UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

UNITED STATES OF AMERICA	:	
- against -	:	S1 05 Cr. 888 (LAK)
JEFFREY STEIN, JOHN LANNING, RICHARD SMITH, JEFFREY EISCHEID, PHILIP WIESNER, JOHN LARSON, ROBERT PFAFF, DAVID AMIR MAKOV, LARRY DELAP, STEVEN GREMMINGER, RAYMOND J. RUBLE, also known as "R.J. Ruble," GREGG RITCHIE, RANDY BICKHAM, MARK WATSON, CAROL WARLEY, DAVID RIVKIN, CARL HASTING, RICHARD ROSENTHAL, and DAVID GREENBERG,	:	
Defendants.	:	

GOVERNMENT'S OPPOSITION TO DEFENDANTS' RENEWED MOTION TO DISMISS THE INDICTMENT

MICHAEL J. GARCIA,
United States Attorney for the Southern District of New York,
Attorney for the United States of America.

JOHN M. HILLEBRECHT,
KEVIN M. DOWNING,
RITA M. GLAVIN,
MARGARET GARNETT,
Assistant United States Attorneys
Of Counsel.

June 22, 2007

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- against -	:	S1 05 Cr. 888 (LAK)
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The Government respectfully submits this memorandum of law in opposition to the Defendants' Motion to dismiss the Indictment, and in response to the Court's May 30, 2007 Order. In that Order the Court posed the question "What if any sanctions other than dismissal of the entire indictment are available with respect to the constitutional violations found by the Court?" As explained below, based on the Government's analysis of the Court's prior ruling and on extensive legal research, we have concluded that the defendants are correct in their assertion that the only remedy that directly addresses the Constitutional violations found by the Court is dismissal of the Indictment. While we continue to respectfully disagree with the findings of fact and conclusions of law set forth in *United States* v. *Stein, et al.*, 435 F. Supp. 2d 330 (S.D.N.Y. 2006) ("*Stein I*"), given the Court's previous rulings, it appears that the only

action the Court could take consistent with those rulings would be dismissal of the Indictment. *See Stein* v. *KPMG, LLP*, ___ F.3d ___, 2007 WL 1487822, at *7 (2d Cir. May 23, 2007) ("Dismissal of an indictment for Fifth and Sixth Amendment violations is always an available remedy. . . . Assuming the cognizability of a substantive due process claim and its merit here, dismissal of the indictment is the proper remedy."). However, as explained below, the Government does not believe that dismissal would be appropriate as against certain defendants — including specifically defendants Ritchie, Makov, Larson, Pfaff, and Greenberg (as well as Ruble).

Point I

THE PROPER REMEDY FOR THE CONSTITUTIONAL VIOLATIONS FOUND BY THE COURT

A. Assuming the Correctness of Stein I, Dismissal Is the Proper Remedy

In *Stein I*, the Court found a violation of the KPMG Defendants' Sixth Amendment right to counsel and Fifth Amendment right to substantive due process of law arising out of KPMG's decisions to condition and cap the payment of legal fees, and the Government's purported actions in relation to those decisions. The Court held that "[a] criminal defendant has a right to obtain and use in order to prepare a defense resources lawfully available to him or her, free of knowing or reckless government interference." This right, the Court found, was "fundamental" under the Fifth Amendment's Due Process Clause. 435 F. Supp. 2d at 361.

Because in the Court's estimation the Thompson Memorandum and the

Government's conduct "necessarily impinge[d] upon the [KPMG Defendants'] ability to defend themselves," and because the Memorandum and those actions "cannot withstand strict scrutiny under the Due Process clause," the KPMG Defendants' Fifth Amendment rights were found to be violated. 435 F. Supp. 2d at 364-65. Separate and apart from that analysis, the Court also held that the Government's purported "effort to limit defendants' access to funds for their defense" violated the Sixth Amendment. 435 F. Supp. 2d at 365-70.

In the course of the *Stein I* decision, the Court reached a number of legal conclusions pertinent to the question of remedy.[1] As an initial matter, the Court held that a KPMG defendant's "right to obtain and use in order to prepare a defense resources lawfully available to him or her, free of knowing or reckless government interference" is "fundamental" and "basic to our concepts of justice and fair play." *Stein I*, 435 F. Supp. 2d at 361-62. The Court further held that, based on its findings of fact concerning the Thompson Memorandum and the Government's actions, that the Government's conduct had "impinged upon the KPMG Defendants' ability to defend themselves" and "almost certainly will affect what these defendants can afford to permit their counsel to do," thereby "impact[ing] the defendants' ability to present the defense they wish to present."

[1] In deciding *Stein I*, the Court considered and rejected a panoply of arguments made by the Government. *See, e.g.,* Government's Supplemental Memorandum on Issues Concerning the Defendants' Right to Counsel (April 27, 2006) ("Gov't Supp. Mem."); Government's Post Hearing Memorandum on Issues Concerning the Defendants' Right to Counsel (May 22, 2006). We renew all of those arguments and incorporate them by reference here.

435 F. Supp. 2d at 363. The Court also ruled that the Government "acted with the purpose of minimizing these defendants' access to resources necessary to mount their defenses or, at least, in reckless disregard that this would be the likely result of its actions." 435 F. Supp. 2d at 366-67. The transgressions of the Constitution found by the Court have, in the Court's view, "interfered with the KPMG Defendants' right to be represented as they choose," a violation that "is complete irrespective of the quality of representation [the Defendants] receive." 435 F. Supp. 2d at 369. This, the Court concluded, created a "structural defect," that by definition "'affected — and contaminated — the entire criminal proceeding.'" 435 F. Supp. 2d at 370 (quoting *Satterwhite* v. *Texas*, 486 U.S. 249, 257 (1988)). Indeed, the Court opined that "it is difficult to imagine circumstances in which an error more properly could be said to threaten to taint an entire proceeding." 435 F. Supp. 2d at 371-72. The Court also held that the Government's actions created "'an appearance of impropriety that diminishes faith in the fairness of the criminal justice system in general.'" 435 F. Supp. 2d at 373 (quoting *Young* v. *United States ex rel. Vuitton et Fils S.A.*, 481 U.S. 787, 811 (1987).

Given all of this, the Court reached its bottom line: "The KPMG Defendants can be restored to the position they would have occupied but for the government's constitutional violation if defense costs already incurred and yet to be incurred are paid." 435 F. Supp. 2d at 374. In that event, "the effect of the government's unconstitutional interference would have been remedied or, at least, mitigated

substantially"; absent such payments, the Court would consider dismissal of the Indictment. 435 F. Supp. 2d at 380; *see also United States* v. *Stein*, 452 F. Supp. 2d 230, 237-38 (S.D.N.Y. 2006) ("*Stein III*") (in *Stein I* the Court "deferred the request of the KPMG Defendants to dismiss the indictment based upon the government's misconduct, reasoning that dismissal might prove inappropriate if KPMG were obligated to advance the defense costs, in which case all or much of the harm caused and still threatened by the government's actions might be remedied or avoided"), *vacated on other grounds sub nom. Stein* v. *KPMG, LLP*, ___ F.3d ___, 2007 WL 1487822, at *7 (2d Cir. May 23, 2007) .

Given the logic and express holdings of the Court's decision in *Stein I*, and given (i) the ruling by the Court of Appeals on the ancillary jurisdiction question and (ii) the fact that KPMG steadfastly declines to pay the defendants' fees, it is difficult to understand how anything short of dismissal of the Indictment would suffice. The Court has held that the defendants' Fifth and Sixth Amendment rights have been infringed and that those violations have led to "structural error," and the remedy that the Court hoped would restore the defendants "to the position they would have occupied but for the government's constitutional violation" has not come to pass. If the Court's analysis and holdings in *Stein I* are correct — and we respectfully submit that they are not — following any trial and conviction, on appeal "a *per se* rule of reversal [would apply] when a structural error is present at trial, even if the record contains overwhelming

evidence of guilt." *Peck* v. *United States*, 106 F.3d 450, 454 (2d Cir. 1997). If the cause of the "structural defect" is the fact that KPMG is not paying, "regardless of the cost," "defense costs already incurred and yet to be incurred," 435 F. Supp. 2d at 336, 374, it is difficult to conceive of a remedy other than such payments. On this point, we are forced to agree with the defense: "alternatives short of dismissal are simply not viable." (Joint Mem. at 27).

