

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

August Term, 2007

(Argued: March 25, 2008

Decided: August 28, 2008)

Docket No. 07-3042-cr

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UNITED STATES OF AMERICA,

Appellant,

- v.-

JEFFREY STEIN, JOHN LANNING, RICHARD
SMITH, JEFFREY EISCHEID, PHILIP WIESNER,
MARK WATSON, LARRY DELAP, STEVEN
GREMMINGER, GREGG RITCHIE, RANDY
BICKHAM, CAROL G. WARLEY, CARL HASTING,
and RICHARD ROSENTHAL,

Defendants-Appellees.

- - - - -x

Before: JACOBS, Chief Judge, FEINBERG and HALL,
Circuit Judges.

The United States appeals from an order of the United
States District Court for the Southern District of New York
(Kaplan, J.), dismissing an indictment against Defendants-
Appellees, thirteen former partners and employees of

1 accounting firm KPMG, LLP. We affirm the district court's
2 ruling that the government deprived Defendants-Appellees of
3 their right to counsel under the Sixth Amendment by causing
4 KPMG to place conditions on the advancement of legal fees to
5 Defendants-Appellees, and to cap the fees and ultimately end
6 them. Because the government failed to cure the Sixth
7 Amendment violation, and because no other remedy will return
8 Defendants-Appellees to the status quo ante, we affirm the
9 dismissal of the indictment. In a separate summary order
10 filed today, we dismiss as moot the government's appeal from
11 the order of the district court suppressing proffer
12 statements made by Defendants-Appellees Richard Smith and
13 Mark Watson.

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1 DENNIS JACOBS, Chief Judge:

2 The United States appeals from an order of the United
3 States District Court for the Southern District of New York
4 (Kaplan, J.), dismissing an indictment against thirteen
5 former partners and employees of the accounting firm KPMG,
6 LLP. Judge Kaplan found that, absent pressure from the
7 government, KPMG would have paid defendants' legal fees and
8 expenses without regard to cost. Based on this and other
9 findings of fact, Judge Kaplan ruled that the government
10 deprived defendants of their right to counsel under the
11 Sixth Amendment by causing KPMG to impose conditions on the
12 advancement of legal fees to defendants, to cap the fees,
13 and ultimately to end payment. See United States v. Stein,
14 435 F. Supp. 2d 330, 367-73 (S.D.N.Y. 2006) ("Stein I").
15 Judge Kaplan also ruled that the government deprived
16 defendants of their right to substantive due process under
17 the Fifth Amendment.¹ Id. at 360-65.

¹In later decisions, Judge Kaplan ruled that defendants Richard Smith and Mark Watson's proffer session statements were obtained in violation of their Fifth Amendment privilege against self-incrimination, and that their statements would be suppressed, see United States v. Stein, 440 F. Supp. 2d 315 (S.D.N.Y. 2006) ("Stein II"); that the court had ancillary jurisdiction over Defendants-Appellees' civil suit against KPMG for advancement of fees, see United States v. Stein, 452 F. Supp. 2d 230 (S.D.N.Y. 2006) ("Stein

1 We hold that KPMG's adoption and enforcement of a
2 policy under which it conditioned, capped and ultimately
3 ceased advancing legal fees to defendants followed as a
4 direct consequence of the government's overwhelming
5 influence, and that KPMG's conduct therefore amounted to
6 state action. We further hold that the government thus
7 unjustifiably interfered with defendants' relationship with
8 counsel and their ability to mount a defense, in violation
9 of the Sixth Amendment, and that the government did not cure
10 the violation. Because no other remedy will return
11 defendants to the status quo ante, we affirm the dismissal
12 of the indictment as to all thirteen defendants.² In light
13 of this disposition, we do not reach the district court's
14 Fifth Amendment ruling.

III"), vacated, Stein v. KPMG, LLP, 486 F.3d 753 (2d Cir. 2007); and that dismissal of the indictment is the appropriate remedy for those constitutional violations, see United States v. Stein, 495 F. Supp. 2d 390 (S.D.N.Y. 2007) ("Stein IV").

²In a separate summary order filed today, we dismiss as moot the government's appeal from the order of the district court suppressing proffer statements made by Defendants-Appellees Smith and Watson.

1 **BACKGROUND**

2 **The Thompson Memorandum**

3 In January 2003, then-United States Deputy Attorney
4 General Larry D. Thompson promulgated a policy statement,
5 Principles of Federal Prosecution of Business Organizations
6 (the "Thompson Memorandum"), which articulated "principles"
7 to govern the Department's discretion in bringing
8 prosecutions against business organizations. The Thompson
9 Memorandum was closely based on a predecessor document
10 issued in 1999 by then-U.S. Deputy Attorney General Eric
11 Holder, Federal Prosecution of Corporations. See Stein I,
12 435 F. Supp. 2d at 336-37. Along with the familiar factors
13 governing charging decisions, the Thompson Memorandum
14 identifies nine additional considerations, including the
15 company's "timely and voluntary disclosure of wrongdoing and
16 its willingness to cooperate in the investigation of its
17 agents." Mem. from Larry D. Thompson, Deputy Att'y Gen.,
18 U.S. Dep't of Justice, Principles of Federal Prosecution of
19 Business Organizations (Jan. 20, 2003), at II. The
20 Memorandum explains that prosecutors should inquire
21 whether the corporation appears to be protecting its
22 culpable employees and agents [and that] a
23 corporation's promise of support to culpable employees
24 and agents, either through the advancing of attorneys

1 fees, through retaining the employees without sanction
2 for their misconduct, or through providing information
3 to the employees about the government's investigation
4 pursuant to a joint defense agreement, may be
5 considered by the prosecutor in weighing the extent and
6 value of a corporation's cooperation.
7

8 Id. at VI (emphasis added and footnote omitted). A footnote
9 appended to the highlighted phrase explains that because
10 certain states require companies to advance legal fees for
11 their officers, "a corporation's compliance with governing
12 law should not be considered a failure to cooperate." Id.
13 at VI n.4. In December 2006--after the events in this
14 prosecution had transpired--the Department of Justice
15 replaced the Thompson Memorandum with the McNulty
16 Memorandum, under which prosecutors may consider a company's
17 fee advancement policy only where the circumstances indicate
18 that it is "intended to impede a criminal investigation,"
19 and even then only with the approval of the Deputy Attorney
20 General. Mem. from Paul J. McNulty, Deputy Att'y Gen., U.S.
21 Dep't of Justice, Principles of Federal Prosecution of
22 Business Organizations (Dec. 12, 2006), at VII n.3.

23 **Commencement of the Federal Investigation**

24 After Senate subcommittee hearings in 2002 concerning
25 KPMG's possible involvement in creating and marketing
26 fraudulent tax shelters, KPMG retained Robert S. Bennett of

1 the law firm Skadden, Arps, Slate, Meagher & Flom LLP
2 ("Skadden") to formulate a "cooperative approach" for KPMG
3 to use in dealing with federal authorities. Stein I, 435 F.
4 Supp. 2d at 339. Bennett's strategy included "a decision to
5 'clean house'--a determination to ask Jeffrey Stein, Richard
6 Smith, and Jeffrey Eischeid, all senior KPMG partners who
7 had testified before the Senate and all now [Defendants-
8 Appellees] here--to leave their positions as deputy chair
9 and chief operating officer of the firm, vice chair-tax
10 services, and a partner in personal financial planning,
11 respectively." Id. Smith was transferred and Eischeid was
12 put on administrative leave. Id. at 339 n.22. Stein
13 resigned with arrangements for a three-year \$100,000-per-
14 month consultancy, and an agreement that KPMG would pay for
15 Stein's representation in any actions brought against Stein
16 arising from his activities at the firm. Id. at 339. KPMG
17 negotiated a contract with Smith that included a similar
18 clause; but that agreement was never executed. Stein IV,
19 495 F. Supp. 2d at 408.

20 In February 2004, KPMG officials learned that the firm
21 and 20 to 30 of its top partners and employees were subjects
22 of a grand jury investigation of fraudulent tax shelters.

1 Stein I, 435 F. Supp. 2d at 341. On February 18, 2004,
2 KPMG's CEO announced to all partners that the firm was aware
3 of the United States Attorney's Office's ("USAO")
4 investigation and that "[a]ny present or former members of
5 the firm asked to appear will be represented by competent
6 coun[sel] at the firm's expense." Stein IV, 495 F. Supp. 2d
7 at 407 (first alteration in original and internal quotation
8 marks omitted).

9 **The February 25, 2004 Meeting**

10 In preparation for a meeting with Skadden on February
11 25, 2004, the prosecutors--including Assistant United States
12 Attorneys ("AUSAs") Shirah Neiman and Justin Weddle--decided
13 to ask whether KPMG would advance legal fees to employees
14 under investigation. Stein I, 435 F. Supp. 2d at 341.
15 Bennett started the meeting by announcing that KPMG had
16 resolved to "clean house," that KPMG "would cooperate fully
17 with the government's investigation," and that its goal was
18 not to protect individual employees but rather to save the
19 firm from being indicted. Id. AUSA Weddle inquired about
20 the firm's plans for advancing fees and about any legal
21 obligation to do so. Id. Later on, AUSA Neiman added that
22 the government would "take into account" the firm's legal

1 obligations to advance fees, but that "the Thompson
2 Memorandum [w]as a point that had to be considered." Id.
3 Bennett then advised that although KPMG was still
4 investigating its legal obligations to advance fees, its
5 "common practice" was to do so. Id. at 342. However,
6 Bennett explained, KPMG would not pay legal fees for any
7 partner who refused to cooperate or "took the Fifth," so
8 long as KPMG had the legal authority to do so. Id.

