The Defense Strikes Back: 
United States v. Stein—A
Significant First Step in
Recouping the Rights and
Privileges of Targeted
Employees [¶4.1]

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Can the federal government require that companies withhold payment of
legal fees to indicted employees as a sign of cooperation? At least one federal court

The fraudulent accounting debacles and accompanying collapses of major cor-
porations such as Enron, Tyco International, and other companies shortly after the turn of the millennium rightly put
the government on notice that stepped up oversight and prosecution of corporate
accounting practices were required to restore investor confidence and faith.

However, what began as simple prosecutorial strategy—for example, informally encouraging corporations to waive the
attorney-privilege to gain access to its internal investigations in exchange for
leniency—has morphed into an aggressive policy (as expressed in the Thompson Memorandum) over the last several years
that undercuts the privilege and right of individuals to be represented by counsel paid for by their employer.

The Holder Memorandum
The roots of the Thompson Memorandum lie within another
Department of Justice Memorandum entitled Federal Prosecution of Corporations
(more commonly known as the “Holder Memorandum”), authored by then-United States Deputy Attorney General Eric
Holder. The Holder Memorandum (the text of which can be found at
http://www.usdoj.gov/criminal/fraud/policy/Chargingcorps.html) sets forth factors
prosecutors are to consider in determining whether to charge a corporation with a
criminal offense. These factors include:
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 the corporate attorney-client and work product protection” as well as “whether the corporation appears to be protecting its culpable employees and agents” by “the advancing of attorneys fees, through retaining the employees without sanction for their misconduct, or through providing information to the employees about the government’s investigation pursuant to a joint defense agreement.” The Holder Memorandum concludes that all of these factors “may be considered by a prosecutor in weighing the extent and value of a corporation’s cooperation.”

Thus, as far back as 1999, the groundwork had been laid to pressure corporations merely under investigation to waive the attorney-client privilege and lean on employees to cooperate by threatening to withhold attorneys’ fees or terminate their employment. Although the Holder Memorandum is tempered to a certain extent by providing that the listed factors are not “outcome-determinative,” the stage had been set for an even more aggressive approach following the accounting disasters that occurred after 2000.

The Thompson Memorandum

The more aggressive approach came in the form of the Thompson Memorandum, written in 2003 by Larry D. Thompson, the United States Department of Justice Deputy Attorney General. The Thompson Memorandum (officially titled Principles of Federal Prosecution of Business Organizations and available at http://www.usdoj.gov/dag/cftf/corporate_guidelines.htm) was the result of a Corporate Fraud Task Force established by Executive Order. The Thompson Memorandum did not significantly alter the relevant factors identified by the Holder Memorandum. Rather, the major change instituted by the Thompson Memorandum is that, unlike the Holder Memorandum, it was binding on federal prosecutors. Consequently, under the Thompson Memorandum, in analyzing whether an indictment against a corporate entity is appropriate, a U.S. Attorney was required to weigh in favor of indictment if she or he suspected that a corporation was paying a culpable employee’s attorneys fees, or if the corporation did not terminate that employee. Essentially, strict adherence to the Thompson Memorandum left a corporation with no choice in these matters. The import of these decisions is not in question. The stakes of a formal indictment (much less a conviction) are simply too high for most corporations to risk. With the virtual destruction of Arthur Anderson LLP upon indictment—few remember the company was eventually acquitted—the practical effect of the Thompson Memorandum was to effectively curtail the funding of attorneys fees for potentially culpable employees, to say nothing of making waiver of a corporation’s attorney-client privilege a nearly foregone conclusion.

The Pendulum Begins to Swing Back?: United States v. Stein

A recent decision handed down by the federal District Court in the Southern District of New York may provide a glimpse at how courts will, in the future, view and potentially disallow aggressive prosecutorial tactics. The Stein opinion
announces its intentions by immediately setting forth a summary of the constitutional principles involved in the decision: first, the right to a fundamentally fair trial; second, the right to the assistance of a lawyer; and third (although not a constitutional right, one recognized by the Stein Court as an important consideration), the common practice of an employer paying for the legal expenses of an employee sued or accused of a crime emanating from his or her work. It is from the intersection of these principles that the main holding of Stein is drawn.

Factually, Stein addresses issues related to an IRS investigation of KPMG relating to allegedly abusive tax shelters developed, marketed, and implemented by KPMG. In keeping with a long-standing policy, KPMG agreed to pay for legal representation for certain officials who were facing potential criminal allegations. In one of its first meetings with the prosecutors, it was made clear to KPMG that any payment of legal fees to employees would not be looked on favorably by the government in determining whether KPMG would be indicted. As a direct result of this meeting and follow-up communications with prosecutors, KPMG announced that it would pay legal fees for employees; however, employees had to agree to fully cooperate with the government, which included foregoing any exercise of the employees’ Fifth Amendment right to remain silent. Further, prosecutors insisted that KPMG stress to its employees that legal representation was not required to talk to federal investigators. Finally, KPMG made it clear that payment of legal fees would cease if the employee were criminally charged by the government.

