ON THE INSIDE LOOKING OUT: A DISCUSSION OF THE INCREASED ENFORCEMENT ACTIONS AGAINST IN-HOUSE COUNSEL

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Introduction and Agenda

- Overview of Current Environment
- Legal Theories and Risk Areas
- Selected Cases
- Steps to Minimize Risk – Practical Tips
Overview of Current Environment
Prominent Lawyer Pleads Guilty for Role in Billionaire’s Alleged Embezzling

An up-and-coming Miami lawyer has agreed to plead guilty to conspiracy to commit mail fraud and money laundering in connection with his representation of a wealthy businessman, the National Law Journal reports.

Miami lawyer Richard Simring entered the plea in July in the Eastern District of Virginia, but few were aware of the development, according to the story. The publication describes Simring as a rising legal star and community activist who clerked for Rosemary Barkett, the former chief justice of the Florida Supreme Court who now sits on the Atlanta-based 11th U.S. Circuit Court of Appeals. At one time he was a partner at Stroock Stroock & Lavan.
Overview of Current Environment

Department of Justice
Office of Public Affairs

FOR IMMEDIATE RELEASE Tuesday, November 9, 2010

Pharmaceutical Company Lawyer Charged with Obstruction and Making False Statements

WASHINGTON – An attorney for a major pharmaceutical company was charged with obstruction and making false statements, the Justice Department announced today. Lauren Stevens of Durham, N.C., was charged with one count of obstructing an official proceeding, one count of concealing and falsifying documents to influence a federal agency, and four counts of making false statements to the Food and Drug Administration (FDA).
Overview of Current Environment

THE UNITED STATES ATTORNEY’S OFFICE
SOUTHERN DISTRICT OF NEW YORK

Joseph Collins, Principal Attorney For Former Commodities Firm Refco, Sentenced In Manhattan Federal Court To One Year And One Day In Prison For Securities Fraud

FOR IMMEDIATE RELEASE

Monday, July 15, 2013

Preet Bharara, the United States Attorney for the Southern District of New York, announced that JOSEPH P. COLLINS, formerly the principal outside attorney for the now defunct financial services company, Refco Group Inc. (“Refco”), was sentenced today in Manhattan federal court to one year and one day in prison for conspiracy, securities fraud, filing false statements with the SEC, and wire fraud, in connection with his role in the fraud underlying the collapse of Refco. The accounting fraud at Refco, once the nation’s largest independent commodities firm, cost investors and lenders more than $2.4 billion in losses. COLLINS was convicted in November 2012, after a four-week jury trial before Chief U.S. District Judge Loretta A. Preska, who imposed today’s sentence.
Overview of Current Environment

- Government agencies, including the DOJ, view lawyers as “gatekeepers” who are often in the best position to prevent or discover fraud in the first instance.

  - The SEC and DOJ have ramped up their efforts to hold attorneys liable for corporate wrongdoing. Recent high-profile cases include and **U.S. v. Collins** (Joseph P. Collins, former Mayer Brown partner) and **U.S. v. Stevens** (Lauren Stevens, former Associate General Counsel for GlaxoSmithKline).

  - The SEC “will pursue cases against lawyers who allegedly violate the securities laws with scienter, render misleading opinions used in public disclosures, or engage in conduct that would render a non-lawyer liable for the same activity under comparable circumstances.” (Monson).

  - At the SEC Speaks 2013 Conference, senior enforcement staff emphasized that the Commission is increasingly pursuing cases against gatekeepers, including lawyers and accountants.

- There is an inherent tension between the role of in-house counsel as advisor and as gatekeeper.
Overview of Current Environment

Recent publications and studies have suggested that regulators are increasing their efforts to discipline and prosecute attorneys, including in-house counsel, accused of wrongdoing.

- An October 2012 report for InsideCounsel found that “The federal government has ramped up its efforts to hold individuals accountable in cases of corporate wrongdoing …. In the past the Department of Justice and the [SEC] rarely targeted in-house lawyers for acting in their role as legal advisors. Nonetheless … corporate counsel are being scrutinized closely by the government.”

- A March-April edition of Practical Compliance for Risk Management for the Securities Industry noted significant activity against in-house counsel for charges ranging from aiding and abetting, securities fraud and false representations to the SEC and other agencies.