In our earlier briefing, the Government took the position that, assuming the correctness of the Court's findings, "the appropriate remedy would be to have KPMG reconsider its decision to advance fees to the defendants without reference to the Thompson memo or fear that doing so would constitute a breach of KPMG's deferred prosecution agreement." (Gov't Supp. Mem. at 17-18). The Court rejected the Government's position. *Stein I*, 435 F. Supp. 2d at 373-74. We also argued that the only appropriate mechanism by which money for the defendants' legal fees and related expenses can be obtained from Federal funds is the Criminal Justice Act. (Gov't Supp. Mem. at 21). The Court agreed that any order directing *the Government* to pay the defendants' fees, under any of several theories advanced by the defendants, would run afoul of sovereign immunity. 435 F. Supp. 2d at 374-76. As we also previously argued to the Court, to the extent that a given defendant establishes that he has suffered actual prejudice, in that he or she lacks sufficient funds to adequately defend the case, the appropriate remedy is an application under the Criminal Justice Act. (*See, e.g.*,

Government's Memorandum in Opposition to Defendant Carl Hasting's Motion for a Stay and for Other Relief (February 22, 2007) at 6-7; *cf.* June 20, 2007 Memorandum and Order at 8-9 (suggesting possibility of a CJA appointment for Hasting's counsel)). While we believe that CJA appointments along the lines suggested by the Court in its June 20 Order would suffice to remedy any possible claim of actual prejudice of constitutional magnitude, even accepting the majority of the conclusions in *Stein I*, it is difficult to understand how such a remedy would suffice in the context of the Court's ruling that prejudice to the defendants is to be presumed and that the Government's "interfere[nce] with the KPMG Defendants' right to be represented as they choose" is a constitutional violation that "is complete irrespective of the quality of representation [the Defendants in fact] receive." 435 F. Supp. 2d at 369.

There seems to be little dispute as to the governing law regarding dismissals of indictments. The Supreme Court has made clear that "[c]ases involving Sixth Amendment deprivations are subject to the general rule that remedies should be tailored to the injury suffered from the constitutional violation and should not unnecessarily infringe on competing interests." *United States* v. *Morrison*, 449 U.S. 361, 364 (1981); *cf. United States* v. *Chitty*, 760 F.2d 425, 431 n.3 (2d Cir. 1985) (Fifth Amendment violations are subject to similarly tailored remedies). The proper approach is to "identify and then neutralize the taint by tailoring relief appropriate in the circumstances to assure the defendant the effective assistance of counsel and a fair trial." *United States* v.

Morrison, 449 U.S. at 365. The core of this rationale is the necessity of prejudice to the defendant; "absent demonstrable prejudice, or substantial threat thereof, dismissal of the indictment is plainly inappropriate, even though the violation may have been deliberate." 449 U.S. at 365. In *Morrison*, federal agents intentionally approached the indicted defendant without the knowledge of her attorney, attempted to persuade her to cooperate in the investigation, and disparaged the attorney and suggested she change lawyers. Even though the defendant rebuffed those efforts, and continued to be represented by the same lawyer, she moved to dismiss the indictment and the Third Circuit ordered that the indictment be dismissed. The Supreme Court reversed because of the lack of prejudice, but specifically noted that there was no claim that "there was continuing prejudice which, because it could not be remedied by a new trial or suppression of evidence, called for more drastic treatment." 449 U.S. at 365 n.2.

Here, of course, the Court has already held that the Government has "interfered with the KPMG Defendants' right to be represented as they choose," a violation that "is complete irrespective of the quality of representation [the Defendants] receive" and as to which prejudice is to be presumed. *Stein I*, 435 F. Supp. 2d at 369. This, the Court concluded, created a "structural defect," that by definition "affected — and contaminated — the entire criminal proceeding." 435 F. Supp. 2d at 370 (citation omitted); *id.* at 369 ("Improper government conduct has created a significant risk that the KPMG defendants' ability to present the defense they choose has been compromised.").

By the express terms of *Stein I*, the Court has already held as a practical matter that the Government's conduct has "contaminated" the entire criminal proceeding. We continue to believe that the legal and factual premises underlying that conclusion are mistaken. But if the Court's opinion in *Stein I* stands, we have concluded that no remedy short of dismissal appears adequate to vindicate the interests identified in that opinion.

B. The Government's Conduct Was Not Outrageous And it Did Not "Shock the Conscience"

We believe this to be the case notwithstanding the fact that the defendants cannot possibly establish that the Government's conduct in this case constitutes such outrageous behavior as to "shock the conscience." (Joint Mem. at 3). *See, e.g., United States* v. *Marshank*, 777 F. Supp. 1507, 1522, 1525 (N.D. Cal. 1991) (holding that dismissal of indictment for Fifth and Sixth Amendment violations "is appropriate where continuing prejudice from the constitutional violation cannot be remedied by suppression of the evidence" or otherwise, and dismissing on those grounds independent of separate finding of "outrageous government conduct); *see also id.* at 1519 ("A Fifth Amendment due process violation may occur when government interference in an attorney-client relationship results in ineffective assistance of counsel ***or*** when the government engages in outrageous misconduct.") (emphasis added); *Stein I*, 435 F. Supp. 2d at 336, 374 (constitutional violation lay in interfering with defendants' ability to have KPMG pay defense fees "regardless of the cost," but defendants "can be restored to the position they would have occupied but for the government's constitutional violation if defense costs

already incurred and yet to be incurred are paid"). In *Marshank* the trial court strove to "tailor the remedy to the injury," considering suppression and other possibilities, but ultimately concluded under the "bizarre circumstances" of the case (in which the Government used a defense lawyer to identify and target Marshank for the Government and then, while acting as his lawyer, cajole him into giving statements to the Government) that "the fruit of the prosecutor's transgression [was] the indictment itself" and that it was "simply impossible to excise the taint" of the constitutional violation from the case. 777 F. Supp. at 1522. Because the Government's violation "infected every part of the investigation and prosecution of the defendant," there was "no means other than dismissal of the indictment to remedy the due process violation." 777 F. Supp. at 1523.

A case like *Marshank* differs from cases like *United States* v. *Gonzalez-Lopez*, ___ U.S. ___, 126 S. Ct. 2557 (2006), or *United States* v. *Williams*, 372 F.3d 96 (2d Cir. 2004). Although the defendants in both of those cases "suffered from a tangible violation of his Sixth Amendment right to counsel," *Williams*, 372 F.3d at 110, neither the Supreme Court nor the Second Circuit found it necessary to dismiss the indictment. In *Gonzalez-Lopez*, the Supreme Court held that the defendant was denied counsel of choice and that that "structural error" required reversal of the conviction, but remanded for a new trial (at which, presumably, the defendant could be represented by his first-choice defense counsel). 126 S. Ct. at 2564-66. In *Williams*, the Second Circuit refused even to order a new trial, much less dismiss the indictment, holding that the ineffective assistance of

counsel caused by the Government's conduct was limited to the pre-trial stage and concluding that the proper remedy was a re-sentencing, with the trial court attempting to "reconstruct the likely result Williams would have obtained had he not had conflicted counsel." 372 F.3d at 111. Here, by contrast, if the Court's holding in *Stein I* is correct, there would appear to be no similar remedy available.

Accordingly, given that the Court has already held that the Government has violated the Fifth and Sixth Amendment rights of the defendants, and given that neither the Government nor the defense has been able to suggest a remedy that addresses the violation as defined by the Court, we respectfully submit that the Court need not consider the defendants' arguments as to outrageous misconduct. In any event, even accepting all of the defendants' many unsupported allegations at face value, given the ample precedent in this area there is no way that the Government's conduct can be said to "rise to the necessary level of outrage." *United States* v. *Williams*, 372 F.3d at 112. Due process challenges to an indictment based on outrageous Government conduct have almost never succeeded. *United States* v. *Berkovich*, 168 F.3d 64, 68-69 (2d Cir. 1999) (citing *United States* v. *LaPorta*, 46 F.3d 152, 160 (2d Cir. 1994) (finding only one case where a court has found such conduct since 1976, and that case involved a finding of entrapment)).

