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Show Me the Money: The Thompson Memo, Stein, and an Employee's Right to the Advancement of Legal Fees Under the McNulty Memo

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Show Me the Money: The Thompson Memo, *Stein*, and an Employee's Right to the Advancement of Legal Fees Under the McNulty Memo

John Power*

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I. Introduction

Imagine, for a moment, that you are an employee at a company under investigation for corporate malfeasance. Perhaps the wrongdoing involves establishing illegal tax shelters, the reason the U.S. Attorney's Office (USAO) investigated KPMG beginning in 2002.¹ Maybe you had a role in creating these tax shelters and could be held criminally or civilly liable. Or maybe you are innocent of any wrongdoing but were involved to such an extent that you can easily foresee interviews with the USAO, grand jury testimony, indictment, discovery, and a full trial before your name is cleared. Either way, you can tell that the process will likely drag on for months or years and cost tens or hundreds of thousands of dollars in legal fees.

The only bright spot might be that your company has a policy of advancing to its employees the necessary legal fees to fight such charges. Until recently, this bright spot would quickly black out if you learned that the USAO planned on following guidelines in the Justice Department's "Principles of Federal Prosecution of Business Organizations."² Known as the Thompson Memo, these guidelines stated, among other things, that when deciding whether or not to indict a business, prosecutors should view its advancement of legal fees to employees under investigation as a factor that weighs in favor of indicting that business.³

Wishing to avoid indictment, your company informs you that, contrary to your expectations, they will only pay your legal fees if you agree to meet with the USAO and cooperate fully. You must waive your right to remain silent and put the prosecution to its proof, and instead you must be entirely forthcoming in

1. See *United States v. Stein*, 435 F. Supp. 2d 330, 338 (S.D.N.Y. 2006) [hereinafter *Stein III*] (discussing the USAO's investigation of KPMG's illegal tax shelters). This case has been called "the largest tax fraud case in United States history." *Id.* at 362. Prosecutors maintain that the illegal tax shelters at issue deprived the Treasury Department of \$2.5 billion in tax revenue. See Lynnley Browning, *Prosecutors in KPMG Tax Shelter Case Offer to Try 2 Groups of Defendants Separately*, N.Y. TIMES, Oct. 5, 2006, at C11 (discussing the enormity of the tax shelters at issue).

2. See generally Memorandum from Larry D. Thompson, Deputy Attorney Gen., Principles of Federal Prosecution of Business Organizations (Jan. 20, 2003), available at http://www.usdoj.gov/dag/cftf/business_organizations.pdf [hereinafter Thompson Memo] (establishing federal guidelines for corporate prosecutions) (on file with the Washington and Lee Law Review).

3. See *id.* at 7-8 (indicating that the advancement of legal fees should be considered by federal prosecutors).

all answers. You remain, of course, free to stand on your rights, but you will have to pay your own way.

This is the situation a number of KPMG employees found themselves in beginning in 2004 when, in the interest of saving itself from the impending ruin of criminal indictment,⁴ KPMG informed its employees that the company would pay up to \$400,000 of their legal fees, but only if the employees cooperated fully with the government and were not themselves charged with criminal indictment.⁵ Faced with legal fees beyond their means, a number of KPMG employees relented and gave statements to the USAO.⁶ While this strategy enabled KPMG to avoid indictment and saved the firm as a whole,⁷ it left indicted employees without the resources necessary to fight their prosecution.

In a series of opinions, known as the *Stein* opinions, issued during the summer and fall of 2006, the District Court for the Southern District of New York rejected as illegitimate the pressure the government, through KPMG, placed on these employees.⁸ These opinions raised numerous questions about the validity of the Thompson Memo and sparked significant backlash.⁹ In December 2006, the Justice Department replaced the Thompson Memo with the McNulty Memo.¹⁰ While the McNulty Memo states that advancement of

4. See *Stein III*, 435 F. Supp. 2d at 337 (discussing how an indictment resulted in the collapse of Arthur Anderson LLP well before the case was even tried); see also *id.* at 345 n.54 (indicating that KPMG's decision not to advance legal fees was "blatantly self-interested" as an effort to demonstrate compliance with the Thompson Memo and avoid indictment).

5. See *id.* at 345–46 (discussing KPMG's condition that their employees be "prompt, complete, and truthful" in their cooperation with the government).

6. See *id.* at 347 (noting that some employees caved under the pressure of having to pay their own legal fees and submitted to interviews with the government).

7. See *id.* at 349 (discussing KPMG's eventual Deferred Prosecution Agreement, which obliges KPMG to, among other things, pay a \$456 million fine, admit extensive wrongdoing, and accept restrictions on its practice in exchange for a dismissal of the charges).

8. See *id.* at 331 (discussing governmental pressure); *United States v. Stein*, 452 F. Supp. 2d 230, 237 (S.D.N.Y. 2006) [hereinafter *Stein IV*] (same). For a more detailed description of governmental pressure, see *infra* Part III.C.

9. See Lynnley Browning, *Justice Department is Reviewing Corporate Prosecution Guidelines*, N.Y. TIMES, Sept. 13, 2006, at C3 (noting comments by Senators Arlen Specter and Patrick Leahy calling for modifications to the Thompson Memo).

10. See Press Release, Dep't of Justice, U.S. Deputy Attorney General Paul J. McNulty Revises Charging Guidelines for Prosecuting Corporate Fraud: New Guidance Further Encourages Corporate Compliance I (Dec. 12, 2006), available at www.usdoj.gov/opa/pr/2006/December/06_odag_828.html (last visited Jan. 30, 2007) (discussing the revisions to the Thompson Memo) (on file with the Washington and Lee Law Review). The new version of the memorandum, named for its author U.S. Deputy Attorney General Paul J. McNulty, is available at http://www.usdoj.gov/dag/speech/2006/mcnulty_memo.pdf (last visited Jan. 30, 2007) (on file with the Washington and Lee Law Review).

legal fees should generally not be taken into account when considering whether to indict a business, critics argue that the changes in the McNulty Memo are mostly cosmetic.¹¹ Thus, despite the fact that the Department of Justice issued new guidelines for business prosecution, many of the questions raised by the *Stein* opinions remain, particularly those concerning the advancement of legal fees to employees under investigation.

This Note examines an employee's right to advancement and argues that, after *Stein*, companies need to explicitly include or exclude advancement agreements in their employment contracts, and companies should be concerned about creating implied contracts by advancing legal fees to some employees on an ad hoc basis. Part II provides an overview of employee indemnification and advancement. This Part also includes some current arguments in favor of reining in indemnification agreements based on the belief that holding executives unaccountable creates a moral hazard and has various hidden transaction costs thereby undermining one of the essential underpinnings of corporate criminal liability in the first place: Its ability to encourage internal oversight. Part III discusses the recent *Stein* opinions, looking closely at the facts and examining how the court arrived at its conclusion concerning the KPMG defendants' right to advancement. Part IV explores the consequences of *Stein*, which led directly to the McNulty Memo, and examines whether the McNulty Memo actually has changed the rules of the game. This Part then turns to the crucial question for employees and employers: What is the current state of advancement under the McNulty Memo? This Part argues that both employers and employees need to be aware of the full costs and benefits of advancement and that employment contracts should be explicit on the subject.

II. Advancement and Indemnification in Corporate America

Indemnifying corporate officers for expenses incurred while defending criminal suits related to their employment is a relatively recent notion.¹² Although indemnification is common in today's business world,¹³ debates continue about whether it actually benefits businesses or society at large. While indemnification allows businesses to attract employees who might otherwise be scared away by liability issues,¹⁴ critics argue that it also creates a moral hazard whereby executives stand to reap the full benefits of playing over the line while

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11. See *infra* Part IV (discussing the similarities of the Thompson and McNulty Memos).
 12. See *infra* Part II.A (discussing the origins of indemnification).
 13. See *id.* (discussing the current state of indemnification).
 14. See *id.* (discussing the arguments in favor of indemnification).

remaining insulated from criminal penalties for reckless or intentionally wrongful actions.¹⁵

A. Arguments for Indemnification and Advancement

Corporate indemnification of officers does not have a lengthy history. In 1939, the court in *New York Dock Co. v. McCollom*¹⁶ investigated the foundations of indemnification before concluding that it could exist under limited circumstances.¹⁷ The court began by explicitly rejecting the notion that a corporation had a "legal obligation in the strict technical sense" to reimburse its directors' legal expenses under agency principles.¹⁸ Next, the court agreed with the proposition that "[l]iability . . . to suits is considered a risk attendant on directorships, to be assumed, together with the more compensatory features of that office."¹⁹

The court did, however, conclude that an obligation to pay directors' legal expenses could be found under the equitable principle that a party to litigation "is ordinarily entitled to have his lawyers compensated and similar expenses paid from the fund or property" when that party "creates, increases, or protects

15. See *infra* Part II.B (discussing the arguments against indemnification).

16. *N.Y. Dock Co. v. McCollom*, 16 N.Y.S.2d 844 (App. Div. 1939). In *New York Dock*, the plaintiff, New York Dock Company, Inc., sought a declaratory judgment that it was not liable for any part of \$86,755.14 in legal costs expended by its directors, defendants here, in defending a prior stockholder's action. *Id.* at 845–46. After characterizing the defendants' arguments as relying on "dubious authority," the court concluded that there was "no legal obligation in the strict technical sense" on New York Dock Company's part to indemnify its directors. *Id.* at 847. Indeed, the court found that, in general, "[l]iability to suits . . . is considered a risk attendant on directorships, to be assumed, together with the more compensatory features of that office." *Id.* at 848 (citations omitted). That said, the court found that a director's expenses could be reimbursed when the director's successful defense served in some way to benefit the corporation itself. *Id.* at 849. The court refused to decide whether such a showing had been made and instead called for further briefing on the matter. *Id.* at 849–51.

17. See *id.* at 849 (discussing the reasons for indemnification). The court concluded:

[When] a director can clearly and persuasively demonstrate to the court upon an application for reimbursement or when called upon to refund corporate money already received by way of reimbursement, that in conducting his own defense successfully he has conserved some substantial interests of the corporation which otherwise might not have been conserved, or has brought some definite benefit to the corporation which otherwise might have been missed, the court may direct or confirm reimbursement, as the case may be.

Id.

18. *Id.* at 847.