- A November 11, 2013 National Law Journal article entitled CFPB Puts Lawyers in Cross Hairs noted that the Consumer Financial Protection Bureau (CFPB) “has filed more lawsuits against lawyers than almost any other group.”
Overview of Current Environment

- The trend of government agencies scrutinizing the conduct of in-house counsel will continue.
- Notably, a recent DOJ / SEC FCPA Deferred Prosecution Agreement and accompanying corporate plea specifically mentioned the role of in-house counsel in the underlying fraudulent conduct.
    - “In July 2005, one of WEATHERFORD’s in-house legal counsel, in fact, falsely represented to an outside law firm that the joint venture had been vetted and approved by other outside counsel, when, in fact, no outside law firm ever conducted such vetting or gave such approval.”
  - *United States v. Weatherford Services, Ltd.*, 13CR734 (S.D.Texas) (filed November 26, 2013) – Related individuals highlighted in the information, include:
    6. “Weatherford Legal Counsel A,” a citizen of the United States, was a Senior Corporate Counsel at Weatherford from in or around October 2004 until in or around June 2008.
Legal Theories and Risk Areas
Legal Theories and Risk Areas

Common actions against in-house counsel fall roughly into two categories:

- In-house counsel accused of participating in the alleged wrongdoing (Simring, Collins, Harbinger)
- In-house counsel accused of obstructing or impeding an internal investigation or response to a government inquiry (Stevens, Kellogg)
- Government views actions against in-house counsel as having a significant deterrent effect

Potential theories include:

- False Statements (18 U.S.C. § 1001)
- Obstruction of justice (18 U.S.C §§ 1503, 1505)
- Destruction, Alteration or Falsification of Records (18 U.S.C. § 1519)
- Securities fraud (Section 17(a) of the Securities Act of 1933 or Section 10(b) of the Securities Exchange Act of 1934)
- Numerous regulations -- the SEC, for example, has the authority to sanction attorneys under Rule 102(e) for engaging in ethical violations while “practicing before the Commission.”
Sarbanes-Oxley Section 307

Section 307 of Sarbanes-Oxley required the SEC to establish “minimum standards of professional conduct for attorneys appearing and practicing before the Commission.” The Commission adopted a final rule implementing Section 307 in August 2003.

The definition of “appearing and practicing before the Commission” under Section 307 is very broad and covers the same type of conduct as Rule 102(e).

Under Section 307, attorneys who become aware of evidence of a “material violation” of the securities laws or a breach of fiduciary duty or similar violation by an issuer have an “up-the-ladder” reporting obligation.

- Initially, the report must be made to Chief Legal Counsel or CEO
- If there is not an appropriate response, the matter must be reported to the audit committee, the full Board, or another committee of independent directors.

The SEC has yet to bring any enforcement cases under Section 307.
Attorney Ethics Rules Also Apply

ABA Model Rules: 1.2(d): “A lawyer shall not counsel a client to engage, or assist a client, in conduct the lawyer knows is criminal or fraudulent ….”

Rule 4.1: “In the course of representing a client, a lawyer shall not knowingly: (a) make a false statement of material fact or law to a third person; or (b) fail to disclose a material fact to a third person when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client, unless disclosure is prohibited by Rule 1.6.”

Rule 1.13: imposes a fiduciary duty on the in-house lawyer to protect the “best interest” of the company. This Rule also authorizes and may require an attorney to report violations to a higher authority in the organization.

Equivalent state ethics rules: for example, D.C., Maryland, Virginia Rules of Professional Conduct.
Risk Areas

- **Internal investigations:**
  - Be clear with your company about the objectives of the investigation
  - Process is critical in dealing with witnesses, documents, and information flow
  - Consider whether outside counsel should be engaged to assist with the investigation and any required document production
  - If outside counsel is brought in to handle an internal investigation, consider whether in-house counsel should be present at interviews
  - Preserving and/or gathering documents for litigation

- **Dealing with Auditors**
  - Understand their processes and requirements
  - It is critical to be accurate and clear
Risk Areas

Government Investigations

- Risk for in-house lawyers increases when they are out in front and in direct contact with the government
- Government tends to look more suspiciously at zealous advocacy by in-house counsel on behalf of the company
- Outside counsel typically seen as more independent

Dealing with witnesses in government investigations

- Consider conflicts of interest
- Know the importance of preparing witnesses for testimony/interviews
- Ensure proper administration and documentation of Upjohn warnings
Risk Areas

- Drafting or certifying government filings:
  - There should be a process for review and sign-off by relevant business units; have business people with knowledge sign certifications
  - Lawyers need to ask questions and understand issues
  - In-house counsel’s role should be limited to interpreting and providing advice on requirements for certifications (pricing, small business, TAA compliance)

- Drafting transaction documents:
  - Lawyers must insist on articulable and sound business purpose
Risk Areas – Does Context Matter?

- Adversarial proceeding versus provision of prospective advice on future conduct?
- Is analysis different if advice relates to strictly economic behavior versus advice for a corporation or actor involved in inherently dangerous industry?
- What if the lawyer personally profited from the substance of the advice?
It has happened before – Selected Cases
This case is related to *U.S. v. Okun* in which Edward Okun was sentenced to 100 years in prison for his role in a scheme to defraud and obtain approximately $126 million in client funds held in a 1031 exchange qualified intermediary fund.

