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Another View: Corporate Cooperation Taken to New Lows

Using the Deferred Prosecution Agreement to Violate the Rights of Individuals

The Deferred Prosecution Agreement (DPA) entered into between KPMG and the U.S. Attorney's Office for the Southern District of New York on Aug. 29, 2005, is just the latest example of the federal government's perverting the notion of corporate cooperation, so that "cooperation" means uttering only the words that the government authorizes. Corpora-tions are increasingly faced with the option of being put out of business or capitulating to the demands of overzealous prosecutors who possess seemingly unchecked powers. The ability of prosecutors to force corporations to accept a full complement of draconian provisions too frequently results in individual employees' being left behind to take the fall for the "good" of the company. KPMG's acceptance of the terms of the DPA is a clear example of how these prosecutorial powers can strip individuals of their constitutional rights.

The KPMG DPA contains several remarkable provisions. As an initial matter, the government has dictated that KPMG, upon pain of corpor-ate death, must adhere to the government's version of facts that the tax strategies at issue are inherently fraudulent. This company confession is embodied in the DPA's "Statement of Facts," which mirrors the indictment of the 19 individuals now blamed for KPMG's alleged wrongdoing, *United States v. Stein et al.*, S1 05 Cr. 888 (LAK) (S.D.N.Y., October 19, 2005). The DPA prohibits KPMG and any of its employees from making any statement, in any context, which is inconsistent with the Statement of Facts. It also requires KPMG to waive any attorney-client privilege or work product protection in favor of the government while allowing it to retain the protections against others. KPMG was forced to accept these and other conditions of the DPA despite that fact that: 1) none of the tax strategies charged as a crime have ever been found to be illegal; and 2) for years, KPMG assured its management, employees, and customers, as well as the government, that the strategies were lawful. The DPA will prevent KPMG from bringing these facts to light.

The government's heavy-handed tactics can be traced back to the now infamous memo drafted by former Deputy Attorney General Larry Thompson in January 2003. The Thompson Memo, among other things, sets forth a list of factors prosecutors are supposed to weigh in determining whether to charge a corporation criminally. Prosecutors are directed to look at several factors, including the nature of the alleged offense, whether the offense was voluntarily disclosed, any remedial measures taken by the target corporation, whether the employees deemed responsible for the wrongful acts have been terminated, and the extent of the corporation's cooperation with the government.

The Thompson Memo, and its strong-armed implementation by the DOJ, has been roundly criticized by a wide spectrum of commentators. *See, eg,* Mary Jo White, Corporate Criminal Liability: What Has Gone Wrong? *Prac. Law Inst., Corp. Law and Prac*. Course Handbook Series, Nov. 2004 at 815; George Ellard, Making the Silent Speak and the Informed Wary. 42 *Am. Crim. L. Rev.* 985 (2005). But the DPA in this case goes even beyond the Thompson Memo, and turns the principle of cooperation into a tool to obliterate history. Not only is KPMG required to cooperate "actively" with the DOJ, but it must adhere to a single, government-approved version of the truth no matter what the evidence shows. The KPMG DPA is a clear example of how the Thompson Memo laid the groundwork for prosecutorial tactics that have increasingly served to compromise the rights of individuals.

KPMG Repeatedly Defended the Tax Strategies

For years KPMG operated under the assumption that the tax strategies at issue were legal. In fact, in October 2003, in anticipation of media coverage of the strategies, KPMG's then-Chairman wrote a memorandum to all KPMG partners in which he reiterated that KPMG provided "appropriate tax-planning services" and that these services were "fully supported by the Internal Revenue Code and related regulations." In anticipation of Senate hearings on tax shelters, KPMG's then-CEO distributed a memorandum to KPMG partners stating that the strategies "were complex and technical, but were consistent with the laws in place at the time."

KPMG fervently defended the strategies before the Senate and prepared a formal statement describing the exhaustive review process to which it had subjected the strategies. In further defense of the strategies, KPMG directed six of its partners — five of whom would later be indicted — to appear before the Senate to testify regarding the strategies. One appeared before a Senate committee on Nov. 18, 2003, and justified KPMG's strategies in testimony that was consistent with KPMG's then-existing corporate position that the strategies were legal.

Criminal Investigation of KPMG

Subsequent to the Senate hearings, KPMG became a target of a grand jury investigation, and the DOJ made clear that KPMG would be indicted (and thus destroyed) unless it capitulated totally to the government's demands. To avoid that fate, on June 16, 2005, KPMG publicly stated that the tax strategies that it had so long defended were "unlawful," that it "regretted" that the shelters had ever been offered, and that it had made sure that "those responsible for the wrongdoing have been separated from the firm."

KPMG formally capitulated by signing the DPA in August 2005. Aside from the basic agreement by KPMG to pay criminal fines and take remedial measures, the DPA contained a series of remarkably broad and powerful provisions. First, KPMG was required to repudiate all actions it had taken to defend the strategies by adopting the Statement of Facts, which proclaimed them illegal and amounted to a corporate declaration of guilt.

Second, the DPA explicitly prohibits KPMG from taking any position, in any context, that is inconsistent with the Statement of Facts. Any breach of this provision has drastic consequences, including the potential institution of criminal charges against KPMG. Just before KPMG signed the DPA, a group of current and former KPMG Board members and partners authored a memo criticizing the proposed DPA and reiterated that the tax shelters had been thoroughly reviewed and approved by KPMG in the past. They also expressed fear that their jobs would be in jeopardy and their lives otherwise destroyed if they came forward publicly with these views. Under the DPA, they will be prohibited from offering any testimony at trial that could possibly help the indicted employees defend against the charges asserted against them. Fortunately for the individual defendants, this type of conduct is not always accepted by federal courts. Most recently, in *United*

States v. Leung, 351 F. Supp. 2d 992 (C.D. Cal. 2005), the court dismissed an indictment where a plea agreement barred a co-defendant who possessed potentially exculpatory evidence from providing information or assistance to the remaining defendant.

Third, KPMG was obligated to waive any privileges (subject to a few narrow exceptions) as against the government while being permitted to preserve those privileges as against third parties such as the indicted individuals. The only purpose for this waiver could be to distort the truth further by depriving the defendants of information that is of central relevance to their defense.

There can be no legitimate law enforcement interest in requiring, by contract, that a corporation accused of wrongdoing and hundreds of key witnesses adhere to only one version of the facts. If the truth and the evidence were consistent with the Statement of Facts, no balanced and ethical prosecutor would have a need for it. Its only function can be to mislead and deprive the finder of fact of relevant evidence.

Although there may be circumstances that weigh in favor of the government's use of DPAs, the frequency with which this prosecutorial tool is being used since the publication of the Thompson Memo — AOL, AIG, Banco Popular, CIBC, Computer Associates, Merrill Lynch, PNC, *etc.* — is cause for alarm. The KPMG DPA is especially alarming because the IRS recently offered dozens of firms that made and sold questionable tax shelters a way to avoid criminal prosecution if they came forward, paid appropriate penalties, and turned over all information regarding the shelters. Had this offer of leniency been made earlier, KPMG may not have been forced to sign a DPA that potentially seals the fate of its former partners.

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