19. *Id.* at 848 (citations omitted).

a fund or property for the benefit of a class."²⁰ While this reasoning allowed for indemnification, it did so on the narrowest of grounds:

[In cases where] a director can clearly and persuasively demonstrate to the court upon an application for reimbursement or when called upon to refund corporate money already received by way of reimbursement, that in conducting his own defense successfully he has conserved some substantial interests of the corporation which otherwise might not have been conserved, or has brought some definite benefit to the corporation which otherwise might have been missed.²¹

Although indemnification began as a limited shield, compelling arguments called for its expansion. As one court explained, indemnification exists to "promote the desirable end that corporate officials will resist what they consider" unjustified suits and claims, "secure in the knowledge that their reasonable expenses will be borne by the corporation they have served if they are vindicated."²² Beyond that, its larger purpose is "to encourage capable men to serve as corporate directors, secure in the knowledge that expenses incurred by them in upholding their honesty and integrity as directors will be borne by the corporation they serve."²³ Thus, the major concern addressed by indemnification is that, without some sort of shield, competent individuals will not seek positions of leadership within companies and businesses will be unable to attract desirable personnel. Specifically, indemnification "encourages corporate service by capable individuals by protecting their personal financial resources from depletion [because of] . . . litigation that results by reason of that service."²⁴

In addition to attracting competent individuals to the business arena, indemnification serves to promote robust decisionmaking once those individuals are in office. Executives fearful of lawsuits would fail to take advantage of every opportunity, and this "undue risk aversion on the part of corporate managers" would create its own "set of dangers to shareholders."²⁵ For this reason, the Delaware Supreme Court has noted that "indemnification and advancement . . . are viewed less as an individual benefit arising from a

20. *Id.* at 846.

21. *N.Y. Dock*, 16 N.Y.S.2d at 894.

22. *Stifel Fin. Corp. v. Cochran*, 809 A.2d 555, 561 (Del. 2002) (citations omitted).

23. *Id.*

24. *Stein III*, 435 F. Supp. 2d 330, 354 (S.D.N.Y. 2006) (quoting *Homestore, Inc. v. Tafeen*, 888 A.2d 204, 211 (Del. 2005)).

25. Peter Margulies, *Legal Hazard: Corporate Crime, Advancement of Executives' Defense Costs, and the Federal Courts*, 7 U.C. DAVIS BUS. L.J. 55, 75 n.77 (2006).

person's employment and more as a desirable mechanism to manage risk in return for greater corporate benefits."²⁶ The court further explained:

Delaware's corporation code authorizes liberal indemnification provisions for officers and directors of its corporations for sound policy reasons that benefit all of a corporation's constituencies. Indemnification provisions authorized by statute and incorporated into bylaws by shareholder action demonstrate the desire to broaden the flexibility of decision making by eliminating the chilling effect of potential personal liability on the part of officers and directors. Shareholder democracies want directors and officers to engage in broadly based decision making in order to enhance shareholder value by encouraging prudent risk taking to their and the other corporate constituencies' advantage. Indemnification for officers and directors should be seen less as an individual benefit arising from personal employment than as a desirable underwriting of risk by the corporation in anticipation of greater corporate-wide rewards. Analyzing director and officer indemnification provisions as if they were salary, company cars or other personal corporate perquisites simply makes no sense. More simply put, director and officer indemnification benefits the corporation more than the director or the officer covered.²⁷

State legislatures responded to these arguments, and today all states have statutes addressing indemnification.²⁸ Some states require indemnification while others merely permit it,²⁹ with most statutes recognizing indemnification as a protection that can be contracted for.³⁰ Because lawsuits can lead to substantial out-of-pocket expenses before an individual is entitled to repayment by the company under indemnification provisions, many states authorize businesses to advance legal expenses to their personnel.³¹

Therefore, while indemnification provisions guarantee employees eventual repayment for defending suits, advancement provisions allow a company to reimburse employees on a running basis so that the employees do not have to shoulder potentially immense legal fees on their own for lengthy periods before

26. *Kaung v. Cole Nat'l Corp.*, 884 A.2d 500, 509 (Del. 2005) (citations omitted).

27. *Scharf v. Edgcomb Corp.*, No. 15224, 1997 WL 762656, at *4 (Del. Ch. Dec. 2, 1997).

28. *See Stein III*, 435 F. Supp. 2d at 354 (discussing the legislative role in enacting indemnification statutes); *see also* Pamela H. Bucy, *Indemnification of Corporate Executives Who Have Been Convicted of Crimes: An Assessment and Proposal*, 24 IND. L. REV. 279, 282 n.11 (1990) (citing the indemnification statutes of each state as of 1990).

29. *See Stein III*, 435 F. Supp. 2d at 354-55 (discussing various state statutes regarding indemnification).

30. *See id.* (noting that most states allow for indemnification through contractual negotiation).

31. *See id.* at 355 (indicating that many states allow for indemnification provisions).

enjoying repayment. One court recently emphasized the importance of advancement:

Advancement [of legal fees] is an especially important corollary to indemnification as an inducement for attracting capable individuals into corporate service. Advancement provides corporate officials with immediate interim relief from the personal out-of-pocket financial burden of paying the significant on-going expenses inevitably involved with investigations and legal proceedings.³²

Advancement and indemnification provisions are common in today's business world.³³ Indeed, they are so common that they exist not only as agreements between companies and agents, but can also be insured against.³⁴ Commonly referred to as Director & Officer (D&O) insurance, these policies first arose in the 1950s and 1960s.³⁵ Today, well over 90% of American public companies purchase some kind of D&O insurance.³⁶ These provisions are not, however, without controversy.³⁷ Furthermore, as was the case in *Stein*, issues of indemnification and advancement become complicated when a partnership like KPMG has no express agreement to advance legal fees to its employees³⁸ but does have a thirty-year track record of doing so.³⁹

B. Arguments Against Indemnification and Advancement

Indemnification and advancement, widely recognized as providing numerous benefits, are not without critics. In many respects, this is a case of "second verse, same as the first," as the arguments against indemnification are many of the same that were first used to impose corporate liability:

32. *Homestore, Inc. v. Tafeen*, 888 A.2d 204, 211 (Del. 2005).

33. *See Happ v. Corning, Inc.*, 466 F.3d 41, 42 (1st Cir. 2006) (calling indemnification provisions "common in modern corporations").

34. *See, e.g., Fed. Ins. Co. v. Tyco Int'l Ltd.*, 792 N.Y.S.2d 397, 398 (App. Div. 2005) (describing a suit by an insurance company contesting its liability to indemnify Dennis Kozlowski and other Tyco officers who had "Executive Protection Policies" that included "Fiduciary Liability" and "Executive Liability and Indemnification").

35. *See* Sean J. Griffith, *Uncovering a Gatekeeper: Why the SEC Should Mandate Disclosure of Details Concerning Directors' and Officers' Liability Insurance Policies*, 154 U. PA. L. REV. 1147, 1162 (2006) (discussing the origins of Director & Officer insurance).

36. *See id.* at 1168 (discussing the prevalence of D&O insurance).

37. *See infra* Part II.B (discussing arguments opposed to indemnification).

38. *See Stein III*, 435 F. Supp. 2d 330, 340 (S.D.N.Y. 2006) (noting that KPMG's partnership agreement and by-laws are silent on the issue of indemnification and advancement).

39. *See id.* (indicating that, at least since 1974, KPMG has advanced legal fees for all employees in civil, criminal, and regulatory proceedings).

Indemnification creates a moral hazard whereby officers, in the absence of accountability, are tempted to partake in illegal conduct beneficial to their company and themselves, but injurious to the general public.⁴⁰ Additionally, some see indemnification and advancement provisions as a form of compensation with no link to performance and as part of the pervasive modern corporate culture of hyper-compensation.⁴¹ To fully appreciate the arguments opposed to indemnification and advancement, however, it is important to understand the development of corporate liability from a time when only individuals could be found criminally liable to the state of affairs today, where either misbehaving individuals or the corporation as a whole, or both, can be held criminally liable.

While it is now well settled that corporations can be held criminally liable for the actions of its personnel,⁴² this was not always so.⁴³ Early English cases held that, while culpable employees could be charged with crimes, companies themselves could not be charged because they were not recognized as natural persons but rather as artificial entities.⁴⁴ "As an abstraction, [companies] lacked physical, mental, and moral capacity to engage in wrongful conduct, or to suffer punishment. It could neither commit criminal acts, entertain criminal intent, nor suffer imprisonment. It had no soul, and so could not be blamed."⁴⁵

American courts followed British precedent and had difficulty imputing criminal intent upon an abstraction,⁴⁶ thus justifying the rule that only a business's misbehaving employees could be criminally liable.⁴⁷ This longstanding position was supported not only by the existing understanding of corporate personality, but also by arguments recognizable to modern eyes:

40. See generally Margulies, *supra* note 25 (discussing the basic arguments for and against indemnification).

41. See *id.* at 59 (arguing that indemnification is a form of compensation with no link to performance, or even that the value of indemnification provisions bear an inverse relationship to performance because their value only kicks in when an executive needs representation for possibly wrongful actions).

42. See, e.g., *N.Y. Cent. R.R. v. United States*, 212 U.S. 481, 492–93 (1909) (stating, among other things, that a corporation can be held criminally liable for the actions of its agents).

43. See generally Kathleen F. Brickey, *Corporate Criminal Accountability: A Brief History and an Observation*, 60 WASH. U. L.Q. 393 (1982) (discussing the history of corporate criminal liability).

44. See *id.* at 396 (indicating that corporations could not be indicted because they were not thought of as real persons).

45. *Id.*

46. See *id.* at 405–15 (discussing the evolution of American courts' holdings from not finding corporations liable, like the British, to slowly finding them liable in specific situations).

47. See *id.* at 396 (citing a British case from 1701 that stated, "A corporation is not indictable but the particular members of it are").

The corporation as a whole should not bear responsibility for the actions of a few bad apples, and the innocent shareholders should not suffer the consequences for actions they neither authorized nor could have prevented.⁴⁸

Regarding the "innocent shareholder" argument, proponents of corporate liability argued that employee misbehavior is one of the risks shareholders accept when they invest in a particular company.⁴⁹ Furthermore, because shareholders stand to gain when illegal activity increases profits, it is only fair that they suffer when the illegal activity is discovered.⁵⁰ As to the "few bad apples argument," the counter-argument was that liability encourages the entire corporation to set up internal checks and reviews, thereby preventing the bad apples from engaging in criminal activity in the first place.⁵¹ While individual liability, by itself, encourages top executives to close their eyes to wrongdoing in order to avoid personal liability, the potential of corporate liability encourages just the opposite because the failure to have proper preventative mechanisms in place will lead to liability for the entire corporation.⁵²

The problem with indemnification and advancement, as their detractors see it, is that these policies serve to undo much of the work done by corporate criminal liability. While corporate liability encourages responsible management, indemnification and advancement promote lax controls and a disregard for legitimate risk.⁵³ These policies, they argue, create a moral hazard whereby employees insulated from the negative consequences of their actions are encouraged to behave irresponsibly.⁵⁴ Without indemnification, the potentially great rewards of criminal activity are countered by the consequences of being caught. When getting caught no longer carries a punishment, however, people have "fewer incentives to conform their behavior" to acceptable practices⁵⁵ and

48. See FRANCIS T. CULLEN, WILLIAM J. MAAKESTAD & GARY CAVENDER, *CORPORATE CRIME UNDER ATTACK: THE FORD PINTO CASE AND BEYOND* 351-53 (1987) (discussing the arguments in favor of finding individual executives liable rather than the corporation itself).

49. See *id.* at 352 (noting the reasons why shareholder suffering should not be seen as a reason to limit corporate liability).

