

ACC's CLO THINKTANK EXECUTIVE REPORT

CORPORATE LIABILITY: PROSECUTORIAL TRENDS AND TACTICS

This Executive Report provides an overview of discussion results from ACC's CLO ThinkTank session titled "Corporate Liability: Prosecutorial Trends and Tactics" held in New York City on September 30, 2005. ACC's CLO ThinkTank sessions are designed to provide a forum for CLOs who wish to exert greater leadership at the bar, in the courts, and in the halls of government on emerging issues of greatest concern. Following is summary information on key topics and takeaways, discussion point highlights, and follow-up initiatives identified by these CLO thought leaders.

ThinkTank participants included the following Fortune 500 company thought leaders:

- Peter Beshar, Senior Vice President, General Counsel & Corporate Secretary, Marsh & McLennan
- Susan Blount, Senior Vice President and General Counsel, Prudential Financial
- Greg Butler, Senior Vice President, Secretary and General Counsel, Northeast Utilities Service Company
- Michelle Gluck, Executive Vice President, General Counsel & Corporate Secretary, LandAmerica Financial Group, Inc.
- Bill Lytton, Executive Vice President and General Counsel, Tyco International, Ltd.
- Bob Lupone, Senior Vice President, General Counsel and Secretary, Siemens Corporation
- David Machlowitz, Senior Vice President and General Counsel, Medco Health Solutions, Inc.
- Michele Mayes, Senior Vice President and General Counsel, Pitney Bowes, Inc.
- Barry Nagler, Senior Vice President, General Counsel and Secretary, Hasbro, Inc.
- Richard Willard, Senior Vice President and General Counsel, The Gillette Company

KEY TOPICS

Below is a list of key discussion topics covered during this CLO ThinkTank session:

- The Dysfunctional and Unfair Result of being Subjected to Multiple Enforcers
- Concerns Underlying Many Prosecutors' Approach
- How Government Makes Charging Decisions: Experience and Trends
- Investigations: Outside vs. Internal: Degrees of Independence
- Organizational Structure and Alignment of Compliance Department
- Privilege Erosion
- Records Retention Issues

KEY TAKEAWAYS

Thought leaders participating in this session described a number of ideas and practices. Listed below are the top five key themes and takeaways. Ideas on additional issues are described in the Discussion Highlights section below, and thoughts on action items are summarized in the final section titled Conclusion & Proposed Action Items.

- Multiple enforcers, including the emergence of ‘non-traditional prosecutors’ and prosecutors who lack the knowledge of how corporations really work, present challenges unrelated to the nature of any underlying allegations.
- The reality is that there are collateral and distorted consequences resulting from the government’s charging process and the inappropriate “incentives” it creates, and enforcers should be aware of and consider how short-sighted zeal could damage long-term compliance.
- Prosecutorial trends and tactics impact the conduct of internal investigations, and present concerns over the corporation’s performance of ‘probable cause reviews,’ tension between government’s view of benefits of using outside counsel to lead investigations (which can have paralyzing impacts on the business unit under review) and the law department’s view of the benefits of using and involving in-house lawyers.
- The government’s push to house the compliance function outside of the legal department is not a best practice for many companies, and the notion that it is should dispelled.
- Action items to address some of these concerns include: educating prosecutors about the realities of corporate practice and how compliance policies work in reality; revisiting and re-writing the Thompson memorandum; developing a business-level coalition to voice concerns over government prosecutorial policies (since individual companies cannot protest without being branded as anti-responsible); and pursuing initiatives to help eliminate the widely-held public perception that corporations are evil.

