

December 8, 2006

The Honorable Alphonso R. Jackson  
Secretary of Housing and Urban Development  
451 Seventh Street, S.W., Room 10000  
Washington, D.C. 20410-1047

Dear Mr. Secretary:

On behalf of the American Bar Association (“ABA”) and its more than 410,000 members, I write to express our increasing concern regarding certain policies, practices, and procedures of the Department of Housing and Urban Development (“HUD” or the “Department”) that threaten to erode the constitutional and other legal rights of the employees of state and local government entities that administer federal awards by discouraging the entities from providing their employees with the legal assistance they need to defend themselves during government investigations and enforcement proceedings. In particular, we have serious concerns regarding recent threats by certain officials in your Department’s Enforcement Center to take enforcement action against the directors of these state and local government entities because they covered the costs of legal assistance for their employees from program funds. In our view, these threats are improper, and we urge you to take appropriate remedial action as soon as possible.<sup>1</sup> As Chair of the ABA Task Force on Attorney-Client Privilege, I have been authorized to express the ABA’s views on these important issues.

It is our understanding that use of program funds by these state and local government entities for employee legal costs that do not involve affirmative claims against the United States appears to be authorized under Office of Management and Budget (OMB) Circular A-87, Attachment B, Item 10 **“Defense and prosecution of criminal and civil proceedings, and claims.”** Subsection (b), states: “Legal expenses required in the administration of Federal programs are allowable. Legal expenses for prosecution of claims against the Federal Government are unallowable.” Attachment B, Section 32(a) of the Circular also appears to permit use of such funds for “costs of professional and consultant services rendered by persons who are members of a particular profession or possess a special skill ... when reasonable in relation to the services rendered ...”

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<sup>1</sup> In August 2006, the ABA adopted Resolution 302B, which opposes governmental policies, practices and procedures that have the effect of eroding the constitutional and other legal rights of current or former employees, officers, directors or agents (“employees”) of an organization by pressuring the organization to take certain action against the employees, including not paying for their legal fees during investigations. The ABA resolution and a detailed background report are available at [http://www.abanet.org/buslaw/attorneyclient/materials/hod/emprights\\_recommendation\\_adopded.pdf](http://www.abanet.org/buslaw/attorneyclient/materials/hod/emprights_recommendation_adopded.pdf) and [http://www.abanet.org/buslaw/attorneyclient/materials/hod/emprights\\_report\\_adopded.pdf](http://www.abanet.org/buslaw/attorneyclient/materials/hod/emprights_report_adopded.pdf)

We understand the asserted rationale for attempting to restrict expenditures for legal costs otherwise authorized is that somehow the expenditures are considered to be for the personal benefit of the employees even where they are acting within the scope of their employment. The decision in *Arizona Oddfellow-Rebekah Housing v. HUD*, 125 F.3d 771 (9<sup>th</sup> Cir. 1997) would seem to contradict such a distinction by expressly holding that payment of legal costs with program revenues are an eligible cost under HUD's Federal Housing Administration regulatory agreement with the owners of that multifamily project. Judge A. Wallace Tashima pointed out that where program revenues were used "to defend lawsuits growing out of the operation of the project," such expenditures were not personal ones. In that instance, the legal costs were provided to defend against a "pattern or practice" discrimination suit brought by HUD against the project management. *Arizona Oddfellow-Rebekah*, 125 F.3d. at 775.

The President of the ABA, Karen Mathis, recently testified before the Senate Judiciary Committee regarding certain similar Justice Department policies, outlined in the so-called "Thompson Memorandum," which raise many of the same policy considerations as the HUD policy in question.<sup>2</sup> In her written statement to the Committee, she explained that the ABA opposes governmental policies, practices, and procedures that "erode...employees' constitutional and other legal rights, including the right to effective legal counsel." She added that such a governmental "policy is inconsistent with the fundamental legal principle that all prospective defendants—including an organization's current and former employees, officers, directors and agents—are presumed to be innocent." She went on to note that such a "policy overturns well-established corporate governance practices by forcing companies to abandon the traditional practice of indemnifying their employees and agents or otherwise assisting them with their legal defense for employment-related conduct until it has been determined that the employee or agent somehow acted improperly."

