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**FOR IN-HOUSE
COUNSEL**



April 12, 2007

Personal Liability Risks Facing In-House Counsel

ACC AMERICA
Association of Corporate Counsel
Delaware Valley (DELVACCA) Chapter

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AKIN GUMP
STRAUSS HAUER & FELD LLP
Attorneys at Law



MARCH 8, 2007 – CHRISTOPHER COX, SEC CHAIRMAN

“...lawyers are what today we call crucial gatekeepers responsible for safeguarding shareholders’ interests by advising companies on disclosure standards and all of the requirements of our securities laws...

* * *

...It’s because the roles of gatekeeper and watchdog come with a great deal of responsibility that, when professionals – lawyers or accountants – fail to live up to their responsibility, the Commission will bring enforcement actions...”



JUNE 4, 2003 – LARRY THOMPSON, THEN U.S. DEPUTY ATTORNEY GENERAL

“Major corporate fraud cannot happen over an extended period of time without the complicity of accountants, lawyers and other professionals...[recent government investigations] have further proven our commitment to follow the evidence wherever it leads – to not only those executives but also those lawyers or other professionals who defraud the investing public.”



FEBRUARY 19, 2007 – SUSAN HACKETT, VICE PRESIDENT OF THE ASSOCIATION OF CORPORATE COUNSEL (PHILADELPHIA INQUIRER ARTICLE)

“The exodus is unprecedented among the ranks of corporate attorneys, who ensure the legality of commercial transactions...The departures reflect added responsibility that in-house lawyers now bear for company actions, she said.

‘I have never seen as much turnover in high-profile positions,’ said Hackett... ‘This has been a watershed.’”



LANDSCAPE

- Post Enron/Arthur Andersen focus has shifted toward deferred prosecution of companies and enhanced scrutiny of officers, directors and professionals.
- Companies more willing to lay blame at feet of in-house counsel.
- To increase size of potential settlements and to pit corporate insiders against one another, plaintiffs more willing to sue in-house counsel.



- Hewlett-Packard
- Rite Aid
- Symbol Technologies
- General Re
- Computer Associates International
- McAfee
- Comverse Technology
- Monster Worldwide



RISKS IN EVERYDAY SITUATIONS:

- Internal investigations?
- Dealing with auditors?
- Preserving and/or gathering documents for litigation or regulatory review?
- Witness preparation?
- Drafting transaction documents relating to activities from prior quarter?
- Drafting SEC filings?



SOURCES OF PERSONAL LIABILITY RISKS FACING IN-HOUSE COUNSEL

- A. Governmental Liability
 - 1. Civil
 - 2. Criminal
- B. Liability to shareholders
- C. Liability to employer/client
- D. Liability to other parties



STEPS IN-HOUSE COUNSEL CAN TAKE TO MINIMIZE PERSONAL LIABILITY

1. Document the advice you provide.
2. Be right. Know the law. Question the basis of outside legal advice.
3. Do not do management's bidding.
4. Take an active role in investigating, seeking to remedy, and, if required, reporting any potential corporate improprieties.
5. When dealing with employees and outside parties, make it clear that you represent your company.
6. Avoid using investigative techniques that are questionable such as pretexting.
7. Understand your obligations for dealing with witnesses and documents in criminal and civil actions. Your obligations may be different. Know how to handle discussions with witnesses in internal and in criminal investigations and be cautious in attempting to narrow the scope of criminal document subpoenas to avoid potential obstruction of justice implications.
8. Obtain compensation packages that are not tied to the compensation of the company's top officers.
9. Do not rely solely upon indemnity provisions to protect you. Examine whether Errors and Omissions Insurance or some other insurance vehicle offers you better protection.
10. Know the license requirements of the states in which you work and provide legal advice.



STEPS IN-HOUSE COUNSEL CAN TAKE TO MINIMIZE PERSONAL LIABILITY

1. Document the advice you provide.



Tyco Int'l, Ltd. v. Mark Belnick, No. 02-CV-4644 (S.D.N.Y. June. 17, 2002)

- General counsel of Tyco International, Ltd. charged with, grand larceny and securities fraud charges in connection with allegedly unauthorized and undisclosed compensation and loans.
- Tyco sued for, among other things, breach of fiduciary duty.
- Later acquitted of the criminal charges.
- On October 7, 2005, subsequent to Mr. Belnick's acquittal, Tyco and Mr. Belnick settled the civil complaint and a separate arbitration proceeding Mr. Belnick had filed.
- Belnick has returned to practicing law as a solo practitioner.



ACTIONS AGAINST IN-HOUSE COUNSEL BY EMPLOYERS/CLIENTS

- A. Suits by clients against in-house counsel are not common, but recent corporate scandals have shown that clients/employers are becoming more willing to sue former in-house counsel.

- B. Asserting that the actions of in-house counsel were not done to benefit the company and were outside the scope of employment may be seen as a strategy to avoid vicarious liability for the actions of corporate counsel.