50. See *id.* (discussing the rationale for shareholder losses).

51. See *id.* (discussing the argument that the potential of corporate liability as a whole will encourage the corporation as a whole to set up systems to prevent illegal activity).

52. See *id.* ("[T]he existence of corporate criminal liability also provides an incentive for top officers to supervise middle- and lower-level management more closely. Individual liability, in the absence of corporate liability, encourages just the opposite: top executives may take the attitude of 'don't tell me, I don't want to know.'").

53. See Margulies, *supra* note 25, at 67 (noting that, with indemnification "managers take risks that they would avoid if they were more accountable").

54. See *id.* at 59 (observing how indemnification encourages moral hazard).

55. See *id.* (examining the concept of moral hazard).

increased incentive to cut corners and adopt "more aggressive legal interpretations."⁵⁶

While indemnification, detractors argue, encourages misbehavior, advancement encourages conspirators to "circle the wagons" once their wrongdoing has been discovered.⁵⁷ For example, in the case of a corporate criminal conspiracy, advancement encourages loyalty to the conspiracy, as all parties are assured vigorous representation without the depletion of personal resources.⁵⁸ Without the prospect of repayment until the finding of innocence at the end of a lengthy trial, however, a particular defendant without substantial resources might reasonably choose to cooperate with the prosecution to avoid such an expense.⁵⁹

Thus, while some argue indemnification and advancement are essential tools for companies engaging in the risky behavior necessary to establish competitive advantages, others argue that indemnification and advancement immunize employees from the consequences of their own wrongdoing, frustrating both internal controls and external prosecutions. Regardless, the fact that both a company and its employees can be criminally indicted presents an interesting question to prosecutors: When do you charge the individuals and when do you charge the company? The Thompson Memo was designed to set forth principles to aid U.S. Attorneys in deciding that question,⁶⁰ and it placed a premium on a company's cooperation with the prosecution.⁶¹

III. *The Thompson Memo and Stein*

In the wake of major corporate scandals during the first few years of the new century, indemnification and advancement were viewed with increased

56. *See id.* at 64–68 (discussing, particularly in the context of the Enron debacle, how managers without accountability for their actions engage in increasingly risky behavior, discourage less-risky behavior, and silence dissent).

57. *See id.* at 79–80 (observing how advancement prevents the government from "peeling off" individuals who might wish to cooperate with the government).

58. *See id.* (observing how advancement encourages "loyalty to the conspiracy").

59. *See id.* at 80 (discussing how advancement "provid[es] protection against the consequences of breaching legal norms" as defendants will not have to pay their legal expenses).

60. *See* Thompson Memo, *supra* note 2, at 1 ("Attached to this memorandum are a revised set of principles to guide Department prosecutors as they make the decision whether to seek charges against a business organization.").

61. *See id.* at 3 (indicating that a factor in the company's favor was "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 protections").

skepticism. Public faith in corporations was in decline following misdeeds by Enron, WorldCom, Adelphia, Rite Aid, Symbol Technologies, Qwest, Dynegy, and HealthSouth, to name a few, and Congress called for significant changes in the handling of corporate crime.⁶² Part of the Department of Justice's response to this outcry was the Thompson Memo, issued on January 20, 2003, which turned a company's decision to advance legal fees to its employees under investigation into a black mark indicating less than full cooperation with the government, and was, therefore, a factor that argued in favor of indicting that company.⁶³ *United States v. Stein*⁶⁴ handed this guidance a harsh rebuke.⁶⁵

A. *The Thompson Memo*

The Thompson Memo was an attempt to clarify the principles U.S. Attorneys should use when considering whether or not to indict business entities. Just as the McNulty Memo would supersede the Thompson Memo, the Thompson Memo superseded the Holder Memo.⁶⁶ The Holder Memo, formally entitled "Federal Prosecution of Corporations," was issued in June 1999 by then-U.S. Deputy Attorney General Eric Holder.⁶⁷

The Holder Memo put forward "common sense considerations" for federal prosecutors to consider before deciding whether to charge a corporation⁶⁸ but noted that "[f]ederal prosecutors [we]re not required to reference these factors in a particular case, nor [we]re they required to document the weight they accorded specific factors in reaching their decision."⁶⁹ When deciding to indict a company, the Holder Memo suggested that prosecutors consider "the seriousness of the offense, the pervasiveness of wrongdoing within the entity, the company's efforts to remedy past misconduct, the adequacy of other

62. See Kathleen F. Brickey, *Enron's Legacy*, 8 BUF. CRIM. L. REV. 221, 222–28 (2004) (discussing some of the major corporate fraud scandals of recent years and the various ways Congress and policing agencies have responded to them).

63. See *infra* Part III.A (discussing the Thompson Memo and its effects).

64. *Stein III*, 435 F. Supp. 2d 330 (S.D.N.Y. 2006).

65. See *infra* Part III.B (discussing *Stein III*).

66. See *Stein III*, 435 F. Supp. 2d 330, 336 (S.D.N.Y. 2006) (discussing the Holder Memo in its context as a precursor to the Thompson Memo). For the Holder Memo, see Memorandum from Eric Holder, Deputy Attorney Gen., Federal Prosecution of Corporations (June 16, 1999) [hereinafter Holder Memo], available at http://www.abanet.org/poladv/priorities/privilege_waiver/1999jun16_privwaiv_dojholder.pdf (last visited Mar. 4, 2007) (on file with the Washington and Lee Law Review).

67. See *Stein III*, 435 F. Supp. 2d at 336 (noting the issuance of the Holder Memo).

68. See *id.* (discussing the Holder Memo).

69. *Id.* (quoting from the Holder Memo, *supra* note 66, at 1).

remedies," and other similar factors.⁷⁰ In addition, it asked U.S. Attorneys to consider "'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.'"⁷¹ Inducing corporate cooperation rather than obfuscation was one of the main goals of the Holder Memo, which informed U.S. Attorneys that "'[i]n gauging the extent of the corporation's cooperation, the prosecutor may consider the corporation's willingness to identify the culprits within the corporation, including senior executives, to make witnesses available, to disclose complete results of its internal investigation, and to waive attorney-client and work-product privileges.'"⁷² The Holder Memo further defined its idea of cooperation:

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 upon the circumstances, a corporation's promise of support to culpable employees and agents, either *through the advancing of attorney 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, may be considered by the prosecutor in weighing the extent and value of a corporation's cooperation.⁷³

However, the Holder Memo did note that "'[s]ome states require corporations to pay the legal fees of officers under investigation prior to a formal determination of their guilt. Obviously, a corporation's compliance with governing law should not be considered a failure to cooperate.'"⁷⁴

Following Enron and its ilk, U.S. Deputy Attorney General Larry D. Thompson revised the Holder Memo, and issued the Thompson Memo in early 2003.⁷⁵ Unlike the Holder Memo, intended only to provide guidance, the Thompson Memo was binding on all federal prosecutors.⁷⁶ With that exception, the Thompson Memo contained few major changes from the Holder

70. *Id.* (discussing the Holder Memo).

71. *Id.* at 337 (quoting the Holder Memo, *supra* note 66, § II, ¶ 4).

72. *Id.* (quoting the Holder Memo, *supra* note 66, § VI, ¶ A).

73. *Id.* (quoting the Holder Memo, *supra* note 66, § VI, ¶ B) (emphasis added).

74. *Id.* (quoting the Holder Memo, *supra* note 66, § II, ¶ B n.3).

75. *See id.* at 338 (discussing the issuance of the Thompson Memo, which was formally entitled "Principles of Federal Prosecution of Business Organizations").

76. *See id.* (describing differences between the Thompson Memo and the Holder Memo).

Memo, and "the language concerning cooperation and advancing legal fees by business entities was carried forward without change."⁷⁷

The Thompson Memo began:

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 wrongfulness under investigation. The revisions make clear that such conduct should weigh in favor of a corporate prosecution.⁷⁸

The Thompson Memo, thus, put a premium on a corporation's real and meaningful cooperation with the government.

This heightened emphasis on cooperation not only gave guidance to U.S. Attorneys but also empowered companies under investigation. Companies knew that if they were indicted, they could expect a fate similar to accounting firm Arthur Anderson, which collapsed shortly after it was indicted on charges stemming from its role in the Enron scandal, long before the case against it was ever tried or a verdict rendered.⁷⁹ Companies now knew, however, that if they followed the Thompson Memo and cooperated fully with the government, they could hopefully avoid indictment. The Thompson Memo, therefore, gave businesses under investigation the motive to prove the authenticity of their cooperation by avoiding any activity with the appearance of protecting culpable employees, such as the advancement of legal fees.

B. *The Facts of Stein*

In the atmosphere of increased corporate scrutiny following Enron and other scandals,⁸⁰ the Internal Revenue Service (IRS) began investigating illegal tax shelters.⁸¹ Shortly thereafter, the Senate held public hearings in

77. *Id.* at 338.

78. Thompson Memo, *supra* note 2, at 1.

79. *See Stein III*, 435 F. Supp. 2d 330, 337 (S.D.N.Y. 2006) (noting that accounting firm Arthur Anderson LLP collapsed after it was indicted, well before the case was tried or a verdict rendered); *see also id.* at 337 n.11 (stating that amici briefs informed the court that "no major financial services firm has ever survived a criminal indictment" (citations omitted)).

80. *See Brickley*, *supra* note 62, at 228–35 (discussing the creation of the Corporate Fraud Task Force by executive order in July 2002; the Justice Department's creation of the Enron Task Force in January 2002; Congress's enactment of the Sarbanes-Oxley Act in July 2002; the U.S. Sentencing Commission's revised sentencing guidelines as directed by the Sarbanes-Oxley Act; and the introduction of the Thompson Memo).

81. *See Stein III*, 435 F. Supp. 2d at 338 (discussing the origins of the KPMG

November 2003, at which several senior KPMG partners and former partners testified.⁸² Their presence at these hearings was not well received.⁸³ Concerned about fallout from these hearings and the IRS proceedings, KPMG retained the law firm of Skadden, Arps, Slate, Meagher & Flom (Skadden) "to come up with a new cooperative approach."⁸⁴ One aspect of this approach was to clean house and ask Jeffrey Stein, deputy chair and chief operating officer of the firm, Richard Smith, vice chair-tax services, and Jeffrey Eischeid, a senior partner in personal financial planning, to leave their positions.⁸⁵ Mr. Stein's retirement from the firm was coupled with a three-year, \$100,000 per month consulting agreement, as well as an agreement that he would be represented in suits brought against him, KPMG, and its personnel.⁸⁶ This representation would be at KPMG's expense by counsel suitable to both him and the firm, or by counsel acceptable to himself in suits where he was the only party.⁸⁷

Despite these efforts, the IRS made a criminal referral to the Department of Justice, and in early 2004, the USAO for the Southern District of New York took up the case.⁸⁸ Prosecutors continued to maintain that the tax shelters in question deprived the Treasury Department of \$2.5 billion in tax revenue.⁸⁹ The USAO delivered letters to between twenty and thirty KPMG partners and employees advising them that their conduct fell within the scope of a grand jury investigation.⁹⁰

investigation). In early 2002, the IRS issued nine summonses to KPMG, which "was less than fully compliant" with the summonses. *Id.* The government was forced to file a petition with the U.S. District Court for the District of Columbia to have these summonses enforced. *Id.*

82. *See id.* (discussing the public hearings before the Permanent Subcommittee on Investigations of the Senate Committee on Governmental Affairs held in November 2003 on "the development, marketing, and implementation of abusive tax shelters by accountants, lawyers, financial advisors, and bankers").