As the Second Circuit noted in *United States* v. *Chin*, 934 F.2d 393, 398-99 (2d Cir. 1991), the type of conduct so extreme as to "shock the conscience" includes primarily "[e]xtreme physical coercion" or "torture" (physical or psychological) that is

'brutal and . . . offensive to human dignity." *United States* v. *Chin*, 934 F.2d at 398-99. As illustrative examples, the Second Circuit cited *Rochin* v. *California*, 342 U.S. 1656, 172 (1952), and *Huguez* v. *United States*, 406 F.2d 366, 381-82 (9th Cir. 1986). In *Rochin*, "police officers broke into defendant's bedroom, attempted to pull drug capsules from his throat, and, finally, forcibly pumped his stomach to retrieve the capsules." *Chin*, 934 F.2d at 399. In *Huguez*, "border patrol officers forcibly removed narcotics packets from [the] defendant's rectum while defendant was handcuffed and spreadeagled across the table by other officers." *Chin*, 934 F.2d at 399. However negative a view one might hold as to the Thompson Memorandum, the Government's conduct in this case, or the Government's conduct of corporate criminal investigations generally, it is far-fetched in the extreme to suggest that any such conduct can "be said to 'shock the conscience' as would physical coercion or torture." *Chin*, 934 F.2d at 393.

The defendants suggest that this case "is not dissimilar in principle" to the rare cases finding "outrageous" government conduct that does not involve physical torture or the like, citing specifically *United States* v. *Marshank*, 777 F. Supp. 1507 (N.D. Cal. 1991), *United States* v. *Sabri*, 973 F. Supp. 134 (W.D.N.Y. 1996), and *United States* v. *Stringer*, 408 F. Supp. 2d 1083 (D. Or. 2006). (Joint Mem. at 22). Reference to those cases belies the claim. As discussed above, in *Marshank* the Government "actively collaborated with [the defendant's lawyer] to build a case against the defendant, showing a complete lack of respect for the constitutional rights of the defendant," with almost all

of the Government's evidence against Marshank consisting of "information received from his own attorney." 777 F. Supp. at 1524. *Sabri* was a similar situation, in which the defendant's immigration lawyer, acting at the Government's direction, initiated a telephone conversation with her client, recorded that conversation at the Government's behest, and steered the conversation to the topic of violence, eliciting the statements that resulted in her client's indictment on charges of threatening to kill federal officials. 973 F. Supp. at 138, 147. In *Stringer*, the court found that the prosecution used a long-term civil SEC investigation to gather evidence for a criminal case that it had already decided to bring. *See Stringer*, 408 F. Supp. 2d at 1087. On facts that amply established an explicit "strategy to conceal the criminal investigation from defendants," the court found that the prosecution "spent years hiding behind the civil investigation to obtain evidence, avoid criminal discovery rules, and avoid constitutional protections." 408 F. Supp. 2d at 1088-89. Simply describing the facts of those cases makes plain that, contrary to the Defendants' claims, those cases are indeed grossly "dissimilar in principle" to the conduct found by the Court here.

Defendants' attempt to gin up facts that bring this case close to such blatant and egregious misconduct necessarily fails. In support of their claim that the Government engaged in outrageous misconduct, the defendants point to ten factors, briefly addressed below. Given the analysis adopted by the Court in *Stein I*, there is no need for the Court to consider these issues on this motion. In any event, the defendants' allegations as to

each of these events are without merit and could not satisfy the standard for outrageous government misconduct.[2] The ten factors are as follows.

(i) "New Evidence" Regarding the Findings in *Stein I* — We briefly address the purported "new evidence" that defendants point to in support of their claims and certain findings in *Stein I*. First, defendants point to a voicemail message that then-Chairman Gene O'Kelly sent to all KPMG partners on February 18, 2004, as evidence that "[p]rior to [the] February 25 meeting, KPMG clearly intended to follow its prior practice of always paying fees for its members and employees." (Joint Mem. at 7). But the voicemail message, viewed in context, indicates no such thing. According to the text of that voicemail, O'Kelly informed the current partners of the commencement of the USAO investigation, stated that the firm intended to "fully cooperate" with that investigation, and that "[a]ny present or former members of the firm asked to appear [in that investigation] will be represented by competent council [*sic*] at the firm's expense and should contact the Office of General Counsel." (Exhibit C to Spears Declaration).[3]

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[2] We have not attempted to address every spurious allegation launched by the defendants in their voluminous briefing on this "supplemental" motion. Rather, we have limited ourselves to what appear to be the key points raised by defendants. Of course, failure to respond here to a particular assertion in one defendant's brief or another does not indicate agreement with those claims.

[3] Although defendants suggest that this voicemail transcript was somehow hidden from them, it was produced to defendants in electronic form on March 14, 2006, and had previously been produced in "hard copy" paper discovery. It appears that the Government received the electronic version of the document as part of a supplemental production from KPMG in January 2006. Moreover, at least some of the defendants likely received the original voicemail message in February 2004 — including Smith, Rosenthal, Warley, Gremminger, and possibly Eischeid.

Of course, KPMG *did* provide counsel at its expense for every current or former partner who was interviewed by the USAO and requested such counsel. Moreover, the voicemail message is nearly identical to the language in a memo that went to a wide group of KPMG partners and employees on March 12, 2004 (*i.e.,* after KPMG had notified the defendants and others of its decision regarding paying legal fees subject to a cap and certain conditions), which stated that KPMG would "be responsible for the payment of reasonable fees and related expenses in connection with . . . representation regarding this investigation." *Stein I*, 435 F. Supp. 2d at 346 n.62 (quoting K271-73 at 272, and noting that "The failure to indicate that payment of legal fees would cease if the recipient were charged or to refer to the $400,000 cap apparently is attributable to the fact that those limitations were contained in letters sent to counsel for persons who already had received subject letters from the government while the advisory memorandum went to a broader group."). Finally, the defense inference is also inconsistent with the testimony of Joseph Loonan (KPMG's general counsel) at the Fee Hearing, who testified that the discussions he had with then-Chairman Gene O'Kelly and others regarding how and whether KPMG would pay fees for the tax shelter investigation took place *before* the February 25 meeting with the Government. (May 9 Transcript at 142-143).

Second, the defendants point to handwritten notes apparently taken by Greg Russo, chairman of Risk Management at KPMG, during a meeting with Skadden lawyers following the February 25 Meeting at the USAO. (Exhibit D to the Spears Declaration).

Despite the defendants' fanciful narrative as to the meaning of these notes (*see, e.g.*, Joint Mem. at 8-9; Smith Mem. at 2-3), it is impossible to discern from the face of the notes which portions reflect advice by Skadden, which portions reflect Skadden's summary of events or statements at the February 25 Meeting, which portions reflect Skadden's interpretation of those events or statements, and which portions reflect Russo's own thoughts or impressions or statements. Notably, the defendants declined the opportunity to call Mr. Russo as a witness at the Fee Hearing, where any such recollections could have been inquired into under oath and tested with cross-examination. Indeed, defendants' assertion that these notes buttress their claim that the USAO directed particular fee decisions by KPMG at the February 25 Meeting is directly contradicted by a witness with personal knowledge of the post-meeting debriefing whom the defendants *did* call as a witness at the Fee Hearing: Joseph Loonan. In response to a question from Mr. Spears, "What do you recall [Skadden] telling you, if anything, that the government had said [at the February 25 Meeting] about payment of fees for individuals in connection with the investigation?" (May 9 Transcript at 165), Mr. Loonan responded, "I do not recall that I was told *anything about what the government said about the payment of attorneys' fees*." (May 9 Transcript at 165-66 (emphasis added)).