9 Later in the meeting, AUSA Weddle asked Bennett to
10 ascertain KPMG's legal obligations to advance attorneys'
11 fees. AUSA Neiman added that "misconduct" should not or
12 cannot "be rewarded" under "federal guidelines." Id. One
13 Skadden attorney's notes attributed to AUSA Weddle the
14 prediction that, if KPMG had discretion regarding fees, the
15 government would "look at that under a microscope." Id. at
16 344 (emphasis omitted).

17 Skadden then reported back to KPMG. In notes of the
18 meeting, a KPMG executive wrote the words "[p]aying legal
19 fees" and "[s]everance" next to "not a sign of cooperation."
20 Stein IV, 495 F. Supp. 2d at 408.

21 **Communications Between the Prosecutors and KPMG**

22 On March 2, 2004, Bennett told AUSA Weddle that

1 although KPMG believed it had no legal obligation to advance
2 fees, "it would be a big problem" for the firm not to do so
3 given its partnership structure. Stein I, 435 F. Supp. 2d
4 at 345 (internal quotation marks omitted). But Bennett
5 disclosed KPMG's tentative decision to limit the amount of
6 fees and condition them on employees' cooperation with
7 prosecutors. Id.

8 Two days later, a Skadden lawyer advised counsel for
9 Defendant-Appellee Carol G. Warley (a former KPMG tax
10 partner) that KPMG would advance legal fees if Warley
11 cooperated with the government and declined to invoke her
12 Fifth Amendment privilege against self-incrimination. Id.

13 On a March 11 conference call with Skadden, AUSA Weddle
14 recommended that KPMG tell employees that they should be
15 "totally open" with the USAO, "even if that [meant
16 admitting] criminal wrongdoing," explaining that this would
17 give him good material for cross-examination. Id.

18 (alteration in original and internal quotation marks
19 omitted). That same day, Skadden wrote to counsel for the
20 KPMG employees who had been identified as subjects of the
21 investigation. Id. The letter set forth KPMG's new fees
22 policy ("Fees Policy"), pursuant to which advancement of

1 fees and expenses would be

2 [i] capped at \$400,000 per employee;

3
4 [ii] conditioned on the employee's cooperation with the
5 government; and

6
7 [iii] terminated when an employee was indicted.

8
9 Id. at 345-46. The government was copied on this
10 correspondence. Id. at 345.

11 On March 12, KPMG sent a memorandum to certain other
12 employees who had not been identified as subjects, urging
13 them to cooperate with the government, advising them that it
14 might be advantageous for them to exercise their right to
15 counsel, and advising that KPMG would cover employees'
16 "reasonable fees." Id. at 346 n.62.

17 The prosecutors expressed by letter their
18 "disappoint[ment] with [the] tone" of this memorandum and
19 its "one-sided presentation of potential issues," and
20 "demanded that KPMG send out a supplemental memorandum in a
21 form they proposed." Id. at 346. The government's
22 alternative language, premised on the "assum[ption] that
23 KPMG truly is committed to fully cooperating with the
24 Government's investigation," Letter of David N. Kelley,
25 United States Attorney, Southern District of New York, March
26 17, 2004, advised employees that they could "meet with

1 investigators without the assistance of counsel," Stein I,
2 435 F. Supp. 2d at 346 (emphasis omitted). KPMG complied,
3 and circulated a memo advising that employees "may deal
4 directly with government representatives without counsel."
5 Id. (emphasis omitted).

6 At a meeting in late March, Skadden asked the
7 prosecutors to notify Skadden in the event any KPMG employee
8 refused to cooperate. Id. at 347. Over the following year,
9 the prosecutors regularly informed Skadden whenever a KPMG
10 employee refused to cooperate fully, such as by refusing to
11 proffer or by proffering incompletely (in the government's
12 view). Id. Skadden, in turn, informed the employees'
13 lawyers that fee advancement would cease unless the
14 employees cooperated. Id. The employees either knuckled
15 under and submitted to interviews, or they were fired and
16 KPMG ceased advancing their fees. For example, Watson and
17 Smith attended proffer sessions after receiving KPMG's March
18 11 letter announcing the Fees Policy, and after Skadden
19 reiterated to them that fees would be terminated absent
20 cooperation. They did so because (they said, and the
21 district court found) they feared that KPMG would stop
22 advancing attorneys fees--although Watson concedes he

1 attended a first session voluntarily.³ See United States v.
2 Stein, 440 F. Supp. 2d 315, 330-33 (S.D.N.Y. 2006) ("Stein
3 II"). As Bennett later assured AUSA Weddle: "Whenever your
4 Office has notified us that individuals have not . . .
5 cooperat[ed], KPMG has promptly and without question
6 encouraged them to cooperate and threatened to cease payment
7 of their attorney fees and . . . to take personnel action,
8 including termination." Letter of Robert Bennett to United
9 States Attorney's Office, November 2, 2004; see, e.g., Stein
10 II, 440 F. Supp. 2d at 323 (describing KPMG's termination of
11 Defendant-Appellant Warley after she invoked her Fifth
12 Amendment privilege against self-incrimination).

13 **KPMG Avoids Indictment**

14 In an early-March 2005 meeting, then-U.S. Attorney
15 David Kelley told Skadden and top KPMG executives that a
16 non-prosecution agreement was unlikely and that he had
17 reservations about KPMG's level of cooperation: "I've seen
18 a lot better from big companies." Bennett reminded Kelley

³As discussed above, in a decision that is the subject of the summary order filed today, the district court held that Defendants-Appellees Smith and Watson's proffer statements were obtained in violation of their Fifth Amendment privilege against self-incrimination and that their statements would be suppressed. Id. at 337-38.

1 how KPMG had capped and conditioned its advancement of legal
2 fees. Kelley remained unconvinced.

3 KPMG moved up the Justice Department's chain of
4 command. At a June 13, 2005 meeting with U.S. Deputy
5 Attorney General James Comey, Bennett stressed KPMG's
6 pressure on employees to cooperate by conditioning legal
7 fees on cooperation; it was, he said, "precedent[]setting."
8 Stein I, 435 F. Supp. 2d at 349 (internal quotation marks
9 omitted). KPMG's entreaties were ultimately successful: on
10 August 29, 2005, the firm entered into a deferred
11 prosecution agreement (the "DPA") under which KPMG admitted
12 extensive wrongdoing, paid a \$456 million fine, and
13 committed itself to cooperation in any future government
14 investigation or prosecution. Id. at 349-50.

15 **Indictment of Individual Employees**

16 On August 29, 2005--the same day KPMG executed the
17 DPA--the government indicted six of the Defendants-Appellees
18 (along with three other KPMG employees): Jeffrey Stein;
19 Richard Smith; Jeffrey Eischeid; John Lanning, Vice Chairman
20 of Tax Services; Philip Wiesner, a former tax partner; and
21 Mark Watson, a tax partner. A superseding indictment filed
22 on October 17, 2005 named ten additional employees,

1 including seven of the Defendants-Appellees: Larry DeLap, a
2 former tax partner in charge of professional practice;
3 Steven Gremminger, a former partner and associate general
4 counsel; former tax partners Gregg Ritchie, Randy Bickham
5 and Carl Hasting; Carol G. Warley; and Richard Rosenthal, a
6 former tax partner and Chief Financial Officer of KPMG.⁴
7 Pursuant to the Fees Policy, KPMG promptly stopped advancing
8 legal fees to the indicted employees who were still
9 receiving them. Id. at 350.

10 **Procedural History**

11 On January 12, 2006, the thirteen defendants (among
12 others) moved to dismiss the indictment based on the
13 government's interference with KPMG's advancement of fees.⁵
14 In a submission to the district court, KPMG represented that
15 the Thompson memorandum in conjunction with the
16 government's statements relating to payment of legal
17 fees affected KPMG's determination(s) with respect to
18 the advancement of legal fees and other defense costs
19 to present or former partners and employees In

⁴The superseding indictment filed on October 17, 2005 charged 19 defendants in 46 counts for conspiring to defraud the United States and the IRS, tax evasion and obstruction of the internal revenue laws (although not every individual was charged with every offense).

⁵According to the district court, "[a]ll defendants previously employed by KPMG joined in the motion." Id. at 336 n.5.

1 fact, KPMG is prepared to state that the Thompson
2 memorandum substantially influenced KPMG's decisions
3 with respect to legal fees

4 Stein IV, 495 F. Supp. 2d at 405 (internal quotation marks
5 and emphasis omitted).

6 At a hearing on March 30, 2006, Judge Kaplan asked the
7 government whether it was "prepared at this point to commit
8 that [it] has no objection whatsoever to KPMG exercising its
9 free and independent business judgment as to whether to
10 advance defense costs to these defendants and that if it
11 were to elect to do so the government would not in any way
12 consider that in determining whether it had complied with
13 the DPA?" The AUSA responded: "That's always been the case,
14 your Honor. That's fine. We have no objection to that . .
15 . . They can always exercise their business judgment. As
16 you described it, your Honor, that's always been the case.
17 It's the case today, your Honor."