DISCUSSION HIGHLIGHTS

MULTIPLE ENFORCERS: EXPLOSION OF REGULATING AND PROSECUTING/ENFORCEMENT AGENCIES; TURF PROBLEMS

- Multiple Enforcers/ Landscape and Landmines: Participants described multiplicity of regulators at the federal, state and local levels and the difficulty in knowing who has the authority to settle and resolve situations. Corporations are at the mercy of a rapidly increasing line of regulators and their enforcement colleagues, none of whom care what the others are doing except as it might enhance charges they are considering. Additional discussions described the emergence of ‘non-traditional prosecutors,’ such as State Treasurers who are assuming a more prominent role with regard to pension fund matters, and the GSA which has begun an alarming new practice of removing due process from debarment decisions.
- Multiple Enforcers/ Pre-emption Should be Sought: The concept of promoting pre-emption as a possible remedy to address the multiplicity of enforcers was raised. The underlying premise is that interstate commerce works best when there aren’t potentially conflicting and oppressive regulations at every level, and that pre-emption could help identify who has the lead and authority to resolve a matter. Pre-emption could be argued as a matter of statutory interpretation (commerce clause) or public policy; nothing is more likely to bury any chance a company has to recover from a failure (which should be everyone’s goal) than to have their singular failure pursued by 15 separate state, federal, and regulatory investigations, 5 different prosecutions and unlimited derivative suits.

- Multiple Enforcers/ Ideas on Initiatives to Address: Education and advocacy on the general notion of promoting interstate commerce and pre-emption were described as possible ways to address the challenge of having multiple enforcers. To pursue this avenue, participants discussed the possibility of pulling together a coalition of thinktanks (e.g., AEI, Brookings, etc.) and developing a plan, followed by lobbying Congress by industry.

CONCERNS UNDERLYING MANY PROSECUTORS' APPROACH; EDUCATION OPPORTUNITIES RE KNOWLEDGE ON HOW CORPORATIONS WORK

- Prosecutors Approach/ Challenges: Participants discussed prosecutors' lack knowledge of corporate realities and how companies work, that prosecutors behave as if they believe that companies are inherently evil, and that everyone who works within them is at some level a crook. Meaningful supervision of younger prosecutors is lacking; notion that SEC has some processes for oversight by more experienced enforcement personnel (who are usually more experienced before arriving at the SEC and who have greater institutional knowledge of companies and a better understanding of how they work) but this experience appears to be lacking to a far greater degree in DOJ and at the State AG level.
- Prosecutors Approach/ Ideas on Initiatives to Address:
 - Internship/secondment/swapping of in-house and government attorneys was presented as a possible way to help educate prosecutors and regulators about how corporations work.
 - AG Institute: the concept of having corporate legal leaders participate as faculty members at the annual AG Institute to provide insights into how corporations actually function and the laudable compliance efforts undertaken by in-house practitioners was presented as another possible initiative.
 - AG Advisory Council Dialogue: initiate dialogue between the AG Advisory Council, NAAG, etc. and CLOs to establish joint/commonality for compliance concerns, share and discuss emerging issues, and overall convey that in-house lawyers are not the enemy and companies are not "all created evil."

EXPERIENCES AND TRENDS – HOW GOVERNMENT MAKES CHARGING DECISIONS

- Collateral Consequences/ Realities: Government's charging process and decisions, as well as emerging practices in the suspension and debarment area, have very real impacts that can impose devastating collateral damage on others (such as shareholders, employees, customers/clients, and even the government if debarment is at issue). Participants raised questions of how prosecutors might be well advised to consider these consequences and/or whether there is a duty to consider wider constituencies. The discussion included the lamentable demise of the entire Andersen entity (instead of simple punishment for those who were responsible for wrongdoing), as well as an example of GSA taking on debarment outside of the DOD context, and a lack of understanding on the part of prosecutors regarding the consequences of debarring one of the government's biggest suppliers. Discussions also included the concept of the government's use of the 'Responsible Corporate Officer Doctrine' to coerce companies to cooperate by threatening officers who had no criminal intent and may not even have been negligent, as well as the anti-compliance impact that often results from forced privilege waivers in order to be deemed "cooperative."
- Collateral Consequences/ Ideas on Initiatives:
 - Education initiatives as described above.
 - Revisit Thompson Memorandum: Is there an opportunity to impact the application and interpretation of this memorandum? Consider scenario where corporate counsel might be able suggest edits; possibility of also adding specific factor relating to impact on shareholders.