(ii) The Negotiation Over KPMG's Statement of Facts — KPMG entered into a Statement of Facts that was appended as Exhibit C to the DPA. In connection with the proceeding before Judge Preska at which KPMG waived indictment

and agreed to enter into the DPA, Judge Preska questioned Sven Holmes, former United States District Judge and presently the chief legal officer for KPMG, regarding, among other things, whether the board of KPMG had authorized the acceptance of the DPA and whether "the firm admit[s] the truth of the facts that are set out in Exhibit C, the statement of facts that's attached to the agreement," to which Holmes answered, "Yes, your Honor." (August 29, 2005, Transcript at 2-5, 8; 05 Cr. 526 (LAP)). Defendants assert that "KPMG's self-immolating statement of facts was induced by Government coercion" (Joint Mem. at 11) and that "the statement was not based on KPMG's own knowledge of wrongdoing" (Joint Mem. at 15), and thus the Statement is "additional evidence of misconduct" that would support dismissal of the indictment. (Joint Mem. at 11 n.21). This argument is preposterous.[4]

Before addressing certain of defendants' most egregious misstatements and unsupported inferences, it is useful to set out some basic principles that seem beyond dispute. First, business entities, like individuals, can commit crimes and are properly and lawfully the subject of criminal investigation and prosecution.[5] Second, it thus follows

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[4] We note that the Court has already denied defendant Ruble's motion to dismiss notwithstanding his argument that the Government coerced KPMG to adopt the Statement of Facts in an effort to "silence KPMG employees" and others who, absent the Statement of Facts, might contradict the Statement or "help the defense" in other ways. (*See* Memorandum on Behalf of Defendant Raymond J. Ruble Joining in Co-Defendants' Motion to Dismiss ("Ruble Mem.") at 2; *cf.* June 18 Order (Ruble's "other arguments are baseless")).

[5] Federal corporate criminal liability has been black-letter law since at least the turn of the last century, *see New York Cent. & Hudson R.R. Co.* v. *United States*, 212 U.S. 481, 495 (1909); *United States* v. *Illinois Central R.R. Co.*, 303 U.S. 239 (1938); *United States* v. *A & P*

that United States Attorneys have a duty to conduct investigations and consider seeking criminal charges when federal prosecutors have evidence that violations of federal laws by business entities have occurred, just as they do with individuals. And, third, the law is well-settled that the prospect of lenient treatment for criminal suspects or defendants in exchange for cooperation with the Government does not constitute improper coercion.[6] In light of these principles, and the facts regarding the Government's investigation of KPMG's criminal conduct and the resolution of that investigation, the defendants' assertions must be rejected, and there can be no question that their allegations cannot form the basis for a finding of "outrageous government misconduct."

The commencement of the USAO criminal investigation came on the heels of several well-publicized excoriations of both KPMG's tax shelter practices and its conduct in the face of investigations into those practices. These included investigative hearings in the United States Senate into those practices; a scathing Senate report regarding the firm's conduct, which specifically called for further investigative action by the DOJ; an IRS audit investigating KPMG for a possible "tax shelter promoter penalty";

Trucking Co., 358 U.S. 121 (1958).

[6] *See, e.g., United States* v. *Ruggles*, 70 F.3d 262, 265 (2d Cir. 1995) (statements by the Government regarding benefits of cooperation or the possibility of leniency are not improperly coercive, and do not render statements involuntary); *United States* v. *Bye*, 919 F.2d 6, 9-10 (2d Cir. 1990) (same); *see also United States* v. *Singleton*, 165 F.3d 1297, 1301 (10th Cir. 1999) (*en banc*) ("From the common law, we have drawn a longstanding practice sanctioning the testimony of accomplices against their confederates in exchange for leniency. . . . Indeed, no practice is more ingrained in our criminal justice system.") (internal quotations and citations omitted).

a referral of KPMG by the IRS to the DOJ for summons enforcement in connection with the IRS audit; a highly critical Special Master's report regarding KPMG's summons compliance; and the filing of a host of civil suits against the firm by former tax shelter clients that potentially exposed the firm to hundreds of millions of dollars in civil damages. KPMG had also been the subject of extensive negative press coverage regarding its conduct and these events. It is therefore unsurprising that KPMG was anticipating that the USAO's investigation could lead to criminal charges, and that KPMG sought from the beginning to avoid that result. Nor is it surprising that the prosecutors from the USAO may have viewed KPMG with skepticism, given this history.

When KPMG's counsel first met with the Government on February 25, 2004, they opened the meeting by asserting that the firm should not be criminally charged due to the collateral consequences, regardless of the conduct in which it may have engaged. (*See, e.g.,* U 101, U 113-114 (admitted into evidence at the Fee Hearing). KPMG also indicated from the very first meeting with the USAO that the firm intended to cooperate fully with the investigation and that it did not intend to escape criminal charges by defending the substance of the firm's conduct. (*Id*.) This remained KPMG's position throughout the USAO investigation — with a few small exceptions, the firm made no effort to defend the conduct or the underlying facts, and focused its arguments throughout the process on why, regardless of the seriousness of the underlying conduct, KPMG should not be criminally charged, including (i) the collateral consequences to the firm and

the capital markets, (ii) the steps the firm had taken and would continue to take to change its culture and implement compliance and other procedures that would prevent a recurrence of similar conduct, and (iii) its cooperation with the Government's investigation. (*Compare* U 113-114 *with* Exhibit I to Spears Declaration (Barloon memo regarding March 2, 2005, meeting) *with* Exhibit H to Spears Declaration (Barloon memo regarding June 13, 2005, meeting with the Deputy Attorney General)).

The serious discussions regarding how the Government's investigation of KPMG would be resolved did not occur until the Spring of 2005, a year after the February 25 Meeting and after an extensive investigation into KPMG's conduct, including review of millions of pages of documents and interviews with hundreds of witnesses. KPMG was given ample opportunities to make its case for why it should not be criminally charged despite its serious criminal conduct, and the record indicates that those presentations, and the concerns raised in them, were given careful, serious and sustained consideration by David Kelley, the United States Attorney for the Southern District of New York. At the same time that KPMG was making its case for avoiding criminal charges, Mr. Kelley and the line prosecutors assigned to the investigation were giving KPMG's counsel their candid responses to KPMG's presentations and the factors that were influencing the decision that Mr. Kelley would have to make.[7] (*See, e.g.,* Exhibit G

[7] Defendants repeatedly characterize these statements as "threats" to indict the firm. This is nonsensical. Taken to its logical end, defendants would appear to prefer a regime in which, to avoid the "threats" of potential indictment, criminal investigations of entities were conducted with no communication with the entity regarding its status, and where federal prosecutors simply

to Spears Declaration, Exhibit I to Spears Declaration).

After the series of meetings in March and April, Mr. Kelley informed KPMG as to his decision regarding whether KPMG should face criminal charges. KPMG requested the opportunity to make a presentation to the Deputy Attorney General, James B. Comey, and did so at a meeting on June 13, 2005. As the Court is aware from review of the so-called "White Paper" (and as is apparent from the table of contents of that White Paper, which was provided to the defense as part of the Fee Hearing production), KPMG's presentation and appeal to Mr. Comey was based almost entirely on the Thompson Memo factors that do not go to the underlying conduct. The only exception was KPMG's argument that the firm itself did not have the requisite *mens rea* to have corruptly obstructed the Senate or IRS investigations; KPMG did not claim that no obstruction had occurred, only that there was insufficient evidence to charge the firm itself with a separate criminal count of obstruction. Following this presentation and meeting, Mr. Comey decided that a deferred prosecution agreement should be negotiated with KPMG. It was in this context that the serious negotiations over the contours of an agreement, and its accompanying statement of facts began.

KPMG's initial proposal for a statement of facts was made by Skadden on

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proceeded to indictment against entities, if they concluded such action was warranted, without advising those entities of their intentions or offering them the opportunity to make presentations on alternative resolutions or to appeal the decision of the U.S. Attorney for that district. This result would be absurd, and totally contrary to the Department of Justice's longstanding policies, from the Holder Memorandum through the McNulty Memorandum, to take into account a variety of factors other than those traditionally guiding the prosecutor's discretion on charging decisions.

