ACC REPORTS

In-House Counsel in the Liability Crosshairs

From Trusted Counselor to Vigilant Gatekeeper:
The Evolving Liability Environment for Corporate Counsel

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This document and related work on in-house counsel liability for corporate failures can be found online at http://www.acc.com/php/cms/index.php?id=371

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ACC Reports – In-House Counsel in the Liability Crosshairs

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I. Overview and Executive Summary

Your high school physics teacher taught you that Sir Isaac Newton's Third Law of Motion states, "For every action, there is an equal and opposite re-action."

Most observers of the behavior of human beings, both individually and in groups, intuitively sense the same principle at work, but none of us need a scientist (rocket or pre-rocket) to remind us that human and social reactions to human misbehavior are not always proportional. So it has been with the reactions of lawmakers, regulators, prosecutors, disciplinary counsel, plaintiffs' lawyers, clients, and others to the corporate scandals of 2001-02. There have been numerous reactions, all different, some proportional, and some not.

It seems that no seminar or article directed toward corporate counsel today is complete unless it pays homage to this radically new world in which corporate counsel find themselves after the fall of Enron, the rise of Sarbanes-Oxley, and other events that followed. Doubtless, some have grown weary of the rhetoric and the warnings about how everything has changed. In reality, the fundamentals have not changed: Lawyers are and always have been professionals with a strong ethical creed and a focus on doing the right thing. This important fact partly explains why in-house lawyer roles and attendant "responsibilities" to influence the behavior of others in the corporate structure are under such close scrutiny and in increasing demand by stakeholders who want to guarantee better corporate legal compliance.

The result: Heightened scrutiny applied to lawyer behavior leads to a new focus, increased vigilance, and an experiential change in the tone and tenor of daily routines and relationships in the company by corporate counsel the world over, in large and small departments, and in every conceivable industry and specialty. Our research and member interaction shows that this issue is of greatest concern and proximity to the chief legal officer. Counsel for companies in higher-risk industries may experience the pressure stemming from this heightened scrutiny more dramatically than others.

One major driver of such changes in in-house lawyers' daily routine, both real and perceived, has been the emerging and increasing targeting of corporate counsel and decisions regarding their liability arising from larger corporate failures. Since the very inception of this new era, monitoring and evaluating this changing liability environment has been a significant concern of the Association of Corporate Counsel (ACC). This article brings current and expands prior research on the numerous elements that may be contributors to this environment and attempts to draw from this analysis real-world lessons and practical guidance for corporate counsel who wish to navigate their roles with a better understanding of the pitfalls that have tripped up others.

Though the reality of today's liability environment is complex, it will surprise no one that one of its significant aspects continues to be the growing reality forming around the paradigm of corporate counsel as "gatekeepers." We conclude that this reality is today taking firm shape and form as liability has increasingly been imposed or sought against in-house lawyers, particularly by the Securities and Exchange Commission (SEC) and federal prosecutors. Increasingly, the concept of lawyers as "gatekeepers," bandied about for years by academics and regulators, is visible in stark relief in the facts of some recent actions against corporate counsel. Of course, corporate counsel can be relatively easy targets for prosecutors because of their integral role in corporate decision-making at the highest levels and because they are regulated professionals for whom separate, more explicit, and often higher, standards of conduct frequently apply. The enactment of the SEC's Section 307 regulations and recent amendments to the ABA Model Rules of Professional Conduct, already enacted in some jurisdictions, have only served to heighten those separate standards of conduct.

One of the most profound ways in which the changed environment has become visible is what appears to many to be the significantly enhanced liability environment for all in-house counsel – more dramatically apparent for counsel inside public companies, but nevertheless touching counsel for private and non-profit companies, as well. SEC enforcement actions, lawsuits by investors, even criminal charges – these risks dot the pages of the ACC Docket and many other legal and business publications that cross corporate counsel's lines of sight.

But how real a change does all this apparently increased activity signify? Does every in-house lawyer face a "perp walk" or a shareholder derivative suit in her future? Of course not. Our intention in this article is not to over-react or suggest that the sky is falling. While the number of suits and other proceedings against in-house lawyers has increased exponentially in recent years and deserves appropriate attention, the absolute number of corporate counsel who have been targeted is still a very small number. But, when it happens, it is front-page news, and rightly so.

So, most importantly, what should conscientious corporate counsel do? How do we learn from what we see that is of concern, and how do we avoid the damnation of repeating mistakes made by others? Are there practical ideas, best practices, or guidance that we can impart? These are the questions this article sets out to address. And we've created extensive bibliographies of ACC and other folks' materials that offer additional ability to drill down into cases or issues that concern you most.

ACC stand ready to help and to lead. As always, we're your bar association, and we exist to serve you: If you have questions, need our assistance on something related to this topic, wish to suggest that we intervene in a case of concern, or want to further plumb the ACC networks and scheduled programming for other leading practices or grassroots conversations with your peers on this issue, please call us. That's what we're here for!

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Conclusions Drawn

Quite obviously, the lessons that can and should be learned from the experiences of the corporate counsel whose situations are addressed in this article will vary significantly depending on the circumstances of the reader. An in-house lawyer supervisor in a larger law department will, and should, draw different guidance than a lawyer on the bottom rung of a longer reporting chain, or one in an outpost of a distant division or business unit, or one who acts as the sole counsel for an entire company. Further, your industry also matters: Corporate counsel in a privately-held real estate development company will certainly focus upon different aspects of this analysis than counsel working inside a publicly-traded pharmaceutical mega-company. That said, some general conclusions do emerge from our analysis:

- Increasingly, the rhetoric of lawyers as "gatekeepers" is becoming reality.

The notion that lawyers, and especially corporate counsel, are expected to serve as "gatekeepers," protecting the public and investors against wrongful actions of their clients, is being supported by efforts to impose personal liability, both civil and criminal, on corporate counsel when they are perceived as falling short of that goal. Separate and apart from any actions against corporate counsel for insider trading activity, the SEC commenced six enforcement actions against corporate counsel in 2005, three enforcement actions against corporate counsel in 2006, and eight enforcement actions against corporate counsel in 2007. Likewise, not including prosecutions involving insider trading activity, we have located five criminal cases against corporate counsel initiated in 2005, seven criminal cases against corporate counsel initiated in 2006, and two criminal cases against corporate counsel initiated so far in 2007.

- Perspectives on what is "accepted conduct" change, sometimes incredibly rapidly and without warning, and corporate counsel must be aggressively on the look-out for these changes.

Hindsight will always be 20/20, and the experience of recent years makes abundantly clear that it is not possible to anticipate every form of conduct that may later appear problematic when scrutinized with different eyes in different times. Many of the risk management filters by which corporate conduct is judged touch in some way the roles of corporate counsel – Is it ethical? Is it legal? Even if it passes both those tests, how might this affect our reputation with customers, competitors, or suppliers? What is our company's appetite for risk and does this fit in that balance? Beyond any of these concerns, how will a regulator, prosecutor, judge, or jury think about what we've done when they examine our behavior and how it appears in 20/20 hindsight? And how will the media "spin" our failures and our responses?

The risk management lens makes corporate counsel uniquely positioned to be sensitive to these potential changes in perspective, and to attempt to use what has been called "hindsight in real time"[1] to protect both themselves and their companies. Of course, in-house lawyers cannot predict the future any better than their business colleagues, but their knowledge and training, and their cognizance of recent and anticipated changes in the business and regulatory environment, all uniquely enable them to attempt the thought experiment necessary to consider, while events are unfolding, what today's events will look like in six months, or even six years, to the many internal and external constituents of their client.

- <u>"Wearing two hats" continues to carry real risks for corporate counsel.</u>

Our review of recent SEC enforcement actions and criminal prosecutions, as well as our analysis of the role that corporate counsel play in supervising corporate investigations, indicates that the practice of corporate counsel shouldering responsibilities in their companies outside of strictly legal ones, and by which they carry non-legal titles, continues to carry tangible risk for the lawyers. This is even more difficult as traditionally "legal" roles related to compliance counseling morph into a broader focus on business ethics and compliance leadership, with separate functions leaders (sometimes within and sometimes outside of the legal department) covering compliance, privacy, ethics, governance, internal audit, and a host of other responsibilities. Sometimes those leading these efforts are lawyers and sometimes not, but whether these functions are housed in the law department or not, lawyers support their efforts, often in dual business/legal capacities.

We therefore believe that this risk of being seen as the client rather than the lawyer is probably increasing. Regulators, prosecutors, and courts appear to be putting corporate counsel under the microscope for their conduct in connection with activities where corporate counsel have worn a non-legal hat, sometimes heightening the ordinary expectations and duties of that non-legal role to include the lawyer's

1 To the authors' knowledge, the phrase "hindsight in real time" was first used by Aaron E. Hoffman, Senior Vice President – Loss Prevention of Attorneys' Liability Assurance Society (ALAS), the mutual legal malpractice insurance company that insures most large law firms in the United States. Over the last generation, ALAS pioneered the techniques of loss prevention within large law firms, and this concept was simply a description of one of the techniques that sophisticated loss prevention lawyer used, both to analyze loss prevention issues as they are happening and to counsel lawyers who are in the midst of these issues.

legal training and knowledge. Obviously, this may increase the risks of such dual roles both for the lawyer and the client.

- Wearing only one hat may be less of an excuse for ignorance of business activities than it used to be.

