

The Thompson Memo Ruling

Recent Decision May Have Little Effect on Other Cases

By Irvin B. Nathan and Michael S. Lewis

Judge Lewis Kaplan's eloquent and eminently correct decision striking down the Justice Department's policy embodied in the "Thompson Memo" that pressures corporations, by threat of indictment, to cut off legal fees to "culpable" employees, was widely publicized and acclaimed. But it may ultimately produce little change in the real world of white-collar criminal defense.

In the specific case — the KPMG tax fraud prosecution, *United States v. Stein*, 435 F. Supp. 2d 330, 362 (S.D.N.Y. 2006) — Judge Kaplan thus far has been unwilling to dismiss the criminal charges because of the government's conduct or order the government to pay the lost fees. Instead, the court attempted to jawbone KPMG into resuming payments. When this failed, the court opened an ancillary civil proceeding that permitted the criminal defendants to sue KPMG for legal fees on the ground that its past practices show an implied agreement to advance legal fees. Every indication is that KPMG will vigorously fight the claim at this month's trial and will appeal if it loses.

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The KPMG decisions surely will prompt corporate policy-makers to rethink charter and bylaw provisions and their past practices relating to reimbursement of legal fees to indicted or targeted officers, directors or employees. Companies will be watching to see how Judge Kaplan's rulings fare in the Court of Appeals and whether other courts follow his lead. When asked to advance fees, companies will weigh the risk of being sued if they refuse. But they are likely to conclude that the policy expressed in the Thompson Memo reflects the mindset of current-day federal prosecutors, and that the risk of a lawsuit for fees is far outweighed by the risk of alienating prosecutors by funding the legal defense of their quarry, especially since few plaintiffs are likely to have such strong evidence of government coercion as was presented to Judge Kaplan.

THE KPMG DECISIONS

By pre-trial motions, the criminal defendants, former KPMG partners, challenged the prosecutors' implementation of the Thompson Memo provision directing prosecutors to consider, in determining whether to indict a corporation, if it is advancing legal fees to employees or agents that the government considers "culpable." The Memo suggests that advancing fees may be a factor leading to the indictment of the corporation because it means the company is not fully cooperating. (The Memo does take into account state laws that may require the advancement of legal fees and notes that compliance

with such state law will not be a basis for finding a lack of cooperation.)

The evidentiary record demonstrated that the U.S. Attorney's Office had carried out these provisions in a ham-handed manner, making clear by repeated comments from the very first meeting with KPMG's counsel that the firm was likely to face indictment if it did not cut off or cap legal fees to the indicted partners. Indictment of a firm — as the Arthur Andersen experience demonstrated — is likely to be its death knell. It is hardly surprising that a few well-timed references by prosecutors to the Thompson Memo can achieve the desired effect.

Before Judge Kaplan issued a decision, the Supreme Court, in *United States v. Gonzalez-Lopez*, — U.S. — , 126 S. Ct. 2557, 2563 (2006), reaffirmed that the Sixth Amendment guarantees criminal defendants the right to be represented by a qualified attorney whom they can afford to hire. "Deprivation of the right is 'complete' when the defendant is erroneously prevented from being represented by the lawyer he wants," the Court ruled.

Citing the principles underlying the Supreme Court's decision, Judge Kaplan held that the Thompson Memo's fee advancement provisions (and the government's use of them) violated the defendants' Sixth Amendment right to counsel and their Fifth Amendment substantive-due-process right to "to obtain and use in order to prepare a defense resources lawfully available to [the defendants], free of knowing and reckless government interference." Stein

at 362. Judge Kaplan's decision stopped short of granting the most far-reaching remedy sought by defendants, dismissal of the case. He also denied, on sovereign immunity grounds, the defendants' claim for damages against the government. Instead, he granted declaratory relief and opened a civil docket so that the defendants could press their claim for fees against KPMG.