March 17, 2005 (Exhibit J to Spears Declaration), as an opening gambit in its effort to reach a negotiated resolution of the USAO investigation. The statement can only be described as passive and pallid, and Skadden acknowledged at subsequent meetings that the statement suffered from "wordsmith[ing]" and "too much lawyering" and a desire to avoid anything that could cause problems for KPMG in its mushrooming civil litigation over its tax shelter conduct, including using what Skadden described as "weasel words". Skadden also clearly stated that the firm was prepared to "say more" or make more extensive admissions if necessary. (*See* Exhibit M to Spears Declaration, Barloon memo regarding March 18, 2005, meeting). KPMG clearly hoped that such an equivocal statement, with no real acceptance of responsibility or acknowledgment of wrongdoing by the firm, would be sufficient to secure the result they desired. Needless to say, the proposed statement was entirely unacceptable to the USAO, and there is absolutely nothing improper in communicating this dissatisfaction. As is well-known to this Court (and experienced defense counsel), this Office, quite appropriately, requires potential cooperators and defendants seeking alternative dispositions to make a full admission of their criminal conduct to the satisfaction of the Government, and to fully accept responsibility for that conduct, before receiving the benefits of a cooperation agreement or deferred prosecution agreement. This determination is made solely by the prosecutors, based on what the Government's investigation has revealed about the nature and extent of the criminal conduct at issue. The Government's refusal to accept KPMG's initial

proposed statements is entirely consistent with this policy.[8]

Moreover, the defendants' assertion that the Government essentially dictated the statement and "coerced" KPMG into accepting it is not supported by the facts. The final Statement was the subject of intense negotiation, with changes proposed and rejected by both sides.[9] Once negotiations for the DPA were in full swing, both sides knew that the final statement would have to be one that KPMG could swear was true in open court. Indeed, the lead prosecutor told KPMG's counsel very early in the process that, if there were statements that the Government believed were true that KPMG did not want to make, either because KPMG *did not believe they were true*, or because a particular statement would cause specific problems for the firm, they should so advise the Government. (*See* Exhibit N to Spears Declaration at 5). When the agreement was finalized, of course, former District Judge Sven Holmes, authorized to speak on behalf of

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[8] The evolution of the firm's statements from passive to active acceptance of responsibility and admissions of criminal culpability is likewise typical of potential cooperators in criminal cases, whether individuals or entities, who often begin their proffers or potential cooperation by being willing to offer information about the wrongdoing of others, while minimizing any personal wrongdoing, and eventually arrive at a point of being willing to fully admit their own criminal conduct.

[9] *See, e.g.,* July 18, 2005 red-lined draft of the Statement of Facts, sent from Skadden to the USAO, attached as Exhibit C to the Glavin Declaration; which contains many substantive changes or deletions requested by Skadden that are in the final Statement of Facts, including changing "fraudulently concealing" to "actively taking steps to conceal" in paragraph 2(iv), changing "intentionally misstating" to "misrepresenting" in paragraph 2(v), and deleting the sentence "This conclusion [that FLIP and OPIS were more likely than not] was not true because KPMG believed that the transaction had no chance of prevailing if the IRS were to discover either from KPMG or its clients the truth about how the transactions were arranged and for what purpose" from paragraph 9.

the firm in his role as chief legal officer, informed Judge Preska in open court that KPMG "admitted the truth of the facts set forth" in the Statement of Facts.

Defendants argue that the Statement of Facts must have been coerced and must not have been based on KPMG's actual knowledge of its wrongdoing by repeating the canard that the Government had forbidden KPMG from conducting an internal investigation. Review of the facts indicates that this assertion is vastly overstated and, in any event, cannot support the inference that defendants wish to draw. It is correct that the USAO asked Skadden to notify the prosecution team before conducting any investigative interviews related to the tax shelter investigation, and (if the person was someone whom the prosecution team still wanted to interview) to delay any internal interview or to provide the USAO with the questions that Skadden wanted to ask. This is hardly unusual in the midst of ongoing investigations, as KPMG's counsel explained to KPMG's Board. (*See* Exhibit O to Spears Declaration at 5; Statement of Facts ¶ 35). In addition, the USAO did ask Skadden, in the summer of 2004, not to undertake its own investigation at that time of KPMG's statements regarding SOS in response to the IRS summons. (*See* Exhibit D to Glavin Declaration). Of course, Skadden and KPMG had full access to all of the many documents that they were producing to the USAO in response to grand jury subpoenas and otherwise; the numerous internal investigations that had been conducted prior to the USAO investigation (such as the internal investigation into David Greenberg's conduct, the various interviews conducted by other law firms regarding

KPMG's summons compliance process, etc.); the discovery and depositions in the ongoing civil litigation, including testimony to the IRS; the findings related to the IRS summons compliance, and the Senate PSI testimony, report and exhibits; and other sources of information related to the conduct at issue in the Statement of Facts. This wealth of information was clearly enough for various highly experienced counsel to conclude that there was ample evidence of KPMG's criminality. (*See, e.g.,* Exhibit G to Spears Declaration (notes of Marjorie Peerce at pages 1, 3, 4, citing Sven Holmes stating "I have done a personal review of a great number of documents. . . . What went on here [with regard to the tax shelter conduct] in magnitude was huge. There was firm practice through the tax practice and through the infra structure of the firm. . . . I recognize that the conduct was of such an egregious caliber"); Exhibit H to Spears Declaration (Skadden memorandum of June 13, 2005, meeting with James Comey, citing Bob Bennett stating "the firm acknowledged that a number of partners, including high-level ones, 'did engage in a conspiracy to evade taxes'."; citing Sven Holmes stating "KPMG admitted and acknowledged having engaged in criminal conduct. . . 'we're saying criminal' and we were 'prepared to acknowledge a conspiracy to defraud'"); Exhibit M to Spears Declaration (Skadden memo of March 18, 2005, meeting, citing Kenneth Bialkin stating that "there was 'no doubt that people communicating to the IRS knew there was information that wasn't being disclosed'"; citing Bob Bennett stating that "We have no doubt that crimes were committed"); Exhibit E to Glavin Declaration (Kenneth Bialkin

email of March 24, 2005)).

Defendants rely heavily on an email sent by Joseph Loonan to Skadden on March 19, 2005, in which Loonan asserts his belief that the recitation of the Government's view of the facts underlying KPMG's criminal culpability was "in large part . . . false, misleading and unsupportable." (Exhibit L to Spears Declaration). Not only is this view contrary to other counsel's conclusions, as noted above, and ultimately to the decision by the firm to enter the DPA and subscribe to the Statement of Facts, but at most it merely indicates that one KPMG insider had a different view of the underlying facts and, perhaps understandably, had difficulty accepting that his firm and his partners had engaged in criminal conduct. But, more importantly, the weight that defendants put on the Loonan email cannot be reconciled with their core argument that the Statement of Facts could not have been based on KPMG's "own knowledge of wrongdoing" because of the purported lack of an independent internal investigation. Both things cannot be true, and the defendants cannot have it both ways. Either KPMG and its advisors knew enough about the underlying facts to form a view on their criminal culpability and make reliable statements regarding that culpability, or they did not. It cannot be the case that they knew enough about the underlying conduct to have an informed and accurate view as to the firm's innocence, but that any view as to the firm's guilt must have been coerced and not based on sufficient knowledge.

Finally, the defendants' assertions regarding how the alleged misconduct with respect to the Statement of Facts has harmed or prejudiced them, and thus how they have standing to argue that their own indictment should be dismissed due to "outrageous misconduct" purportedly directed at another defendant, are essentially the same arguments that were raised and rejected by the Court in the pre-trial motion practice, and they should be rejected again. Defendants allege that the Statement has chilled potential defense witnesses who are still employed by KPMG and has tainted the potential jury pool for a trial in this matter. Of course, if either of these purported harms came to pass, they would be of legitimate concern to both the Court and the Government. However, there is no evidence whatsoever that that is so, and as such defendants' claims remain, as they were in April 2006, entirely "speculative," and thus they provide no basis for dismissing the Indictment against these defendants. *United States* v. *Stein*, 2006 WL 1063295, *2-3 (S.D.N.Y. Apr. 5, 2006).

(iii) KPMG's Termination of Richard Smith — Defendant Richard Smith asserts that an additional basis for a finding of "outrageous misconduct" is the Government's supposed role in KPMG's decision not to enter into a negotiated "Retention Agreement" with him, and in the firm's decision to terminate his partnership for cause in April 2005. There is almost no evidence for these assertions, and certainly no evidence that the Government's role was nefarious, directed personally at Richard Smith, or amounted to outrageous governmental misconduct. First, Smith suggests that, at the

February 25 Meeting, the USAO "caused KPMG to renege on the 'pending' Retention Agreement with Mr. Smith." (Smith Mem. at 4). This is baseless – there is absolutely no evidence that the Government had any idea that KPMG was negotiating a retention agreement with Smith, much less what its terms were. The Government does not dispute that Gene O'Kelly may have told Smith that the firm would not sign the Agreement during the pendency of the USAO investigation, but that position is neither surprising nor attributable to the Government. Rather, it appears entirely reasonable that KPMG might not wish to tie its own hands with a multi-year, multi-million-dollar agreement with a person whom the firm had already removed from his prior position as a result of his (at least) embarrassing testimony before the U.S. Senate relating to the same events that were currently the subject of a criminal investigation by federal prosecutors. Despite creative interpretation, the Russo notes provide no help to Smith's argument, for all the reasons discussed above.