Recent SEC enforcement actions and criminal prosecutions of corporate counsel demonstrate that, although corporate counsel (and their clients) may be better served by not having counsel carry additional non-legal titles and responsibilities, corporate counsel appear to be increasingly expected to be knowledgeable of their company's finances, lines of business, and operational strategies, and the business implications of questions and decisions that the lawyer may address only tangentially. While we realize that this conclusion and the immediately prior one are in tension, we believe that the evidence supports both and that an appropriate middle ground is possible for prudent corporate counsel.

- Some of the recent liability experience of corporate counsel suggests an element of "bystander liability" for lawyers near the scene of a business disaster.

Without excusing any underlying criminality or other misconduct, and without suggesting that the lawyers involved were blameless, a few of the situations we surveyed suggest that corporate counsel are increasingly subject to being swept up in a dragnet by regulators or prosecutors where they were only marginally or peripherally associated with the targeted conduct. Private lawyers and law firms have seen this phenomenon in malpractice exposure for some time, especially where the defrauding client of the lawyer or law firm has no available deep pocket, and the law firm appears to have just that. While this conclusion is certainly not comforting for corporate counsel generally, it does provide an identifiable incentive for corporate counsel who sense corporate misconduct or serious difficulty nearby to take action, rather than wait for more facts or greater confidence that a problem actually exists.

- A thoroughly ethical culture matters more today than it ever has, both to the health and well-being of corporate clients and to the personal well-being and preservation of their corporate counsel.

We will not rehearse again in this article the many benefits of establishing, maintaining, and fostering an ethical culture, nor will we attempt to detail how that might be accomplished. There are lots of ACC resources on tap in our virtual library for those who wish to consult further. That said, the known details of many of the situations reported in this article, including the backdating cases, strongly suggest that the more robust the ethical culture of a company and, separately, of its law department, the less likely it is that the bad conduct of individuals (which may to some degree, be inevitable in any human enterprise) will unavoidably lead to bad consequences for the business and for the lawyers nearby. The conventional wisdom, of course, is that a company with a robust ethical culture will be able to rely on this fact as supportive of, for example, better treatment at the hands of federal regulators and prosecutors. More than that is at work, however, as we believe that culture probably has a deeper influence on the course of the underlying events, people's responses to those events, and the likelihood of compounded or continuing bad conduct, quite obviously benefiting the business and the lawyers involved.

- Check your license, so you don't wreck it.

Recent media coverage of the licensure problems of a number of high-profile corporate counsel has brought to the surface a risk of potential liability exposure (and serious public embarrassment) for corporate counsel and their employers. The simple point: Corporate counsel need to be sure their licensure status is consistent with the law of the state where they maintain an office and regularly practice. Resources exist that make it easy to check, and there are answers to most all of your questions (even if you don't want to hear them), since regulation of practice is reasonably clear-cut.[2] The consequences of ignorance of your status and failing to be in compliance can haunt a lawyer for his entire career. Finally, any in-house lawyer with supervisory responsibilities over other attorneys would be extremely well advised to personally make sure that those lawyers are appropriately licensed since their lack of licensure could bite you as a supervisor professionally responsible for sending an unauthorized lawyer out into practice when you should have known that she was not a "lawyer" as defined by the state.

- There appears to be a rising trend in the wave of liability exposure for corporate counsel, but its future magnitude is impossible to predict.

Placed first in our detailed analysis, the various liability aspects of the stock options backdating scandal appear to dwarf other elements of the liability environment. Without these enforcement actions and prosecutions, the overall liability landscape we have surveyed would look quite different. With that exposure largely now visible, though not fully adjudicated, who can say from whence the next such unexpected source of difficulty for corporate counsel might come? What we can say with clarity and with reasonable certainty, however, is that, even if the frequency and severity of instances of corporate counsel liability trend downward once the stock options backdating scandals are behind us, the liability landscape left in the wake of these scandals and other recent events will be significantly changed. Prosecutors and regulators will not un-learn their attitudes and approaches to investigating and prosecuting alleged corporate misconduct, and corporate counsel will not soon be able to lay down their new mantle of responsibility as "gatekeepers."

2 ACC has excellent resources on this subject available on its website at http://www.acc.com/php/cms/index.php?id=229.

- Some areas of liability exposure appear now to be of less concern than they were several years ago.

There are a few areas where two more years of data has provided some limited comfort for those concerned with the liability exposure of corporate counsel. Specifically, some observers, including your authors, had serious concerns in the first few years of this new era about the liability exposure of corporate counsel for legal malpractice and related claims (e.g., breach of fiduciary duty) by clients against corporate counsel, as well as shareholder derivative actions and securities class actions that might more particularly target corporate counsel. We see little in our analysis to suggest that these areas should be the focus of the most serious concern of corporate counsel.

- Villa's Rules still rule.

As we explain below, this article builds in part upon John K. Villa's 2005 work in surveying SEC and criminal actions against corporate counsel.[3] Now having examined the more recent SEC and criminal actions against corporate counsel, as discussed in this article, we believe that Villa's rules remain valid. With respect to SEC enforcement actions, Villa offered the following:

> Rule #1: The Top Lawyer is Nearly Always the Target.
>
> Rule #2: Inside Lawyers Who Relied On Outside Counsel's Advice are Seldom SEC Targets.
>
> Rule #3: Putting Money in Your Pocket is Not Necessary to Prompt SEC Enforcement.
>
> Rule #4: Disclosures, Particularly Omissions in Disclosures, are Usually the Problem.
>
> Rule #5: A Generalist Lawyer Serving as General Counsel Must Seek Out Sound Advice or Pay the Price.
>
> Rule #6: If You Hold Several Corporate Offices, Your Company Failed, or You Sat on a Serious Problem You Could Have Taken to the Board, Your Risk Increases.[4]

With respect to criminal prosecutions of corporate counsel, Villa offered the following:

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3 John K. Villa, SEC and Criminal Proceedings Against Inside Corporate Counsel, Association of Corporate Counsel, Sept. 2005, available at http://www.acc.com/resource/v6063.

4 Id. at 1-4.

Rule #1: Chief Legal Officers are Criminal Targets, Too.

Rule #2: Big Losses Increase Risk of Prosecution.

Rule #3: Having Outside Counsel Can Make a Big Difference.

Rule #4: Perjury and Obstruction Often Become the Crime Charged.

Rule #5: Mere Knowledge of Conduct Later Deemed Criminal is Typically Not Enough.

Rule #6: Counsel Are Seldom Charged Where the Alleged Fraud is Complex and Its Propriety Debatable.

Rule #7: The Prosecutors' True Goal: Undermine the Executive's Advice-of-Counsel Defense.[5]

The Data We Examined

The conclusions set forth above have been reached on the basis of a wide-ranging review of data related to the liability of corporate counsel.

First, this article undertakes a comprehensive exploration of a number of specific realms of exposure for corporate counsel that have recently come into sharp public focus: (1) the wave of stock option backdating scandals, ranging from Apple to United Health; (2) the role that corporate counsel play in supervising corporate internal investigations; and (3) the licensure status of corporate counsel residing in, or practicing in, states in which they are not licensed.

Second, as mentioned above, this article builds directly on prior work prepared for ACC that examined issues related to the liability exposure of corporate counsel. Building on ACC's 2005 article, "Paradise Tarnished: Today's Sources of Liability Exposure for Corporate Counsel,"[6] as well as other analysis commissioned by ACC, this article attempts to bring current, broaden, and deepen our analysis of the changing liability environment for corporate counsel. In early 2005, the scandals of 2001-02 were a more recent memory, their implications and resulting proceedings were still playing out, Sarbanes-Oxley was still a recently-enacted law, and corporate counsel were still learning the Section 307 regulations. In that 2005 piece, we told the stories of more than a dozen corporate counsel for ten troubled companies, in some detail. At the time, the grist for our analysis was still

5 Id. at 4-6.

6 Lucian T. Pera & Brian S. Faughnan, Paradise Tarnished: Today's Sources of Liability Exposure for Corporate Counsel, Association of Corporate Counsel 2005, available at http://www.acc.com/public/article/ethics/liability.pdf.

more anecdote than data. We believe that this has changed, and that the intervening time permits us to reach firmer conclusions and draw more helpful lessons.

In this article, we spend a little time asking, "Where are they now?", as to some of those corporate counsel discussed in Paradise Tarnished, and we revisit areas of liability exposure previously discussed. We also devote substantially more, and substantially more comprehensive, attention to other areas of liability exposure for corporate counsel, including what we consider a reasonably complete range of the significant types of liability exposure that corporate counsel face. These topics include SEC violations, criminal charges, shareholder derivative and securities class actions, litigation sanctions, legal malpractice and related claims, and lawyer discipline.

The other ACC work from 2005 upon which this article builds is an article written by John K. Villa, SEC and Criminal Proceedings Against Inside Corporate Counsel,[7] which comprehensively surveyed all known SEC proceedings against, and all known criminal prosecutions of, inside counsel since 1998 and set forth a number of proposed "Rules" to guide corporate counsel drawn from those proceedings. In this article, we discuss the known SEC proceedings against, and known criminal prosecutions of, inside counsel that have occurred since the publication of that article. In so doing, however, we have not focused on actions where the conduct of corporate counsel in question involves things like insider trading, outright theft, or other criminal conduct where the fact that they are corporate counsel is merely incidental.

Practical Advice?

