How to Be In House, But Not In The Dog House: Surviving Stepped Up Scrutiny of Corporate Counsel

ACC CLE Brown Bag Program
July 17, 2008
Employment

Trends in Wage and Hour Litigation: How Companies and Their Counsel Are Responding
Introduction

- Wage & Hour Class Actions on the rise across the country
- 15 to 25 Wage & Hour Class Actions filed each week in California
- California is hotbed of class action activity given anti-employer legislation containing many substantive and technical traps
Current Litigation Environment

- Plaintiffs’ attorneys originally targeted “low hanging fruit” – employers with large employee populations and low wages (e.g., retail, insurance agents, etc.)

- The focus has shifted to higher paying jobs (IT, securities brokers, mortgage brokers), multi-state claims and technical violations of wage and hour laws
Settlements

- Farmers Insurance -- $210M (claims adjusters)
- State Farm -- $135M (claims adjusters)
- Merrill Lynch -- $37M (stockbrokers)
- Pacific Bell -- $35M (engineers)
- Computer Sciences -- $24M (tech support workers)
- Radio Shack -- $30M (store managers)
- Group Voyagers Inc. -- $14M (tour guides)
- Starbucks -- $18M (store managers)
- Cingular -- $5M (call center employees)
- BCI Coca-Cola -- $20M (outside salespersons)
Settlements

- UPS -- $18M (part-time supervisors)
- Pacific Telesis -- $27M (sales managers)
- Electronic Arts -- $15M (computer graphics artists)
- Longs Drug -- $11M (store managers)
- Wal-Mart -- $140M (off-the-clock; meal) (Fed)
- Sport and Fitness Clubs of Am -- $38M (off-the-clock; meal and rest)
- Wal-Mart -- $33M (3¢ overtime/regular rate of pay calculation violation)
- UPS -- $87M (meal and rest)
- Wal-Mart -- $172M (meal and rest) (CA) (jury verdict)
California Trends

- Meal and Rest Periods
- Off-the-Clock
- Preliminary/Postliminary time
- Donning and Doffing
- Tip sharing
California Trends

- Pay Practices
  - Pay stubs
  - Regular rate
  - Pay frequency
  - Pay timeliness
  - Expense reimbursements
  - Wage deductions
  - Minimum wage

- Recording time & Recordkeeping
# Meals Period Exposure

*(non exempts only) - California*

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<th>PENALTIES</th>
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<td>1 hour of straight time wages owed per noncompliant meal and rest period (up to 3 potential violations in a 10-hour day / 5 potential violations in a day over 10 hours)</td>
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<td>100*/200** -- per noncompliant meal and/or rest period (PAGA)</td>
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* Initial pay period
** Subsequent pay periods
Sample Penalty – Meal Period Violation

- California Hypothetical Violation
  - Employee makes $10/hour
  - 26 payroll periods
  - One missed meal period @ pay period
  - Therefore 1 hour of wages not paid @ pay period
  - $260 under payment of wages
  - Assumes terminated at end of one year period
# Meals Period Exposure (non exempts only) - California

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**Penalties on a $260 wage mistake = $42,950**
Exempt or Non-Exempt?

- California Hypothetical Violation
  - Employee earns a salary of $75,000 per year
  - Employee works an average of 9 hours each work day
  - Employee is misclassified as “Exempt”
Exempt or Non-Exempt?

- Damages are calculated as:
  - $75,000 / $36.06 hour
  - Overtime rate is $54.09
  - $54.09 X 5 daily overtime hours per week = $270.45 each week
  - $270.45 X 50 work weeks = $13,522.50
  - Four year liability period = $54,090
  - If 10 employees are similarly misclassified, liability is $540,900
Exempt or Non-Exempt?

- All companies are susceptible to misclassification claims
- Antiquated “widget-maker” laws do not apply neatly to high-tech and other jobs in a services-based economy
- Many “grey area” employees:
  - IT Workers
  - Accountants
  - Assistant Managers
  - Telemarketers
  - Financial Analysts
  - Mortgage Bankers
  - Stockbrokers
  - Insurance Adjusters
- Plaintiffs’ lawyers have seized on the ambiguity in the law
Exempt or Non-Exempt?