INVESTIGATIONS: INDEPENDENT VS. INTERNAL

- Investigations/ Experiences and Process: Participants discussed issues surrounding how to properly respond to a government inquiry and whether to initiate an internal investigation or conduct the investigation using independent counsel. Questions regarding when the investigation itself could appear to be grounds for a possible obstruction charge due to the nature of government's demand for early self reporting (versus the lawyers' natural tendency to want to conduct an investigation first), and dealing with the problems of reporting before the facts are in were also discussed.
 - Obligation to the Board to get the facts: Some think this is most efficiently accomplished by conducting at least the initial phase of the investigation in-house. If the company goes outside, the notion of using independent counsel and having a ready-list of additional firms for board members who want their own counsel or investigations done was raised. Also noted during the discussion was the potential impact of the individual in the role of audit committee chair and the role of the CLO in negotiating with this individual. The practice of having two law firms-one to conduct the factual investigation and another to conduct a privileged investigation was discussed, and some raised issues of how this may lead to two uncertain legal budgets and duplicative efforts.
 - Quick 'probable cause review': The practice of conducting a quick 'probable cause' review was discussed, and participants noted that they might conduct the initial review internally for small matters; and, for close calls, independent outside counsel that has expertise in a given area may be utilized with in-house lawyers made available (but not setting a budget for outside counsel to avoid concerns that insiders were dictating the terms or limiting the investigation).
 - Tension between getting to the bottom of a matter and how to handle it: Impacts on the business area being investigated were discussed (may have 'paralyzing' effect). Investigations led by outside counsel tend to take longer and have greater scorched earth impact on the business. Additional impacts include high costs and credibility of effort with the Board.
 - Participants invalidated the government's perception that independent investigators will be more successful in getting to the truth. They discussed beliefs that the opposite is true: In-house counsel often are able to get better results due to the reservoir of established trust and relationships, as well as their knowledge of how to make things work inside the company. People clam up when the outside lawyers arrive, or panic and starting saying anything they can think up to move the government away from them (even conjecture and half truths, etc.).
 - Issuing the corporate 'Miranda' warning: Methods and results for issuing the corporate Miranda warning were discussed, as well as the concern that lawyers for the company are between a rock and a hard place in trying to comfort and advise employees who are scared navigating the process: e.g., can or should the lawyer tell the employee to consider getting own lawyer, the impact of reminding employees that non-cooperation with an investigation is grounds for dismissal, reminder that lying in the course of an internal investigation could be deemed obstruction of justice, etc.
 - Process for voluntary disclosure & DOJ speeches regarding timing: Internal processes may include identifying and sizing the issue, defining collateral consequences, and having a plan in place prior to going to the Board (unless the Board is implicated). Participants discussed the tension regarding timing- especially with regard to DOJ speeches that voluntary disclosure may be considered too late if communicated after a preliminary probable cause review. Additional concerns that lawyers will focus more on the process and keeping it clean than on remedying the client's wrongdoing, finding the culprit and fixing the issues

- Investigations/ Ideas on Initiatives: Participants discussed whether there might be an opportunity for a dialogue with the DOJ regarding the timing of disclosure and allowing for the ability to perform a probable cause investigation (example model might be the VPPP program under OSHA and creating a safe harbor for investigations).

COMPLIANCE: INSIDE OR OUTSIDE OF THE LEGAL DEPARTMENT

Compliance by the Government's Book: SEC / HHS / OIG statements suggest that it is a corporate best practice for compliance to be housed outside of the law department. SEC/Cutler looks to see whether compliance reports to the CEO. Question of whether it makes sense for the compliance department to be outside of legal and/or for the government to be setting best practices was discussed.

- Compliance Department/ Ideas on Initiatives: Do more at the business-school level to educate on corporate governance. Dispel the notion that the compliance function will be more effective if it reports to the CEO or Board. While that may sound good in theory, in many organizations the function will be better managed if its head reports to a more "hands-on" manager with a related expertise, such as the General Counsel or the CFO. Possibly enlist the help of respected independent thought leaders (such as Norm Veasey) to support this thought.