KPMG has refused to advance fees voluntarily. In a recent opinion in the ancillary proceeding, the court signaled that at the expedited trial this month, the criminal defendants are likely to prevail on the claim that KPMG has an implied contractual obligation to advance legal fees to its former partners. The court rejected claims that it lacked subject matter jurisdiction and that the matter should be arbitrated, finding that arbitration would take too long and, under the circumstances, would be contrary to public policy. If the only evidence of KPMG's past practices is what Judge Kaplan summarized in his opinions, it is unlikely that most courts would be as persuaded by the implied-contract argument as Judge Kaplan appears to be.

THE AFTERMATH OF THE KPMG DECISIONS

Judge Kaplan's decisions invalidating portions of the Thompson Memo have been justifiably praised for providing a much-needed check on increasingly aggressive attempts by the government to undermine the adversary process in the context of white-collar prosecutions. See, eg, Thompson Memo, R.I.P.? *The Wall Street Journal*, June 28, 2006, at A14. Indeed, his decision has already been favorably cited by another court in the context of a company's suit to secure the right to advance fees to its employees, *United States v. Payment Processing Center, LLC*, 2006 U.S. Dist. LEXIS 51477, *11 (E.D.Pa. July 26, 2006). Further, the decision appears to have provided the framework for a joint resolution recently passed by the American Bar Association House of Delegates and the New York State Bar Association seeking to prohibit the government from holding the advancement of fees against companies under investigation.

In mid-September, the president of the ABA, Karen J. Mathis, testified before the Senate Judiciary Committee urging the repeal of a number of provisions of the Thompson Memo. Citing Judge Kaplan's opinions, Mathis said the Memo's provision against the advancement of legal fees to "culpable" agents "stands the presumption of innocence on its head" and "overturns well-established corporate governance practices." Senate Judiciary Chairman Arlen Specter (R-PA), Vice Chairman Patrick Leahy (D-VT) and even former Attorney General Edwin Meese appeared to agree, and called for a change in the policy. Unfortunately, despite these salutary developments, there is reason to suspect that the rulings will not significantly affect white-collar criminal practice, as some initially expected. This is because no change is likely at DOJ, and corporations, with an instinct for self-preservation, may well recognize that advancing legal fees to indicted individuals is only likely to antagonize prosecutors who have discretion to indict the company. Like Judge Kaplan, most judges likely will be reluctant to dismiss the charges against the individuals whose fees have been cut off and will be unwilling or unable, because of sovereign immunity, to require the government to reimburse the defendants for the loss of legal fees. Further, KPMG's decision to fight the defendants' lawsuit is probably due in part to fear that the government will not look favorably upon a resumption of its payment of fees. Other companies are likely to have similar concerns.

In light of Judge Kaplan's decisions and pending the likely appeals, companies will have to grapple with the complexities of a new environment in which more subtle signals from the government about fees could become increasingly difficult to interpret and control. At least two basic options are available. First, companies may want to adopt policies that explicitly provide maximum flexibility in determining whether to advance defense fees. However, this option may not be

attractive to corporate executives and directors. As it gets harder to recruit and retain top-quality officers and directors, many may insist on indemnification provisions that entitle them to advancement of legal fees in criminal and civil actions. A second option is to make advancement of fees virtually mandatory. A company could then tell a future prosecutor that it had no choice but to pay. Of course, this will also leave the company liable for breach of express contract to an indicted agent if the company later decides, under the circumstances, to decline to advance fees. Corporations will have to balance satisfying their agents' needs against the future, currently unforeseeable demands of prosecutors.

CONCLUSION

The well-reasoned decisions in the KPMG case demonstrate that the policy of the Department of Justice against corporate funding of the defense of presumptively innocent agents undermines the adversary process that the Fifth and Sixth Amendments are designed to protect. However, it is extremely unlikely that the government will soon abandon that policy, or that prosecutors will not follow it. Unfortunately, corporations are likely to be more influenced by the hope of avoiding a corporate indictment than by eloquent court opinions about the impropriety and unconstitutionality of government pressure against company advancement of legal fees.



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