18 Judge Kaplan ordered discovery and held a three-day
19 evidentiary hearing in May 2006 to ascertain whether the
20 government had contributed to KPMG's adoption of the Fees
21 Policy. The court heard testimony from two prosecutors, one
22 IRS agent, three Skadden attorneys, and one lawyer from
23 KPMG's Office of General Counsel, among others. Numerous

1 documents produced in discovery by both sides were admitted
2 into evidence.

3 **Stein I**

4 Judge Kaplan's opinion and order of June 26, 2006
5 noted, as the parties had stipulated, that KPMG's past
6 practice was to advance legal fees for employees facing
7 regulatory, civil and criminal investigations without
8 condition or cap. See Stein I, 435 F. Supp. 2d at 340.
9 Starting from that baseline, Judge Kaplan made the following
10 findings of fact. At the February 25, 2004 meeting, Bennett
11 began by "test[ing] the waters to see whether KPMG could
12 adhere to its practice of paying its employees' legal
13 expenses when litigation loomed [by asking] for [the]
14 government's view on the subject." Id. at 341 (footnote
15 omitted). It is not clear what AUSA Neiman intended to
16 convey when she said that "misconduct" should not or cannot
17 "be rewarded" under "federal guidelines"; but her statement
18 "was understood by both KPMG and government representatives
19 as a reminder that payment of legal fees by KPMG, beyond any
20 that it might legally be obligated to pay, could well count
21 against KPMG in the government's decision whether to indict
22 the firm." Id. at 344 (internal quotation marks omitted).

1 "[W]hile the USAO did not say in so many words that it did
2 not want KPMG to pay legal fees, no one at the meeting could
3 have failed to draw that conclusion." Id.

4 Based on those findings, Judge Kaplan arrived at the
5 following ultimate findings of fact, all of which the
6 government contests on appeal:

7 [1] "the Thompson Memorandum caused KPMG to consider
8 departing from its long-standing policy of paying legal
9 fees and expenses of its personnel in all cases and
10 investigations even before it first met with the USAO"
11 and induced KPMG to seek "an indication from the USAO
12 that payment of fees in accordance with its settled
13 practice would not be held against it";

14
15 [2] the government made repeated references to the
16 Thompson Memo in an effort to "reinforce[] the threat
17 inherent in the Thompson Memorandum";

18
19 [3] "the government conducted itself in a manner that
20 evidenced a desire to minimize the involvement of
21 defense attorneys"; and

22
23 [4] but for the Thompson Memorandum and the
24 prosecutors' conduct, KPMG would have paid defendants'
25 legal fees and expenses without consideration of cost.

26
27 Id. at 352-53.

28 Against that background, Judge Kaplan ruled that a
29 defendant has a fundamental right under the Fifth Amendment
30 to fairness in the criminal process, including the ability
31 to get and deploy in defense all "resources lawfully
32 available to him or her, free of knowing or reckless

1 government interference," id. at 361, and that the
2 government's reasons for infringing that right in this case
3 could not withstand strict scrutiny, id. at 362-65. Judge
4 Kaplan also ruled that the same conduct deprived each
5 defendant of the Sixth Amendment right "to choose the lawyer
6 or lawyers he or she desires and to use one's own funds to
7 mount the defense that one wishes to present." Id. at 366
8 (footnote omitted). He reasoned that "the government's law
9 enforcement interests in taking the specific actions in
10 question [do not] sufficiently outweigh the interests of the
11 KPMG Defendants in having the resources needed to defend as
12 they think proper against these charges." Id. at 368.
13 "[T]he fact that advancement of legal fees occasionally
14 might be part of an obstruction scheme or indicate a lack of
15 full cooperation by a prospective defendant is insufficient
16 to justify the government's interference with the right of
17 individual criminal defendants to obtain resources lawfully
18 available to them in order to defend themselves"
19 Id. at 369.

20 Judge Kaplan rejected the government's position that
21 defendants have no right to spend "other people's money" on
22 high-priced defense counsel: "[T]he KPMG Defendants had at

1 least an expectation that their expenses in defending any
2 claims or charges brought against them by reason of their
3 employment by KPMG would be paid by the firm," and "any
4 benefits that would have flowed from that expectation--the
5 legal fees at issue now--were, in every material sense,
6 their property, not that of a third party." Id. at 367. He
7 further determined that defendants need not show how their
8 defense was impaired: the government's interference with
9 their Sixth Amendment "right to be represented as they
10 choose," "like a deprivation of the right to counsel of
11 their choice, is complete irrespective of the quality of the
12 representation they receive." Id. at 369.

13 As to remedy, Judge Kaplan conceded that dismissal of
14 the indictment would be inappropriate unless other avenues
15 for obtaining fees from KPMG were first exhausted. Id. at
16 373-80. To that end, Judge Kaplan invited defendants to
17 file a civil suit against KPMG under the district court's
18 ancillary jurisdiction. Id. at 377-80, 382. The suit was
19 commenced, and Judge Kaplan denied KPMG's motion to dismiss.
20 United States v. Stein, 452 F. Supp. 2d 230 (S.D.N.Y. 2006)
21 ("Stein III"). However, this Court ruled that the district
22 court lacked ancillary jurisdiction over the action. Stein

1 v. KPMG, LLP, 486 F.3d 753 (2d Cir. 2007).

2 **Stein IV**

3 Judge Kaplan dismissed the indictment against the
4 thirteen defendants on July 16, 2007. Stein IV, 495 F.
5 Supp. 2d at 427. He reinforced the ruling in Stein I that
6 the government violated defendants' right to substantive due
7 process by holding that the prosecutors' conduct also
8 "independently shock[s] the conscience." Id. at 412-15.
9 Judge Kaplan concluded that no remedy other than dismissal
10 of the indictment would put defendants in the position they
11 would have occupied absent the government's misconduct. Id.
12 at 419-28.

13 The government appeals the dismissal of the indictment.
14

15 **DISCUSSION**

16 We review first **[I]** the government's challenges to the
17 district court's factual findings, including its finding
18 that but for the Thompson Memorandum and the prosecutors'
19 conduct KPMG would have paid employees' legal fees--pre-
20 indictment and post-indictment--without regard to cost.
21 Next, because we are hesitant to resolve constitutional
22 questions unnecessarily, **[II]** we inquire whether the

1 government cured the purported Sixth Amendment violation by
2 the AUSA's in-court statement on March 30, 2006 that KPMG
3 was free to decide whether to advance fees. Since we
4 conclude that this statement did not return defendants to
5 the status quo ante, [III] we decide whether the
6 promulgation and enforcement of KPMG's Fees Policy amounted
7 to state action under the Constitution and [IV] whether the
8 government deprived defendants of their Sixth Amendment
9 right to counsel.

10
11 **I**

12 The government challenges certain factual findings of
13 the district court. We review those findings for clear
14 error, viewing the evidence in the light most favorable to
15 defendants and asking whether we are left "with the definite
16 and firm conviction that a mistake has been committed."
17 Anderson v. City of Bessemer City, 470 U.S. 564, 573 (1985)
18 (internal quotation marks omitted).

19 The government points out that the Thompson Memorandum
20 lists "fees advancement" as just one of many considerations
21 in a complex charging decision, and thus argues that Judge
22 Kaplan overread the Thompson Memorandum as a threat that

1 KPMG would be indicted unless it ceased advancing legal fees
2 to its employees.

3 Judge Kaplan's finding withstands scrutiny. KPMG was
4 faced with the fatal prospect of indictment; it could be
5 expected to do all it could, assisted by sophisticated
6 counsel, to placate and appease the government. As Judge
7 Kaplan noted, KPMG's chief legal officer, Sven Erik Holmes,
8 testified that he considered it crucial "to be able to say
9 at the right time with the right audience, we're in full
10 compliance with the Thompson Memorandum." Stein I, 435 F.
11 Supp. 2d at 364 (emphasis added and internal quotation marks
12 omitted). Moreover, KPMG's management and counsel had
13 reason to consider the impact of the firm's indictment on
14 the interests of the firm's partners, employees, clients,
15 creditors and retirees.

16 The government reads the Thompson Memorandum to say
17 that fees advancement is to be considered as a negative
18 factor only when it is part of a campaign to "circle the
19 wagons," i.e., to protect culpable employees and obstruct
20 investigators. And it is true that the Thompson Memorandum
21 instructs a prosecutor to ask "whether the corporation
22 appears to be protecting its culpable employees and agents."

1 But even if the government's reading is plausible, the
2 wording nevertheless empowers prosecutors to determine which
3 employees will be deprived of company-sponsored counsel:
4 prosecutors may reasonably foresee that employees they
5 identify as "culpable" will be cut off from fees.