83. *See id.* at 338–39 (discussing KPMG's reception at the Senate hearing, and noting that Senator Levin suggested that one KPMG witness "try an honest answer") (citations omitted).

84. *Id.* at 339 (citations omitted).

85. *See id.* (discussing KPMG's efforts to clean house and noting that all three of these individuals had testified before the Senate).

86. *See id.* at 339 (discussing Mr. Stein's compensation package for leaving the firm).

87. *See id.* (discussing future representation and Mr. Stein's compensation package).

88. *See id.* (discussing the process by which KPMG's actions came to the attention of the USAO).

89. *See* Browning, *supra* note 1, at C11 (discussing the enormity of the tax shelters at issue).

90. *See Stein III*, 435 F. Supp. 2d 330, 340–41 n.30 (S.D.N.Y. 2006) (discussing the USAO's "subject" letters, sent between February 18 and February 26, 2004, and noting that the

The USAO then set up a meeting with Skadden on February 25, 2004, and in preparation for this meeting drafted a list of talking points that included asking whether KPMG was advancing legal fees to individuals under investigation.⁹¹ At this meeting, Skadden explained that KPMG had decided to clean house to change the atmosphere of the firm, that it had already taken action against high-level personnel, that it would cooperate fully with the investigation, and that KPMG's goal was to save KPMG, not to protect any individual.⁹² In a reference to Arthur Anderson's end, Skadden noted that an indictment would similarly lead to KPMG's demise.⁹³

When the issue finally arose, Skadden "tested the waters" concerning KPMG's ability to advance legal expenses to its employees.⁹⁴ Although KPMG's partnership agreement and by-laws were silent on the issue of advancement and indemnification, KPMG had covered the legal fees for partners and employees dating back to at least 1974 without a preset cap—on one occasion spending over \$20 million for the defense of four partners in a criminal investigation and related civil litigation.⁹⁵ While the government indicated that it would consider any legal obligations related to advancement, it specifically cited the Thompson Memo as a factor that needed to be taken into account.⁹⁶ At this point, Skadden informed the USAO of KPMG's common practice of paying legal fees but added that KPMG's partnership agreement was vague and Delaware law gave the company the discretion to act as it wished.⁹⁷ Skadden then added that KPMG was still looking into its legal obligations, but indicated that, if it had the discretion to do so, it would not pay legal fees for employees who failed to cooperate with the government or who invoked their Fifth Amendment rights.⁹⁸ While there is some dispute as to precisely what

majority were delivered by February 20, 2004).

91. *See id.* at 341 (discussing the USAO's preparation for its meeting with Skadden).

92. *See id.* (analyzing the discussions between Skadden and the government at the February 25 meeting).

93. *See id.* (discussing Skadden's argument at its meeting with the government that an indictment of KPMG would cause it to "go[] out of business").

94. *See id.* (noting the discussion of legal fees).

95. *See id.* at 340 (discussing KPMG's comprehensive past-practice of advancing and indemnifying their partners and employees).

96. *See id.* at 341 (discussing the USAO's specific reference to the Thompson Memo in response to Skadden's concerns about KPMG's obligation to advance legal fees).

97. *See id.* at 342 (discussing Skadden's response to the government's reference to the Thompson Memo).

98. *See id.* (noting that KPMG's attorneys informed the government that, if KPMG could,

happened next,⁹⁹ after a brief change of topic,¹⁰⁰ the conversation once again returned to advancement.¹⁰¹ The government stressed that it did not wish to see KPMG pay legal expenses for its employees,¹⁰² and that a decision to do so would not be viewed favorably.¹⁰³

Shortly after this meeting, Skadden informed the government that KPMG did not think it had any legal obligation to advance legal fees.¹⁰⁴ On March 11, 2004, Skadden held a conference call with the government and indicated KPMG would be "as cooperative as possible" in the hopes of avoiding indictment.¹⁰⁵ The government responded by asking KPMG to urge their employees to be fully cooperative with the government, "even if that [meant admitting] criminal wrongdoing."¹⁰⁶

According to the court, "[t]he actions of the USAO, coupled with the Thompson Memorandum, had the desired effect."¹⁰⁷ On March 11, Skadden forwarded to the USAO a copy of the letter it was sending counsel for the KPMG defendants who had already received subject letters or who appeared to be under suspicion.¹⁰⁸ The letter indicated that KPMG would pay an

it would not support its employees who refused to work with the government).

99. *See id.* at 342–44 (discussing a comment by Ms. Shirah Neiman, chief counsel to the U.S. Attorney, who attended this meeting between the government and KPMG's attorneys). Ms. Neiman argued that her comment that "misconduct" should not "be rewarded," and an accompanying reference to federal guidelines, concerned the severance agreements between KPMG and Messrs. Stein, Eischeid, and Smith, and the Federal Sentencing Guidelines. *Id.* The court, however, found that, at the very least, KPMG's representatives reasonably took this to be another reference to the Thompson Memo and an indication that the government did not wish to see KPMG advance legal fees to its employees. *Id.*

100. *See id.* at 342 (noting that the conversation changed to KPMG's actions regarding Messrs. Stein, Eischeid, and Smith, and whether or not either KPMG or Skadden had conducted an internal investigation to determine who the "bad guys" were).

101. *See id.* at 342–44 (discussing the return to the legal fees issue).

102. *See id.* at 344 (stating that "while the USAO did not say in so many words that it did not want KPMG to pay legal fees, no one at the meeting could have failed to draw that conclusion").

103. *See id.* at 344 (quoting from handwritten notes taken at the meeting that state "if u have discretion re fees—we'll look at that under a microscope").

104. *See id.* at 344–45 (discussing Skadden's report to the government on KPMG's obligations to advance legal fees and the limits and conditions KPMG planned on placing on its advancement).

105. *See id.* at 345 (discussing the substance of the March 11, 2004 conference call).

106. *Id.* Indeed, the government indicated that such information would be good material for cross-examination, which the court found strongly indicated an expectation, even at this early stage, to prosecute individuals for their participation in the tax shelter plan. *Id.*

107. *Id.*

108. *See id.* (discussing the material Skadden enclosed and sent to the USAO).

individual's legal fees up to \$400,000 on the condition that the individual cooperate fully with the government.¹⁰⁹ Along with that carrot, the letter included the stick that "payment of . . . legal fees and expenses will cease immediately if . . . [the recipient] is charged by the government with criminal wrongdoing."¹¹⁰ A day later, KPMG sent a memorandum to a wider range of employees concerning contact with the government, urging full cooperation, but noting some advantages of retaining counsel and indicating that the employees had a right to do so.¹¹¹ The government was "disappointed with [the] tone" and "one-sided representation of potential issues" in this memorandum and demanded KPMG distribute a supplemental memo.¹¹² The salient difference in this supplemental memo was to stress the fact that KPMG's employees were free to meet with the government without counsel.¹¹³

The government subsequently capitalized on the groundwork it had laid with its references to the Thompson Memo and KPMG's desire to avoid indictment.¹¹⁴ The government repeatedly informed Skadden of KPMG personnel who refused to cooperate fully, and each time Skadden informed the attorney for that individual that advancement of legal expenses would end unless their client complied.¹¹⁵ Sometimes these threats worked, and the individual agreed to an interview with the government; other times, KPMG terminated the employment as well as the advancement of legal fees to individuals who refused to cooperate.¹¹⁶

While the government was using its pressure to encourage KPMG personnel to give interviews, KPMG itself still sought to avoid indictment.¹¹⁷ On August 4, 2004, KPMG executives met with the chief of the criminal

109. *See id.* (discussing the form letter Skadden sent to counsel for KPMG defendants indicating that their fees would be advanced as long as they "cooperate with the government and . . . be prompt, complete, and truthful").

110. *Id.* at 345–46.

111. *See id.* at 346 (discussing the March 12, 2004 memorandum sent by Joseph Loonan, KPMG's deputy general counsel).

112. *Id.* at 346.

113. *See id.* at 346–47 (discussing the government's demand for a supplemental memorandum and noting that the intended effect of this new memorandum was to encourage KPMG employees to agree to interviews with the government without first meeting with counsel).

114. *See id.* at 347 (discussing the USAO's ability to press its advantage).

115. *See id.* (discussing how the USAO took advantage of its position).

116. *See id.* (discussing the actions employees took when notified of the fact that they would no longer have their legal fees covered, as well as KPMG's response to those actions).

117. *See id.* (noting that KPMG's own legal problems were not yet resolved as it pressured its own employees into interviews with the government).

division of the USAO as well as other federal prosecutors.¹¹⁸ At this meeting, the government noted rich severance packages KPMG had given to some executives and stated that this raised a "troubling issue" under the Thompson Memo.¹¹⁹ KPMG attempted to deflect the issue by agreeing that the packages were "high in one or two cases," but stated that KPMG only expected to advance legal fees up to \$400,000, and only on condition of full cooperation.¹²⁰ By October 2004, however, KPMG had substantially passed that figure with regard to Mr. Stein.¹²¹

KPMG continued its attempt to avoid indictment by "touting its cooperation with the investigation and its limitation of attorneys' fees for individuals."¹²² In a March 2, 2005 meeting, however, then U.S. Attorney David N. Kelly interrupted one of these moments by saying, "Let me put it this way. I've seen a lot better from big companies."¹²³ KPMG decided to make a "last-ditch" effort by appealing to the highest levels of the Justice Department, and thought it essential "to be able to say at the right time with the right audience, we're in full compliance with the Thompson Guidelines."¹²⁴ On May 5, 2005, shortly before a meeting with U.S. Deputy Attorney General James Comey, KPMG terminated the consulting and advancement portions of its severance agreement with Mr. Stein.¹²⁵ It did so "because [KPMG] thought it would help [its case] with the government."¹²⁶

KPMG met with Deputy Attorney General Comey on June 13, 2005, at which time it stressed the "precedent setting" pressure it was able to place on its employees to get them to cooperate by linking advancement of legal fees to full cooperation.¹²⁷ KPMG's efforts were ultimately successful, and on August 29,

118. *See id.* (discussing the August 4, 2004 meeting between KPMG executives and Karen Seymour, then chief of the criminal division of the USAO).

119. *See id.* (indicating the government's interest in the severance packages KPMG had given to some of its executives).

120. *See id.* (discussing KPMG's attempt at getting around the issue of the high severance packages it had agreed to).

121. *See id.* at 347–48 n.74 (indicating that KPMG had paid \$646,757.80 for Mr. Stein's criminal investigation alone, without factoring in the costs related to civil litigation).

122. *See id.* at 348 (discussing KPMG's continued attempts to prevent indictment).