In her statement to the Senate Judiciary Committee, Ms. Mathis also stressed that "it should be the prerogative of a company to make an independent decision as to whether an employee should be provided defense or not...[as] the fiduciary duties of the directors in making such decisions are clear, and they are in the best position to decide what is in...[its] best interest . . ." Attempts by enforcement officials to threaten corporate management to prevent such legal assistance to its employees, she continued, "improperly weaken the entity's ability to help its employees to defend themselves in criminal actions." She further explained that "it is essential that employees, officers, directors and other agents of organizations have access to competent representation in criminal cases and in all other legal matters."

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<sup>2</sup> On September 12, 2006, ABA President Mathis testified before the Senate Judiciary Committee on the topic of "The Thompson Memorandum's Effect on the Right to Counsel in Corporate Investigations," and her written statement is available at <http://www.abanet.org/buslaw/attorneyclient/materials/064/064.pdf>. In particular, Ms. Mathis expressed the ABA's opposition to those portions of the Thompson Memorandum that encourage organizations to waive their attorney-client privilege and work product protections, and take certain punitive actions against their employees such as not paying their attorneys' fees, in order to receive cooperation credit. While it is not the focus of this letter, the ABA is also concerned regarding another analogous HUD policy, expressed in a recent formal Notice to public housing authorities (PHAs), urging them to include an addendum in all contracts with legal counsel that would restrict their attorneys' ability to assert the attorney-client privilege on behalf of these clients in regard to HUD investigations and enforcement proceedings. In effect, it is an indirect effort to get unwary and unsophisticated housing authorities to waive their privilege. In addition, the provision in the Notice would also prevent PHA attorneys from representing Authority employees in investigations and enforcement matters relating to administration of these programs.

ABA President Mathis also observed that “[t]he costs associated with defending a government investigation involving complex corporate and financial transactions can often run into the hundreds of thousands of dollars.” Therefore, she continued, “. . . when government prosecutors . . . succeed in pressuring a company not to pay for the employee’s legal defense, the employee typically may be unable to afford effective legal representation.” This same reasoning applies to the HUD policy of discouraging the directors of state and local government entities from using program funds to cover their employees’ legal defense costs.

We also bring to your attention that several of the key employee-related policies in the Justice Department’s Thompson Memorandum about which Ms. Mathis testified have been declared to be constitutionally suspect by the federal judge presiding over the pending case of *U.S. v. Stein*, also known as the “KPMG case.” On June 26 of this year, U.S. District Court Judge Lewis A. Kaplan issued an extensive opinion suggesting that actions by enforcement officials in discouraging or preventing a company from advancing attorneys’ fees to employees under investigation may violate the employees’ Fifth Amendment right to substantive due process and their Sixth Amendment right to counsel. *United States v. Stein*, No. S1 05 Crim. 0888 (LAK) (June 26, 2006).

Much of the impetus for the ABA position regarding payment of employees’ legal fees was provided by the Department of Justice policies that were the subject of Judge Kaplan’s strong criticism as well as the concerns raised by a coalition of rather diverse groups.<sup>3</sup> The ABA position is not limited to criminal proceedings. Rather we generally oppose “governmental policies, practices and procedures” that would restrict the ability of organizations to make an independent judgment as to whether their employees were operating within the scope of their employment, and hence, whether the organization should provide them with a legal defense or not.

In light of the OMB language cited above that clearly expresses the cost eligibility of such expenditures by state and local government entities carrying out federal programs, this administration, as well as its predecessors dating back to 1988, have consistently approved the use of federal program funds for legal expenses to defend and resolve disputes that may arise between these entities and the Federal government. Fundamental principles of due process and fairness undergird the OMB provisions in question.<sup>4</sup>

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<sup>3</sup> In her September 12, 2006 statement to the Senate Judiciary Committee, ABA President Mathis indicated that the ABA and its Task Force on Attorney-Client Privilege have been working in close cooperation with a broad and diverse coalition of influential legal and business groups—ranging from the U.S. Chamber of Commerce and the Association of Corporate Counsel to the American Civil Liberties Union and the National Association of Criminal Defense Lawyers—in an effort to reverse federal governmental policies that erode attorney-client privilege, work product, and employee protections. She further noted in her statement that “the remarkable political and philosophical diversity of that coalition shows just how widespread these concerns have become in the business, legal, and public policy communities.”