Second, Sven Holmes testified in a civil deposition that he made the decision to fire Richard Smith as part of a process of removing anyone who had been a high-level supervisor over the firm's tax shelter conduct, regardless of personal wrongdoing.[10] (Exhibit N to Obeid Declaration, at, *e.g.,* 52, 55; *see also* Exhibit G to

[10] Smith takes inconsistent positions in his brief with respect to whether KPMG had adequate information to make its own determination as to whether he should be fired for cause. At several points he references the purported prohibition on an internal investigation and argues that because of that KPMG couldn't possibly have had the necessary information to fire him on its own (*see, e.g.,* Smith Mem. 5 n.9), and at another point he asserts that KPMG and Skadden had conducted "in-depth reviews" into his conduct and had determined there was no reason to

Spears Declaration (notes of Marjorie Peerce of Holmes statement at April 27, 2005, meeting that "I have done a personal review of a great number of documents. . . . This problem became a firm wide problem and I made it my mission to determine who had responsibility for it or who derogated their responsibility. One partner has been terminated for cause . . . I hope that I will have dealt with everyone at the firm who made this a firm wide problem.")). Finally, the comments and questions that Smith points to in his brief to argue that the Government directed that he be fired cannot support an argument that the Government had an interest in Smith's firing or desired that result. Rather, those questions and comments came in response to one of the arguments that KPMG made repeatedly in the spring of 2005 to support their position that criminal charges would be inappropriate — that the firm had "cleaned house," changed its culture, was in essence a "different firm" run by "different people" than the firm that had engaged in the conduct described in the Statement of Facts. (*See, e.g.*, Exhibit M to Spears Declaration at 0170128). The Government did not simply accept these assertions from KPMG's representatives, any more than prosecutors would simply accept assertions from an individual's defense counsel that criminal conduct under investigation was "aberrant behavior" when the Government's investigation indicated otherwise. In short, KPMG acted to further its own interests in firing Smith and in declining to enter into a multi-million-dollar retention agreement with him. To the extent that Smith has a grievance, it

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fire him (*see* Smith Mem. 9 n.15). As discussed above with respect to the Loonan e-mail, both things cannot be true.

is with KPMG. There is nothing nefarious in this record, and nothing that amounts to outrageous government misconduct warranting dismissing of the Indictment against Richard Smith.

(**iv) The Potential Conflict Between Defendants and Their Pre-Indictment Counsel** — Rosenthal argues that the Government's conduct created an actual conflict of interest between him and his counsel "due to KPMG's conditioning payment of fees on Mr. Rosenthal cooperating with the government." (Supplemental Memorandum of Defendant Richard Rosenthal on Motion to Dismiss ("Rosenthal Supp. Mem.") at 3). According to Rosenthal, the Government "had a legal obligation to inform Mr. Rosenthal of the legal consequences of the conflict that the government had created." (Rosenthal Supp. Mem. at 3). The right to conflict-free counsel, however, flows from the Sixth Amendment and attaches only after indictment. *See, e.g., United States* v. *Levy*, 25 F.3d 146, 153 (2d Cir. 1994) (right to conflict-free counsel "stems from the Sixth Amendment" and district court has obligation of inquiry "whenever there is a possibility that *a criminal defendant's* attorney suffers from any sort of conflict of interest") (emphasis added); *United States* v. *Schwarz*, 283 F.3d 76 (2d Cir. 2002) (same).

Rosenthal is correct that, after he was indicted and his Sixth Amendment rights attached, the Government sought a hearing pursuant to *United States* v. *Curcio*, 680 F.2d 881 (2d Cir. 1982), with respect to co-defendant Ritchie because it believed that his fees were being paid by his employer, Pacific Capital Group. Rosenthal claims that we

should have sought a pre-indictment waiver of the conflict that existed because *his* fees were being paid by KPMG. (Rosenthal Supp. Mem. at 4; *see also* Joint Mem. at 10 n.9 (same, citing Government's duty to raise issue with the court)). Such a rule, however, would seem at odds with the defendants' core position on legal fees. If the Government had a *Curcio* obligation on these facts, it would be forced to seek *Curcio* waivers before the Part I Judge, pre-indictment, any time a corporation under investigation advanced legal fees to its employees. That is not the law, nor do we imagine defense counsel would advocate that it ought be. By his own admission, Rosenthal, a sophisticated individual who served as Chief Financial Officer for KPMG, was fully advised by his own lawyer as to the conditions under which KPMG was paying his legal fees. His allegation that the Government had a legal obligation to advise him in September 2004 (some thirteen months before he was indicted) as to the potential conflict implications regarding those payments is unsupported by any pertinent citation, is not the law, and provides no support for a finding that the Government's conduct was untoward in any way.

(v) The Government's Arguments Regarding Severance — The defense also argues that the Government acted in an outrageous manner in that it "strategically misled this Court relating to severance." (Joint Mem. at 16). According to this argument, the Government's "strategy has been to oppose severance in order to induce guilty pleas, using fees as leverage." (Joint Mem. at 18). There is no support for this argument whatever. The Government sought an indictment of a large number of defendants

because a large number of conspirators participated in a massive fraud that spanned a number of years. Indictments of similar numbers of defendants in cases involving similarly large-scale criminal enterprises are, as the Court well knows, common in this District. *See, e.g.*, *United States* v. *Bellomo*, 06 Cr. 008 (LAK) (34 defendants); *United States* v. *Geng Chen*, 05 Cr. 938 (DAB) (41 defendants); *United States* v. *Lim Shang*, 04 Cr. Cr. 1205 (BSJ) (28 defendants). As the Government routinely argues in such cases, and as it argued to the Court in this case, it is usually prudent to defer ruling on severance motions until the parties have had a chance to engage in plea discussions, because the reality is that in almost every case a large percentage of criminal defendants plead guilty. (*See* transcript of 10/24/05 conference (Exhibit T to Spears Declaration) at 19 (prosecutor arguing that Court should defer ruling on severance because "some defendants might plead guilty"); transcript of 3/30/06 conference (Exhibit U to Spears Declaration) at 95-96 (THE COURT: "you quite rightly think that it is at least possible that two or three months from now we are looking at a much smaller case")). That this has not occurred in this case is, we submit, due in large part to the uncertainty for all parties generated by the numerous collateral proceedings that have been pending since *Stein I*, as well as the pending motion to dismiss.

In short, as to severance the Government has behaved in a manner entirely consistent with its usual practice in large, complex cases, and the defendants can point to nothing that suggests the contrary, and certainly nothing that makes the routine practice of

opposing severance in the expectation that a certain number of defendants will plead guilty conduct that "shocks the conscience."[11]

(vi) Discovery in This Case — Defendants make a number of complaints about the discovery in this case, the principal one being a simple reiteration of their central argument in *Stein I*, that the Government's "misconduct has deprived [the defense] of the resources to make adequate use of the materials that have been produced." (Joint Mem. at 29 n.38). Significantly, though, the defendants "are not complaining about the volume of discovery they have received per se." (*Id.*).[12] Defendants Larson and Pfaff complain specifically that the Government had been refusing to produce to it certain categories of documents from the investment advisor firm Quadra, and then "[s]uddenly" produced such material on June 1. (*See* Supplemental Motion to Dismiss of Defendants John Larson and Robert Pfaff ("Larson & Pfaff Supp. Mem.") at 10). In fact, the Government has previously produced material from Quadra and related entities to the extent such materials have been in its possession, and has produced materials similar to that produced on June 1 in prior discovery production. (*See* Glavin Dec. ¶ 12). The

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[11] Again, the Court has already rejected this argument while denying defendant Ruble's motion to dismiss. (*See* Ruble Mem. at 1-2; *cf.* June 18 Order (Ruble's "other arguments are baseless")).

[12] As detailed in the defense papers, the Government made a substantial production of additional documents in early June. As explained in the Declaration of AUSA Rita Glavin, filed along with this memorandum, a large portion of that production would in the ordinary course have been produced to the defendants earlier, but was delayed by Ms. Glavin's absence due to trial. (*See* Glavin Dec. ¶¶ 4-5).

suggestion that there is some devious plot to withhold documents is baseless.