123. *Id.*

124. *Id.*

125. *See id.* (stating that KPMG "unilaterally terminated the consulting services portion of the severance agreement and cut off payment of Mr. Stein's attorneys' fees").

126. *See id.* (indicating KPMG's motivation for its actions at this point regarding Mr. Stein) (citations omitted).

127. *See id.* at 348–49 (discussing the June 13, 2005 meeting between KPMG and Deputy Attorney General Comey).

2005, it entered into a Deferred Prosecution Agreement.¹²⁸ Among other things, KPMG agreed "to admit extensive wrongdoing, to pay a \$456 million fine, and to accept restrictions on its practice."¹²⁹ Assuming KPMG complied with these provisions, the charges would be dropped and it would avoid indictment.¹³⁰

The Deferred Prosecution Agreement also included a provision that KPMG would continue to cooperate with the government in its prosecution of individual KPMG personnel and former personnel.¹³¹ When the government filed its initial indictment for individual defendants, KPMG responded by cutting off the advancement of legal fees to those defendants.¹³² On January 19, 2006, the individual defendants "moved to dismiss the indictment . . . on the ground that the government had interfered improperly with the advancement of attorney's fees by KPMG in violation of their constitutional and other rights."¹³³

C. *The Stein Court's Findings on Advancement and the Thompson Memo*

The court conducted a hearing on the role of prosecutorial pressure in May 2006 from which it drew four conclusions.¹³⁴ First, the Thompson Memo caused KPMG to consider abandoning its long-standing policy of advancing legal fees to its personnel in all cases and investigations.¹³⁵ Second, the government made repeated references to the Thompson Memo in an effort to strong-arm KPMG into cooperation.¹³⁶ Third, the government manifested a clear interest in limiting the role defense attorneys would play in its investigation and prosecution.¹³⁷ Fourth, KPMG's decision to cut off the

128. *See id.* (discussing KPMG's Deferred Prosecution Agreement).

129. *Id.*

130. *See id.* at 349 (discussing the particulars of KPMG's Deferred Prosecution Agreement).

131. *See id.* at 349–50 (indicating that the Deferred Prosecution Agreement was contingent on factors related to the USAO's attempt to prosecute individual defendants for their involvement in the tax shelters at issue).

132. *See id.* at 350 (discussing the government's indictment of individual defendants and KPMG's response to such action).

133. *Id.*

134. *See id.* at 350–53 (discussing various motions and actions taken before the hearing on governmental pressure on May 8–10, 2006 and the four findings that resulted from this hearing).

135. *See id.* at 352 (summarizing the court's first factual conclusion).

136. *See id.* at 352–53 (summarizing the court's second factual conclusion).

137. *See id.* at 353 (summarizing the court's third factual conclusion).

payment of legal fees to individuals was a direct result of the pressure applied by the Thompson Memo and the USAO, and that, but for that pressure, KPMG would have paid all legal fees for its partners and employees both prior to and after indictment without consideration of cost.¹³⁸

The twentieth century saw a steady march in favor of broadening an individual's right to counsel,¹³⁹ revolutionizing what originally only meant that the government could not prevent a defendant from being represented.¹⁴⁰ *Stein*, however, is not the typical right to counsel case. To begin with, the right to counsel only "attaches at the initiation of adversarial proceedings"¹⁴¹ such as arraignment, indictment, or a preliminary hearing, and because interviews with the government do not fall into this category, the right had not attached.¹⁴² Second, it was not the government, directly, who interfered with the defendants' attempt to obtain counsel, but KPMG, their employer, who cut off funding.¹⁴³ According to *Caplin & Drysdale, Chartered v. United States*¹⁴⁴ and

138. See *id.* (summarizing the court's fourth factual conclusion).

139. See generally *Powell v. Alabama*, 287 U.S. 45, 73 (1932) (holding that counsel needed to be appointed for indigent defendants in capital cases); *Betts v. Brady*, 316 U.S. 455, 473 (1942) (holding that under special circumstances counsel needed to be appointed for indigent defendants); *Gideon v. Wainwright*, 372 U.S. 335, 354 (1963) (holding that indigent defendants were entitled to counsel when charged with a felony); *Argersinger v. Hamlin*, 407 U.S. 25, 37 (1972) (holding that counsel must be appointed for any criminal prosecution, felony or misdemeanor, that actually leads to imprisonment); *Alabama v. Shelton*, 535 U.S. 654, 658 (2002) (holding that indigent defendants are entitled to appointed counsel for a suspended sentence when there is a possibility that jail time could result).

140. See *Powell v. Alabama*, 287 U.S. 45, 60–67 (1932) (discussing the fact that, at common law, English courts could prevent individuals from being represented by counsel, and that the Sixth Amendment was designed as a guarantee against this practice).

141. See *Stein III*, 435 F. Supp. 2d 330, 366 (S.D.N.Y. 2006) (discussing the government's argument that the right to counsel had not yet attached for the individual defendants).

142. *Id.*

143. See *Stein III*, 435 F. Supp. 2d at 348 (discussing how KPMG cut off payment of Mr. Stein's attorneys' fees).

144. *Caplin & Drysdale, Chartered v. United States*, 491 U.S. 617 (1989). In *Caplin & Drysdale*, the Supreme Court decided that a federal drug forfeiture statute that does not allow an exception for assets used to pay legal expenses does not violate the Fifth and Sixth Amendments. *Id.* at 619. The statute, 21 U.S.C. § 853(a), authorized the forfeiture of "property constituting, or derived from . . . proceeds . . . obtained" from drug-related criminal activity. *Caplin & Drysdale*, 491 U.S. at 619–20. Petitioner, the law firm retained by Christopher Reckmeyer, claimed that Reckmeyer owed it close to \$200,000 worth of legal fees related to services rendered while representing Reckmeyer on drug importation and distribution charges. *Id.* at 619, 621. The forfeiture provision of 21 U.S.C. § 848 left Reckmeyer with no funds to pay this debt, and petitioner claimed that the statute, with no exception of legal fees, was unconstitutional because it "upsets the 'balance of power' between the Government and the accused in a manner contrary to the Due Process Clause of the Fifth Amendment." *Caplin & Drysdale*, 491 U.S. at 621, 623–24. The Court, however, found that while an individual has a

United States v. Monsanto,¹⁴⁵ the Sixth Amendment does not grant individuals the right to spend "'other people's money' on expensive defense counsel."¹⁴⁶

The first hurdle the *Stein III* court tackled was that the individual defendants were, in fact, entitled to have their counsel provided for by KPMG, and that this was not "other people's money." The *Stein III* court began by noting that, under governing Delaware law, KPMG was free to indemnify its employees at its discretion,¹⁴⁷ and especially noted that this "includes the authority to advance defense costs prior to final judgment."¹⁴⁸ Furthermore, the court noted that KPMG's "unbroken track record" of advancement gave the individual defendants "every reason to expect that KPMG would pay their legal expenses in connection with the government's investigation and, if they were indicted, defending against any charges that arose out of their employment by KPMG."¹⁴⁹ Because the court was only considering indemnification in light of governmental pressure, the court declined to go any further,¹⁵⁰ but a subsequent opinion delved into the issue of implied contracts:

right to be represented by adequate counsel, he does not have a right to an attorney he cannot afford. *Id.* at 624–25. Furthermore, just as a robbery suspect has no right to use the proceeds from that theft, "a defendant has no Sixth Amendment right to spend another person's money for services rendered by an attorney." *Id.* at 626. Because the defendant did not have good title to these ill-gotten-gains, *id.* at 627, and the government has a strong interest in recovering all forfeitable assets, *id.* at 631, the Court found that there is nothing unconstitutional about a forfeiture statute that does not allow for an exception for those forfeitable assets to be used towards legal fees, *id.* at 634.

145. *United States v. Monsanto*, 491 U.S. 600 (1989). In *Monsanto*, the Supreme Court decided that 21 U.S.C. § 853(a), which called for the forfeiture of assets derived from drug-law violations, was not unconstitutional because it prevented defendant from using those funds to pay an attorney. *Monsanto*, 491 U.S. at 602–03. The Court began by finding that the language of the statute was clear and unambiguous, and provided no exception for forfeitable assets to be used for legal fees. *Id.* at 606. The Court then addressed respondent's constitutional arguments that this statute violated his Fifth and Sixth Amendment rights, to which it replied that it would dismiss this argument based on similar reasoning found in *Caplin & Drysdale, Chartered v. United States*, 491 U.S. 617 (1989), announced the same day. *Monsanto*, 491 U.S. at 614. Lastly, the Court found that there was no problem restraining the use of assets before a finding of guilt as long as there was a finding of probable cause that those assets were forfeitable. *Id.* at 615.

146. *See Stein III*, 435 F. Supp. 2d at 367 (discussing the government's argument that the individual defendants had no right to use KPMG's money to fund their legal defense).

147. *See id.* at 355 (indicating that KPMG was free "to indemnify and hold harmless any partner or other person from and against any and all claims and demands whatsoever" (citations omitted)).

148. *Id.*

149. *Id.* at 356.

150. *See id.* ("[I]t appears quite possible that all [individual defendants] had contractual and other legal rights to indemnification and advancement of defense costs, although the Court declines to decide that in this ruling.").

A contract implied in fact may result as an inference from the facts and circumstances of the case, although not formally stated in words, and is derived from the presumed intention of the parties as indicated by their conduct. It is just as binding as an express contract arising from declared intention, since in the law there is no distinction between agreements made by words and those made by conduct.¹⁵¹

The court thus rejected the argument that KPMG's years of indemnification were a series of independent arrangements that did not create an ongoing legal obligation.¹⁵² Rather, the court found that where "there was no statement or agreement that [indemnification and advancement were] not an integral part of the employment bargain between the firm and its employees . . . a reasonable trier of fact could well find the existence of an implied in fact contract."¹⁵³ Due to this implied in fact contract, the court found that the KPMG employees had a right to advancement and that these funds were not "other people's money" simply because they came from KPMG's coffers.¹⁵⁴ The defendants had a property right in their advancement,¹⁵⁵ and the Sixth Amendment protects an individual's right to use his own funds for his defense.¹⁵⁶

With the defendants' right to advancement established, the court faced the second hurdle of showing that the defendants were entitled to meet with counsel before commencement of formal adversarial procedures. By making a stew of the Due Process Clause, the Confrontation Clause, and the Assistance of Counsel Clause, the court arrived at the conclusion that "[t]he Supreme Court long has protected a defendant's right to fairness in the criminal process."¹⁵⁷ An essential element of this fairness is the respect for "the autonomy of the criminal defendant,"¹⁵⁸ meaning that "the government may not

151. See *Stein IV*, 452 F. Supp. 2d 230, 261 (S.D.N.Y. 2006) (discussing implied in fact contracts) (citations omitted).

152. See *id.* (discussing KPMG's "unbroken track record" of indemnification and advancement, which KPMG tried to characterize as individual "matter[s] of grace" rather than as the foundation for an implied in fact contract).

153. *Id.* at 263.