STEPS IN-HOUSE COUNSEL CAN TAKE TO MINIMIZE PERSONAL LIABILITY

2. Be Right. Know the law. Question the basis of outside legal advice.



In the Matter of Google Inc. and David C. Drummond, Rel. No. 33-8523 (Jan. 13, 2005)

- SEC enforcement action that found Mr. Drummond, Google's general counsel, caused Google to violate the registration provisions of the Securities Act of 1933.
- Action stemmed from Mr. Drummond's determination that Google could rely on various exemptions to avoid delivering detailed financial statements to investors.
- Mr. Drummond advised Google's board to approve the issuance of additional options, but did not disclose his legal analysis on the registration exemptions or risks involved with the option grants. Google ultimately issued millions of dollars worth of stock options without a proper exemption or proper registration under the Securities Act.
- On January 13, 2005, Google and Drummond agreed to an order that they cease and desist from violating or causing violations of the registration and financial disclosure requirements.



STEPS IN-HOUSE COUNSEL CAN TAKE TO MINIMIZE PERSONAL LIABILITY

3. Do not do management's bidding.



U.S. v. William F. Sorin, Crim No. 06-817 (E.D.N.Y. July 31, 2006)

- General counsel of Comverse charged with Comverse's former CEO and CFO for alleged role in the development of a scheme to backdate millions of dollars in stock options for the benefit of themselves and other employees.
- The SEC also filed a civil suit claiming several securities violations, alleging that Sorin drafted "grant documents with false grant dates," obtained the approval of Comverse's Stock Option Committee, and "on multiple occasions, provided CTI's outside auditors with documentation that misrepresented the grant date of the stock option awards."



SEC v. Jonathan Orlick, Case No. CV-03-4376 (C.D. Cal.) (January 6, 2004)

- SEC charged Orlick, the former General Counsel of Gemstar-T.V. Guide International, Inc., with violating the antifraud and reporting provisions of the federal securities laws.
- SEC alleged that Orlick repeatedly signed false management letters to Gemstar's auditors, and aided and abetted Gemstar's filing of false and misleading financial statements.
- Orlick settled with the SEC by agreeing (1) to entry of a permanent injunction; (2) to pay approximately \$305,000 in disgorgement, penalties and prejudgment interest; and (3) to be suspended from practicing before the SEC under Rule 102(e) of the SEC's Rules of Practice.



Pereira v. Cogan, No. 00-CIV-619 (S.D.N.Y. 2000)

- Bankruptcy trustee sued several former officers and directors of Trace International, including general counsel Philip Smith for (1) breach of fiduciary duty and (2) unlawful payment of dividends and redemption of preferred stock.
- In his role as Trace's general counsel, Smith hired and supervised outside counsel. As Trace's Secretary he maintained the corporate minute books. He was also the general counsel and secretary of two public companies in which Trace had substantial investments.
- There were no allegations that Smith received any personal benefit from any of the transactions that were challenged.



Pereira v. Cogan, No. 00-CIV-619 (S.D.N.Y. 2000) (con't)

- A federal judge held that five executives, including Smith, were liable for not stopping Trace's former CEO from taking millions of dollars from Trace International Holdings for his own personal use.
- On June 30, 2005, the U.S. Court of Appeals for the Second Circuit vacated the verdict, granted a new trial and held that the case should be decided by a jury.
- As of April 5, 2007, no new trial date has been set.



TRENDS IN ACTIONS AGAINST IN-HOUSE COUNSEL BY OTHER THIRD PARTIES

- A. Actions brought by, among others, bankruptcy and litigation trustees.

- B. Claims may include attempts to allege breach of fiduciary duty and deepening insolvency claims.



STEPS IN-HOUSE COUNSEL CAN TAKE TO MINIMIZE PERSONAL LIABILITY

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



In the Matter of John E. Isselman Jr., Rel. No. 34-50428 (Sept. 23, 2004)

- SEC enforcement action against general counsel of Electro Scientific Industries, Inc. (“ESI”).
- ESI’s CFO eliminated certain employee benefits for certain employees of the company, which allowed ESI to record a profit for the quarter, rather than a loss.
- The CFO did not consult with the general counsel regarding his decision to eliminate these benefits and the general counsel was not involved in any aspect of the decision. The general counsel learned of the decision when the CFO presented the quarterly results to the audit committee, in which the CFO stated that the decision regarding benefits had been approved by legal counsel. Although the general counsel was unaware of any legal opinions relating to the subject, he did not question the CFO.



In the Matter of John E. Isselman Jr., Rel. No. 34-50428 (Sept. 23, 2004) (con't)

- The general counsel later sought legal counsel on the elimination of the benefits and was informed that the company did not take the legal steps necessary to eliminate the employee benefits. Upon learning this information, he did not immediately report it to the company's audit committee or accountants.
- The SEC found that the general counsel failed to provide important information to the company's board, audit committee and auditors regarding the accounting transaction, which caused ESI to file false financial statements with the SEC.



