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## District Court Dismisses Criminal Charges After Finding that Government Violated Constitutional Rights in Pressuring Employer Not to Advance Legal Fees

On July 16, 2007, in *U.S. v. Stein*, the U.S. District Court for the Southern District of New York dismissed criminal charges pending against 13 of 16 defendants, all former partners or employees of the KPMG accounting firm, after finding that the government's actions in pressuring KPMG not to advance the defendants' legal expenses violated their constitutional rights to due process and legal counsel.

The defendants faced criminal liability from their roles in promoting abusive tax shelters. With a view to avoiding its own indictment for its tax-shelter activities, KPMG bowed to government pressure and ceased to advance the legal fees of the individual defendants. In a prior decision in 2006, the district court held that the government's conduct in pressuring KPMG violated the individual defendants' constitutional rights. In this week's decision, the court reaffirmed its earlier decision and further held that the only suitable remedy was dismissal of the charges against those defendants who suffered from the government's actions.

The government practices at issue in *Stein* originated in the so-called "Thompson Memorandum," which was a 2003 memo from Deputy Attorney General Larry Thompson to all U.S. Attorneys. The memorandum outlined the facts and circumstances that should be considered in deciding whether to seek criminal indictments against business entities. Chief among the relevant factors was the degree of a company's cooperation in dealing with federal prosecutors, and payment of the legal fees of company personnel potentially involved in wrongdoing was viewed as evidence of a lack of cooperation, at least where payment of legal fees was not legally required.

The Thompson Memorandum squarely placed employers in a dilemma – either abandon employees in order to lessen the risks of indictment or assist employees in their own defense and face heightened risk of indictment. The court's 2006 *Stein* decision provided employers some relief in holding that government pressure to deny requests for payment of legal expenses violated the defendants' constitutional rights. In fact, in December 2006, following the *Stein* court's first decision, the United States Department of Justice issued a

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revised memorandum (the McNulty Memorandum) directing that, in assessing a company's cooperation, "[p]rosecutors generally should not take into account whether a corporation is advancing attorneys' fees to employees or agents under investigation and indictment." This week's *Stein* decision reaffirmed the court's earlier holding of unconstitutionality and further held that the only effective remedy under the circumstances was dismissal of the charges against the defendants harmed by the government's actions.

*Stein* clearly offers employers a measure of relief from the dilemma posed by the original Thompson Memorandum. Particularly with the revisions to the Thompson Memorandum prompted by *Stein*, employers who crafted compliance policies in light of the original memo may wish to consider revisions consistent with the holdings in *Stein*. However, with the clear possibility (if not likelihood) of a government appeal of *Stein* to the Second Circuit Court of Appeals, "wait and see" may be the better path as there may well be more chapters yet to be written in this story.