Throughout this article, we also focus, in light of the data points reviewed and the lessons that should be learned from those data points, on what corporate counsel can do to protect themselves, on a day-to-day basis, from liability in the new environment. Our analysis points to a number of items of practical advice corporate counsel should heed in navigating the new liability environment, many of which accord with existing conventional wisdom and common sense:

1. <u>Don't Break the Law.</u>

An obvious point. Still, given the many documented instances where corporate counsel have ended up in the crosshairs of the SEC or the Department of Justice for their own illegal conduct, it surely bears repeating. The stock option backdating scandal demonstrates vividly why: The steps that were consistently necessary in order to effect the grants of stock options on a backdated basis involved conduct such as falsifying corporate documents and other efforts to hide what was going on from auditors that certainly should have raised "red flags" for the corporate

7 John K. Villa, SEC and Criminal Proceedings Against Inside Corporate Counsel, Association of Corporate Counsel, Sept. 2005, available at http://www.acc.com/resource/v6063.

counsel involved. Moreover, all other precautionary steps designed to reduce your potential liability exposure in this new environment will be in vain if your own personal conduct violates the law.

2. The Devil Is Almost Always in The Details.

Be sure that the scope of your work on a particular question is appropriate. Client demands for rapid, efficient responses usually work strongly against a lawyer erring on the side of too broadly interpreting her necessary involvement in an issue. But those same pressures can lead an inside lawyer to take too small a role in the company's efforts to address an issue. Because corporate counsel often do have a voice in how much involvement they will have in a decision, or how much work they should do on a particular matter (perhaps more so than for lawyers in private practice, for example), corporate counsel need to be particularly attuned to avoiding "drive-by lawyering." In our analysis we have seen instances of lawyers who appear to have too quickly "signed off" on issues, where prudence should have dictated greater review and involvement. Perhaps more so for corporate counsel than for lawyers in private practice, demands for rapid responses, from fellow members of the business "team," coupled with an expectation that corporate counsel is already intimately familiar with the business context and history, can sometimes lead in-house lawyers to pay less attention than they should to the details.

3. Protect the Privilege, but Manage Expectations.

Corporate counsel must take appropriate precautions, in advance, to increase the chance that the privilege can be sustained. This is not news, but no one else in corporate counsel's organization is better situated or more appropriately responsible for taking every necessary measure to preserve the attorney-client privilege. Such measures can include: (a) preparing two versions of documents or reports, one that is merely factual and one that includes privileged communications; (b) being diligent in providing the appropriate "Corporate Miranda" or "Upjohn warning" to corporate employees when you interview them; (c) devising two separate plans for responding to government inquiries before problems arise – one plan that counts on privilege protection and one plan that does not; and (d) if, or when, a government regulator does demand that the privilege be waived, making efforts to negotiate some level of protection in the nature of selective waiver, even if such an agreement is unlikely to later hold up -- the company will still be no worse off than it would have been if it simply waived the privilege without getting such an agreement.[8] Nevertheless, the client contacts that you work with, work for, and report to, need to understand that, despite your best efforts, the corporation's right to attorney-client privilege may not survive if the conduct of officers or directors of the corporation comes under scrutiny as potentially contrary to the interests of the investing public.

8 ACC has extensive resources on privilege protection techniques, starting with our treatise, "Pragmatic Practices for Privilege Protection," online at http://www.acc.com/public/attyclientpriv/pragpract.pdf. Also, browse our privilege homepage at http://www.acc.com/php/cms/index.php?id=84.

4. Be A Lawyer, Not A Witness.

Avoid taking steps that would make you more likely to have to become a fact witness in the future regarding events.

5. Know Your Hats; Disclose Your Hats.

Maintain the clarity of your role, especially if you are performing any non-lawyer duties. If you fill a role for your company beyond being corporate counsel, consider ways that you can avoid blurring your legal and non-legal functions. If you believe there could be doubt among people in the room, or if you believe that someone with the benefit of hindsight could claim any doubt, clearly indicate your role. And consider not merely indicating that you do represent the company, but that you do not represent anyone else in the room.

6. Watch Your Back.

Recent events underscore that corporate counsel are expendable too. The backdating scandal, as well as the public discussion over the role of corporate counsel in supervising corporate investigations, serve as reminders of the harsh reality that, if the perception develops that cutting ties with corporate counsel will benefit the company or others, then corporate counsel becomes just as expendable to her employer as other business colleagues who may be tossed under the bus in an effort to divert prosecutorial attention from others or from a charge that the entity is not cooperating (and should be charged, too).

7. Just Because Everyone Else Is Doing Something Does Not Make It Right.

The data appears to show that the idea of backdating stock option grants likely emerged at one or more technology companies in California and then spread like a virus as employees jumped from company to company, discussing how their options had worked at their previous place of employment or as compensation consultants found this their newest idea to sell. Corporate counsel should become comfortable with the things they are being asked to implement for their employers on the substance and merits of the transaction in question, and not on the basis that it has become an industry practice or that others are signing off on it.

II. Introduction: Setting the Context

Even those weary of clichés must concede that the world of corporate counsel has changed and continues to change.

Over the last five years, for example, there has been public furor about lawyer-client confidentiality, and even changes in the ABA Model Rules of Professional Conduct and some state lawyer ethics rules on the subject. But despite the mind-numbing complexity of the rules in this area, the paradigm of confidentiality still governs lawyer conduct. True, it has been weakened – or perhaps more accurately, tempered. Still, in most jurisdictions, and in most factual circumstances, a lawyer remains duty-bound to maintain her client's confidentiality, mostly prohibiting a lawyer from acting anything truly like a policeman, informing on her clients to regulators or law-enforcement authorities.

Yet, despite the fact that corporate counsel are lawyers and lawyers remain duty-bound to protect client confidentiality, we are told that corporate counsel are now called on to be "cops on the beat," carefully keeping their clients under surveillance for any illegality or misconduct, and "blowing the whistle" on clients if they misbehave.[9] We are also told that inside lawyers have now become "gatekeepers;" indeed, this seems to be the favorite descriptive term of some SEC officials, whose pronouncements are justifiably closely followed by all corporate counsel in public companies.[10]

"Gatekeeping"

What does it mean then for corporate counsel that they are being looked at as the "gatekeeper"? It does not merely mean that corporate counsel's own actions will be scrutinized (although they will). It also means that corporate counsel are going to be held responsible for their client's actions. It is something akin to reverse vicarious liability – the employee being held to account for the actions or inactions of her employer. As a result, corporate counsel will be measured and faulted as much if not more for what they do not do. These responsibilities for corporate counsel cannot be explained away merely as consistent with the obligations that corporate counsel owe to their clients, even when their client is an entity. After all, although the attorney ethics rules explain that corporate counsel represent the organization and not its individual officers, the attorney ethics rules explicitly acknowledge that it is individual actors such as officers or directors who make decisions for the organization and thus it is those officers who act as the client, and not the attorneys who serve them.

9 See, e.g., David B. Bayless and Tammy Albarrn, "Recent SEC Enforcement Actions Against In-House Lawyers: An Ominous Trend for the Legal Profession," 11 Andrews White-Collar Crime Reporter 2 (July 31, 2007).

10 See, e.g., Stephen M. Cutler, "The Themes of Sarbanes-Oxley as Reflected in the Commission's Enforcement Program," Speech before UCLA School of Law, Sept. 20, 2004, available at http://www.sec.gov/news/speech/spch0920045mc.htm). Cutler was then the SEC's Director of Enforcement and is now the general counsel of a major financial services company. See also SEC Commissioner Atkin's Remarks, page 6, available at http://www.sec.gov/litigation/investreport/34-44969.htm, and Commissioner Goldschmidt's comments, available at http://www.sec.gov/news/speech/spch111703hjg.htm.

The "gatekeeper" model is not premised upon those sorts of responsibilities. Rather, it is premised upon a notion that the true clients of corporate counsel are the shareholders of the organization. In a capitalist system where corporate ownership changes hands through public trading of stock on a constant, daily basis, this translates to the investing public being viewed as corporate counsel's true "clients." From a broader policy perspective, the irony of this presumption of true loyalty to shareholders is that it propels the lawyer to work far more toward "shorter- term" interests than toward longer-term decision-making and prosperity, clearly the opposite of the interests that the public claims it wants corporate lawyers to pursue. While the idea of lawyers serving shareholders is in direct conflict with ethical laws governing lawyer behavior, it is clearly a clear message underlying recent SEC enforcement actions and criminal prosecutions discussed in this article.

No rhetoric has been more revealing in this regard than that of SEC Chairman Christopher Cox. In April 2007, while addressing a gathering of corporate counsel, Chairman Cox explicitly stated his view that in-house counsel and the SEC are "partners" who have a shared "mission to protect investors" and provided this advice to corporate counsel as to how they should go about their business: "In every transaction you handle, every governance problem you tackle, and every shareholder communication you write, keep in mind that America's investors are depending on you."

But, upon close analysis, if we are really to believe that the SEC has reached the conclusion that being a "gatekeeper" is synonymous with being the SEC's partner in protecting the investing public, then the term "gatekeeper" is both weak as metaphor and problematic as a factual assertion. Most of us do, of course, understand that corporate lawyers (along with accountants, auditors, and certain financial advisors) stand as essential players to many corporate transactions (often, for example, essentially controlling access to capital markets), and that their status as officers of the court and their vigilance and refusal to participate in or countenance wrongdoing should help prevent or deter wrongdoing.[11] Still, an inside counsel's ability to deter wrongdoing at a company often depends less on rules and regulations, and more on persuasive or moral authority. In playing that role, counsel's only real leverage may depend on her willingness to "withdraw," either quietly or noisily, or with threat that effective discharge for the client's ongoing illegal activities a suicidal trump card that no one plays lightly. So, metaphorically, whose "gate" is it anyway; who's being kept in . . . or out?