(vii) The Government's Motion Practice — Certain defendants also complain that the Government has pursued a "cynical tactic" of resisting certain disclosures, prevailing before Your Honor on the issue, and then voluntarily producing some of the documents sought. (Larson & Pfaff Supp. Mem. at 7). Curiously, the assertion that the Government has proceeded in bad faith rests principally on the fact that we voluntarily produced documents (such as memoranda of interviews) as to which the defendants plainly are not entitled. In our motion practice we have proceeded in good faith to vindicate positions we believe to be supported by the law and the facts. Given that, the fact that we have on occasion produced to the defense certain documents that we have no obligation to produce cannot constitute outrageous conduct.

(viii) The Government's "Lack of Candor" — The defendants argue that the Government's conduct is outrageous in that the prosecution was "economical with the truth" in responding to the motion to dismiss. (Joint Mem. at 19 (quoting *Stein I*, 435 F. Supp. 2d at 380-81)). We respectfully disagree with the Court's findings in that respect, as explained in part in the June 30, 2006, letter to your Honor from the United States Attorney. We continue to believe that the Court erred in its conclusions. The suggestion that the Government's conduct is sufficiently "outrageous" because we continue to argue our position in the Court of Appeals (Joint Mem. at 20-21) is frivolous.

(ix) McNulty Memo — In arguing that the Government's conduct was sufficiently outrageous to justify dismissal, the defendants also argue that it is "significant" that the Thompson Memorandum has been superseded by the "McNulty Memorandum," apparently because *if* "the McNulty Memorandum [had] been in effect in February 2004, its express terms would have been violated by the prosecutors here." (Joint Mem. at 22). That argument fails as well. The McNulty Memorandum clarified that the advancement of legal fees "generally" should not be taken into account in assessing cooperation, but "in extremely rare cases. . . may be taken into account when the totality of the circumstances show that it was intended to impede a criminal investigation." (McNulty Memo. n.3). The Memorandum also imposes a requirement for approval from the Deputy Attorney General before considering this factor in charging decisions. Finally, this expanded discussion of the role of fee advancement notes that "[t]his prohibition is not meant to prevent a prosecutor from asking questions about an attorney's representation of a corporation or its employees. FN: Routine questions regarding the representation status of a corporation and its employees, including how and by whom attorneys' fees are paid . . . are appropriate and this guidance is not intended to prohibit such inquiry." (McNulty Mem. § VII).

Contrary to defendants' claims, even if the McNulty Memorandum had been in place at the time of the KPMG investigation, the USAO's actions would have been in full compliance with that policy. Both AUSAs who testified at the Fee Hearing

stated unequivocally that their understanding of the Thompson Memorandum's reference to fees was in circumstances where a corporation under investigation was using fee advancement as a means of shielding culpable employees and agents.[13] *Stein I*, 435 F. Supp. 2d at 363. The McNulty Memorandum makes explicit that that remains permissible. (McNulty Mem. n.3). Furthermore, the AUSAs in this case also testified that they never had the belief that KPMG was using its fee advancement policy to so shield culpable employees, and further that KPMG's policies with regard to fee advancement in the investigation were not considered as part of the ultimate charging decision. (5/8/06 Tr. at 67-68). Moreover, as the defendants note in their briefs, that charging decision was made by the Deputy Attorney General at the time, James Comey, the very person who would be required to approve any consideration of fee advancement in charging decisions under the policy described in the McNulty Memorandum. Finally, the inquiries made regarding fees at the initial February 25 Meeting between the USAO and Skadden fall squarely within the McNulty Memorandum's description of permissible questions regarding representation and payment of fees – whether KPMG intended to pay legal fees for current and former employees and what their obligations were in that regard.

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[13] We recognize that the Court has previously held that "that is not what the Thompson Memorandum says," and that "the text strongly suggests that advancement of defense costs weighs against an organization independent of whether there is any 'circling of the wagons.'" *Stein I*, 435 F. Supp. 2d at 363-34. We respond here to the argument that the prosecutors' conduct was so outrageous as to "shock the conscience," as to which we submit that the testimony of the prosecutors regarding their subjective understanding of the Thompson Memorandum remains relevant.

As the McNulty Memo makes clear, in restating a principle that is surely familiar to the Court, internal Department of Justice charging policies do not confer any substantive rights on anybody. (*See* McNulty Mem. § XIII). *See generally United States* v. *Catino*, 735 F.2d 718, 725 (2d Cir. 1984) (provisions of U.S. Attorney Manual create no enforceable rights); *United States* v. *Ng*, 699 F.2d 63, 71 (2d Cir. 1983) (same). Nor can a *post facto* change in an internal memoranda be deemed evidence of "outrageous conduct."

(x) KPMG's Payments Pursuant to the DPA — Defendant Wiesner argues that the Government engaged in outrageous misconduct by forcing KPMG to make certain payments pursuant to the DPA, trotting out two arguments that have already been rejected on nearly-identical briefing by this Court and by the Honorable Loretta A. Preska: (i) that $356 million of the $456 million paid by KPMG as part of its Deferred Prosecution Agreement ("DPA") should be made available to defendants to pay their defense costs in this action, and (ii) that the payment of the $356 million as part of the DPA was itself unlawful. (*See* Wiesner's Supplemental Memorandum of Law in Suport of Dismissal ("Wiesner Supp. Mem.") at 1-2). As to the first point, this Court expressly rejected this sanction in *Stein I*, finding that any order directing the Government to pay over these funds would run afoul of sovereign immunity. 435 F. Supp. 2d at 374-76. Wiesner now suggests that the failure of the Government to voluntarily impose this sanction upon itself amounts to ongoing prosecutorial misconduct (*see* Wiesner Supp.

Mem. at 5); Wiesner never explains how, exactly, the United States Attorney's Office for the Southern District of New York (or, for that matter, the Department of Justice) would have the power or authority to transfer $356 million from the United States Treasury to these defendants on its own initiative, even if it wished to do so. The concern expressed in the Wiesner memo regarding prosecutors arrogating to themselves the role of the legislature or the judiciary apparently does not extend to this imagined ability of the USAO or the Justice Department to allocate the public fisc.

As to Wiesner's second point, this argument was soundly rejected by Judge Preska when put forward by Wiesner and other defendants in opposition to dismissal of the criminal information as to KPMG, and should likewise be rejected here.[14] Because this issue has been fully briefed already, the Government respectfully refers the Court to its opposition briefing before Judge Preska (attached as exhibit B to the Bachrach Declaration), and to Judge Preska's opinion finding Wiesner's arguments "meritless." *United States* v. *KPMG, LLP*, 2007 WL 541956, *6, *7-8 (S.D.N.Y. Feb. 15, 2007) (Preska, J.) (rejecting Wiesner's claim that the monetary component of the DPA was unconstitutional, unlawful, or improper) (Exhibit D to the Bachrach Declaration).

[14] Wiesner's suggestion, in footnote 5 of his memorandum, that "[n]otwithstanding its stance in the litigation before Judge Preska, the government has apparently elected to change its deferred prosecution agreements," citing the USAO's recent DPA with Jenkens & Gilchrist, is without foundation. That a different entity, under different facts and circumstances, was party to a different resolution, is not a change in policy. Nor does it reflect any change whatsoever from the position the Government argued before Judge Preska, which arguments it renews before this Court in response to Wiesner's nearly-identical briefing here.

Thus, taken separately or together, nothing about these allegations "shocks the conscience" to the extreme degree called for by the cases. In any even, the defendants' "outrageous conduct" arguments rest in large part on spurious assertions regarding the Government's "master plan" of calculated misconduct as to which there is not a shred of evidence in the record. To the extent that the Court decides that it needs to reach these additional allegations of misconduct, we respectfully submit that there is no competent evidence of record to support any of these allegations.

Point II

NOT ALL DEFENDANTS ARE SIMILARLY SITUATED

The Court's May 30 Order asked the parties to address the question "[t]o what extent are all of the KPMG Defendants similarly situated with respect to the motion?" The Court noted its particular interest in whether defendants Larson, Pfaff and Ritchie were charged primarily with conduct that occurred during their employment at KPMG, as opposed to conduct that occurred after that employment ended. The Government does not dispute that defendant Ritchie is charged primarily with conduct that occurred while he was employed at KPMG. While the majority of the conduct with which defendants Larson and Pfaff are charged took place after they had left their positions at KPMG, the Government does not dispute that some of their charged conduct took place while they were KPMG employees.