6 The government also takes issue with Judge Kaplan's
7 finding that the prosecutors (acting under DOJ policy)
8 deliberately reinforced the threat inherent in the Thompson
9 Memorandum. Id. at 352-53. It protests that KPMG
10 considered conditioning legal fees on cooperation even
11 before the February 25, 2004 meeting and that KPMG adopted
12 its Fees Policy free from government influence. However,
13 Judge Kaplan's interpretation of the meeting is supported by
14 the following record evidence. Because withholding of fees
15 would be problematic for a partnership like KPMG, Bennett
16 began by attempting to "sound out" the government's position
17 on the issue. Stein IV, 495 F. Supp. 2d at 402. The
18 prosecutors declined to sign off on KPMG's prior
19 arrangement. Instead they asked KPMG to ascertain whether
20 it had a legal obligation to advance fees. KPMG responded
21 with its fallback position: conditioning fees on
22 cooperation. Id. In Judge Kaplan's view, this was not an

1 official policy announcement, but rather a proposal: Skadden
2 lawyers repeatedly emphasized to the prosecutors that no
3 final decision had been made. One available inference from
4 all this is that the prosecutors' inquiry about KPMG's legal
5 obligations was a routine check for conflicts of interest;
6 but on this record, Judge Kaplan was entitled to see things
7 differently.⁶

8 Nor can we disturb Judge Kaplan's finding that "the
9 government conducted itself in a manner that
10 evidenced a desire to minimize the involvement of defense
11 attorneys." Stein I, 435 F. Supp. 2d at 353. During the
12 March 11 phone call between the prosecutors and Skadden,
13 AUSA Weddle demanded that KPMG tell its employees to be
14 "totally open" with the USAO, "even if that [meant
15 admitting] criminal wrongdoing," so that he could gather
16 material for cross-examination. Id. at 345 (alterations in
17 original and internal quotation marks omitted). On March
18 12, the prosecutors prevailed upon KPMG to supplement its

⁶It is unnecessary for us to determine the import of AUSA Neiman's statement that misconduct should not or cannot be rewarded or to decide whether AUSA Weddle actually said that the government would look at discretionary fee advancement "under a microscope." Stein I, 435 F. Supp. 2d at 344.

1 first advisory letter with another, which clarified that
2 employees could meet with the government without counsel.
3 In addition, prosecutors repeatedly used Skadden to threaten
4 to withhold legal fees from employees who refused to
5 proffer--even if defense counsel had recommended that an
6 employee invoke the Fifth Amendment privilege. Judge Kaplan
7 could reasonably reject the government's version of these
8 events.

9 Finally, we cannot say that the district court's
10 ultimate finding of fact--that absent the Thompson
11 Memorandum and the prosecutors' conduct KPMG would have
12 advanced fees without condition or cap--was clearly
13 erroneous. The government itself stipulated in Stein I that
14 KPMG had a "longstanding voluntary practice" of advancing
15 and paying employees' legal fees "without regard to economic
16 costs or considerations" and "without a preset cap or
17 condition of cooperation with the government . . . in any
18 civil, criminal or regulatory proceeding" arising from
19 activities within the scope of employment. Id. at 340
20 (internal quotation marks omitted). Although it "is far
21 from certain" that KPMG is legally obligated to advance
22 defendants' legal fees, Stein v. KPMG, LLP, 486 F.3d 753,

1 762 n.3 (2d Cir. 2007), a firm may have potent incentives to
2 advance fees, such as the ability to recruit and retain
3 skilled professionals in a profession fraught with legal
4 risk. Also, there is evidence that, before the prosecutors'
5 intervention, KPMG executed an agreement under which it
6 would advance Stein's legal fees without cap or condition
7 (and negotiated toward an identical agreement with Smith).
8 And while the government maintains that the civil, criminal
9 and regulatory investigations confronting KPMG constituted
10 an unprecedented state of affairs that might have caused
11 KPMG to adopt new and different policies, Judge Kaplan was
12 not required to agree. Indeed, KPMG itself represented to
13 the court that the Thompson Memorandum and the prosecutors'
14 conduct "substantially influenced [its] determination(s)
15 with respect to the advancement of legal fees."

16 For the foregoing reasons, we cannot disturb Judge
17 Kaplan's factual findings, including his finding that, but
18 for the Thompson Memorandum and the prosecutors' conduct,
19 KPMG would have advanced legal fees without condition or
20 cap.

1 there been no constitutional error," United States v.
2 Carmichael, 216 F.3d 224, 227 (2d Cir. 2000).

3 In Stein IV, Judge Kaplan concluded that dismissal of
4 the indictment as to the thirteen defendants was warranted
5 because no other remedy would restore them to the position
6 they would have enjoyed but for the government's
7 unconstitutional conduct. Stein IV, 495 F. Supp. 2d at 419-
8 28. Specifically, Judge Kaplan found that the government
9 deprived four defendants--Gremminger, Hasting, Ritchie and
10 Watson--of counsel of their choice. Id. at 421 ("[T]hey
11 simply lack the resources to engage the lawyers of their
12 choice, lawyers who had represented them as long as KPMG was
13 paying the bills." (footnote omitted)). Judge Kaplan also
14 found that all thirteen defendants--even those who were
15 still represented by their counsel of choice--were forced by
16 KPMG's withholding of post-indictment legal fees "to limit
17 their defenses . . . for economic reasons and that they
18 would not have been so constrained if KPMG paid their
19 expenses." Id. at 419. After reviewing defendants'
20 finances and determining the estimated cost of legal
21 representation, Judge Kaplan concluded: "[N]one of the
22 thirteen KPMG Defendants . . . has the resources to defend

1 this case as he or she would have defended it had KPMG been
2 paying the cost, even if he or she liquidated all property
3 owned by the defendant." Id. at 425.

4 The government argues that it cured any Sixth Amendment
5 violation on March 30, 2006, when it told the district court
6 that KPMG was free to "exercise [its] business judgment."
7 Therefore, the government contends, the appropriate remedy
8 for any constitutional violation would be to allow
9 defendants to retain their counsel of choice using whatever
10 funds KPMG is willing to provide now. At most, the
11 government claims, all that would be warranted is an
12 adjournment of trial to afford defendants additional time to
13 review documents and consult with counsel and expert
14 witnesses; and since 16 months passed between the
15 government's March 30, 2006 in-court statement and the July
16 16, 2007 dismissal of the indictment, defendants have
17 already enjoyed this remedy.

18 Judge Kaplan was unpersuaded. In his view, KPMG is
19 unlikely to pay defendants' legal fees as if the government
20 had never exerted any pressure: KPMG might prefer not to be
21 seen as reversing course and implicitly "admitting that it
22 caved in to government pressure"; the defendants have been

1 "indicted on charges the full scope of which may not
2 previously have been foreseeable to KPMG"--so that defense
3 costs may be larger than expected; and KPMG has since paid a
4 \$456 million fine under the DPA, reducing the firm's
5 available resources. Stein I, 435 F. Supp. 2d at 374.

6 We agree with the district court. The prosecutor's
7 isolated and ambiguous statement in a proceeding to which
8 KPMG was not a party (and the nearly 16-month period of
9 legal limbo that ensued) did not restore defendants to the
10 status quo ante.

11 Judge Kaplan asked whether the government would
12 represent that [i] it has no objection to "KPMG exercising
13 its free and independent business judgment as to whether to
14 advance defense costs" and [ii] "if it were to elect to do
15 so the government would not in any way consider that in
16 determining whether it had complied with the DPA." The AUSA
17 affirmed only the first proposition. See supra p. [18].
18 And as to that, the AUSA stated that the government's
19 position had not changed: so the import of that statement
20 depends on what position one thinks the government had
21 previously adopted.

22 Furthermore, it was unrealistic to expect KPMG to

1 exercise uncoerced judgment in March 2006 as if it had never
2 experienced the government's pressure in the first place.
3 The government's intervention, coupled with the menace
4 inherent in the Thompson Memorandum, altered the decisional
5 dynamic in a way that the district court could find
6 irreparable. Having assumed a supine position in the DPA--
7 under which KPMG must continue to cooperate fully with the
8 government⁷--it is not all that likely that the firm would
9 feel free to reverse course.

10 True, even if KPMG had decided initially to advance
11 legal fees, it might always have changed course later: it is
12 undisputed that KPMG's longstanding fees policy was
13 voluntary and subject to revision. (In fact, in the civil
14 suit KPMG represented that it would not have obligated
15 itself to pay millions of dollars in fees on behalf of an
16 unknown number of employees without regard to the charges
17 ultimately lodged against them.) So, the government argues,
18 even absent government pressure KPMG would not have advanced
19 legal fees indefinitely and without condition.

⁷"The cooperation provisions of the DPA . . . require KPMG to comply with demands by the USAO . . . [or else face] the risk that the government will declare that KPMG breached the DPA and prosecute the criminal information to verdict." Stein I, 435 F. Supp. 2d at 350.

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III

Judge Kaplan found that “KPMG’s decision to cut off all payments of legal fees and expenses to anyone who was indicted and to limit and to condition such payments prior to indictment upon cooperation with the government was the direct consequence of the pressure applied by the Thompson Memorandum and the USAO.” Stein I, 435 F. Supp. 2d at 353 (emphasis added); see also Stein II, 440 F. Supp. 2d at 334 (relying on this finding to conclude that KPMG’s conduct was fairly attributable to the State for Fifth Amendment purposes). The government protests that KPMG’s adoption and enforcement of its Fees Policy was private action, outside the ambit of the Sixth Amendment.

When “[t]he district court’s dismissal of [an] indictment raises questions of constitutional interpretation, . . . we review the district court’s decision de novo.” United States v. King, 276 F.3d 109, 111 (2d Cir. 2002).

Actions of a private entity are attributable to the State if “there is a sufficiently close nexus between the State and the challenged action of the . . . entity so that

1 the action of the latter may be fairly treated as that of
2 the State itself." Jackson v. Metro. Edison Co., 419 U.S.
3 345, 351 (1974). The "close nexus" test is not satisfied
4 when the state "[m]ere[ly] approv[es] of or acquiesce[s] in
5 the initiatives" of the private entity, S.F. Arts &
6 Athletics, Inc. v. U.S. Olympic Comm., 483 U.S. 522, 547
7 (1987) (internal quotation marks omitted and first
8 alteration in original), or when an entity is merely subject
9 to governmental regulation, see Jackson, 419 U.S. at 350 &
10 n.7. "The purpose of the [close-nexus requirement] is to
11 assure that constitutional standards are invoked only when
12 it can be said that the State is responsible for the
13 specific conduct of which the plaintiff complains." Blum v.
14 Yaretsky, 457 U.S. 991, 1004 (1982). Such responsibility is
15 normally found when the State "has exercised coercive power
16 or has provided such significant encouragement, either overt
17 or covert, that the choice must in law be deemed to be that
18 of the State." Id.

