 28, Deputy Attorney General Mark R. Filip announced new revisions

to the DOJ's guidelines for investigation and prosecution of corporate crimes, with the principle focus being on requests by prosecutors for waiver of privileges. (See <http://www.usdoj.gov/opa/documents/corp-charging-guidelines.pdf> to view the revisions.)

Under the 2003 Thompson Memorandum, the DOJ made an organization's willingness to waive its attorney-client privilege and work product protection a factor in determining whether the organization should be charged. Responding to criticism over prosecutors' heavy-handedness in seeking or demanding waivers and the resulting chilling effect on attorney-client communications, the 2006 McNulty Memorandum provided specific procedural and substantive guidelines to be followed before waivers could be requested. Criticism continued, however, with complaints that the McNulty Memorandum did not go far enough and that prosecutors did not follow it in practice. Senator Arlen Specter and others pressed for legislation to, among other things, prohibit prosecutors from seeking privilege waivers and prohibit prosecutors from using a privilege waiver as a factor in determining whether a corporation has cooperated with the government.

In the face of these criticisms and continued pressure from Congress, the DOJ's newest guidelines (now

incorporated in the U.S. Attorneys' Manual rather than in a stand-alone memorandum) go further yet. They draw a distinction between privileged communications and underlying facts, with the latter being non-privileged and a proper subject of prosecutorial requests, and the former not: "while a corporation remains free to convey non-factual or 'core' attorney-client communications or work product — if and only if the corporation voluntarily chooses to do so — prosecutors should not ask for such waivers and are directed not to do so."

The new guidelines also provide that "the mere participation by a corporation in a joint defense agreement does not render the corporation ineligible to receive cooperation credit, and prosecutors may not request that a corporation refrain from entering into such agreements."

And on the issue that led to the opinions in the Stein litigation discussed above, while the McNulty Memorandum provided that prosecutors "generally should not take into account whether a corporation is advancing attorneys' fees to employees or agents under investigation and indictment," the new guidelines are phrased in stronger terms: "In evaluating cooperation, however, prosecutors should not take into account whether a corporation is advancing or reimbursing attorneys' fees or providing counsel to

employees, officers, or directors under investigation or indictment. Likewise, prosecutors may not request that a corporation refrain from taking such action." However, the guidelines do not prohibit a prosecutor from asking questions about these topics "where otherwise appropriate under the law."

Finally, the new guidelines attempt to set a new tone with respect to oversight of prosecutors, providing that counsel for corporations who believe prosecutors are violating the guidance on cooperation credit and respect for privileges are encouraged to raise their concerns with supervisors, including the appropriate U.S. Attorney or Assistant Attorney General.

Commentary:

The new guidelines represent a significant step forward in the DOJ's prosecutorial guidance. It is unclear, however, how the new guidelines will play out in practice. Moreover, they do not go as far as the proposed legislation.

First, the guidelines do not address whether prosecutors can weigh in on whether an employee should be fired for invoking the Fifth Amendment privilege against self-incrimination, while the pending legislation would prohibit prosecutors from doing so.

Second, unlike the proposed legislation, the guidelines do not have the binding effect of law

and they apply only to the DOJ (with certain areas, like antitrust, being excluded) and not to other agencies.

Third, under the new guidelines prosecutors may still give cooperation credit to a corporation that voluntarily waives its privileges, without a governmental request. Accordingly, there will still be an incentive for corporations to waive privileges, whereas the pending legislation would prevent consideration of a corporation's privilege waiver in assessing

cooperation, even if done without a request by prosecutors.

Fourth, the underlying facts are often reflected in memos of employee interviews generated by lawyers during the course of an internal investigation. In that instance, the guidelines state that prosecutors may request, and a finding of cooperation may turn on, the production of the factual information acquired through those interviews. This distinction may not always be so simple in practice. It may be difficult, for example,

to disclose the underlying facts without conveying the manner in which the corporation learned of those facts and thus encroaching on the privileged nature of the employee interview. Accordingly, disputes may continue to arise as to whether the prosecutors may insist on specific types of disclosures as a prerequisite to affording credit for cooperation.

Accordingly, the extent to which the new guidelines will appease critics of recent prosecutorial guidance and tactics remains to be seen.

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