11 According to the extensive New York City Bar's 2006 report on the lawyer's role on corporate governance, the seminal article on "gatekeeping" is Rainier H. Kraakman, Gatekeepers: The Anatomy of a Third-Party Enforcement Strategy, 2 J.L. Econ. & Org. 53 (1986), and a particularly thorough, recent treatment of lawyers' potential role as gatekeepers is John C. Coffee, Jr., Gatekeepers: The Professions and Corporate Governance (2006). See Report of the Task Force on the Lawyer's Role in Corporate Governance at 22 n.16, Association of the Bar of the City of New York (November 2006). For anyone attempting to orient themselves in the debate and developments of the last few years, the City Bar report is a fine starting point.

"Lawyer-Statesman"

But the attempts to re-frame the appropriate role for corporate counsel do not stop with the seemingly negative notions of turning lawyers into various forms of minders for their clients. One of the most respected elders of the world of corporate counsel has called, in practical and idealistic tones, for corporate counsel to respond to this new environment positively by becoming (or becoming again) "lawyer-statesmen."[12]

Of course, all of these descriptions do convey something of the real changes that have overtaken corporate counsel in the last few years. Still, with all this thought and debate, the proper boundaries of the new role of corporate counsel in our new global, 24/7/365 business environment, still seem to be a work in progress. Fortunately for your authors, defining these boundaries is not the purpose of this article; instead, we will test and explore one particular premise about why the role of corporate counsel has changed and will continue to change, and explore its implications for the real lives of in-house lawyers.

Whither Privilege?

Another strong cross-current affecting every corporate counsel in America is the shifting environment of attorney-client privilege and confidentiality.

Inspired by threatened SEC rulemaking and revisions in the ABA Model Rules of Professional Conduct, the rules governing our ethical duty of confidentiality – and, perhaps more precisely, our authority or mandate to make certain disclosures not authorized by clients or their constituents – are changing, and the shift is toward more disclosure, not less.

At the same time, the strong push by regulators and law enforcement authorities to aggressively pursue suspected corporate criminality grew into a "culture of waiver," with businesses under scrutiny being regularly pressured to waive attorney-client privilege as a core part of the "cooperation" needed to avoid greater sanctions. Of course, increased waiver of attorney-client privilege has tended to expose to dramatically greater scrutiny the activities, advice, and work of in-house counsel, sometimes to the chagrin (or worse) of counsel. More recently, the client community has forcefully pushed back, with ACC's strong leadership, seeking to rein in the aggressive pursuit of waiver.

No student of the emerging and changing liability environment for corporate

12 Benjamin W. Heineman, Jr., "The Ideal of the 'Lawyer-Statesman,'" ACC Docket 22, no. 5, at 61-67 (May 2004), available at http://www.acc.com/resource/v4851. Heineman is the retired general counsel of General Electric Corporation and now serves as Distinguished Senior Fellow a Harvard Law School's Program on the Legal Profession.

counsel can be oblivious to the health and well-being of the attorney-client privilege and confidentiality under the ethics rules.[13]

Earlier Work

In this context of rapidly changing expectations, more than two years ago, the Association of Corporate Counsel took a first hard look at the changing liability environment that was emerging from the rubble of corporate scandal. The resulting article, "Paradise Tarnished: Today's Sources of Liability Exposure for Corporate Counsel,"[14] examined in detail the data then available and told, in some detail, the stories of more than a dozen corporate counsel for some ten troubled companies. The data points were relatively meager, but there were some lessons to be drawn from a close examination of the individual factual situations, even if some of them were then unresolved.

Not long after this article, ACC published another article that comprehensively surveyed all known SEC proceedings against inside counsel and all known criminal prosecutions of inside counsel since 1998.[15] Again, a number of interesting and valuable lessons and themes emerged from the evidence as it then stood. Since that time, a spate of coverage in ACC media and the legal and business press have trumpeted the issues of general counsel liability, sometimes providing thoughtful guidance,[16] but sometimes apparently designed to sensationalize or scare lawyers into believing that suits against them are commonplace and likely.[17] Also, helpful efforts have been made by other organizations to catalogue actions against or involving in-house counsel.[18]

Now, at least two more years into the post-Sarbanes-Oxley era, it would be lovely if we could say that enough dust has cleared to draw firm conclusions. We can't. But even though firm conclusions still are not possible, we do at least have more

13 ACC maintains an enormous set of resources on the privilege. For example, see ACC's Attorney-Client Privilege homepage, offering articles, resources, testimony, and links, available at http://www.acc.com/php/cms/index.php?id=84.

14 ACC's "Paradise Tarnished: Today's Sources of Liability Exposure for Corporate Counsel," available at http://www.acc.com/public/article/ethics/liability.pdf.

15 John K. Villa, "SEC and Criminal Proceedings Against Inside Corporate Counsel" (Association of Corporate Counsel, Sept. 2005), available at http://www.acc.com/protected/article/ethics/seccrimproceed.pdf.

16 See, e.g., Randy S. Segal and Richard K.A. Becker, "Through The Looking Glass: Ten Lessons from In-House Counsel on Trial, " ACC Docket 22, no. 5 (May 2004); 22–39, available at http://www.acc.com/resource/getfile.php?id=4850.

17 See, for example, the National Law Journal's review of cases brought against in-house lawyers in 2007. Pameal A. McLean, "The Year of Living Dangerously," Nat'l L.J., Oct. 1, 2007, available at http://www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=1190970184688.

18 See, e.g., Committee on Corporate Counsel, American Bar Association, Section of Litigation, "General Counsel Under Attack Criminal and Enforcement Proceedings, Investigations, and the Travails of In-House Counsel," September 12, 2007, available at http://www.abanet.org/litigation/committees/corporate/docs/2007_materials_underattack.pdf.

data, and more experience, and the conclusions we can now draw will be better grounded in data, and less reliant on anecdote.

The Topic At Hand

Recognizing the existing environment in which government prosecutors and regulators view themselves in a partnership with corporate counsel to fulfill a mission of protecting the public, this article explores one of the most important changes facing corporate counsel: the sources and scope of liability exposure for corporate counsel, especially those who government officials, plaintiff's lawyers, and public interest watchdogs believe have failed to fulfill this function. This article undertakes a discussion of this topic with a view toward enabling corporate counsel to evaluate for themselves how they and their employers should shape and execute their role as corporate counsel.

In this article, we revisit the subject of the changed and still-changing liability environment for corporate counsel, intentionally casting the net more broadly than in the 2005 article, but reaching toward the same goal: An understanding of events that yields practical guidance for corporate counsel trying to serve their clients and avoid any unnecessary risk of personal liability. The premise we explore in this article is that one of the more important ways in which change has come to the world of corporate counsel is in the nature and scope of scrutiny of their actions (or inaction) as well as the potential liability that now surrounds their work and the decisions that they make. It is simply impossible to intelligently describe or re-shape the role of corporate counsel without an accurate, well-rounded appreciation of how this aspect of their environment has changed.

Thus, this article will explore the ways in which the liability environment for corporate counsel has changed, and continues to change, with a view toward enabling corporate counsel to evaluate for themselves how this environment may affect how they practice law every day and their ongoing relationship with their clients.

To get to such practical guidance, we will take a thorough look at several high-profile areas in which corporate counsel either have suffered liability or have been visibly exposed to it – the stock options backdating scandals, several corporate investigations gone bad, and public controversies about the licensure status and possible violations of the unauthorized practice of law statutes by corporate counsel. Then, viewing areas of liability exposure more by category, we will examine recent activity leading to corporate counsel's exposure to liability from SEC charges, criminal charges, shareholder derivative actions, litigation sanctions, legal malpractice and related claims, and lawyer disciplinary charges. As we examine each of these topics, we will pause to see whether any lessons or themes emerge from our analysis.

We will also review some of our data and analysis relate to a number of perennial issues that face corporate counsel – for example, the "two hats" problem, indemnification of inside counsel and malpractice insurance, and the role of compliance in inside counsel's portfolio of assignment. Then, in concluding, we try to draw broader lessons for corporate counsel concerning their liability exposure.

In so doing, however, we will not cover cases that focus on actions where the conduct of corporate counsel in question involves insider trading, outright theft, or other criminal conduct where the fact that they are corporate counsel is merely incidental. The standards for judging such conduct has not changed and we have few constructive lessons to offer from such cases beyond, "Don't break the law." In other words, our focus has not been on actions against corporate counsel that can be explained away by saying: "Just because you are a lawyer does not mean you get a pass to engage in conduct that would constitute a violation for anyone else at the company."[19]

Be forewarned: Although there is now a fair body of data available on this subject, we have just crossed the frontier of a new world – cliché or not – and recent performance is no guarantee of future events. Moreover, the reader's results may vary, as the lessons to be drawn from this analysis for the head of a large law department in a giant public company will surely be quite different from those drawn by the solo general counsel of a small private company.