19 Although Supreme Court cases on this issue "have not
20 been a model of consistency," Edmonson v. Leesville Concrete
21 Co., 500 U.S. 614, 632 (1991) (O'Connor, J., dissenting),
22 some principles emerge. "A nexus of state action exists

1 between a private entity and the state when the state
2 exercises coercive power, is entwined in the management or
3 control of the private actor, or provides the private actor
4 with significant encouragement, either overt or covert, or
5 when the private actor operates as a willful participant in
6 joint activity with the State or its agents, is controlled
7 by an agency of the State, has been delegated a public
8 function by the state, or is entwined with governmental
9 policies." Flagg v. Yonkers Sav. & Loan Ass'n, 396 F.3d
10 178, 187 (2d Cir. 2005) (emphasis added and internal
11 quotation marks omitted); see also Skinner v. Ry. Labor
12 Executives' Ass'n, 489 U.S. 602, 615 (1989) (finding state
13 action where "the Government did more than adopt a passive
14 position toward the underlying private conduct" and where it
15 "made plain not only its strong preference for [the private
16 conduct], but also its desire to share the fruits of such
17 intrusions"). But see Maher v. Roe, 432 U.S. 464, 476
18 (1977) ("Constitutional concerns are greatest when the State
19 attempts to impose its will by force of law; the State's
20 power to encourage actions deemed to be in the public
21 interest is necessarily far broader." (emphasis added)).

22 The government argues: KPMG simply took actions in the

1 shadow of an internal DOJ advisory document (the Thompson
2 Memorandum) containing multiple factors and caveats; the
3 government's approval of KPMG's Fees Policy did not render
4 the government responsible for KPMG's actions enforcing it;
5 even if the government had specifically required KPMG to
6 adopt a policy that penalized non-cooperation, state action
7 would still have been lacking because KPMG would have
8 retained the power to apply the policy; and although the
9 prosecutors repeatedly informed KPMG when employees were not
10 cooperating, they did so at KPMG's behest, without knowing
11 how KPMG would react. We disagree.

12 KPMG's adoption and enforcement of the Fees Policy
13 amounted to "state action" because KPMG "operate[d] as a
14 willful participant in joint activity" with the government,
15 and because the USAO "significant[ly] encourage[d]" KPMG to
16 withhold legal fees from defendants upon indictment.⁸
17 Flagg, 396 F.3d at 187. The government brought home to KPMG
18 that its survival depended on its role in a joint project
19 with the government to advance government prosecutions. The

⁸As explained in section IV.A, infra, the government's pre-indictment conduct was designed to have an effect once defendants were indicted, and it is therefore proper to consider such conduct for purposes of evaluating state action.

1 government is therefore legally "responsible for the
2 specific conduct of which the [criminal defendants]
3 complain[]." Blum, 457 U.S. at 1004 (emphasis omitted).

4 The government argues that "KPMG's decision to
5 condition legal fee payments on cooperation, while
6 undoubtedly influenced by the Thompson Memorandum, was not
7 coerced or directed by the Government." But that argument
8 runs up against the district court's factual finding (which
9 we do not disturb) that the fees decision "was the direct
10 consequence" of the Memorandum and the prosecutors' conduct.
11 Stein I, 435 F. Supp. 2d at 353. Nevertheless, it remains a
12 question of law whether the facts as found by the district
13 court establish state action. See Blum, 457 U.S. at 1004
14 (asking whether the private conduct "must in law be deemed
15 to be that of the State" (emphasis added)).

16 State action is established here as a matter of law
17 because the government forced KPMG to adopt its constricted
18 Fees Policy. The Thompson Memorandum itself--which
19 prosecutors stated would be considered in deciding whether
20 to indict KPMG--emphasizes that cooperation will be assessed
21 in part based upon whether, in advancing counsel fees, "the
22 corporation appears to be protecting its culpable employees

1 and agents." Since defense counsel's objective in a
2 criminal investigation will virtually always be to protect
3 the client, KPMG's risk was that fees for defense counsel
4 would be advanced to someone the government considered
5 culpable. So the only safe course was to allow the
6 government to become (in effect) paymaster.

7 The prosecutors reinforced this message by inquiring
8 into KPMG's fees obligations, referring to the Thompson
9 Memorandum as "a point that had to be considered," and
10 warning that "misconduct" should not or cannot "be rewarded"
11 under "federal guidelines." Stein I, 435 F. Supp. 2d at
12 341-42. The government had KPMG's full attention. It is
13 hardly surprising, then, that KPMG decided to condition
14 payment of fees on employees' cooperation with the
15 government and to terminate fees upon indictment: only that
16 policy would allow KPMG to continue advancing fees while
17 minimizing the risk that prosecutors would view such
18 advancement as obstructive.

19 To ensure that KPMG's new Fees Policy was enforced,
20 prosecutors became "entwined in the . . . control" of KPMG.
21 Flagg, 396 F.3d at 187. They intervened in KPMG's
22 decisionmaking, expressing their "disappoint[ment] with

1 [the] tone" of KPMG's first advisory memorandum, Stein I,
2 435 F. Supp. 2d at 346, and declaring that "[t]hese problems
3 must be remedied" by a proposed supplemental memorandum
4 specifying that employees could meet with the government
5 without being burdened by counsel. Prosecutors also "made
6 plain" their "strong preference" as to what the firm should
7 do, and their "desire to share the fruits of such
8 intrusions." Skinner, 489 U.S. at 615. They did so by
9 regularly "reporting to KPMG the identities of employees who
10 refused to make statements in circumstances in which the
11 USAO knew full well that KPMG would pressure them to talk to
12 prosecutors." Stein II, 440 F. Supp. 2d at 337. (The
13 government's argument that it could not have known how KPMG
14 would react when informed that certain employees were not
15 cooperating is at best plausible only vis-à-vis the first
16 few employees.) The prosecutors thus steered KPMG toward
17 their preferred fee advancement policy and then supervised
18 its application in individual cases. Such "overt" and
19 "significant encouragement" supports the conclusion that
20 KPMG's conduct is properly attributed to the State.⁹

⁹Because the Sixth Amendment attaches only upon indictment, the KPMG conduct attributable to the government is relevant only insofar as it contributed to KPMG's

1 The authorities cited by the government are not to the
2 contrary. The government relies on Blum v. Yaretsky, 457
3 U.S. 991 (1982), and Albert v. Carovano, 851 F.2d 561 (2d
4 Cir. 1988) (en banc), two cases in which state action was
5 held to be lacking. In Blum, a class of Medicaid patients
6 unsuccessfully challenged the transfer and discharge
7 decisions of private nursing homes. The patients claimed
8 that the private conduct was attributable to New York State
9 because state regulations required that the nursing homes
10 transfer patients to a facility providing the level of care
11 “‘indicated by the patient’s medical condition or needs.’”
12 Blum, 457 U.S. at 1007-08 (quoting N.Y. Comp. Codes R. &
13 Regs. tit. 10, §§ 416.9(d)(1), 421.13(d)(1) (1980)). Even
14 though the regulations “encouraged for efficiency reasons”
15 the “downward” transfer of patients to “lower levels of
16 care,” id. at 1008 n.19 (emphasis added), and even though
17 “federal law require[d] . . . state officials [to] review”
18 nursing home assessments and “[a]djust[] . . . benefit

decision to withhold legal fees upon defendants’ indictment.
See Part IV, infra. Many of KPMG’s actions occurred prior
to the August and October 2005 indictments. Nevertheless,
when the defendants were indicted, KPMG had been so schooled
by the government in the necessity of enforcing a particular
fee advancement policy that KPMG understood what was
expected of it once the indictments came down.

1 levels in response to a decision to discharge or transfer a
2 patient," id. at 1010, the Supreme Court ruled that state
3 action was lacking. As the Court explained, the
4 "regulations do not require the nursing homes to rely on the
5 [patient care assessment forms designed by New York] in
6 making discharge or transfer decisions," and "do not dictate
7 the decision to discharge or transfer in a particular case."
8 Id. at 1008, 1010 (emphasis added). Instead, those
9 decisions "ultimately turn[ed] on medical judgments made by
10 private parties according to professional standards that are
11 not established by the State." Id. at 1008.

12 Likewise, Albert declined to deem the disciplinary
13 decisions of a private college to be state action, despite a
14 New York law requiring colleges to adopt disciplinary rules
15 and file them with the state. Albert, 851 F.2d at 568-69.
16 We rejected plaintiffs' claim that the college was compelled
17 by New York State to promulgate a disciplinary policy that
18 it would not have adopted otherwise. The policy was not "a
19 rule of conduct imposed by the state," we explained, because
20 "[c]olleges are free to define breaches of public order
21 however they wish, and they need not resort to a particular
22 penalty in any particular case." Id. at 564, 568.

1 Moreover, even if the state had mandated a particular rule,
2 “the ultimate power to select a particular sanction in
3 individual cases would, as in [Blum], rest with the private
4 party.” Id. at 571. That is, there was “nothing in either
5 the legislation or those rules” that “required that these
6 appellants be suspended.” Id. at 568 (emphasis added).