154. *Stein III*, 435 F. Supp. 2d 330, 367 (S.D.N.Y. 2006) (refuting the "other people's money" argument).

155. See *id.* (stating that the defendants had a property interest in indemnification and advancement and thus any funds that would have flowed from that interest).

156. See *id.* (explaining that individuals are free to use their own money for their own defense under the Sixth Amendment).

157. See *id.* at 357 ("Whatever the textual source, however, the Court consistently has held that criminal defendants are entitled to be treated fairly throughout the process. In everyday language, they are entitled to a fair shake.").

158. *Id.*

both prosecute a defendant and then seek to influence the manner in which he or she defends the case."¹⁵⁹

Out of this interest in autonomy, the court stated that the government may not "interfere at will with a defendant's choice of counsel, as the Constitution 'protect[s] . . . the defendant's free choice independent of concern for the objective fairness of the proceedings.'"¹⁶⁰ Concluding this line of thought, the court stated, "In short, fairness in criminal proceedings requires that the defendant be firmly in the driver's seat, and that the prosecution not be a backseat driver."¹⁶¹ Furthermore, fundamental fairness is essential not only following the commencement of adversarial proceedings, but throughout the entire criminal process.¹⁶²

In this light, the court considered the magnitude of the criminal case before it.¹⁶³ At the time of the opinion, the government had produced between five million and six million pages of documents, plus transcripts of 335 depositions and 195 income tax returns.¹⁶⁴ Briefs for pretrial motions had already passed the 1,000 page mark, and the government expected its case in chief to last three months.¹⁶⁵ The court estimated that it would cost a defendant \$375,000 simply to have one attorney sit in trial for eight hours a day for the expected six-month trial, absent any expenses for transcripts, copying, travel, etc.¹⁶⁶ Considering that a defendant would want his attorney to be prepared and therefore spend time reviewing some documents, the court estimated that a minimal defense would run between \$500,000 and \$1 million and could easily go higher.¹⁶⁷ Considering this immense sum, interference with a defendant's access to funds available for his defense was no trifling matter and would remove the defendant from the driver's seat of his defense because he would be forced to make choices based on cost.¹⁶⁸

159. *Id.*

160. *Id.* (citations omitted).

161. *Id.* at 358.

162. *See id.* at 360 ("The Court's jurisprudence thus makes clear that defendants have the right, under the Due Process Clause, to fundamental fairness throughout the criminal process.").

163. *See id.* at 362 (considering the unthinkable nature of approaching such a massive case with insufficient funds).

164. *See id.* (describing the massive extent of discovery).

165. *See id.* (describing the size of pretrial motions and the expected length of trial).

166. *See id.* at 362 n.163 (estimating the cost of trial for a defendant).

167. *See id.* (estimating legal expenses).

168. *See id.* at 362 (noting that the government interfered with the defendants' ability to obtain resources for their costly defense, and that this necessarily constrained their defense).

Despite the Thompson Memo's interference with defendants' right to use resources lawfully available for their own defense, the court noted that the Thompson Memo could remain if it proved narrowly tailored to achieve a compelling governmental interest.¹⁶⁹ The court, however, failed to discern any attempt to tailor the Thompson Memo to target only those cases where advancement was part of a deliberate attempt to "circle the wagons" and obstruct a legitimate prosecution.¹⁷⁰ The court thus found that the Thompson Memo's provision calling on U.S. Attorneys to interpret advancement of legal fees as a failure to cooperate constituted an illegitimate use of governmental pressure because it compelled KPMG to cease advancing legal fees in an effort to win cooperation points, and therefore denied employees access to funds they had a legal right to use for their defense.¹⁷¹

Through a close examination of the Thompson Memo and *Stein*, this Part has demonstrated what can happen to employees squeezed by their employer's desire to avoid indictment. Considering the importance the government places on cooperation, and the enormous risk that criminal indictment represents, KPMG tried to curry favor with the prosecution by transforming its traditional advancement practice into something that provided almost no protection for its employees. But from KPMG's standpoint, this plan worked.

IV. *Advancement After Stein*

The *Stein* opinions were major judicial broadsides against the Thompson Memo, ushering in a groundswell of public opinion in the business, legal, and political communities opposed to its tactics. While this outcry led to the revisions manifested in the McNulty Memo, critics argue that the McNulty Memo does not go far enough.¹⁷² Indeed, considering the similarities between the McNulty Memo and the Thompson Memo, there are no assurances that another company wishing to avoid indictment will not look to what worked for KPMG and hope that same strategy will work again. A new group of employees could find themselves in a position similar to those at KPMG. For this reason, both employers and employees need to revisit their policies on

169. *See id.* (describing the Thompson Memo's need to meet strict scrutiny to be permissible).

170. *See id.* at 362–66 (observing that the Thompson Memo conceivably could be tailored to meet compelling governmental interests, but that it was not).

171. *See id.* at 364–65 (stating that the Thompson Memo "often prevents companies from providing employees and former employees with the financial means to exercise their constitutional rights to defend themselves").

172. *See infra* Part IV.C (discussing criticism of the McNulty Memo).

advancement with a full understanding of the costs and benefits of those provisions, and explicit statements regarding advancement should be their preferred position.

A. The End of the Thompson Memo and the Coming of the McNulty Memo

The "groundbreaking" *Stein* opinion "[shook] the foundations of corporate prosecutorial policy."¹⁷³ It was the first major judicial criticism of the Thompson Memo,¹⁷⁴ and although it was "only a District Court opinion," opinions from the Southern District of New York on white collar crime carry more sway than the typical district court opinion.¹⁷⁵ The Thompson Memo had aided federal prosecutors in winning over 1,000 convictions in corporate fraud cases in recent years,¹⁷⁶ but *Stein* redirected attention to the hardball tactics those prosecutors were using.¹⁷⁷ These opinions "may have signaled the beginning of the end for the Thompson Memorandum."¹⁷⁸

As criticism mounted from business and legal groups over the following months, the Senate Judiciary Committee called a hearing on September 12, 2006, at which Deputy Attorney General Paul McNulty was the only witness to support the Thompson Memo.¹⁷⁹ The committee's chairman, Republican Senator Arlen Specter, and ranking Democrat, Senator Patrick Leahy, both labeled the Thompson Memo coercive and called for changes.¹⁸⁰ Witnesses

173. See Craig F. Margolis, *Thompson Memorandum on Fees Found Unconstitutional*, 3 No. 12 CORP. COMPLIANCE & REG. NEWSL. 3, Sept., 2006, available at Westlaw, 3 No. 12 CORPCRN 3 (describing the impact of the *Stein* opinions).

174. See Rodney Peck, *United States v. Stein: DOJ Policy Threatening Companies with Indictment Based Upon Advancement of Employee Legal Fees Ruled Unconstitutional*, MONDAQ BUS. BRIEFING, Aug. 9, 2006, available at 2006 WLNR 13714223 (discussing the expected impact of the *Stein III* ruling).

175. See *id.* (discussing the importance of the Southern District of New York in the context of white collar crime).

176. See Lynnley Browning, *U.S. Moves to Restrain Prosecutors*, N.Y. TIMES, Dec. 13, 2006, at C1 (noting the number of convictions the Thompson Memo has aided in recent years).

177. See *id.* (discussing the public criticism of the Thompson Memo following the KPMG decisions and the fact that it led to the McNulty Memo).

178. John J. Carney & Dennis O. Cohen, *McNulty Memo: Changes Game or Keeps Congress Out?*, 237 N.Y.L.J. 2, 2 (2007), available at <http://bakerlaw.com/PublicDocs/News/Articles/LITIGATION/NYLIJ%20McNulty%20Memo%20Carney%20Cohen%201-2007.pdf> (on file with the Washington and Lee Law Review).

179. See Browning, *supra* note 9, at C3 (discussing the Senate Judiciary Committee hearings on the Thompson Memo).

180. See *id.* (discussing comments by Senators Specter and Leahy on the Thompson Memo).

opposing the Thompson Memo included Edwin Meese, III, Attorney General during the Reagan administration, various officials from the American Bar Association, and the former director of the Justice Department's Enron Task Force.¹⁸¹

A day after the Senate hearing, McNulty acknowledged the growing criticism but continued to defend the Thompson Memo.¹⁸² After noting that numerous former Department of Justice officials had spoken against the Memo, McNulty added "I haven't heard from Larry Thompson yet—the Deputy Attorney General who actually issued the guidance. If Thompson objects to the Thompson Memo, I know things are bad."¹⁸³ In early December, Thompson, then serving as general counsel at PepsiCo, conceded that the time may have come to make some changes.¹⁸⁴ As the maelstrom surrounding the Thompson Memo grew,¹⁸⁵ Senator Specter introduced legislation to prohibit the most controversial aspects of the Thompson Memo, specifically its guidance to determine a company's level of cooperation based on its decision to retain, advance legal fees, and indemnify employees under investigation.¹⁸⁶

181. *See id.* (indicating individuals who testified before the Senate Judiciary Committee).

182. *See* Paul J. McNulty, Deputy Attorney Gen., Prepared Remarks at the National Association of Securities Dealers (Sept. 13, 2006), available at http://www.usdoj.gov/archive/dag/speeches/2006/dag_speech_060913.htm (last visited Oct. 9, 2007) (arguing that the Thompson Memo is "misconstrued by our critics" and that its strengths include that it "is transparent, simple, and relies on the common sense prosecutors have been using for decades") (on file with the Washington and Lee Law Review).

183. *Id.*

184. *See* Jessica Guynn, *Federal Tactics Under Assault: Prosecutors' Tool to Investigate Fraud Draws Corporate Fire*, S.F. CHRON., Dec. 9, 2006, at C1 (noting that Larry Thompson, namesake of the Thompson Memo, lauded the intent of the Thompson Memo, but acknowledged that it could use some "appropriate" changes).

185. *See Down to the Wire: Thompson Memo Revised?*, CFO MAG., Dec. 8, 2006, at 4, available at 2006 WLNR 21592357 (stating that calls for revision to the Thompson Memo had come from, among others, the U.S. Chamber of Commerce, the American Civil Liberties Union, and the American Bar Association).