SEC ENFORCEMENT ACTION TRENDS AGAINST IN-HOUSE COUNSEL

- Watch for a growing number of enforcement actions stemming from corporate counsel's "reporting up" obligations under Sarbanes-Oxley.
 - a) Sarbanes-Oxley applies to in-house counsel
 - 1) Applies to all attorneys that appear and practice before the Commission.
 - 2) Section 307 of Sarbanes-Oxley directed the Commission to establish "minimum standards of professional conduct for attorneys appearing and practicing before the Commission in any way, in the representation of issuers." 15 U.S.C. § 7245 (2003).
 - 3) The regulations promulgated under the Act broadly define what it means to be "appearing and practicing before the Commission," and apply not only to those who prepare SEC filings or personally appear before the Commission, but also those who participate in describing material legal events that are mentioned in SEC filings. 17 C.F.R. § 205.2(a)(1)-(2)(ii).



SEC ENFORCEMENT ACTION TRENDS AGAINST IN-HOUSE COUNSEL (con't)

- b) Requires “up the ladder reporting” of improper conduct within a company.
 - 1) An attorney has an obligation to report evidence of a material violation by an issuer of securities laws or breach of fiduciary duty or similar violation. 15 U.S.C. § 7245; 17 C.F.R. § 205.2(i).
 - 2) “Material Violation” includes a violation of an applicable United States federal or state securities law, a material breach of fiduciary duty arising under United States federal or state law, or a similar material violation of any other United States federal or state law. 17 C.F.R. §205.2(i).



STEPS IN-HOUSE COUNSEL CAN TAKE TO MINIMIZE PERSONAL LIABILITY

5. Make it clear that you represent the company.



Reynolds v. Schrock, 341 Ore. 338 (Ore. 2006)

- Not against in-house counsel, but instructive.
- Civil breach of fiduciary duty claim by a non-client third-party against an attorney arising from the attorney's role in drafting a settlement agreement, advising his client about whether certain provisions of the agreement must be complied with in light of the conduct of the third party, and concealing his client's conduct from the third party.
- The Oregon Supreme Court reversed the Oregon Court of Appeals' 2005 ruling that an attorney can be liable to a third party for aiding and abetting a client's breach of fiduciary duty to the third party.
- The Oregon Supreme Court held that "a lawyer may not be held jointly liable with a client for the client's breach of fiduciary duty unless the third party shows that the lawyer was acting outside the scope of the lawyer-client relationship."



ACTIONS BY OTHER THIRD PARTIES

- Potential suits by employees
- Potential suits by outside parties
- Avoid creating appearance of privity



STEPS IN-HOUSE COUNSEL CAN TAKE TO MINIMIZE PERSONAL LIABILITY

6. Avoid using investigative techniques that are questionable such as pretexting.



Worsham v. Ann Baskins, et al., (Cal. Super. Ct. Sept. 14, 2006)

- Derivative shareholder suit against general counsel of Hewlett-Packard and several other officers and directors.
- Allegations stem from, among other things, the alleged use of pretexts (i.e. using false pretenses to obtain private data) to access board members' phone records to find out the source of information leaks to reporters.



STEPS IN-HOUSE COUNSEL CAN TAKE TO MINIMIZE PERSONAL LIABILITY

7. Understand your obligations for dealing with witnesses and documents in criminal and civil actions. Your obligations may be different. Know how to handle discussions with witnesses in internal and in criminal investigations and be cautious in attempting to narrow the scope of criminal document subpoenas to avoid potential obstruction of justice implications.



U.S. v. Steven Woghin, Crim. No. 04-847 (E.D.N.Y. Sept. 22, 2004)

- General counsel of Computer Associates International, Inc. pleaded guilty to securities fraud, conspiracy and obstruction of justice in connection with backdating contracts and coaching witnesses.
- The fraud charge related to Woghin's participation in a practice to keep the company's books open so that it met revenue and earnings estimates.
- The obstruction of justice charge related to his coaching of employees on how to answer questions from investigators and outside counsel without disclosing the existence of the "35 day month" practice.



STEPS IN-HOUSE COUNSEL CAN TAKE TO MINIMIZE PERSONAL LIABILITY

8. Obtain compensation packages that are not tied to the compensation of the company's top officers.



STEPS IN-HOUSE COUNSEL CAN TAKE TO MINIMIZE PERSONAL LIABILITY

9. Do not rely solely upon indemnity provisions to protect you. Examine whether Errors and Omissions Insurance or some other insurance vehicle offers you better protection. Consider layering employed-lawyer insurance policies.



STEPS IN-HOUSE COUNSEL CAN TAKE TO MINIMIZE PERSONAL LIABILITY

10. Know the license requirements of the states in which you work and provide legal advice.



Know the license requirements of the states in which you work and provide legal advice.

- Model Rule of Professional Conduct 5.5
 - Permits in-house counsel to practice law without a license in the state they work, if admitted elsewhere.
 - Only half of the states have adopted some form of Rule 5.5
- 26 states have adopted an in-house counsel rule or license requirements – must be licensed in state or seek limited admission, except in limited circumstances.
- Pennsylvania
 - Pennsylvania Rule of Professional Conduct 5.5
 - Pennsylvania Bar Admission Rule 302, entitled “Limited In-House Corporate Counsel License.”
- New Jersey
 - NJ Court Rule 1:27-2, entitled “Limited License; In-House Counsel.”
- ACCA Website lists requirements for all states.
<http://www.acca.com/admissionRules/index.php>



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