<sup>4</sup>The eligibility of employee legal costs for state and local government entities is bolstered by the language in OMB Circular A-122, “Cost Principles for Non-Profit Organizations.” That Circular governs costs for non-profit organizations. In the case of these non-governmental entities, A-122 disallows legal costs incurred in connection with any criminal, civil or administrative proceedings commenced by the Federal government or a state, local, or foreign government where the proceeding relates to a violation or failure by the non-profit organization to comply with a statute or regulation, *but only* when that proceeding results in a final decision, as relevant here, to debar or suspend the organization. OMB Circular A-122, Attachment B, § 10, provides in relevant part:

We understand that recent threats have been made by certain officials in your Department's Enforcement Center to take enforcement action against the directors of state and local government entities that covered their employees' legal defense costs from program funds. Such threats would appear to be an effort to prevent any effective legal representation for these employees. From a policy standpoint, to impose such financial restrictions—and even threaten further enforcement action against the entities' officials—simply because they authorized provision of legal assistance to their employees unfairly assumes the validity of the Federal government's position in the dispute. In addition, as ABA President Mathis indicated with respect to the analogous Justice Department policies, it will not be feasible for employees of state and local government entities to mount an effective defense to HUD's enforcement actions given the significant legal costs involved unless the entities are permitted to pay those legal expenses from program revenues.

Compelling acquiescence to Federal government demands in this manner is especially inappropriate when applied to other cooperating state and local government entities. Rather, such an enforcement policy seems to be a coercive tactic that assumes that HUD positions are always correct. It presumes the validity of the Enforcement Center's determinations and disregards the possibility that legitimate and valid positions and approaches exist contrary to its contentions. Once a debarment proceeding is initiated, no employees could realistically contest it without assistance from their employer.

There is a judicial process for determination of such disputes that should be utilized. It requires the assistance of counsel to meet due process standards. Such state and local government entities that carry out delivery of federal programs should be entitled to a presumption of appropriate conduct. Unfortunately, administratively prohibiting these entities from using program funds to provide their employees with an adequate legal defense is inconsistent with this presumption.

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Except as otherwise described herein, costs incurred in connection with any criminal, civil or administrative proceeding (including filing of a false certification) commenced by the Federal Government, or a State, local or foreign government, are not allowable if the proceeding: (1) relates to a violation of, or failure to comply with, a Federal, State, local or foreign statute or regulation by the organization (*including its agents and employees*), and (2) results in any of the following dispositions: ... (d) *A final decision by an appropriate Federal official to debar or suspend the organization, to rescind or void an award, or to terminate an award for default by reason of a violation or failure to comply with a law or regulation.* (Emphasis added).

Thus, under OMB Circular A-122, costs associated with defense of agents and employees are clearly allowable organization costs. Costs of defense against a proposed debarment only become unallowable where debarment "of the organization" actually results. Otherwise, legal costs are eligible.

It appears that OMB chose to disallow legal defense costs when a Respondent does not prevail in a debarment action in only two situations: (1) under OMB A-87, Attachment B, Item 10(a) in debarment actions brought by the Federal government against a defense contractor, when it is required to do so by statute, and, (2) under A-122 when the contractor is a non-profit private corporation, not another sovereign entity. OMB, by its use of the language in its two Circulars indicates that it permits state and local government entities to charge legal defense costs for their employees to their Federal award in all debarment actions regardless of the ultimate result, but for non-profits only if debarment does not result.

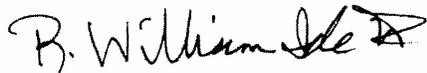
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In sum, we believe that the threats by certain officials in your Enforcement Center to initiate enforcement actions against state and local government entities that decide to cover the cost of their employees' legal assistance from program funds authorized by Congress are inappropriate and counterproductive. Accordingly, would urge you to reconsider the Department's policy and prohibit officials in the Enforcement Center from taking these types of actions.

Thank you for your consideration. If you would like to discuss these issues in greater detail or if you have any further questions regarding the ABA's position, please contact me at (404) 527-4650 or Larson Frisby of the ABA Governmental Office at (202) 662-1098.

Sincerely,

A handwritten signature in black ink that reads "R. William Ide, III". The signature is written in a cursive style with a prominent "R" and "I".

R. William Ide, III, Chair  
ABA Task Force on Attorney-Client Privilege

cc: All Members and Liaisons of the ABA Task Force on Attorney-Client Privilege  
Larson Frisby, ABA Governmental Affairs Office