III. Corporate Counsel in the Liability Crosshairs

A. A few recent areas of public focus

1. Stock options backdating

Over the last eighteen months, few issues touching on the potential liability of corporate counsel have received more news coverage than stock option backdating. Any analysis of the changing liability environment for corporate counsel thus must address this topic. As many readers are aware, however, due to changes in the law in 2002,[20] stock option backdating is unlikely to happen in the future. Thus, while any new misconduct in this area is unlikely, the series of charges brought in this area remains a useful case study for many of the potential areas of liability for corporate counsel – criminal liability, civil lawsuits by government agencies, civil

19 Giovanni P. Prezioso, then General Counsel, Securities and Exchange Commission, Before the Spring Meeting of the Association of General Counsel (April 28, 2005), available at http://sec.gov/news/speech/spch042805gpp.htm.

20 Previously, companies could wait until the end of the fiscal year to report stock option grants involving management or principal stockholders. Now, option grants must be reported to the SEC within two business days of the grant date. See 15 U.S.C. § 78p(a)(2)(c).

lawsuits by shareholders, and disciplinary actions. A close look at the backdating scandals should also serve as a wake-up call that the SEC and other government agencies are targeting corporate counsel. As one former SEC official noted, there has been "truly a monumental change in direction by the SEC's Division of Enforcement."[21]

What is the Backdating Scandal?

A stock option is a benefit that a corporation gives an employee which entitles the employee to purchase company stock at a later date for the stock price at the date of the grant (known as the exercise price or the strike price), often after waiting a specified period of time for the option to vest. If the stock goes up after the option is provided, the employee can exercise his option and receive a profit. If the stock price goes down, then the option has no value. Companies provide stock options to employees both to compensate the employees and to provide an incentive to work to improve the company. Although stock options can be provided to any employee, they are frequently granted to top company executives to give the executives a personal stake in improving the value of the company.

When stock option backdating occurs, the stock option grant letter reflects a date in the past, typically a date when the stock price was lower than the fair market value on the date of the grant. This backdating makes the stock option more valuable as it further increases the difference between the strike price and the actual stock price at the time that the option is exercised.

Backdating had been investigated and the subject of news articles for several years, but the issued moved to the forefront after a front page story in The Wall Street Journal on March 18, 2006, entitled "The Perfect Payday." Building upon prior research from Erik Lie, a business professor at the University of Iowa,[22] the Journal examined SEC filings disclosing stock grants to top executives at a large number of companies from 1992 to mid-2002, and found that for many companies, the grants almost always occurred on days when the stock price was lower than normal, sometimes the lowest stock price of the year. The Journal computed that the odds of this happening by chance were "extraordinarily remote -- around one in 300 billion" and noted, for purposes of comparison, that "[t]he odds of winning the multistate Powerball lottery with a $1 ticket are one in 146 million."[23] The "Perfect Payday" article, and its subsequent follow up won The Wall Street Journal

21 David Bayless and Tammy Albarn, Recent SEC Enforcement Actions Against In-House Lawyers: An Ominous Trend for the Legal Profession, 21 No. 11 Andrews White-Collar Crime Rep. 2.

22 See Randall Heron and Eric Lie's paper on acc.com at http://www.acc.com/resource/getfile.php?id=7483.

23 Charles Forelle and James Bandler, The Perfect Payday, Wall St. J., Mar. 18, 2006, at A1. The Journal continues to report on this issue, and maintains an updated chart on companies and executives involved in backdating scandals, available at http://online.wsj.com/public/resources/documents/info-options-score06-full.html.

the 2007 Pulitzer Prize for Public Service. The Pulitzer board said that the Journal earned its highest journalistic honor because the article has brought about "widespread change in corporate America."[24]

Assistant FBI Director James Buarrus called backdating "the corporate equivalent of placing a bet after the race has been won."[25] But backdating itself is not illegal. After all, companies have a right to set their executives and other employees compensation at whatever levels they choose, Others may look at their decisions and criticize their judgment, but it's not illegal, when properly authorized, for a board to choose a form of compensation that is lucrative to the recipient – that's what an options grant or a bonus or a compensation package is intended to do. Such practices are only deemed illegal when they involve some kind of fraud or lack of proper accounting or disclosure. For instance, filing a back-dated option in a manner that is not reflective of the authorized decision-maker's intent, or that violates SEC compensation reporting requirements, is actionable.

The compensation committee of the board might agree on November 1 to "pay Bob a backdated option grant for October 1," but Bob may arrange for the paperwork that is filed to note the date as October 3, which turned out to be an even more advantageous date. The illegal activity is the change of date, and not the "back-dated" nature of the compensation decision, or the fact that the date chosen offers a particularly lucrative return to Bob. (Indeed, one might wonder why a board would ever issue an options grant on a date that offers no or poor returns to the grant recipient – that's not what bonus-type compensation decisions are intended to do.)

What is also illegal is the failure to disclose the backdating in financial reports and failure to properly account for backdating as an expense to the company. For example, securities laws prohibit the use of manipulative and deceptive devices in connection with the purchase or sale of securities, and the failure to disclose backdating can constitute an intent to defraud another by means of an affirmative misstatement or an omission of material fact.[26] Also, options granted at less than fair market value on the day of the grant can be subject higher taxes, so the failure to disclose the backdating could constitute tax fraud. Backdating might also violate the terms of a company's option plan. Thus, a company that backdated stock options without proper reporting, and the executives involved in backdating, can face criminal liability, a civil fraud suit from the SEC, an IRS audit and prosecution, and lawsuits from shareholders.

Targeting of Corporate Counsel in Backdating Cases

Marc Fagel, associate regional director in the SEC's San Francisco office, recently

24 Katharine Seelye and James Barron, Wall Street Journal Wins 2 Pulitzer Prizes, N.Y. Times, Apr. 16, 2007, available at http://www.nytimes.com/2007/04/17/business/media/17pulitzer.html.
25 Carrie Johnson, 3 Charged as Probe Into Options Widens, Wash. Post, Aug. 10, 2006.
26 15 U.S.C. § 77A et seq.; 15 U.S.C. § 78j(b); 17 C.F.R. 240.10b-5.

remarked that in most cases of financial fraud, the in-house attorneys play no role. Backdating, however, is different because corporate counsel are often involved in decisions about employees' compensation and the paperwork involved in granting stock options. Corporate counsel may have provided advice to executives or the board of directors regarding the decision to backdate stock options, may have been involved in creating false paperwork to make it seem as if options were granted on a date in the past, and may have been involved with inadequate SEC filings that fail to disclose backdating of stock options.[27]

Of course, the SEC investigated corporate counsel for stock option manipulation even before *The Wall Street Journal "Perfect Payday" article*. For example, Leonard Goldner, former general counsel of Symbol Technologies was prosecuted by the federal government and sued by the SEC for his manipulation of stock option dates, although in his case he did not backdate the strike date but instead changed the date that the option was exercised in an attempt to avoid paying hundreds of thousands of dollars in income taxes. Goldner pled guilty to criminal charges in June of 2004 and forfeited $2 million, and he also settled civil charges with the SEC.[28]

Since the *Journal's "Perfect Payday"* article brought backdating to the forefront, however, there has been an unprecedented increase in corporate counsel exposure and liability. The scandal "has caused more inside general counsel to lose their jobs than any event in recent memory…."[29] And the former head of the SEC's San Francisco office recently noted that never before has the SEC pursued "enforcement actions against lawyers (much less against general counsel) as aggressively as it has" in 2007, so "this is truly a monumental change in direction by the SEC's Division of Enforcement."[30]

Here are some details on cases in which corporate counsel found themselves exposed to personal liability because of allegations of stock option backdating:

First prison sentence. The first corporate counsel that the SEC chose to make an example of was William Sorin, former general counsel of Comverse Technology. He was, perhaps, an easy target. He personally profited more than $14 million from the sale of backdated stock options, with about $1 million of this profit allegedly the direct result of the backdating. Sorin had been the company's general counsel since its inception, and he was also Comverse's corporate secretary and a director. The government alleged that Sorin was responsible for drafting Comverse's stock option plans, responsible for the company filing false reports with the

27 Sarah Johnson, Backdating: Are the Lawyers to Blame? CFO.com, Aug. 28, 2007, available at http://cfo.com/article.cfm/9717786?f=search.

28 Eric Dash, Dodging Taxes Is A New Wrinkle in the Stock Options Game, N.Y. Times, Oct. 30, 2006, at C1.

29 Lewis Lowenfels and Alan Bromberg, Backdating Stock Options: Effects Upon In-House Corporate Counsel, 5 No. 13 Corp. Accountability Rep. 13 at 337 (March 30, 2007).

30 David Bayless and Tammy Albarn, Recent SEC Enforcement Actions Against In-House Lawyers: An Ominous Trend for the Legal Profession, 21 No. 11 Andrews White-Collar Crime Rep. 2.