186. *See id.* (discussing Senator Specter's proposed legislation). The other major point of contention with the Thompson Memo that this legislation sought to correct was that the Thompson Memo encouraged prosecutors to ask companies to waive their attorney-client privileges. *Id.* This was controversial largely because the attorney-client privilege is "one of the oldest and most sacrosanct privileges under U.S. law." Browning, *supra* note 176, at C1. On a more practical side, the argument was also made that companies would be hampered in their internal investigations to catch, fix, and prevent even more fraud because executives would be afraid to talk to in-house counsel out of fear of those records being handed over to federal prosecutors, and thus this provision actually hampered the goal of reducing corporate fraud. *See e.g.*, Lynnley Browning, *Judge's Rebuke Prompts New Rules for Prosecutors*, N.Y. TIMES, Dec. 16, 2006, at C4 (stating that "the old guidelines had made companies less likely to root out fraud internally because executives were afraid to talk to in-house lawyers"); Bill McConnell, *Privileged Elite*, DAILY DEAL, Jan. 15, 2007, available at 2007 WLNR 709970 (asserting that

On December 12, 2006, Deputy Attorney General McNulty issued a new memo that revised and superseded the Thompson Memo.¹⁸⁷ Speaking directly to the issue of advancement, the McNulty Memo states:

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. This prohibition is not meant to prevent a prosecutor from asking questions about an attorney's representation of a corporation or its employees.¹⁸⁸

A footnote to this section, however, states:

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. . . . Where these circumstances exist, approval must be obtained from the Deputy Attorney General before prosecutors may consider this factor in their charging decisions.¹⁸⁹

The Department of Justice's press release accompanying the McNulty Memo reinforced the idea that only in "extraordinary instances" under "limited circumstances," a "rare exception" could be made whereby prosecutors could consider advancement, but only if "combined with other significant facts, show[ing] that it was intended to impede the government's investigation."¹⁹⁰ In a speech given the same day, Deputy Attorney General McNulty twice stated

employees might be uncooperative with company lawyers if they thought those discussions would be turned over).

187. See Press Release, *supra* note 10, at 1 (indicating when the McNulty memo was issued).

188. Memorandum from Paul J. McNulty, Deputy Attorney Gen., Principles of Federal Prosecution of Business Organizations 11-12 (Dec. 12, 2006), available at http://www.usdoj.gov/dag/speech/2006/mcnulty_memo.pdf. [hereinafter McNulty Memo] (on file with the Washington and Lee Law Review).

189. *Id.* at 11 n.3 (citations omitted).

190. Press Release, *supra* note 10, at 1 (discussing the extraordinary circumstances that would allow a prosecutor to draw a negative conclusion from a company's advancement of legal fees).

that the new guidelines "generally prohibit" the consideration of advancement.¹⁹¹

B. *The Meaning of the McNulty Memo*

The revisions embodied in the McNulty Memo were almost immediately welcomed by the legal community, but at the same time, concerns arose that the new guidelines did not go far enough in correcting the overzealousness of the Thompson Memo.¹⁹² The Association of Corporate Counsel called the revisions "a day late and a dollar short,"¹⁹³ and the president of the American Bar Association said that the revisions "fall far short of what is needed."¹⁹⁴

Concerns about the pressure wielded by federal prosecutors remain because, while the McNulty Memo uses a softer tone than the Thompson Memo and indicates that some weapons in the prosecutor's arsenal should be used less frequently, these weapons are not forbidden.¹⁹⁵ The McNulty Memo states only that prosecutors "generally" should not take into account the advancement of legal fees when making charging decisions, and although it reminds prosecutors about governing state law and contractual obligations related to advancement, the Thompson Memo contained similar language.¹⁹⁶ The McNulty Memo fails to describe in detail the circumstances that allow for the "extremely rare" occasions when advancement may be considered while

191. See Paul J. McNulty, Deputy Attorney Gen., Prepared Remarks at the Lawyers for Civil Justice Membership Conference Regarding the Department's Charging Guidelines in Corporate Fraud Prosecutions 3 (Dec. 12, 2006), available at http://www.usdoj.gov/dag/speech/2006/dag_speech_061212.htm (last visited Jan. 30, 2007) (introducing the new McNulty Memorandum) (on file with the Washington and Lee Law Review).

192. See Brooke Masters & Patti Waldmeir, *Rules for Fighting Corporate Crime "Still Too Tough,"* FIN. TIMES (U.S.), Dec. 13, 2006, at 6 (noting that many business groups felt the McNulty Memo did not go far enough in revising the "tough tactics" used by the Justice Department to "fight corporate crime in the post-Enron era").

193. *Id.*

194. See Ameet Sachdev, *Toned-Down Tactics in Corporate Probes: Justice Department Tones Down Tactics*, CHI. TRIB., Dec. 13, 2006, at 1 (discussing the reaction to the McNulty Memo).

195. See Thomas P. Vartanian & Michael R. Bromwich, *Viewpoint: Justice Dept. Eases Push on Firms' "Cooperation,"* AM. BANKER, Dec. 22, 2006, at 10, available at 2006 WLNR 22619550 (discussing the idea that the McNulty Memo indicates that prosecutors should use some tools more sparingly); Carney & Cohen, *supra* note 178, at 2 (discussing the fact that the McNulty Memo mainly differs from the Thompson Memo in tone).

196. See Vartanian & Bromowich, *supra* note 195, at 19 (noting that the language in the McNulty Memo is not especially strict on restraining prosecutors, and indeed, is similar to language in the Thompson Memo that proved abusive in practice).

making charging decisions,¹⁹⁷ and all that is required is approval from the Department of Justice.¹⁹⁸ Furthermore, the McNulty Memo is only an internal policy, unenforceable at law, and without remedy if prosecutors fail to strictly abide by its provisions.¹⁹⁹ These loopholes have led some critics to label the McNulty Memo a "symbolic retreat," serving to placate Thompson Memo critics without offering substantive changes.²⁰⁰

While some worry about vagaries in the McNulty Memo's language, others are more concerned about what it fails to say, and the unsaid pressure it allows prosecutors to retain. Designed to place boundaries on what prosecutors can demand, the McNulty Memo does not expressly prohibit the consideration of advancement, and it fails to place a limit on what prosecutors can indicate would be viewed favorably.²⁰¹ Like the Thompson Memo, the McNulty Memo clearly states that a paramount factor in the government's charging decision remains the extent and quality of cooperation.²⁰² The McNulty Memo states that in most cases advancement of legal fees cannot be held against a corporation, but the very fact that cooperation is still highly valued means that much of the pressure present under the Thompson Memo remains.

Lawyers have expressed confusion about the difference between the Justice Department's ability to give credit for full cooperation and their inability to penalize a company for advancing legal fees. According to one

197. See Geoffrey R. Garinther, William H. Devaney & Don R. Berthiaume, *Department of Justice Alters its Procedures For Criminally Charging Corporations*, Dec. 2006, at 3–4, <http://www.venable.com/docs/pubs/1616.pdf> (noting that the phrase "extremely rare" is not defined) (on file with the Washington and Lee Law Review).

198. See *id.* at 4 (arguing that all this process has really done is "put corporate rights in the hands of a different 'alpha-wolf'").

199. See Marcia Coyle, *The "McNulty Memo": Real Change, or Retreat?* (Dec. 20, 2006), <http://www.law.com/jsp/article.jsp?id=1166522800100> (last visited June 17, 2007) (stating that this internal policy does not provide any remedy if prosecutors fail to abide by its guidelines) (on file with the Washington and Lee Law Review).

200. See Mr. Mintz Levin Litigation Group, *McNulty Memorandum Revises DOJ Guidelines for Corporate Prosecutions, But is it Enough?*, MONDAQ BUS. BRIEFING, Jan. 12, 2007, available at 2007 WLNR 1005209 (arguing that the McNulty Memo does not go far enough in correcting the problems of the Thompson Memo).

201. See Abbe D. Lowell, Christopher Man & Obimaka P. Okwumabua, *Is the DOJ's New Policy of Prosecuting Corporations Real Reform or Business as Usual?* (Jan. 31, 2007), <http://www.law.com/jsp/llf/PubArticleLLF.jsp?id=1170151352731> (arguing that "The most significant problem with the McNulty Memorandum is that it speaks only to what the prosecutor can demand, but it does not place any meaningful limit on what the prosecutor can suggest") (on file with the Washington and Lee Law Review).

202. See Alexandra A.E. Shapiro & Robert J. Malioneck, *'Value of Cooperation': McNulty Memo Impact on DOJ*, 236 N.Y.L.J. No. 122, Dec. 27, 2006, at 1, available at http://www.lw.com/upload/pubContent/_pdf/pub1745_1.pdf (on file with the Washington and Lee Law Review).

lawyer, "eliminating negative marks for maintaining privilege means little if credit will be given to companies that do waive their rights. . . . 'As long as waiving privilege can get you cooperation points, most companies will feel like they must give them up whether they've been asked to or not.'"²⁰³ According to another attorney, "The way the world really works is you have a prosecutor who says 'I can't ask you to waive privilege or not pay fees,' . . . but the message to you, the company, might be 'Well, if we do that, we might just score some brownie points.'"²⁰⁴ Thus, while the McNulty Memo aims to limit the circumstances under which advancement may be considered by prosecutors, considerations about advancement may remain, albeit pushed to an unspoken, underground level.²⁰⁵ Both employers and employees may find themselves back in a place very similar to that which existed before *Stein*; to avoid indictment, companies will seek to maximize their cooperation with investigators by not advancing the legal fees necessary for their employees' defense.

C. Employers and the McNulty Memo

Due to the similarities between the McNulty and Thompson Memos that have led some to call the McNulty Memo "no solution,"²⁰⁶ *Stein* remains illustrative of the position many companies will find themselves in: Indictment remains a death blow; cooperation remains preeminent; and "protecting . . . culpable employees and agents" remains a factor that indicates a lack of

203. See Bill McConnell, *Business to DOJ: Shift Further*, DAILY DEAL, Dec. 14, 2006, available at 2006 WLNR 21539753 (discussing the practical effect of a guideline that provides benefits for companies that waive rights, but that cannot penalize them for not waiving those rights, the result being that a company will still feel pressure to waive those rights) (quoting Peter Lawson, Director of Congressional and Public Affairs for the U.S. Chamber of Commerce).

204. See Browning, *supra* note 176, at C1 (quoting attorney Robert S. Bennett).

205. See Pamela A. MacLean, *McNulty Memo on Attorney-Client Privilege Blasted for Lack of Change*, NAT'L L.J. (Jan. 26, 2007), <http://www.law.com/jsp/ihc/PubArticleIHC.jsp?id=1169719351771> (last visited Feb. 28, 2007) (likening the new guidelines to a "don't ask, don't tell" policy that will drive prosecution waiver demands underground) (on file with the Washington and Lee Law Review).

206. *Id.* This article quotes Susan Hackett, a spokeswoman for the Association of Corporate Counsel:

We're thrilled the Department of Justice has taken this step forward after two years of begging. But this proposal is no solution. It not only doesn't go far enough, it still misses the point. They still think the DOJ gets to decide whether corporate counsel they are prosecuting have a right to counsel or not.

Id.

cooperation.²⁰⁷ In this atmosphere, companies can choose to proceed on three distinct tracks with differing risks and rewards: (1) they can make it explicitly clear that they will provide advancement to all employees; (2) they can make it explicitly clear that they will not advance attorney fees to any employees; or (3) they can remain silent and attempt to proceed on an ad hoc basis.