7 In Blum and Albert, it was decisive that [1] actions of
8 the private entity were based on independent criteria (the
9 medical standards; the college rules of conduct), and that
10 [2] the government was not dictating the outcomes of
11 particular cases.

12 Here, however, [1] KPMG was never “free to define”
13 cooperation independently: AUSA Weddle told Bennett that he
14 had “had a bad experience in the past with a company
15 conditioning payments on a person’s cooperation, where the
16 company did not define cooperation as ‘tell the truth’ the[]
17 way we [the prosecutors] define it.” KPMG’s fees
18 advancement decisions in individual cases thus depended
19 largely on state-influenced standards. In addition, [2] the
20 prosecution designated particular employees for deprivation
21 of fees (and, in some cases, termination of employment) by
22 demanding that KPMG threaten and penalize those employees

1 for non-cooperation. As Bennett later reported to the
2 Deputy Attorney General, "[w]henever your Office has
3 notified us that individuals have not . . . cooperat[ed],
4 KPMG has promptly and without question encouraged them to
5 cooperate and threatened to cease payment of their attorneys
6 fees and . . . to take personnel action, including
7 termination." Furthermore, by indicting the thirteen
8 defendants after inspiring and shaping KPMG's Fees Policy
9 and after exacting KPMG's compliance with it, prosecutors
10 effectively selected which employees would be deprived of
11 attorneys' fees. Having forced the constriction of KPMG's
12 longstanding policy of advancing fees, the government then
13 compelled KPMG to apply the Fees Policy to particular
14 employees both pre- and post-indictment. This conduct finds
15 no protection in Blum and Albert.

16 The government also directs us to another line of state
17 action cases: D.L. Cromwell Investments, Inc. v. NASD
18 Regulation, Inc., 279 F.3d 155 (2d Cir. 2002), and United
19 States v. Solomon, 509 F.2d 863 (2d Cir. 1975). These cases
20 involved parallel, cooperative investigations by private
21 regulatory entities and government investigators. In D.L.
22 Cromwell, the USAO and the National Association of

1 Securities Dealers ("NASD") simultaneously investigated
2 plaintiff stockbrokers. The plaintiffs sought to enjoin
3 NASD from compelling on-the-record interviews (on pain of
4 expulsion from their profession), arguing under the Fifth
5 Amendment that the NASD inquiry was a tool of the
6 prosecutors. D.L. Cromwell, 279 F.3d at 156-57. Plaintiffs
7 pointed to the informal and formal sharing of documents and
8 information between the government and the NASD, id. at 157-
9 58, 162, and the fact that the NASD interview demands
10 followed shortly after plaintiffs contested grand jury
11 subpoenas, id. at 162. Similarly, in Solomon, the New York
12 Stock Exchange ("NYSE") had taken testimony from a trader
13 under threat of suspension or expulsion, and then forwarded
14 his deposition to the SEC pursuant to an SEC subpoena. 509
15 F.2d at 864-65.

16 In both cases, we held that there was no state action
17 because the private actors had independent regulatory
18 interests and motives for making their inquiries and for
19 cooperating with parallel investigations being conducted by
20 the government. In D.L. Cromwell, the NASD had a
21 preexisting "regulatory duty to investigate questionable
22 securities transactions," 279 F.3d at 163--that is, it would

1 have requested interviews regardless of governmental
2 pressure. And in Solomon, the NYSE's efforts were "in
3 pursuance of its own interests and obligations, not as an
4 agent of the [government]," 509 F.2d at 869--absent SEC
5 involvement, the NYSE would have investigated anyway.
6 Because the NASD and the NYSE had preexisting and
7 independent investigatory missions, their cooperation with
8 the government was not state action. See Lisa Kern Griffin,
9 Compelled Cooperation and the New Corporate Criminal
10 Procedure, 82 N.Y.U. L. Rev. 311, 369 (2007) (observing that
11 D.L. Cromwell and Solomon "turned in large part on the fact
12 that requests for interviews" were not "generated by
13 governmental persuasion or collusion"). By contrast (as the
14 district court found), absent the prosecutors' involvement
15 and the Thompson Memorandum, KPMG would not have changed its
16 longstanding fee advancement policy or withheld legal fees
17 from defendants upon indictment. See Stein I, 435 F. Supp.
18 2d at 353.

19 The government responds: Solomon declined to find state
20 action even though it involved a private entity compelling
21 interviews with one of its members, backed by the explicit
22 threat of expulsion, in the context of continuous

1 coordination between the NYSE and the SEC on the same side.
2 So how can KPMG, an adversary of the government, also be its
3 partner? See Brentwood Acad. v. Tenn. Secondary Sch.
4 Athletic Ass'n, 531 U.S. 288, 304 (2001) ("The state-action
5 doctrine does not convert opponents into virtual agents.").

6 An adversarial relationship does not normally bespeak
7 partnership. But KPMG faced ruin by indictment and
8 reasonably believed it must do everything in its power to
9 avoid it. The government's threat of indictment was easily
10 sufficient to convert its adversary into its agent. KPMG
11 was not in a position to consider coolly the risk of
12 indictment, weigh the potential significance of the other
13 enumerated factors in the Thompson Memorandum, and decide
14 for itself how to proceed. See Griffin, 82 N.Y.U. L. Rev.
15 at 367 ("The threat of [ruinous indictment] brings
16 significant pressure to bear on corporations, and that
17 threat 'provides a sufficient nexus' between a private
18 entity's employment decision at the government's behest and
19 the government itself.").

20 We therefore conclude that KPMG's adoption and
21 enforcement of the Fees Policy (both before and upon
22 defendants' indictment) amounted to state action. The

1 government may properly be held "responsible for the
2 specific conduct of which the [criminal defendants]
3 complain[]," Blum, 457 U.S. at 1004 (emphasis omitted),
4 i.e., the deprivation of their Sixth Amendment right to
5 counsel, if the violation is established.

7 IV

8 The district court's ruling on the Sixth Amendment was
9 based on the following analysis (set out here in précis).
10 The Sixth Amendment protects "an individual's right to
11 choose the lawyer or lawyers he or she desires," Stein I,
12 435 F. Supp. 2d at 366 (citing Wheat v. United States, 486
13 U.S. 153, 164 (1988)), and "to use one's own funds to mount
14 the defense that one wishes to present," id. (citing Caplin
15 & Drysdale, Chartered v. United States, 491 U.S. 617, 624
16 (1989)). The goal is to secure "a defendant's right to
17 spend his own money on a defense." Id. at 367. Because
18 defendants reasonably expected to receive legal fees from
19 KPMG, the fees "were, in every material sense, their
20 property." Id. The government's interest in retaining
21 discretion to treat as obstruction a company's advancement
22 of legal fees "is insufficient to justify the government's

1 interference with the right of individual criminal
2 defendants to obtain resources lawfully available to them in
3 order to defend themselves." Id. at 369. Defendants need
4 not make a "particularized showing" of how their defense was
5 impaired, id. at 372, because "[v]irtually everything the
6 defendants do in this case may be influenced by the extent
7 of the resources available to them," such as selection of
8 counsel and "what the KPMG Defendants can pay their lawyers
9 to do," id. at 371-72. Therefore, the Sixth Amendment
10 violation "is complete irrespective of the quality of the
11 representation they receive." Id. at 369.¹⁰

¹⁰In Stein IV, Judge Kaplan nevertheless expanded his findings as to Sixth Amendment harms suffered by particular defendants: defendants Gremminger, Hasting and Watson were deprived of their chosen counsel, "lawyers who had represented them as long as KPMG was paying the bills"; and defendant Ritchie was deprived of the services of Cadwalader Wickersham & Taft, "which was to have played an integral role in his defense." 495 F. Supp. 2d at 421. In addition:

All of the [present] KPMG Defendants . . . say that KPMG's refusal to pay their post-indictment legal fees has caused them to restrict the activities of their counsel, limited or precluded their attorneys' review of the documents produced by the government in discovery, prevented them from interviewing witnesses, caused them to refrain from retaining expert witnesses, and/or left them without information technology assistance necessary for dealing with the mountains of electronic discovery. The government has not contested these assertions. The Court therefore has no reason to doubt, and hence finds, that all of them have been

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Most of the state action relevant here--the promulgation of the Thompson Memorandum, the prosecutors' communications with KPMG regarding the advancement of fees, KPMG's adoption of a Fees Policy with caps and conditions, and KPMG's repeated threats to employees identified by prosecutors as being uncooperative--pre-dated the indictments of August and October 2005.¹¹ (Of course, after the indictments were filed KPMG ceased advancing fees to all thirteen of the present defendants who were still receiving fees up to that point. As explained in Part III, this was also state action.) So we must determine how this pre-

forced to limit their defenses in the respects claimed for economic reasons and that they would not have been so constrained if KPMG paid their expenses subject only to the usual sort of administrative requirements typically imposed by corporate law departments on outside counsel fees.

Id. at 418-19 (footnote omitted). Judge Kaplan explained that even though many defendants had net assets ranging from \$1 million to \$5 million, their resources were inadequate "to defend this case as they would have defended it absent the government's actions." Id. at 423.

¹¹Again, "state action" includes both conduct by the government and conduct by KPMG that is fairly attributable to the government. See Part III, supra.

1 indictment conduct may bear on defendants' Sixth Amendment
2 claim.