Exempt status is not a function of:

- Earnings
- “Thinking”
- Collar color
- Confidentiality/Importance
- Status
Exempt or Non-Exempt?

Exempt employees:
- Must fit into narrowly defined exemptions
- Must identify both state and federal exemption for each employee

Non-exempt employees:
- Must pay overtime
- Must provide meal and rest periods in Calif.
Exempt or Non-Exempt?

- Two prong test
  - Salary basis
  - Duties test

- Significant differences between federal and California exemptions:
  - 50% rule applies in California
  - No “highly compensated” exemption in California
Exempt or Non-Exempt?

- Consequences of misclassification
  - Back wages for overtime
  - Possible four year statute of limitations
  - Myriad statutory penalties
  - Liquidated damages under federal law
How Do You Determine Whether Employees Are Classified Properly?

- Conduct a classification review – position by position, individual by individual
- Ensure that employees meet both the duties and pay requirements for exempt status
Converting Employees to Nonexempt Status

How Do You Convert Employees From Exempt To Nonexempt?

- Communication
- Timing
- Systems
- Pay
Essential Methods for Compliance

- Comprehensive Human Resource Compliance & Training Program
- Policies that allow for state-by-state differences
- Human Resource talent
- Established record keeping and retention policies
Essential Methods for Compliance

- Access to specialists
- Configurable pay processing system
- Announced and unannounced audits
- Management accountability
- Working relationship with the Department of Labor
Historically, the SEC rarely pursued enforcement actions against lawyers

Tide change at Enforcement Director Stephen Cutler’s 2004 speech at UCLA

In March 2007, SEC Chairman Christopher Cox reiterated the Division of Enforcement’s focus on “gatekeepers” – including lawyers – who are in a position to prevent or “blow the whistle” on corporate wrongdoing, or were primary actors in the violation
In 2007, the SEC brought 39 enforcement actions against attorneys

- Issuer disclosure (15)
- Insider trading (8)
- Option backdating (7 former in-house counsel of public companies)
- Offering fraud/pump and dump schemes (9)
The Landscape

- In the last year, the DOJ and the SEC charged 11 General Counsel (a record number) with civil or criminal fraud
2007 backdating events:

- Comverse Technology (GC paid $3 million and pled guilty to criminal charges in option backdating action)
- Monster Worldwide (GC consented to officer/director bar in option backdating action)
- MacAfee, Apple, Mercury Interactive, Juniper Networks, Marvell Semiconductor (other backdating suits by SEC against GC’s)
The Landscape

2007 backdating events (cont’d):

- Out of 39 Silicon Valley companies that restated financial results, only 3 GC’s remained in their positions in 2008
- In addition to those charged by the government, many GC’s stepped down or were fired at the time of an internal or government investigation or were otherwise blamed by companies
2007 fraud/trading events:

- Enron (Two former in-house counsel sued for alleged roles in sham sale agreement)
- Tenet Healthcare (SEC action based on GC’s alleged failure to disclose unsustainability of revenue and earnings strategy and DOJ indictment for alleged certification of false Medicare claims)
The Landscape

- 2007 fraud/trading events (cont’d):
  - Amkor (GC sued for alleged insider trading prior to public announcements relating to financial results and transactions and during blackouts)
  - General Re (DOJ indicted AGC for alleged role in sham reinsurance transactions with AIG to create false financial statements)
  - Peregrine Systems (two former GCs criminally indicted for alleged role in company’s alleged fraudulent financial statements)
According to an October 2007 ABA Section of Litigation Report entitled, “General Counsel Under Attack”:

- Since 2000, 77 in-house lawyers either were sued by the SEC, prosecuted by the DOJ or otherwise resigned or stepped down from their positions in connection with alleged wrongdoing or related investigations
- Approximately 28 of these 77 were associated with stock option-related events
Evolution of In-House Counsel

- No longer a corporate confidante
- Expected “gatekeeper” role – client is the company
- Hybrid legal and business roles can be complicated
- Subject to potential waivers of privilege
- More likely to face potential exposure for conduct within the legal or corporate secretary function
PurchasePro – A Cautionary Tale