SEC, and responsible for misleading the company's outside auditors.[31] He allegedly tricked board members into approving the backdated grants by getting them to sign documents with the bogus grant dates already filled in.[32] In August 2006, the SEC sued Sorin and the company's former CEO and CFO, and the DOJ filed criminal charges.[33] Perhaps Sorin could imagine a prosecutor's closing argument that, as a Harvard Law School graduate and an attorney with 30 years' experience, he should have known better; a few months later, Sorin settled with the SEC for millions of dollars, and pled guilty to one count of conspiracy to commit securities fraud, mail fraud and wire fraud. In May 2007, Sorin became the first inside counsel sentenced to prison for backdating, receiving a sentence of one year and one day and being ordered to pay $51.8 million in restitution.[34]

Monster. The second corporate counsel to plead guilty to securities fraud and conspiracy in connection with backdating was Myron Olesnyckyj, former general counsel of Monster Worldwide, the parent company of online job service Monster.com. In 2006, Monster conducted an internal investigation into stock option backdating. As a result of that investigation, the company fired Olesnyckyj in November 2006.[35] In February 2007, he pled guilty to criminal charges, admitting that he had made $381,000 from backdating.[36] That same day, the SEC sued Olesnyckyj,[37] and he settled with the SEC the next month. Much of the key evidence against him consisted of e-mails demonstrating that he knew about the backdating and tried to conceal it, such as one he wrote to a human resources official in 1999 stating: "No written document should ever state lowest price over next 30 days! The auditorw [sic] will view that as backdating options and we'll have a charge to earning in the amount of the difference between price on day 30 and any lower price which is used."[38] There was also evidence that Olesnyckyj had prepared false documents to mislead outside auditors. After pleading guilty, Olesnyckyj sought to resign from the New York bar, and the New York disciplinary authorities filed a cross-motion seeking disbarment. The court disbarred Olesnyckyj, ruling that his plea allocution on the crime of securities fraud established that he intended to

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31 Lewis Lowenfels and Alan Bromberg, Backdating Stock Options: Effects Upon In-House Corporate Counsel, 5 No. 13 Corp. Accountability Rep. 13 at 337 (March 30, 2007); Julie Creswell, 3 at Comverse Charged in Stock Options Case, N.Y. Times, Aug. 10, 2006, available at http://www.nytimes.com/2006/08/10/business/10options.html?ex=1190260800&en=636de5bac33324ec&ei=5070.

32 Paul Davies, A Second Comverse Ex-Executive Pleads Guilty, Wall St. J., Nov. 3, 2006, at A3.

33 SEC v. Alexander, et al., No. 06-CV-3844 (E.D.N.Y.), complaint available at http://sec.gov/litigation/complaints/2006/comp19796.pdf; U.S. v. Sorin, No. 06-723 (E.D.N.Y).

34 Chad Bray, Former Comverse Counsel Pleads Guilty, N.Y. Times, Nov. 3, 2006, available at http://www.nytimes.com/2006/11/03/business/03comverse.html?pagewanted=all; see also Former Comverse Official Receives Prison Term in Options Case, Wall St. J., May 11, 2007.

35 Antone Gonsalves, Monster.com Fires General Counsel in Stock-Options Probe, InformationWeek, Nov. 22, 2006, available at http://www.informationweek.com/internet/showArticle.jhtml?articleID=195900127.

36 Edward Iwata, Former Monster Exec Pleads Guilty, USA Today, Feb. 16, 2007, available at http://www.usatoday.com/money/companies/regulation/2007-02-15-monster-exec-pleads-guilty_x.htm.

37 SEC v. Myron F. Olesnyckyj, No. 07-CV-1176 (S.D.N.Y.), complaint available at http://sec.gov/litigation/complaints/2007/comp20004.pdf.

38 James Bandler and Charles Forelle, Bearing Down: Probes of Backdating Move to Faster Track—Stock-Option Emails at Broadcom Are Focus; Worldwide Plea, Wall St. J., Feb. 16, 2007.

defraud the public.[39]

McAfee. In May 2006, anti-virus software maker McAfee Inc. fired its general counsel, Kent Roberts, because of his role in backdating in 2000. In early 2007, Roberts was indicted by a federal grand jury and subject to an SEC enforcement action.[40] The SEC cited e-mails to and from Roberts showing that he participated in picking the most advantageous dates for stock options and that he wrote false board minutes to coincide with the dates.[41] The complaint also alleges that Roberts, without authorization, changed the grant date of his own stock options to increase the value of his grant by nearly $200,000.

Mercury Interactive. In 1999, actor Bruce Willis received the "Golden Raspberry" award for his much-criticized performance in the film Mercury Rising.[42] Mercury Interactive Corp., faced its own criticism over stock option backdating in 2005, before The Wall Street Journal report that brought backdating to the forefront was published. After the company conducted an internal investigation and released a report in 2005, Mercury Interactive forced three executives to resign because they had participated in and benefited from inappropriate backdating. One of the executives was general counsel Susan Skaer.[43] Numerous civil lawsuits were filed against the company and its officers in 2005, resulting in the filing of a consolidated class action complaint in 2006.[44] The judge dismissed the lawsuit in July, 2007 on various grounds including that the claims of certain class members were time-barred and the complaint lacked specificity regarding the knowledge of the defendants, but gave the plaintiffs leave to file a new lawsuit.[45]

In the meantime, the SEC filed suit against Mercury and Skaer in May of 2007.[46] The SEC cited an e-mail from Skaer to the finance chief suggesting dates that would be best for stock grants to 30 new employees, and also alleged that Skaer falsified numerous documents purporting to memorialize backdated grants and backdated exercises of stock options. For example, she allegedly backdated a vice president's employment letter to make it appear that he was hired on a different date and then priced his options on that date and falsified compensation committee minutes to correspond to that date. The SEC also alleged that Skaer tried to conceal backdating by whiting out a date line at the top of a fax from directors, but this failed because one of the pages was sent upside down with the original

39 In re Myron F. Olesnyckyj, 2007 WL 2003083 (N.Y. App. Div. July 12, 2007).

40 U.S. v. Roberts, No. 07-0100 (N.D. Cal.); SEC v. Kent Roberts, No. 07-CV-00407 (D.C.), complaint available at http://sec.gov/litigation/complaints/2007/comp20020.pdf.

41 Charles Forelle and Siobhan Hughes, SEC Details McAfee Plan for Options, Wall St. J., Mar. 1, 2007, at A11.

42 http://www.razzies.com.

43 Eric Dash, Who Signed Off on Those Options?, N.Y. Times, Aug. 27, 2006, § 3, at 1.

44 In re Mercury Interactive Corp. Securities Litig., No. 05-3395 (N.D. Cal.).

45 In re Mercury Interactive Corp. Securities Litig., 05-3395, 2007 U.S. Dist. LEXIS 59171 (N.D. Cal. 7/30/07). The original order gave plaintiffs 30 days to refile, but the judge subsequently extended the deadline to September 26, 2007 pursuant to a stipulation by the parties.

46 SEC v. Mercury Interactive, LLC et al., No. 07-2822 (N.D. Cal.), complaint available at http://sec.gov/litigation/complaints/2007/comp20136.pdf.

date left on it.[47] Skaer has denied fault, saying that she did not know that the company violated any accounting rules.[48]

KLA-Tencor/Juniper. If one has any doubts about the SEC being willing to go after the general counsel instead of the company, just ask Lisa Berry. Ms. Berry was the general counsel of KLA-Tencor Corp. in the late 1990s and then moved to Juniper Networks, Inc. The SEC settled with both KLA and Juniper without requiring either company to admit wrongdoing or pay a fine.[49] (Note that KLA also asked its then general counsel Stuart Nichols to resign when the company's internal investigation discovered backdating.[50]) But in August of 2007, the SEC filed civil fraud charges against Lisa Berry based upon backdating stock option grants from 1997 to 2003 while she was at these two companies.[51] For example, the SEC alleged that thousands of KLA employees were given stock options dated October 19, 1998, when the stock was $27.63 a share, but the options were actually given two months later when the stock was about $40. The complaint alleges that she was involved in the decision to backdate options and she created the phony documents to enable the process. The SEC staff attorney who investigated the matter stated: "The general counsel is a gatekeeper, and Lisa Berry was supposed to prevent problems like internal corporate fraud, not create them."[52]

Berry responded that she was not responsible for, and did not know about, any failure to follow proper accounting procedures in connection with backdating, and further notes that she did not personally benefit from backdated option grants at either company.[53] The SEC's decision to include KLA in its suit is interesting because Berry had left that company eight years prior to the suit and the statute of limitations on securities fraud is five years. The SEC may be able to argue that Berry's conduct at the two companies constitutes a single pattern of behavior, but even if that argument fails, the SEC can still seek an injunction against Berry (although not financial penalties) based upon activity at KLA over five years ago, plus evidence of alleged misconduct before joining Juniper could strengthen the SEC's case for misconduct while Berry was at Juniper.[54]

47 Mark Boslet and Mark Maremont, Emails Reveal Backdating Scheme—Mercury Complaint Claims Wide Efforts Among Executives, Wall St. J., Feb. 20, 2007, at A4.

48 Charles Forelle and Kara Scannell, SEC Steps Up Backdating Pursuit, Wall St. J., June 1, 2007, at A4.

49 Troy Wolverton, SEC Charges Former Lawyer for KLA-Tencor, Juniper With Fraud, Mercury News, Aug. 28, 2007, available at http://www.mercurynews.com/ci_6741066?source=most_emailed.

50 KLA-Tencor and Altera See Effects of Backdated Options, N.Y. Times, Oct. 17, 2006, available at http://www.nytimes.com/2006/10/17/technology/17altera.html?ex=1318737600&en=52c430d72fa1c6c0&ei=5088&partner=rssnyt&emc=rss.

51 Complaint, SEC v. Lisa Berry, No. 07-4431 (N.D. Cal.), available at http://sec.gov/litigation/complaints/2007/comp20257-berry.pdf.

52 Siobhan Hughes, Juniper, KLA Ex-Counsel Faces Charges Over Options, Wall St. J., Aug. 29, 2007.

53 Id.

54 Justin Scheck, SEC is Preparing Option to Charge Former GC of KLA, The Recorder, Aug. 14, 2007, available at http://www.law.com/jsp/article.jsp?id=1186996023641.