In November 2006, Okun engaged Simring as outside counsel to examine legal issues related to the transfer of client funds from the 1031 fund.

Simring conducted an investigation and told Okun that transfers of client money out of the funds violated the exchange agreements and U.S. law. He advised Okun to revise the agreements and return the money to the exchange funds. Simring further advised that failure to do so would likely result in Okun’s prosecution.

Okun then hired Simring as his Chief Legal Officer with a salary of $850,000 and a signing bonus of $100,000. Simring then learned that Okun had not followed any of Simring’s previous advice.

After learning that the fraudulent conduct was continuing, Simring helped Okun lie to clients who requested their money from the fund, facilitated “lulling” payments to certain investors, and assisted in the transfer of $8 million of investor money to Okun’s personal bank account.

Simring was sentenced to 3 years in prison.

- Former Mayer Brown partner Joseph P. Collins was charged with conspiracy, securities fraud, wire fraud, bank fraud and making false filings with the SEC in connection with a scheme to hide billions of dollars in debt owed to Refco by a holding company partially owned by Refco’s CEO, Phillip Bennett.
  - The DOJ alleged that Collins:
    - Prepared documents facilitating so-called “round trip loan transactions” designed to make it falsely appear as if substantial portions of the loans had been repaid just prior to reporting periods.
    - Made “affirmative misrepresentations and drafted contract terms” that misled others regarding the size of the Bennett holding company loans.
    - Falsely represented to an entity that was purchasing a majority interest in Refco that all material contracts and related-party transactions had been disclosed.

- Collins’ original guilty verdict was vacated by the Second Circuit in January 2012 due to an issue that occurred during jury deliberations. The government retried the case. Collins was convicted in Nov. 2012, and was sentenced to a year and a day in prison in July 2013.

- Case illustrates the importance of: (1) understanding management’s motivations and ensuring there is a legitimate purpose for business transactions; and (2) ensuring that factual representations that counsel makes in the context of negotiating a transaction are accurate.
Indictment alleged that Daugerdas designed tax shelters to appear legitimate even though he understood that the IRS would disallow the claimed tax benefit and seek to impose substantial penalties if the true nature of the transactions were revealed.

Although Daugerdas was not an in-house lawyer, he was arguably charged for providing “legal advice.”

Daugerdas challenged the indictment on the grounds that his advice had technically adhered to a tax ruling.

Daugerdas conduct also included affirmative acts:
- Drafted fraudulent opinion letters.
- Backdated transactions.
- Fabricated transaction documents.
- Prepared fraudulent tax returns.

Daugerdas was convicted.
Last week the State Department Bureau of Political-Military Affairs issued an order debarring a former (non-attorney) compliance officer at Honeywell International from participating in any activities subject to the International Traffic in Arms Regulations (ITAR).

The compliance officer had fabricated a number of export authorizations for items subject to the ITAR. She provided these authorizations to Honeywell employees who (believing they were legitimate) used them to export defense articles.

The shipment of defense articles using these fabricated authorizations resulted in a number of export violations.

This administrative debarment is the result of the State Department’s first institution of an administrative proceeding by referral of a charging letter before an Administrative Law Judge for consideration pursuant to ITAR § 128.4.

- Kellogg was an in-house lawyer for Berkeley Natraceuticals convicted counts of conspiracy to obstruct a government investigation in violation of § 1505.

- Before an FDA inspection at one of Berkeley’s warehouses, a manager informed Kellogg that there were several crates of mislabeled products in the warehouse.

- Kellogg instructed the employee to remove the crates from the facility.

- By instructing the employee to remove the product, Kellogg exposed himself to personal criminal liability.

- Highlights importance of preserving evidence in connection with a government investigation.
The FDA was investigating drug manufacturer GlaxoSmithKline ("Glaxo") for illegally promoting one of its antidepressants for unapproved uses. The FDA requested documents and other information from the company.

Stevens was an Associate General Counsel at Glaxo in charge of responding to the FDA’s requests.

The DOJ indicted Stevens for allegedly making false statements to the FDA that Glaxo representatives had not promoted the drug for unapproved uses and withholding allegedly incriminating documents from Glaxo’s response to the FDA’s requests.

At trial, the judge dismissed the indictment for lack of evidence before the case went to the jury, holding that “even if some of the[] statements were not literally true, it is clear that they were made in good faith which would negate the requisite [intent] element required for all six of the crimes charged in this case.”

In making this finding, the court emphasized that “the defendant sought and obtained the advice and counsel of numerous [in-house and outside] lawyers” and made “full disclosure to them.”
It was reported in December 2011 that the General Counsel (GC) of hedge fund Harbinger Capital Partners received a Wells Notice from the SEC.