This arrangement between KPMG and the prosecutors resulted in numerous employees being denied legal fees for alleged failure to cooperate with the government. KPMG also terminated the employment of some employees who failed to adequately cooperate with the government. The issue ripened for decision in Stein when certain individually charged employees objected to the actions of the government.

The Stein Court concluded that the principles set forth in the Thompson Memorandum, coupled with meetings between KPMG and federal prosecutors, allowed the conclusion that the government had “conducted itself in a manner that evidenced a desire to minimize the involvement of defense attorneys,” resulting in KPMG’s revised policy regarding the payment of legal fees for employees. This led to the holding that the government, through the Thompson Memorandum and actions of the prosecutors, had violated the Fifth and Sixth Amendment rights of individual defendants by causing KPMG to cut off payment of legal fees and defense costs. The Court neatly summarized the rights of criminal defendants: “In everyday language, they are entitled to a fair shake.” More specifically, the Stein opinion held that the “Constitutional requirement of fairness in criminal proceedings not only prevents the prosecution from interfering actively with the defense, but also from passively hampering the defendant’s efforts.” Finally, the Court concluded: “[T]he only question now before the Court is whether a criminal defendant has a 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... this Court concludes that such a right is basic to our concepts of justice and fair play. It is fundamental.”

Implications of the Stein Decision

The direct result of the Stein decision is, at a minimum, to make enforcement of the Thompson Memorandum provision regarding employee legal fees unconstitutional in the Southern District of New York. Unfortunately, the most important questions to corporations under investigation today cannot yet be answered definitively. From a judicial viewpoint, it may take some time for other federal trial and circuit courts to address the issues raised by Stein. Boding well for corporations, however, is the fact that Stein is a well-reasoned and well-articulated opinion that strikes a fair balance between prosecutorial discretion and the protection of constitutional rights. Moreover, it is likely that with the Stein opinion as ammunition, more corporations will fight aggressive prosecutorial methods in an attempt to protect their rights.

To those corporations currently under investigation, news of future changes may come as little solace. If nothing else, however, the Stein decision should provide corporations with, at a minimum, a modicum of leverage when dealing with the government.

In January 2007, the Department of Justice released a memorandum intended to supersede Thompson. The “McNulty Memorandum” (Principles of Federal Prosecution of Business Organizations, authored by Paul J. McNulty, available at http://www.usdoj.gov/dag/speech/2006/mcnulty_memo.pdf). Although the ramifications may not be fully known for some time, on the face of it, it seeks to soften some of the stricter provisions of the Thompson Memorandum. Specifically, the McNulty Memorandum addresses two issues: advancing fees for attorneys to employees and the “sacrosanct” attorney-client privilege.

As to the issue of advancing attorney fees, McNulty echoes the holding of the Stein decision and notes that many state statutes give corporations permission to grant legal fees to employees in advance of a determination of guilt. A prosecutor should therefore not consider such an action as a failure to cooperate.

Regarding the attorney-client privilege, the Memorandum clearly states that waiver of the privilege is “not a prerequisite to a finding that a company has cooperated in the government’s investigation.” However, if prosecutors determine there is a “legitimate need” for the information, they may still seek a waiver. A four factor test is set forth to determine whether such a need exists. If so, prosecutors may employ the “least intrusive” waiver necessary to conduct the investigation.

Immediate reaction to the McNulty Memorandum has been mixed. Although many have applauded the Justice Department’s apparent decision to adopt the Stein holding in regard to the payment of attorneys’ fees to employees, some fear that the Memorandum will do little to stem the pressure tactics used by prosecutors.

Finally, a bill has been introduced in Congress titled the “Attorney-Client Privilege Protection Act of 2006.” The text of the bill provides that the purpose of the proposed Act is “to place on each agency clear and practical limits designed to preserve the attorney-client privilege
and work product protections available to
an organization and preserve the constitu-
tional rights and other legal protections
available to employees of such an organi-
zation.” The Act would forbid federal
agencies from conditioning civil or crimi-
nal charges on a valid exercise of the
attorney-client privilege by an organiza-
tion, by the provision of counsel to an
organization’s employees, by the failure
to terminate an employee or by the entry
of a joint defense agreement. In short, the
proposed Act would gut the Thompson
Memorandum and level the playing field
for corporations.

Although corporations certainly can-
not claim to be out of the woods when
faced with an aggressive federal prosecu-
tor, signs exist that a sense of proportion
and reasonability may soon reshape the
investigative landscape.