

Bloomberg

KPMG Prosecutors Urge Partial Dismissal of Tax Case (Update5)

By David Glovin - Jun 25, 2007

June 25 (Bloomberg) -- Federal prosecutors urged a judge to dismiss charges against 12 of 16 former KPMG LLP partners accused of selling illegal tax shelters, dealing a blow to the largest tax fraud case in U.S. history.

Prosecutors in New York told U.S. District Judge Lewis Kaplan June 23 in court papers he should throw out the case against the 12 former executives after finding the government violated their right to counsel. Charges shouldn't be dismissed against six other defendants, the prosecutors said.

``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," Assistant U.S. Attorney John Hillebrecht wrote in a brief filed with the federal court in Manhattan.

Defendants including former KPMG Deputy Chairman Jeffrey Stein still may be prosecuted. Prosecutors have the right to appeal Kaplan's ruling last year that they violated the defendants' rights by threatening to indict KPMG unless it cut off payment of legal fees for its former executives.

``The government is taking the only position they reasonably can," said Andrew J. Frisch, a defense lawyer at LeClair Ryan in New York and a former federal prosecutor in Brooklyn, New York. ``They're setting it up for an appeal."

Frisch, who isn't involved in the case, called the government's move ``highly unusual" and one that may not succeed if the appeals court agrees that prosecutors violated the defendants' constitutional rights.

Case History

In 2005, U.S. prosecutors accused 17 ex-KPMG executives and two others of selling illegal tax shelters from 1996 to 2005 that cost the U.S. Treasury at least \$2 billion. One executive pleaded guilty, along with other defendants who were later charged. Charges against KPMG were dismissed in January after the firm paid a \$456 million fine.

Last year, Kaplan said prosecutors violated the executives' Fifth and Sixth Amendment rights to a fair trial and effective assistance of counsel with the threat to KPMG over the fees.

``We continue to believe that the legal and factual premises underlying that conclusion are mistaken," Hillebrecht wrote in a 46-page brief. ``No remedy short of dismissal appears adequate" if the earlier ruling stands, he added.

The judge said the constitutional violations might be remedied if the executives could force KPMG to resume paying. He ordered the company to stand trial on whether it owed the legal fees. That led to KPMG's appeal. In May, the appeals court said Kaplan lacked the authority to force such a trial.

No Alternative

The executives subsequently asked Kaplan to dismiss the case, prompting the judge to ask prosecutors whether there were penalties he might impose other than dismissal. Prosecutors have now concluded there's no option other than dismissal.

``By the express terms" of Kaplan's ruling last year, ``the court has already held as a practical matter that the government's conduct has `contaminated' the entire criminal proceeding," Hillebrecht wrote.

Prosecutors urged that charges not be dismissed against six defendants, including two who weren't KPMG executives --Raymond Ruble and David Amir Makov -- and four former KPMG executives, three of whose legal fees were paid by another entity.

Defense attorney Caroline Rule, who represents Richard Smith, KPMG's former vice-chairman of tax services, said she expects prosecutors to appeal last year's ruling on the constitutional issues, if Kaplan grants a dismissal of the fraud charges. Kaplan may also come up with another remedy, she said.

Case Dismissal `Likely'

A dismissal is ``more likely than not," said Rule, of the law firm Kostelanetz & Fink.

Rule said there may be another reason for the government's move. Defense lawyers this month filed documents with new details about U.S. efforts to force KPMG to stop paying fees. Rule said prosecutors may want a dismissal now, before Kaplan considers the new documents, so that they are not part of the official record and don't come before the appeals court when it reviews the case.

Kaplan is scheduled to hold a hearing on July 2 on the dismissal bid.

The case is U.S. v. Stein, 05-CR-888, U.S. District Court, Southern District of New York (Manhattan).

To contact the reporter on this story: David Glovin in New York at dglavin@bloomberg.net.

To contact the editor responsible for this story: Patrick Oster at poster@bloomberg.net.

©2010 BLOOMBERG L.P. ALL RIGHTS RESERVED.