3 "The Sixth Amendment right of the 'accused' to
4 assistance of counsel in 'all criminal prosecutions' is
5 limited by its terms: it does not attach until a prosecution
6 is commenced." Rothgery v. Gillespie County, 554 U.S. ---,
7 128 S. Ct. 2578, 2583 (2008) (quoting U.S. Const. amend. VI)
8 (some internal quotation marks and footnote omitted).

9 "Attachment" refers to "when the [Sixth Amendment] right may
10 be asserted"; it does not concern the separate question of
11 "what the right guarantees," i.e., what the "substantive
12 guarantee of the Sixth Amendment" is at that stage of the
13 prosecution. Id. at 2592, 2594 (Alito, J., concurring).

14 The Supreme Court has "pegged commencement [of a
15 prosecution] to 'the initiation of adversary judicial
16 criminal proceedings--whether by way of formal charge,
17 preliminary hearing, indictment, information, or
18 arraignment.'" Id. at 2583 (majority opinion) (quoting
19 United States v. Gouveia, 467 U.S. 180, 188 (1984)). "The
20 rule is not 'mere formalism,' but a recognition of the point
21 at which 'the government has committed itself to prosecute,'
22 'the adverse positions of government and defendant have

1 solidified,' and the accused 'finds himself faced with the
2 prosecutorial forces of organized society, and immersed in
3 the intricacies of substantive and procedural criminal
4 law.'" Id. (quoting Kirby v. Illinois, 406 U.S. 682, 689
5 (1972) (plurality opinion)).

6 Judge Kaplan focused on KPMG's decision to withhold
7 fees upon indictment: "[T]he constitutional violation
8 pertinent to possible dismissal of the indictment was the
9 government's role in KPMG's action in cutting off payment of
10 legal fees for those who were indicted as distinct from the
11 limitations on payment of legal fees during the
12 investigative stage." Stein IV, 495 F. Supp. 2d at 404 n.54
13 (emphasis added) (citing Stein I, 435 F. Supp. 2d at 373).
14 Therefore, Judge Kaplan explained, "[a]ctions by the
15 government that affected only the payment of legal fees and
16 defense costs for services rendered prior to the indictment
17 . . . do not implicate the Sixth Amendment." Stein I, 435
18 F. Supp. 2d at 373 (emphasis added).

19 By the same token, state action that also (or only)
20 affected the advancement of legal fees for services rendered
21 post-indictment does implicate defendants' Sixth Amendment
22 rights, regardless of when the conduct took place:

1 It is true, of course, that the Sixth Amendment
2 right to counsel typically attaches at the initiation
3 of adversarial proceedings--at an arraignment,
4 indictment, preliminary hearing, and so on. But the
5 analysis can not end there. The Thompson Memorandum on
6 its face and the USAO's actions were parts of an effort
7 to limit defendants' access to funds for their defense.
8 Even if this was not among the conscious motives, the
9 Memorandum was adopted and the USAO acted in
10 circumstances in which that result was known to be
11 exceptionally likely. The fact that events were set in
12 motion prior to indictment with the object of having,
13 or with knowledge that they were likely to have, an
14 unconstitutional effect upon indictment cannot save the
15 government. This conduct, unless justified, violated
16 the Sixth Amendment.

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18 Id. at 366 (emphasis added). In other words, the
19 government's pre-indictment conduct was of a kind that would
20 have post-indictment effects of Sixth Amendment
21 significance, and did.

22 We endorse this analysis. Although defendants' Sixth
23 Amendment rights attached only upon indictment, the district
24 court properly considered pre-indictment state action that
25 affected defendants post-indictment. When the government
26 acts prior to indictment so as to impair the suspect's
27 relationship with counsel post-indictment, the pre-
28 indictment actions ripen into cognizable Sixth Amendment
29 deprivations upon indictment.¹² As Judge Ellis explained in

¹²As Judge Kaplan recognized, the pre-indictment conduct is separately constrained by the Fifth Amendment.

1 United States v. Rosen, 487 F. Supp. 2d 721 (E.D. Va. 2007),
2 "it is entirely plausible that pernicious effects of the
3 pre-indictment interference continued into the
4 post-indictment period, effectively hobbling defendants'
5 Sixth Amendment rights to retain counsel of choice with
6 funds to which they had a right. . . . [I]f, as alleged, the
7 government coerced [the employer] into halting fee advances
8 on defendants' behalf and the government did so for the
9 purpose of undermining defendants' relationship with counsel
10 once the indictment issued, the government violated
11 defendants' right to expend their own resources towards
12 counsel once the right attached." Id. at 734.

13 Since the government forced KPMG to adopt the
14 constricted Fees Policy--including the provision for
15 terminating fee advancement upon indictment--and then
16 compelled KPMG to enforce it, it was virtually certain that
17 KPMG would terminate defendants' fees upon indictment. We
18 therefore reject the government's argument that its actions
19 (virtually all pre-indictment) are immune from scrutiny
20 under the Sixth Amendment.¹³

¹³We need not decide whether KPMG's pre-indictment conditioning and capping of fees--conduct we have determined was state action--establishes a Sixth Amendment violation by

1 **B**

2 We now consider "what the [Sixth Amendment] right
3 guarantees." Rothgery, 128 S. Ct. at 2592 (Alito, J.,
4 concurring).

5 The Sixth Amendment ensures that "[i]n all criminal
6 prosecutions, the accused shall enjoy the right . . . to
7 have the Assistance of Counsel for his defence." U.S.
8 Const. amend. VI. Thus "the Sixth Amendment guarantees the
9 defendant the right to be represented by an otherwise
10 qualified attorney whom that defendant can afford to hire,
11 or who is willing to represent the defendant even though he
12 is without funds." Caplin & Drysdale, Chartered v. United
13 States, 491 U.S. 617, 624-25 (1989). "[A]n element of this
14 right is the right of a defendant who does not require
15 appointed counsel to choose who will represent him." United
16 States v. Gonzalez-Lopez, 548 U.S. 140, 144 (2006).¹⁴

itself. As discussed below, KPMG's termination of fees upon indictment deprived defendants of their Sixth Amendment right to counsel.

¹⁴Although the Sixth Amendment right to counsel of choice "has been regarded as the root meaning of the constitutional guarantee," id. at 147-48, the right is qualified: the attorney must be admitted to the bar, willing to represent the defendant, free from certain conflicts of interest, compliant with the rules of the court, and so on, see Wheat v. United States, 486 U.S. 153, 159-60 (1988).

1 The government must "honor" a defendant's Sixth
2 Amendment right to counsel:

3 This means more than simply that the State cannot
4 prevent the accused from obtaining the assistance of
5 counsel. The Sixth Amendment also imposes on the State
6 an affirmative obligation to respect and preserve the
7 accused's choice to seek this assistance. . . . [A]t
8 the very least, the prosecutor and police have an
9 affirmative obligation not to act in a manner that
10 circumvents and thereby dilutes the protection afforded
11 by the right to counsel.

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13 Maine v. Moulton, 474 U.S. 159, 170-71 (1985). This is
14 intuitive: the right to counsel in an adversarial legal
15 system would mean little if defense counsel could be
16 controlled by the government or vetoed without good reason.

17 Consistent with this principle of non-interference,
18 courts have identified violations of the Sixth Amendment
19 right to counsel where the government obtains incriminating
20 statements from a defendant outside the presence of counsel
21 and then introduces those statements at trial. See, e.g.,
22 id. at 176; Massiah v. United States, 377 U.S. 201, 206
23 (1964). Likewise, the government violates the Sixth
24 Amendment when it intrudes on the attorney-client
25 relationship, preventing defense counsel from
26 "participat[ing] fully and fairly in the adversary
27 factfinding process." Herring v. New York, 422 U.S. 853,

1 858 (1975); see, e.g., id. at 858-59 (holding that a New
2 York statute allowing judges in a criminal bench trial to
3 deny counsel the opportunity to make a closing argument
4 deprived defendant of his Sixth Amendment right to the
5 assistance of counsel); Geders v. United States, 425 U.S.
6 80, 91 (1976) (holding that a trial court's order that
7 defendant not consult with his attorney during an overnight
8 recess during trial violated the Sixth Amendment).

9 Defendants-Appellees do not say that they were deprived
10 of constitutionally effective counsel. See Strickland v.
11 Washington, 466 U.S. 668, 686 (1984). Their claim is that
12 the government unjustifiably interfered with their
13 relationship with counsel and their ability to mount the
14 best defense they could muster.

15 The government, relying on Caplin & Drysdale, Chartered
16 v. United States, 491 U.S. 617 (1989), contends that a
17 defendant has no Sixth Amendment right to a defense funded
18 by someone else's money. In that case, the Supreme Court
19 ruled that a defendant's Sixth Amendment right to retain
20 counsel of choice was not violated when the funds he
21 earmarked for defense were seized under a federal forfeiture
22 statute, because title to the forfeitable assets had vested

1 in the United States. Id. at 628; see also United States v.
2 Monsanto, 491 U.S. 600, 616 (1989) (holding that pretrial
3 restraining order based on showing of probable cause that
4 property is forfeitable “does not ‘arbitrarily’ interfere
5 with a defendant’s ‘fair opportunity’ to retain counsel”).