An explicit policy of advancement has both benefits and drawbacks. In terms of the McNulty Memo, because advancement is now based on an explicit obligation, this advancement cannot be held against the company in question.²⁰⁸ As described above, this company will be able to attract workers otherwise fearful of personal liability and encourage those employees to take the kinds of risks that will provide benefits for all the company's constituents.²⁰⁹ On the downside, this company will no longer be able to point to an absence of advancement as a sign of cooperation with the government and may be stuck advancing millions of dollars of legal fees for which it will never be reimbursed²¹⁰ to individuals it may feel have betrayed the company.²¹¹

An explicit policy of no advancement carries similar benefits and drawbacks, but in reverse positions. On the bright side, a company that denies all advancement is in a position to tout this factor to federal prosecutors and could make a strong showing that such a policy is a meaningful part of the business's "pre-existing compliance program," which the McNulty Memo cites as a factor arguing against indicting the company as a whole.²¹² Unfortunately,

207. McNulty Memo, *supra* note 188, at 11.

208. *See id.* ("[A] corporation's compliance with governing state law and its contractual obligations cannot be considered a failure to cooperate.")

209. *See supra* Part II.A (describing the benefits of advancement and indemnification).

210. *See* Stephen A. Radin, "Sinners Who Find Religion": *Advancement of Litigation Expenses to Corporate Officials Accused of Wrongdoing*, 25 REV. LITIG. 251, 253 (2006) (discussing the fact that "often hundreds of thousands of dollars, and in some cases millions of dollars" worth of legal fees advanced to employees are never repaid once those employees are found guilty and it is determined that they, in fact, had no right to indemnification or advancement, but they have no assets left to repay their employers).

211. *See id.* at 278 (noting that, "at the time that an advancement dispute ripens, it is often the case that the corporate board has drawn harsh conclusions about the integrity and fidelity of the corporate official seeking advancement'" (quoting *Reddy v. Elec. Data Sys. Corp.*, No. Civ. A. 19467, 2002 WL 1358761, at *5 (Del. Ch. June 18, 2002))).

212. *See* McNulty Memo, *supra* note 188, at 4 (discussing the importance of a pre-existing compliance program). This consideration is elaborated later in the McNulty Memo when it states that a meaningful compliance program should be designed "to ensure that corporate activities are conducted in accordance with all applicable criminal and civil laws, regulations, and rules." *Id.* at 12. Based on the concerns that established indemnification and advancement in the first place, as discussed in Part II.A, the reverse would clearly be that a lack of indemnification and advancement would encourage people to be more law abiding and play

as discussed above, a company without indemnification and advancement policies would likely face problems attracting capable employees,²¹³ and the employees it does attract would likely suffer from the kind of "undue risk aversion on the part of corporate managers" that would cause other significant problems for a profit-seeking venture.²¹⁴

A company's last option—official silence on the matter of advancement while approaching each case on an individual ad hoc basis—is the worst approach under the McNulty Memo. First, a company needs to be concerned about creating implied contracts for indemnification, like KPMG.²¹⁵ This is dangerous because, as the court noted in *Stein IV*, "the formation of contracts is based on the parties' objective manifestations of assent, not their uncommunicated subjective views."²¹⁶ Because KPMG had an ongoing practice of indemnifying its personnel, and its employment contracts contained no express language that indemnification and advancement were not integral parts of those employment contracts, the court found that KPMG was indeed obligated to advance legal expenses to the employees in question.²¹⁷ The first danger of silence on the issue of advancement, therefore, is that a company can end up in a situation where a court finds that, unbeknownst to the company, it does, in fact, have to advance legal fees to all employees.

The second problem with indemnification on a case-by-case basis, considering the McNulty Memo, is that voluntary advancement in this manner appears to fall squarely into the McNulty Memo's definition of "Obstructing the Investigation,"²¹⁸ which includes "overly broad assertions of corporate representation of employees or former employees."²¹⁹ The McNulty Memo states prosecutors "generally should not" consider advancement when making charging decisions, but this sentence is immediately followed by one that describes state indemnification statutes, and another that notes many

within the rules because of their awareness of the increased penalty associated with misconduct.

213. See *supra* Part II.A (discussing the importance of indemnification and advancement for attracting capable employees to the business world).

214. See Margulies, *supra* note 25, at 75 n.77 (discussing the argument that timid employees fearful of taking necessary risks would hurt a business so significantly that a complete abandonment of indemnification and advancement is not practical).

215. See *supra* Part III.C (discussing KPMG's creation of implied in fact contracts based on the past practice of indemnifying and advancing employees for thirty years, despite the fact that KPMG's partnership agreement and by-laws were silent on the issue).

216. *Stein IV*, 452 F. Supp. 2d 230, 261–62 (S.D.N.Y. 2006).

217. See *id.* at 261–63 (arguing that KPMG had established an implied in fact contract for indemnification with its employees based on past performance).

218. McNulty Memo, *supra* note 188, at 12.

219. *Id.*

corporations have contractual obligations to advance legal fees because of provisions in their charters, bylaws, or employment agreements.²²⁰ Only after first establishing the existence of statutory or contractual obligations to advance attorney fees does the McNulty Memo conclude "Therefore, a corporation's compliance with governing state law and its contractual obligations cannot be considered a failure to cooperate."²²¹ This appears to make permissible advancement contingent on binding obligations to advance legal fees, but just one paragraph later, the McNulty Memo warns that overly broad assertions of representation of employees can still be considered obstruction of an investigation and count against a company.²²²

This section implies that the government would frown upon an ad hoc decision by a company to advance legal fees to employees under investigation, and it would not penalize a company for advancing legal fees only if that company had a valid obligation to do so. Indeed, even recently created advancement contracts, perhaps in the face of an impending investigation, could be considered one of the "extremely rare cases" where the advancement could be held against a company because it would seem to indicate a desire to impede a criminal investigation.²²³ Silence on the issue of advancement, therefore, is perhaps the worst position for a company to take because a history of advancement can create an obligation the company may not be aware of, but advancement without a clear obligation to do so may be held against the company as an effort to obstruct an investigation. Furthermore, while an explicit policy not to advance can be seen as part of a compliance program, it is

220. *See id.* at 11 (explaining how prosecutors should treat advancement). The McNulty Memo states:

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.

Id.

221. *Id.*

222. *Id.* at 12 ("Another factor to be weighed by the prosecutor is whether the corporation, while purporting to cooperate, has engaged in conduct intended to impede the investigation Examples of such conduct include: Overly broad assertions of corporate representation of employees or former employees.").

223. *See* McNulty Memo, *supra* note 188, at 11 n.3 ("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.").

much harder to make the case that silence on a major issue is part of an effective "program."²²⁴

Considering language in the McNulty Memo that turns advancement into an all-or-nothing policy, companies are well advised to revisit their advancement provisions. There are various reasons why a company may wish to avoid advancement. For one thing, a company may not want to support individuals who misbehaved.²²⁵ For another, it may not want to spend immense sums defending someone who will be found guilty and will never be able to repay those immense sums.²²⁶ Crucially, in an effort to burnish their marks for cooperation and avoid indictment, a company may wish to be able to tell the right people at the right time that they are not advancing attorney fees to their employees under investigation.²²⁷ While these are three compelling reasons, they do not necessarily outweigh the arguments for indemnification and advancement in the first place.²²⁸ Regardless, companies should be aware that they will likely not be able to make this decision on the fly.

D. Employees and the McNulty Memo

While employers face difficult choices about establishing advancement policies, employees too face interesting predicaments related to advancement. Employees need to be particularly concerned because it is their own legal defense, and potentially their own time in jail, if they receive inadequate representation, that their companies are using as bargaining chips in an attempt to avoid indictment.²²⁹ As *Stein* indicates, employees probably do not want to rely on implied contracts for their advancement.²³⁰ Although this implied

224. *See id.* at 14 (noting that prosecutors should ensure a company's compliance program is more than a "paper program" by making "an informed decision as to whether the corporation has adopted and implemented a truly effective compliance program").

225. *See Radin, supra* note 210, at 278 (discussing the fact that companies often draw negative conclusions about the employees to whom they are advancing legal expenses).

226. *See id.* at 253 (indicating that companies are often never reimbursed the hundreds of thousands or millions of dollars that they are owed once it is determined that the employee who was advanced expenses was not entitled to those funds).

227. *See Stein III*, 435 F. Supp. 2d 330, 348 (S.D.N.Y. 2006) (noting that part of KPMG's effort to avoid indictment included the ability "to be able to say at the right time with the right audience, we're in full compliance with the Thompson Guidelines").

228. *See supra* Part II.A (discussing the arguments in favor of indemnification and advancement, and the benefits that such policies can bring to a business).

229. *See supra* Part III.B (discussing KPMG's attempt to use its advancement of legal fees to employees as a bargaining chip with the USAO in order to avoid indictment).

230. *See supra* Part III.B-C (indicating that, although KPMG's employees had implied in

contract was eventually found binding, KPMG did initially attempt to avoid advancing legal fees to its employees.²³¹ This forced some KPMG personnel to give statements to the USAO they likely would not have given, and others to expend large sums on their defense.²³² Additionally, their right to advancement was established only after a major legal battle.²³³ Therefore, employees should seek to have advancement provisions expressly written into their employment agreements or at least seek assurances that the company they work for has advancement provisions included in their bylaws.

V. Conclusion

Advancement of legal fees is a crucial part of the modern business world.²³⁴ The Thompson Memo tried to harness advancement, which normally serves to frustrate prosecutors by providing defendants a vigorous defense, for government purposes, by holding advancement against the company doing the advancing.²³⁵ This policy served to pressure companies into not advancing legal fees to their employees but was found unconstitutional in *Stein III*.²³⁶ Following this decision, the Thompson Memo received intense pressure from the business, legal, and political communities, eventually leading the Department of Justice to revise this controversial policy with a new set of guidelines known as the McNulty Memo.²³⁷ While proponents claimed the McNulty Memo fixed the problems noted by *Stein* and others, critics felt the changes did not go far enough.²³⁸ Indeed, in both what the McNulty Memo says and what it fails to say, questions and concerns about advancement remain. Employees should work to ensure that advancement provisions are actually included as terms of their employment because their employers might attempt

fact contracts for advancement, KPMG tried to avoid its obligation, with significant consequences for some employees).

231. See *supra* Part III.B–C (discussing KPMG’s actions regarding its contract for advancement).

232. See *supra* Part III.B–C (discussing KPMG’s employees’ reaction to their lack of advancement).

233. See *supra* Part III.C (discussing the court’s finding that KPMG’s employees did have implied in fact contracts).

234. See *supra* Part II (discussing advancement).

235. See *supra* Part III.A (discussing the Thompson Memo).

236. See *supra* Part III.B–C (discussing *Stein III* and the court’s holding).

237. See *supra* Part IV.A (discussing how the McNulty Memo changes the Thompson Memo).

238. See *supra* Part IV.B (discussing reactions to the McNulty Memo).

to back out of such requirements in an attempt to win cooperation points from the government.²³⁹ Employers, on the other hand, should seek to formalize these policies, either for or against advancement, as a case-by-case policy appears to carry risks without rewards.²⁴⁰ While different employers and employees may elect to take different paths regarding advancement, the fact remains that following the McNulty Memo, all parties should revisit their policies on advancement, both written and unwritten, with a full understanding of its costs and benefits, particularly its significant implications for criminal litigation.

239. *See supra* Part IV.D (indicating advice for employees).

240. *See supra* Part IV.C (indicating advice for employers).