PRIVILEGE EROSION

- Privilege/ experiences and avenues: Experiences regarding investigations and the erosion of privilege were discussed. Participants were especially concerned that privilege erosions increasingly occur outside of any court proceeding – so cases are not heard in an impartial context or decided based on the arguments of both parties. Participants also discussed the government's practices regarding use of the 'crime fraud exception' as tactic and using the press to their advantage (companies sometimes find out about cases from the press or analysts).
- Privilege/ Ideas on Initiatives: Explore making incremental progress on waiver: don't give in to the government's suggestion that limited waiver is a solution, even though it does potentially protect against greater economic devastation in subsequent third party suits. Also discussed were corporate counsel consortium initiatives to change rules to extend confidentiality to accounting matters, and an upcoming challenge to a CA Insurance Commissioner's authority to investigate and make inappropriate use of the crime-fraud exception.

DOCUMENT RETENTION ISSUES: PROACTIVE PRACTICES IN LIGHT OF TACTICS

- Document Retention/ practices: Concerns were raised about what the standards should be and how to implement standardized document retention protocols or strategies. Participants noted questions regarding what companies can do proactively in light of prosecution trends and tactics: How to educate people on intelligent email writing and policies? What is the business case for retention policies? What are the impacts of instant messaging, email, voice mail, metadata and government requests for all previous drafts? What are best practices and emerging case law on document retention practices? Discussed was a sample practice of setting in advance semi-annual document clean-up days and case law indicating such or similar practice may be viewed as the company encouraging mass document destruction. Participants discussed the notion that judges may not have a good sense of how companies work or understand the practicalities of document storage and the business needs that drive document retention and destruction policies that weren't created for litigation discovery alone. Practices involving Board members and note-taking were also discussed— consensus that it is wise to work on means by which board members' notes and reports are kept private or destroyed.

- Document Retention/ Ideas on Initiatives: Idea was raised of having ACC play role in developing best practices-type standard to give companies an outside source to point to for complying with e-discovery and document destruction standards.

CONCLUSION & PROPOSED ACTION ITEMS

The session ended with CLOs confirming their interest in the ACC CLO ThinkTank session format as useful forum for discussions on issues of interest and importance to CLOs. The participants also supported the idea of having ACC send a request to CLOs to identify their ‘top five issues of concern.’ Responses could serve as a resource for future CLO ThinkTank topics.

Ideas on possible action items to prioritize and select for follow-up include:

- **Internship/Secondment/Swapping of In-House and Gov’t Attorneys:** as a way to help educate prosecutors and regulators about how corporations work
- **Pre-emption:** educate and advocate on general notion of promoting interstate commerce; create coalition of thinktanks (e.g., AEI, Brookings, Labor, Manufacturing, etc.) and develop a plan; lobbying Congress would likely be by industry
- **Develop Best Practices Whitepaper /Standards on Document Retention to help provide cover:** idea that having ACC develop a best practices-type standard could provide an outside source for companies to point to when complying with that standard
- **Revisit the Implementation and Interpretation of Thompson Memorandum:** “here’s how we would edit it,” rather than just “repeal it”
- **Provide Real Supervision to US Attorneys or Career Prosecutors:** idea of using SEC model with greater supervision
- **AG Institute:** explore opportunities for corporate legal leaders to be on the faculty for the prosecutors’ school and educate on corporate realities; possible opportunity for ACC to meet with/coordinate curriculum development to provide greater insights into how corporations function and issues re: in-house practice
- **Dialogue with AG’s Advisory Council and CLOs:** upcoming opportunity to provide Bill Lytton with talking points; explain commonality of concerns- in-house lawyers are not the enemy; maybe also pursue some initiatives with NAAG
- **Do More at the Business-School Level on Governance; Dispel Notion Regarding Need to Place Compliance Function Outside of Legal:** possibly enlist help from Norm Veasey to explore the opportunity to use advocacy to dispel this notion; having the compliance function within legal shouldn’t be viewed as anything other than a sound practice; create a thought process that having the compliance function in legal is reasonable
- **Explore Making Incremental Progress on Waiver:** notion of ‘cow-out-of-the-barn;’ discussion of corporate counsel consortium initiatives to change rules to extend confidentiality to accounting matters
- **Seek Safe Harbor on Investigations and Timing for Disclosure:** consistent with OSHA practices for VPPP
- **Internal Audits:** explore benchmarking possibilities to evaluate where the internal audit function should reside administratively (within finance, legal, other?) and assess whether lawyers should be involved in preparation of internal audits



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