6 The government focuses on the following passage from
7 Caplin & Drysdale:

8 Whatever the full extent of the Sixth Amendment’s
9 protection of one’s right to retain counsel of his
10 choosing, that protection does not go beyond ‘the
11 individual’s right to spend his own money to obtain the
12 advice and assistance of . . . counsel.’ Walters v.
13 National Assn. of Radiation Survivors, 473 U.S. 305,
14 370 (1985) (Stevens, J., dissenting). A defendant has
15 no Sixth Amendment right to spend another person’s
16 money for services rendered by an attorney, even if
17 those funds are the only way that that defendant will
18 be able to retain the attorney of his choice. A
19 robbery suspect, for example, has no Sixth Amendment
20 right to use funds he has stolen from a bank to retain
21 an attorney to defend him if he is apprehended. The
22 money, though in his possession, is not rightfully his
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25 Caplin & Drysdale, 491 U.S. at 626 (emphasis added and first
26 omission in original). The holding of Caplin & Drysdale is
27 narrow: the Sixth Amendment does not prevent the government
28 from reclaiming its property from a defendant even though
29 the defendant had planned to fund his legal defense with it.
30 It is easy to distinguish the case of an employee who
31 reasonably expects to receive attorneys’ fees as a benefit

1 or perquisite of employment, whether or not the expectation
2 arises from a legal entitlement. As has been found here as
3 a matter of fact, these defendants would have received fees
4 from KPMG but for the government's interference. Although
5 "there is no Sixth Amendment right for a defendant to obtain
6 counsel using tainted funds, [a defendant] still possesses a
7 qualified Sixth Amendment right to use wholly legitimate
8 funds to hire the attorney of his choice." United States v.
9 Farmer, 274 F.3d 800, 804 (4th Cir. 2001) (emphasis added).

10 It is axiomatic that if defendants had already received
11 fee advances from KPMG, the government could not (absent
12 justification) deliberately interfere with the use of that
13 money to fuel their defenses. And the government concedes
14 that it could not prevent a lawyer from furnishing a defense
15 gratis. See Caplin & Drysdale, 491 U.S. at 624-25 ("[T]he
16 Sixth Amendment guarantees a defendant the right to be
17 represented by an otherwise qualified attorney . . . who is
18 willing to represent the defendant even though he is without
19 funds."). Presumably, such a lawyer could pay another
20 lawyer to represent the defendant (subject, of course, to
21 ethical rules governing third-party payments to counsel, see
22 United States v. Locascio, 6 F.3d 924, 932-33 (2d Cir.

1 1993)). And if the Sixth Amendment prohibits the government
2 from interfering with such arrangements, then surely it also
3 prohibits the government from interfering with financial
4 donations by others, such as family members and neighbors--
5 and employers. See United States v. Inman, 483 F.2d 738,
6 739-40 (4th Cir. 1973) (per curiam) ("The Sixth Amendment
7 right to counsel includes not only an indigent's right to
8 have the government appoint an attorney to represent him,
9 but also the right of any accused, if he can provide counsel
10 for himself by his own resources or through the aid of his
11 family or friends, to be represented by an attorney of his
12 own choosing." (emphasis added)). In a nutshell, the Sixth
13 Amendment protects against unjustified governmental
14 interference with the right to defend oneself using whatever
15 assets one has or might reasonably and lawfully obtain.

16 The government points out that KPMG's past fee practice
17 was voluntary and subject to change, and that defendants
18 therefore could have had no reasonable expectation of the
19 ongoing advancement of fees. But this argument simply
20 quarrels with Judge Kaplan's finding that absent any state
21 action, KPMG would have paid defendants' legal fees and
22 expenses without regard to cost. See Stein I, 435 F. Supp.

1 2d at 353. Defendants were not necessarily entitled to fee
2 advancement as a matter of law, see Stein v. KPMG, LLP, 486
3 F.3d 753, 762 n.3 (2d Cir. 2007) (commenting that
4 defendants' likelihood of success in obtaining a judgment
5 against KPMG for legal fees is "far from certain"); but the
6 Sixth Amendment prohibits the government from impeding the
7 supply of defense resources (even if voluntary or gratis),
8 absent justification. Therefore, unless the government's
9 interference was justified, it violated the Sixth Amendment.

10 The government is sometimes allowed to interfere with
11 defendants' choice or relationship with counsel, such as to
12 prevent certain conflicts of interest. See, e.g., United
13 States v. Curcio, 680 F.2d 881 (2d Cir. 1982). However, the
14 government has failed to establish a legitimate
15 justification for interfering with KPMG's advancement of
16 legal fees.

17 The government argues that it may inquire into third-
18 party payment of legal fees in certain circumstances. For
19 example, in United States v. Locascio, we affirmed the
20 disqualification of defendant's counsel based in part on
21 defendant's "benefactor payments" to the attorney to serve
22 as "house counsel" to members of the Gambino organized crime

1 family. Locascio, 6 F.3d at 932. We explained that "the
2 acceptance of such 'benefactor payments' . . . raises an
3 ethical question as to whether the attorney's loyalties are
4 with the client or the payor," id. (some internal quotation
5 marks omitted), and that "proof of house counsel can be used
6 by the government to help establish the existence of the
7 criminal enterprise under RICO, by showing the connections
8 among the participants," id. at 932-33.

9 The government's reliance on Locascio is misplaced.
10 There, the attorney's status as "house counsel" "was
11 potentially part of the proof of the Gambino criminal
12 enterprise," id. at 933, i.e., it was evidence going to an
13 element of the crime itself, and it was relevant to
14 ascertaining and preventing potential conflicts of interest,
15 id. at 932. But here, the government claims no such
16 compelling justifications.

17 It is also urged that a company may pretend cooperation
18 while "circling the wagons," that payment of legal fees can
19 advance such a strategy, and that the government has a
20 legitimate interest in being able to assess cooperation
21 using the payment of fees as one factor. Even if that can
22 be a legitimate justification, it would not be in play here:

1 prosecutors testified before the district court that they
2 were never concerned that KPMG was "circling the wagons."
3 Moreover, it is unclear how the circling of wagons is much
4 different from the legitimate melding of a joint defense.

5 The government conceded at oral argument that it is in
6 the government's interest that every defendant receive the
7 best possible representation he or she can obtain. A
8 company that advances legal fees to employees may stymie
9 prosecutors by affording culpable employees with high-
10 quality representation. But if it is in the government's
11 interest that every defendant receive the best possible
12 representation, it cannot also be in the government's
13 interest to leave defendants naked to their enemies.

14 Judge Kaplan found that defendants Gremminger, Hasting,
15 Ritchie and Watson were unable to retain the counsel of
16 their choosing as a result of the termination of fee
17 advancements upon indictment. Stein IV, 495 F. Supp. 2d at
18 421-22. The government does not contest this factual
19 finding, and we will not disturb it. A defendant who is
20 deprived of counsel of choice (without justification) need
21 not show how his or her defense was impacted; such errors
22 are structural and are not subject to harmless-error review.

1 See Gonzalez-Lopez, 548 U.S. at 144, 148-52. “[T]he right
2 at stake here is the right to counsel of choice, . . . and
3 that right was violated because the deprivation of counsel
4 was erroneous. No additional showing of prejudice is
5 required to make the violation ‘complete.’” Id. at 146. Of
6 course, a completed constitutional violation may still be
7 remediable. However, as explained in Part II, the
8 government has failed to cure this Sixth Amendment
9 violation. Therefore, the government deprived defendants
10 Gremminger, Hasting, Ritchie and Watson of their Sixth
11 Amendment right to counsel of choice.

12 The remaining defendants--Bickham, DeLap, Eischeid,
13 Lanning, Rosenthal, Smith, Stein, Warley, and Wiesner--do
14 not claim they were deprived of their chosen counsel.
15 Rather, they assert that the government unjustifiably
16 interfered with their relationship with counsel and their
17 ability to defend themselves. In the district court, the
18 government conceded that these defendants are also entitled
19 to dismissal of the indictment, assuming the correctness of
20 Stein I. See Stein IV, 495 F. Supp. 2d at 393. We agree:
21 these defendants can easily demonstrate interference in
22 their relationships with counsel and impairment of their

1 ability to mount a defense based on Judge Kaplan's non-
2 erroneous findings that the post-indictment termination of
3 fees "caused them to restrict the activities of their
4 counsel," and thus to limit the scope of their pre-trial
5 investigation and preparation. Id. at 418. Defendants were
6 indicted based on a fairly novel theory of criminal
7 liability; they faced substantial penalties; the relevant
8 facts are scattered throughout over 22 million documents
9 regarding the doings of scores of people, id. at 417; the
10 subject matter is "extremely complex," id. at 418; technical
11 expertise is needed to figure out and explain what happened;
12 and trial was expected to last between six and eight months,
13 id. As Judge Kaplan found, these defendants "have been
14 forced to limit their defenses . . . for economic reasons
15 and . . . they would not have been so constrained if KPMG
16 paid their expenses." Id. at 419. We therefore hold that
17 these defendants were also deprived of their right to
18 counsel under the Sixth Amendment.¹⁵

¹⁵This case does not raise, and therefore we have no occasion to consider, the application of our holding to the following scenario: A defendant moves unsuccessfully in the district court to dismiss the indictment on the same Sixth Amendment theory. The defendant proceeds to trial with his or her chosen attorney, and the attorney is forced to limit the scope of his or her efforts due to the defendant's

CONCLUSION

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For the foregoing reasons, we AFFIRM the judgment of
the district court dismissing defendants' indictment.

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financial constraints. The defendant is convicted based on
overwhelming evidence of his or her guilt.