However, defendants Larson, Pfaff and Ritchie are differently situated from the other KPMG Defendants in another important respect — the Government believes that all three defendants have had their fees in this matter (or at least significant portions of those fees) paid by other entities, and none have ever received any funds for legal fees from KPMG at any stage of this criminal case. Indeed, Larson and Pfaff, so far as the Government is aware, never even asked KPMG to pay their legal fees in this matter, and Ritchie did not make a request until mid-2005. (*See* July 26, 2006, Memorandum in Support of KPMG's Motion to Dismiss the Complaint at 10 ("Mr. Ritchie did not ask KPMG to pay any of his criminal defense fees until July 26, 2005, and KPMG declined to make advancement")). As the Court may recall from the *Curcio* inquiry on May 9, 2006, some percentage of Ritchie's legal fees for this case are being paid by his present employer, Pacific Capital Group, which reimburses him for legal expenses under a provision of California law.[15] The Government submits that, if the Court is considering dismissing the indictment as to Ritchie, the Court should require that Ritchie demonstrate that there are legal fees or expenses that are not reimbursed by Pacific Capital Group, but that would have been paid by KPMG according to the Court's findings in *Stein I*. If the answer is that there are no such fees or expenses, then, at best, Ritchie (or Pacific Capital Group) may have a financial claim for contribution against KPMG, but KPMG's decision to limit and cap legal fee payment will have had no cognizable effect on Ritchie's defense

[15] A portion of Ritchie's charged conduct took place while he was employed at Pacific Capital Group, after he left KPMG.

or trial preparation whatsoever, because he will have had the same access to the funds of another party to pay those costs.[16] If his fees and expenses are being paid in the same manner that the Court found they would have been by KPMG, then he is simply not entitled to the remedy of dismissal of the indictment.

The same argument applies with equal force to Larson and Pfaff. While they ran, Presidio Larson and Pfaff created numerous entities, in part to hold the hundreds of millions of dollars in fees that Presidio received from promoting and implementing tax shelters. A number of those entities are now located off-shore, in the Cayman Islands or in Guernsey, and the Government believes that Larson and Pfaff's legal fees in both the criminal and related civil actions have been paid through indemnification claims against these off-shore entities. For example, in June 2006, Larson and Pfaff made an indemnification claim against an entity known as Norvest Ltd., a successor entity to Skandia America Inc., nominally headed by Helge Vilhelmson, whose role as a purportedly independent non-resident alien in certain of the charged shelters will be familiar to the Court from the briefing on the Rule 15 Norway

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[16] The claim in Ritchie's declaration, submitted with his supplemental memorandum on this motion, that he was denied counsel of his choice by KPMG's fee decision thus makes no sense at all. Ritchie was represented by Cadwalader Wickersham & Taft from at least the spring of 2004 until approximately January 2006, when he switched representation to his present counsel of Ms. Arguedas and Ms. Moorman. But none of Ritchie's fees with Cadwalader were *ever* paid by KPMG, and no such request was even made until Cadwalader had been representing Ritchie for over a year. Whatever the reason Ritchie changed counsel, it appears entirely unrelated to whether KPMG was paying his fees. (*Cf.* Declaration of Mark Watson, describing his change in counsel).

depositions. A June 2006 letter from Vilhelmson indicates that $5.1 million was transferred for Pfaff and Larson's legal fees as a result of this request. (*See* Exhibits A and B to Glavin Declaration). The Government also believes that Larson and Pfaff made similar claims in 2005 against an entity called Pigavest Ltd. (which is a successor entity to Norwood Holdings and has bank accounts in Switzerland), receiving at least $1 million as a result of the request, and similar claims in 2005 against yet another entity in Guernsey. In short, it appears that Larson and Pfaff have had their legal fees in this matter — or at least a significant percentage of those fees — paid by other entities, and they have never made any request to KPMG for payment of fees (prior to the civil complaint filed in July 2006 in the "ancillary proceeding"). Accordingly, as with defendant Ritchie, the Government submits that, if the Court is considering dismissing the indictment as to Larson and Pfaff, the Court should require that they demonstrate that there are legal fees or expenses that are not being paid by any of these various third-party entities, but that would have been paid by KPMG according to the Court's findings in *Stein I*. As with Ritchie, if Larson's and Pfaff's fees and expenses are being paid by another entity in the same manner that the Court found they would have been by KPMG, then they are not entitled to the remedy of dismissal of the indictment, even accepting all of the findings in *Stein I*.

As to defendant David Greenberg, he is also not similarly situated to the other KPMG Defendants. The Court has already found, in its opinion and order denying

KPMG's motion to dismiss the civil complaint or compel arbitration, that Greenberg's September 2003 termination agreement with KPMG contains "clear" language releasing any and all present or future claims that Greenberg may have against KPMG, including for payment of any legal fees arising out of his work as a KPMG partner. *Stein III*, 452 F. Supp. 2d at 267. As the agreement waived any right to future payment from KPMG, and thus Greenberg could not have had any expectation or claim to payment of his legal fees by KPMG, and KPMG plainly expressed its intention to be released from any future financial obligations or entanglements with Greenberg, and Greenberg never made any claim or request to KPMG for payment of legal fees or expenses in this matter, it is difficult to see how the Government's actions, as found by the Court in *Stein I*, or KPMG's decisions with regard to fee payments in 2004, could have had any cognizable effect on Greenberg's Fifth or Sixth Amendment rights in this case. Accordingly, Greenberg is not similarly situated to the other KPMG Defendants and there is no basis on which to dismiss the indictment as to him.

Finally, the Court has already denied the motion to dismiss filed by defendant Ruble, primarily on the grounds that he was never employed by KPMG and thus can have no colorable claim to payment of his legal fees by the firm. (*See* June 15 Order). Although defendant Makov did join in the initial motion to dismiss the indictment in January 2006, in all other respects he is identically situated to Ruble — he never worked for KPMG, could never have had any expectation that his legal fees would

be paid by KPMG, and his other arguments for dismissal of the indictment as to him are the same ones that the Court found "baseless" in denying Ruble's motion. Accordingly, for the reasons articulated in the June 15 Order, defendant Makov's motion to dismiss the indictment as to him should be denied.

CONCLUSION

In the Government's view, there are a number of discrete issues that in various Court conferences and arguments have tended to become confused and perhaps improperly intertwined. On the one hand are the defendants' complaints and concerns regarding the magnitude of the discovery in this exceedingly large case, and the problems the defendant have experienced in accessing that discovery. Even considering the massive volume of the discovery in this matter, we believe that we have made extraordinary efforts to assist the defendants in preparing for trial. The vast bulk of the electronic discovery is searchable both by using optical character recognition ("OCR") searches and "field" searches. The Government provided its exhibits to the defendants long ago, and those exhibits are OCR-searchable as well. The defense has long had the Government's witness list, and the 3500 material for those witnesses is also OCR-searchable. (*See* 3/12/07 Tr. at 18-19 (The Court: "[Y]ou've had unprecedented disclosure in this case [including the 3500 material] and you've had all sorts of other stuff months and months earlier than you ever would have in any other case in recognition of the burdens on the defense")). In addition, we have agreed to take what is for this District

the unprecedented step of loading all of the electronic discovery onto a web-accessible database, and to make that available to all defendants at no charge. We believe that these steps, coupled with C.J.A. appointments if those become necessary in individual cases, will substantially assist the defendants in preparing for trial. On the other hand, however, we do not disagree with the defendants that these steps simply do not address the core concern raised by the Court in *Stein I*. As set forth before and repeated above, we do not believe *Stein I* to have been rightly decided. However, assuming *arguendo* the correctness of the decision, we are constrained to say that the appropriate remedy is dismissal of the Indictment as against those defendants who fall within the ambit of *Stein I's* rulings. For that reason, we do not believe that there is any step that the Government could take "voluntarily in an effort to remedy the constitutional violation found by the Court." (May 30 Order).

Dated: New York, New York
June 22, 2007

Respectfully submitted,

MICHAEL J. GARCIA
United States Attorney

By: /s/
John M. Hillebrecht
Kevin M. Downing
Rita M. Glavin
Margaret Garnett
Assistant United States Attorneys
(212) 637-2200