- PPRO a Las Vegas-based internet commerce company
- Hired new GC in 2000
- After approximately 6 months, GC became suspicious of certain revenue transactions
- GC convinced board to convene a special committee and retain experienced independent outside counsel to investigate
PurchasePro – A Cautionary Tale

- As consequence of the investigation initiated by the GC, the CEO/Chairman and others involved left company and company later reported lower revenue
- SEC and DOJ investigated PPRO for securities fraud
- DOJ ultimately prosecuted not only those implicated by the investigation, but also the GC who had initiated the investigation under conspiracy and obstruction of justice theories. SEC did not pursue GC
PurchasePro – A Cautionary Tale

- Six former PPRO senior executives pled guilty to various felony charges
- GC sought separate bench trial and was acquitted of all charges brought by DOJ in December 2005 without putting on a defense
- In acquitting GC, the District Court stated that GC “did a very good job of handling an extraordinarily difficult situation”
- Lessons to be learned or job hazard?
Mitigating Securities Litigation Risk

- Homework before accepting in-house position
  - Management team
  - Board
  - Auditors
- Remember that you are the lawyer for the company not senior management
- “Conscience” of the corporation
- Avoid pressure to say “yes”
- Actively seek advice from outside counsel
Mitigating Securities Litigation Risk

- Relationship with outside counsel
  - Approve retention of outside lawyers
  - Confirm duties to report up when necessary
  - Contact immediately in connection with any crisis
- Maintain communication with and access to board and independent board members
- Active involvement in designing internal controls and procedures involving preservation of documents/ESI – ensure in loop on compliance issues
- Internal audit role – direct to Audit Committee
Never withhold relevant and material evidence from an audit committee, board of directors or investigators at behest of management.

Avoid any conduct which might inadvertently be misconstrued as aiding and abetting a cover-up (e.g., witness testimony).

Conduct yourself in a manner analogous to directors seeking the protections of the business judgment rule (e.g., avoid any conduct which suggest lack of reasonable response or lack of loyalty to the company).
Mitigating Securities Litigation Risk

- Ensure a robust and viable “ethics hot line” preferably staffed or monitored by outside professionals
  - Failure to act on internal whistleblower reports can be basis for liability
  - Cannot be a superficial compliance program with inadequate resources
Mitigating Securities Litigation Risk

- Purchasing and negotiating adequate D&O insurance is not only an issue for senior management and the board
  - Involve skilled broker and outside legal counsel
  - Be attentive to multiplicity of exclusions and severability clauses that can have substantial consequences
  - Consider coverage which survives bankruptcy
Intellectual Property
IP Agenda

- IP Discovery
- IP Litigation
  - High Stakes & High Risk
  - Evaluating & Reporting Risk
- IP Portfolio Management
  - Higher Expectations
Intel Blames Inside Counsel For E-Mail Loss

By Christine Caufield, christine.caufield@portfolio.com

Friday, April 27, 2007 --- A stressed out Intel Corp. lawyer responsible for preserving company documents in the midst of antitrust litigation “lost track” of things and forgot to alert employees to keep their e-mails, the company has admitted.

The microprocessor giant said the pressure of trying to juggle multiple litigation tasks proved too much for its in-house counsel, [your name here?], who “inadvertently” did not send so-called litigation hold notices to more than 370 employees.

The company has blamed [your name here?] for some of the “document retention lapses” that saw the loss of countless e-mails potentially crucial to an antitrust suit brought by rival Advanced Micro Devices.
IP Discovery

- Early Discovery Assessment
  - Witnesses, Documents & Damages
- Maintain Documents
  - Issue and Enforce Document Holds
- Purposeful and Continuous Sampling
  - Employee-Witness Interviews
  - Solicit Feedback from Document Review
  - Utilize Outside Counsel’s Assistance
- Document Management Systems
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IP Discovery Guidelines

- Standards of Practice
  - Discovery Management Systems
  - In House Education
  - Meaningful Retention Policies
  - Utilize Outside Counsel