Apple. Another example of the general counsel – but not the company — being in the hotseat unfolded at Silicon Valley stalwart Apple, Inc. In May of 1996, Apple's general counsel Nancy Heinen abruptly resigned. At the time, nobody outside of Apple seemed to know why she was leaving, with some speculating that she was simply looking to retire.[55] But a few weeks later, Apple announced that it had conducted an internal probe and found some irregularities in its stock option grants. It then formed a special committee to investigate, led by board member Al Gore, and when the committee released its report in October 2006, Apple's CFO resigned, with many speculating that the resignation was forced.[56] In April of 2007, the SEC announced that it was not going to file any actions against Apple as a company, announced that it had filed and settled a lawsuit against the former CFO, and announced that it had filed suit against Heinen.[57] The SEC alleges in its complaint that Heinen directed her staff to prepare false documents that purport to memorialize the stock option grants. It has been reported that the "staff" was Wendy Howell, an Apple in-house attorney who was fired when the company investigated backdating, and who reportedly told investigators that Heinen instructed Howell to create false records.[58] The suit against Heinen continues, making the news recently when Apple CEO Steve Jobs was subpoenaed for a deposition.[59]

Take-Two. In July of 2007, Kenneth Selterman, former general counsel and CAO of Take-Two Interactive Software, Inc. pled guilty to falsifying business records in connection with improper backdating of employee stock options.[60] He was sentenced to three years of probation, plus community service and a fine.[61]

Don't let the door hit you on the way out. There are several examples in which backdating problems have been identified at a company and the company and its general counsel have, at least so far, avoided federal prosecution and an SEC lawsuit, but the general counsel has still suffered by being fired or forced to resign after the company conducted an internal investigation into backdating. The companies may have had very good reasons for firing their general counsel, and in many of these cases, several executives were asked to leave, not just the company's general counsel. Nevertheless, these examples prove that a general counsel's job is vulnerable, and a general counsel may even find himself being made the "fall

55 See, e.g., Apple Head Lawyer Nancy Heinen Resigns, MacUser, May 9, 2006, available at http://www.macuser.com/people/apple_head_lawyer_nancy_heinen.php.

56 John Markoff and Matt Richtel, In Comments About Apple Chief, Questions of Motive, N.Y. Times, Apr. 26, 2007, available at http://www.nytimes.com/2007/04/26/technology/26anderson.html.

57 SEC v. Nancy R. Heinen and Fred D. Anderson, No. 07-2214 (N.D. Cal.), complaint available at http://sec.gov/litigation/complaints/2007/comp20086.pdf; Eric Dash, No Charges for Apple Over Options, N.Y. Times, Apr. 25, 2007, available at http://www.nytimes.com/2007/04/25/technology/25apple.html.

58 Nick Wingfield and Steve Stecklow, Apple Ex-Finance Chief Settles with SEC, Wall St. J., Apr. 24, 2007.

59 Steve Stecklow and Nick Wingfield, Apple's Jobs is Subpoenaed by SEC in Backdating Case, Wall St. J., Sept. 21, 2007, at A4.

60 Two Plead Guilty in Take-Two Case, Wall St. J., July 21, 2007, at B4.

61 Stephen Taub, It's Liberty City for "Grand Theft Auto" Ex-Counsel, CFO.com, Aug. 9, 2007, available at http://www.cfo.com/article.cfm/9623452.

guy" for company problems if the optics of cleaning house require the company to show that it has made changes and held someone accountable for trouble. Examples follow:

•**Altera.** In 2001, Altera Corporation announced that its general counsel C. Wendell Bergère was leaving. In 2006, the company announced that it had conducted an internal investigation and found stock option backdating, and that the former general counsel and the former CEO were at fault.[62]

•***Atmel.*** In 2006, Atmel Corp. fired its general counsel, Mike Ross, and its CEO for the misuse of corporate travel funds. In June of 2007, the company released the results of its internal investigation of backdating, concluding that the fault lied with Ross and the former CEO, who personally benefited from backdated options that were not approved by the board.[63]

•***BEA.*** BEA Systems decided to replace its general counsel, Robert Donohue, because of options backdating, although he will remain in the company as a vice president in the legal department.[64]

•***Biomet.*** Daniel Hann served as general counsel at Biomet, an orthopedics maker, and rose to the position of interim president and CEO. But when an internal investigation discovered stock options backdating, he was asked to resign.[65]

•***Boston Communications.*** The company accelerated the planned retirement of its general counsel, Alan Bouffard, as a result of its backdating investigation.[66]

•***CNET.*** In May 2006, CNET Networks, a San Francisco website operator, appointed a special committee of independent directors to investigate backdating. A few days later, the SEC advised the company that it had launched an informal investigation of CNET, and by the next month the company had received a grand jury document subpoena. In October of 2006, the company released the results of its internal investigations, and shortly thereafter general counsel Sharon LeDuy resigned, as did the co-founder, Chair and CEO of CNET. In September 2007, CNET received good news when the SEC announced that it had closed its

62 KLA-Tencor and Altera See Effects of Backdated Options, N.Y. Times, Oct. 17, 2006, available at http://www.nytimes.com/2006/10/17/technology/17altera.html?ex=1318737600&en=52c430d72fa1c6c0&ei=5088&partner=rssnyt&emc=rss.

63 Mary Swanton, GCs Under Fire, Inside Counsel, June 2005, p. 13.

64 Stacy Cowley, BEA Finds Options Abuse, Demotes Several Execs, CMP Channel, Feb. 15, 2007, available at http://www.crn.com/software/197006404.

65 Barnaby J. Feder, Another Biomet Executive Resigns After Stock Options Backdating Inquiry, N.Y. Times, Apr. 3, 2007, available at http://www.nytimes.com/2007/04/03/business/businessspecial/03biomet-web.html?ref=businessspecial.

66 Todd Wallack, Array of Local Companies Dealing With Options Mess, Boston Bus. J., Oct. 27, 2006, available at http://boston.bizjournals.com/boston/stories/2006/10/30/story11.html.

investigation into CNET without recommending any enforcement actions.[67]

•***F5 Networks, Inc.*** The company announced in early 2006 that it had received a grand jury subpoena and a notice of informal inquiry from the SEC relating to backdating. This was followed by a "rush to the courthouse" to file shareholder derivative actions, including a suit against general counsel Joann Reiter.[68] F5 completed its internal investigation into backdating in November of 2006, and at the same time, Reiter resigned as general counsel.[69]

•***HCC Insurance Holdings.*** After an independent investigation by its board of directors, the company released a report in November 2006 finding evidence of backdating. At the time that the report was released, general counsel Chris Martin resigned, as did the company's CEO.[70]

•***iBasis.*** After a backdating investigation by a special committee, iBasis, Inc. fired its general counsel Jonathan D. Draluck.[71]

•***KB Home.*** Internal investigation into backdating led to several executives being asked to leave, including general counsel Richard Hirst.[72]

•***Marvell Semiconductor.*** Marvell fired its general counsel, Mathew Gloss, at around the same time that it completed its internal investigation into backdating. However, Gloss' attorney insists that Gloss was not fired due to backdating, without giving any indication as to why he was fired.[73]

•***UnitedHealth.*** In October 2006, the company announced that general counsel David J. Lubben and the company's CEO were resigning after an investigation that found stock option backdating.[74]

•***VeriSign.*** Shortly after concluding its internal investigation into backdating, VeriSign's general counsel James Ulam was fired.[75]

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67 Justin Scheck, CNET Escapes SEC Net on Backdating, The Recorder, Sept. 5, 2007, available at http://www.law.com/jsp/article.jsp?id=1188896557354.

68 In re F5 Networks, Inc. Derivative Litigation, 06-794, WL2476278, at *4 (W.D. Wash Aug. 6, 2007).

69 Id. at *10; Top Lawyer Out at F5, TheStreet.com, Nov. 8, 2006, available at http://www.thestreet.com/newsanalysis/technetworking/10320937.html.

70 HCC Shares Sink After CEO Resigns, Houston Bus. J., Nov. 20, 2006, available at http://www.bizjournals.com/houston/stories/2006/11/20/daily3.html?jst=s_cn_hl.

71 See http://online.wsj.com/public/resources/documents/info-optionsscore06-full.html.

72 Eric Dash and Vikas Bajaj, KB Home Ousts Its Chief and 2 Others, N.Y. Times, Nov. 13, 2006, available at http://www.nytimes.com/2006/11/13/business/13home.html?partner=rssnyt&emc=rss.

73 Jessie Seyfer, Marvell GC Disputes That His Firing is Due to Backdating, The Recorder, May 8, 2007, available at http://www.law.com/jsp/article.jsp?id=1178541417979.

74 UnitedHealth CEO to Leave Amid Options Probe, MSNBC.com, Oct. 16, 2006, available at http://www.msnbc.msn.com/id/15280413.

75 Jessie Seyfer, A Very Quiet Departure, Corporate Counsel, Sept. 1, 2007, available at http://www.law.com/jsp/cc/PubArticleCC.jsp?id=1187254924018.

What Does It All Mean?

The SEC continues to investigate stock options backdating, with approximately 140 companies still under scrutiny.[76] Given the SEC's attention to corporate counsel, it seems likely that additional current or former corporate counsel will find themselves in the crosshairs.