The Wells Notice was one of three served on individuals at Harbinger in connection with alleged fraud related to firm founder’s failure to disclose substantial loans that he had taken to pay his personal taxes.

Ultimately, Harbinger’s GC was not charged, even though it was widely reported that she received a Wells Notice.

Based on a complaint that was filed against Harbinger and its founder, it appears that two law firms gave advice on the tax loan disclosure issue.

Harbinger waived privilege to seek to avail itself of reliance on advice of counsel defense.

However, the complaint alleged that Harbinger did not follow the law firm’s advice, and in fact failed to disclose all material information to the outside firm.

Illustrates the importance of full disclosure to counsel rendering advice and how failure to follow advice can provide evidence of bad intent.
This case involved an internal investigation conducted by AOL’s in-house and outside counsel.

The court considered whether employees of AOL could prevent the company from waiving the attorney-client privilege when responding to a grand jury subpoena for interview memos generated during the internal investigation.

Three employees claimed they were represented personally by the in-house attorneys during interviews conducted between March and June 2001.

AOL’s General Counsel administered Upjohn warnings to the employees prior to their interviews during the internal investigation.

While the General Counsel was not accused of any wrong-doing, the wording of the Upjohn warnings became a central issue in the case.

The General Counsel was interviewed multiple times by the government to determine whether the warnings he gave properly communicated that in-house counsel did not represent the individuals and that the company could unilaterally decide to waive the privilege.

Illustrates the risks associated with in-house counsel taking the lead during employee interviews.
Practical Effect of these Cases?

- Do the charges against in-house counsel negatively affect counsel’s cooperation with regulator and the government or counsel’s relationship with their client, in that their appetite for taking aggressive positions on behalf of their client will be diminished?

- One in-house attorney posited this is one of the lessons learned from *Stevens*: “The attempt by the Department of Justice to prosecute a company lawyer for not voluntarily turning herself into a pseudo-government investigator, initiating a companywide search for internal documents and then handing over anything that turned up regardless of the consequences—all in response to a mere inquiry letter—will damage cooperation between in-house lawyers and regulators for years to come.” Eric Esperne, “Lessons Learned from Lauren Stevens”, (Aug. 5, 2011) available at http://www.insidecounsel.com/2011/08/05/inside-experts-lessons-learned-from-lauren-stevens.

- An outside counsel believes it is just the opposite: “The *Stevens* case, if anything, damages the cooperation between lawyers and their client themselves.” Jack Fernandez, *An Essay Concerning the Indictment of Lawyers for their Legal Advice*, 2012.
Steps to Minimize Risk – Practical Tips
Steps to Minimize Risk – Practical Tips

- Document the advice you provide. § 1515(c) “safe harbor”

- Know that attorneys will be scrutinized for obstruction and fraud like anyone else.

- Be right. Know the law. Question the basis of outside legal advice.

- Understand and question management’s motivation.

- Take an active role in investigating, seeking to remedy, and, if required, reporting any potential corporate improprieties.

- Consider engaging outside counsel.

- Understand your obligations for dealing with witnesses and documents in criminal and civil actions.
Tips for In-House Counsel in Government Investigations

- Exercise caution whenever dealing directly with the government during a government investigation
  - Risk is highest when in-house counsel act as the key point of contact (e.g., signing letters, certifications, etc.)

- Understand the nature of the inquiry – What is the agency looking for?
  - Information about an individual employee or other company?
  - Information that goes to how the company conducts business?

- Rely on Outside Counsel
  - Outside counsel who has experience with the agency can provide insight into the government’s objective and implications of inquiry
  - Outside counsel creates a buffer that shows company is relying on advice of outside counsel – strengthens advice of counsel defense (critical to the outcome of the Stevens case)
  - Addressing cost concerns – use outside counsel efficiently
Tips for In-House Counsel in Government Investigations

- Be candid; never mislead the government or attempt to hold back problematic documents
  - Unless there is a claim of privilege, all responsive documents must be produced

- Don’t over commit regarding collecting and producing documents (Stevens)

- Generally do not sit in on interviews of company employees conducted by outside counsel. Avoid becoming a fact witness.

Document Communications with the Government and Outside Counsel

- It is important to document interactions with the government and steps taken to respond to the government inquiry
  - Advice of counsel defense

- Be careful about putting anything in writing that could be subject to interpretation. But maintain records to support that you are providing legal advice to the company (supports § 1515(c) “safe harbor” defense)
Related Exposure for In-House Counsel in Civil Cases

Government investigations are not the only situation in which in-house counsel can create personal liability.

In a civil case, if in-house counsel takes the lead in litigation and advocates a position in court, that lawyer must be sure there is a sound legal basis for the position:

- Important to understand the company’s motivations and reasons for pursuing a certain theory or advocating a position.
- Avoid personally arguing on behalf of the company in court.
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