- Dangerous Practices
  - No Checks & Balances
  - Budget Paralysis
  - Unskilled Personnel
IP Litigation

IP Litigation Is High Risk, High Visibility

2008  Lucent v. Microsoft  $511M  Pending Appeal
2008  Medtronic v. Boston Scientific $250M  Appeal Anticipated
2007  Lucent v. Microsoft $1.8B  JMOL Granted/Pending Appeal
2005  TMSC v. SMIC $175M  Settled
1992  3M v. Johnson & Johnson $107M  Affirmed
1991  Polaroid v. Eastman Kodak $925M  Judgment Paid
High Risk Means Increased Scrutiny

- Assessment of Risk
  - Jurisdiction (US & Foreign)
  - Plaintiff & Plaintiff’s Counsel
  - Accused Products at Issue
    - Product Life Cycle & Future Plans
  - Scope of Discovery
  - Merits
- Assessment of Budgets
- Assessment of Team Size
- Assessment of Litigation Goals

Report Findings
IP Litigation—Budget Control

- Too Much vs. Not Enough
  - Consider worst case scenarios
  - Is the budget commensurate to the risk?
  - Careful litigation team selection
- Make Sure Bills Reflect “Timekeeper Team”
- Track Litigation Action Items & Due Dates
- Motions for Extensions of Time?
- Periodic Status Meetings & Budget Forecasts
- Look for Settlement Opportunities
- Understand Discovery Plan
- Encouraging Outside Counsel Interaction
IP Litigation “Spaghetti Charts”

Team Management

No Discernable Management
IP Portfolio Management

- IP Today is 45% of US GPN ($5.5 Trillion)
- Increased Scrutiny on In House IP Counsel
  - Eliminate “Rubber Stamp” Patent Committees
  - Schedule Meetings with Chief Engineers & Sales
  - Foster IP Culture
  - Prevent Unfettered Standard Body Participation
  - Know the IP Portfolio
    - Portfolio Strengths & Weakness
    - Compare Competitors’ Portfolios
- Improve Portfolio & Leverage for Value
Patent Portfolio Management

Partner with Business Units

- Identify business objectives
- Identify key technologies
- Identify relevant markets
- Consider new products
- Assess competition / ecosystem

Build the IP Portfolio

- Create IP culture
- Identify key IP assets
- Purchase patents
- Portfolio mapping
  - Company portfolio
  - Competitors’ portfolios

Leverage for Value

- IP licensing
- Influence new markets and standard bodies
- Strategic alliances
- Supplier discounts
- Patent assertions
- Patent sales
- Spin offs

Generating Value
Patents/Applications

Number of Patents/Applications

Business Unit A
Business Unit B
Business Unit C
Business Unit D
Business Unit E
Business Unit F
Business Unit G

Business Unit
Example of Industry Analysis

Competitors' Issued U.S. Patents by Technology (U.S. Class)

Technology

- Connectors (526)
- Shielding (41)
- Power Supply (184)
- Transceivers (558)
- Display, 802.11 (174)
- Diode (476)
- Cooling (269)
- Transceiver (62)
- Transceiver (664)
- Transceiver (5020)
- Transceiver (2214)
- Transceiver (1264)
- Connector (581)
- QoS/VoIP (1938)
- Congestion (1466)
- Memory (418)
- Processor (315)
- Hot Swap (284)
- Error Detection (280)
- CDMA (916)
- QoS/VoIP (709)
- Congestion (710)
- Memory (711)
- Processor (712)
- Hot Swap (713)
- Error Detection (714)

Number of Patents

- Connectors (174)
- Shielding (320)
- Power Supply (327)
- Transceivers (331)
- Display, 802.11 (343)
- Diode (349)
- Cooling (361)
- Transceiver (370)
- Transceiver (331)
- Transceiver (343)
- Transceiver (349)
- Transceiver (385)
- Transceiver (439)
- Connectors (455)
- QoS/VoIP (709)
- Congestion (710)
- Memory (711)
- Processor (712)
- Hot Swap (713)
- Error Detection (714)
Typically about 3-10% of your portfolio will be strong patents

Business Unit vs. Competitor