In some ways, of course, backdating is already "old news." Future violations should be rare as a result of rules that went into effect in August 2002 as a part of the Sarbanes-Oxley Act. Previously, companies could wait until the end of the fiscal year to report stock option grants involving management or principal stockholders. Now, option grants must be reported to the SEC within two business days of the grant date.[77] Thus, unless a stock's value changes very significantly over two days, it is unlikely that there will even be an opportunity for backdating in corporate America.

Nevertheless, there is much for corporate counsel to learn from the backdating scandal. First, it teaches that "everyday" tasks of corporate counsel can give rise to criminal liability. David Bayless, the former head of the SEC's San Francisco office, has written that the backdating scandal is interesting because "the type of conduct that these in-house lawyers engaged in is the type of conduct that lawyers typically undertake: preparing board or compensation committee minutes, preparing and editing disclosures in SEC filings and proxy statements, and documenting stock-option grant dates. It is unusual for these types of actions to be the subject of an SEC enforcement action for securities fraud."[78] Nevertheless, Bayless notes that "no lawyer should be surprised to be the subject of an SEC investigation if he or she prepares an SEC filing that contains a statement that the lawyer knows is false."[79]

Indeed, the authors of the Pulitzer Prize-winning Wall Street Journal articles have explained that the SEC has targeted attorneys (and other executives) when there has been written indications of deliberate backdating, falsified documents, efforts to hide manipulations from auditors or investigators, and indications that the attorneys personally benefited.[80] These actions should seem wrong to any corporate counsel who takes the time to think about it. Further, if corporate counsel are uncertain whether it is wrong, he or she should seek out the expertise of someone who does know the law, such as competent outside counsel.

Second, the backdating scandal serves as a reminder that, just because others are

76 Justin Scheck, SEC Stumbles on Privilege Waivers, The Recorder, Sept. 10, 2007, available at http://www.law.com/jsp/ihc/PubArticleIHC.jsp?id=1189155768565.
77 See 15 U.S.C. § 78p(a)(2)(c).
78 David Bayless and Tammy Albarn, Recent SEC Enforcement Actions Against In-House Lawyers: An Ominous Trend for the Legal Profession, 21 No. 11 Andrews White-Collar Crime Rep. 2.
79 Id.
80 James Bandler and Charles Forelle, Bearing Down: Probes of Backdating Move to Faster Track—Stock-Option Emails at Broadcom Are Focus; Worldwide Plea, Wall St. J., Feb. 16, 2007.

doing something doesn't make it right. How many times did your mother ask you when you were a kid if you'd jump off of a bridge just because others were doing it? The same lesson holds true today. Some of these targeted corporate counsel may have thought that there was nothing wrong with backdating because everyone was doing it. So many of the companies involved in the backdating controversy are technology companies in California that some have theorized that the backdating idea may have spread in the 1990s from company to company as a result of employees switching jobs and carrying the idea with them.[81] It has also been discussed at ACC meetings that a number of top compensation consultants retained by companies were touting backdated options as a hot and attractive form of executive compensation, and that their influence with boards, management, and general counsel was great. Indeed, it is difficult for one company not to offer a perk to an employee when other companies competing for the same employee are offering it. But, again, attorneys ought to know better when the practice involves such things as false filings.

Another interesting component in this discussion is the role of auditors for the company. Many companies (whether they have engaged compensation consultants or not) regularly "test" policies or practices they wish to engage in with their outside auditor, both for a sanity check and for confirmation that a practice will be considered proper when the books are opened for examination. ACC members tell us that many auditors "blessed" the backdating concept wholeheartedly, and thus some lawyers may not have paid close attention to details they would otherwise have questioned when the paperwork was crossing their desks. Right or wrong, many lawyers back off, or ignore the detailed analysis, when they are told that the CFO or auditors have blessed a deal. And this practice is one that can't be afforded any longer. Many in-house lawyers don't focus on examining or re-thinking what has been presented as an appropriate accounting treatment or acceptable accounting practice. Indeed, many lack the compensation expertise and financial skills required to second-guess something that has been presented as acceptable in another suitably expert professional's judgment.[82]

Third, the backdating scandal should remind every corporate counsel of the harsh reality that they are expendable. When the board of directors or company executives need to choose between risking the future of the company and risking the future of their corporate counsel, corporate counsel may be left holding the bag. Whether it's clear that anyone has done anything wrong or not, there is substantial pressure and, quite frankly, clear practical experience, that suggests that the company should toss anyone within 100 yards[83] of a corporate scandal under the bus

81 Sarah Johnson, Backdating: Are the Lawyers to Blame?, CFO.com, Aug. 28, 2007, available at http://cfo.com/article.cfm/9717786?f=search.

82 See, e.g., ACC's Top Ten Lists: Top Ten Lessons Learned by CLOs about Executive Compensation from the Stock Options Crisis, available at http://www.acc.com/resource/getfile.php?id=8042.

83 There's an old adage amongst cops on the beat and prosecutors who work on drug cases: Anyone within 100 yards of the sale is a suspect … if they're innocent, they'll be exonerated later. For the general

in order to shut down the relentless media attention and close an investigation. After all, every day that the company remains in the news is another day for the company's brand and value to suffer.

For example, when outsiders speculated about Nancy Heinen's departure from Apple (before backdating at Apple made the news), it was reported that Heinen had an "unusually strong relationship" with Apple CEO Steve Jobs and thus it was "highly unlikely" that she was fired.[84] Apparently, the relationship was not strong enough; a year later she was being called "the company's sacrificial lamb in the lingering fiasco,"[85] and the news stories were focused on what the company would need to do to keep Jobs clear of indictment or tarnish from the scandal. Did Apple have a legitimate reason for forcing Heinen out, did she leave of her own accord in anticipation of what she saw coming and how she might be painted into a corner, or was she was a scapegoat? Regardless of the answer, or even the justness of the outcome for Heinen, the lesson is clear.

Fourth, the backdating scandal, like most any scandal nowadays, should remind corporate counsel that private e-mails that they write today may someday become paragraphs in an SEC complaint. As this article notes elsewhere, companies that are under investigation by the SEC and other government agencies are under pressured to waive the attorney-client privilege and disclose documents written to and from their corporate counsel. These waivers resulted in some of the evidence used to go after corporate counsel for backdating.[86] And even if a company does not waive the privilege, e-mails cannot be protected as privileged if they are subject to the crime-fraud exception: namely, when they are discussions involving a lawyer which result in the furtherance of a crime or fraud.[87] Thus, corporate counsel must not only do the right thing, they must make sure that their writings support that they did the right thing. And yet, as professionals obligated to serve our clients' best interests, we should also not be in the business of creating CYA memos to the file that implicate our clients and prove we are "innocent." When we get to that point, it's time to assess whether we're working for a client we can continue to support, and not whether we can write a memo to make sure our bottoms are properly covered.

Fifth, the backdating scandal serves as a reminder that, even though in-house counsel may have avoided the full stare of SEC attention in the past, those days are over. The SEC is now second-guessing corporate counsel decisions with the

counsel, whose reputation is her largest asset, the possibility of being exonerated later is small comfort and highly unlikely to ever make the same page in the paper that reported her departure in disgrace.

84 Petra Pasternak, Getting to the Core of Apple GC's Mysterious Departure, The Recorder, May 12, 2006, available at http://www.law.com/jsp/article.jsp?id=1147338329872.

85 Jason O'Grady, Nancy Heinen to Take Fall in Apple Options Scandal, ZDNet.com, Apr. 24, 2007, available at http://blogs.zdnet.com/Apple/?p=499.

86 See, e.g., Justin Scheck, SEC Stumbles on Privilege Waivers, Sept. 10, 2007, available at http://www.law.com/jsp/ihc/PubArticleIHC.jsp?id=1189155768565 (noting that a privilege waiver by KLA-Tencor assisted the SEC's investigation of former GC Lisa Berry).

87 Clark v. U.S., 289 U.S. 1, 15 (1933).

benefit of 20/20 hindsight, and they have proven that they will take action if they believe that an inside lawyer dropped the ball. And they're getting very good at tag-teaming with prosecutors and regulators from other agencies, localities, DOJ "Main Justice" in Washington, and individual U.S. Attorney's offices. So their reach is expanding and is more likely to be coordinated with others interested for their own reasons.

In early 2007, SEC Chairman Christopher Cox remarked that the SEC has been looking carefully at the role of lawyers in the stock option backdating scandals. The misconduct in these cases, which requires certain access to records, as well as authority to grant options, raises the question – where were the lawyers? Where were the gatekeepers? And unfortunately, as the Commission's recent actions against individuals at Comverse, Monster Worldwide and McAfee have shown, the answer is quite troubling.[88]

Today the SEC may be concentrating on backdating, but tomorrow the SEC could be looking over the shoulders of general counsel as they make decisions in whatever scandalous practice du jour rises to the top of regulator and media attention next month or next year. That's not to say that their scrutiny is or will be unwarranted, but what may be routine and accepted practice today could be tomorrow's poster child for obvious corporate malfeasance, inviting criticisms not anticipated except by those thinking about how to see around corners.

Practical Guidance

- Corporate counsel are now being targeted by the government like never before, so they must be even more diligent to follow the law, which includes seeking the assistance of out outside counsel if corporate counsel is uncertain on the law
- Just because other corporate counsel appear to be doing something doesn't make it right
- Corporate counsel must protect themselves while they are protecting their companies
- Remember that anything written in an e-mail might someday be discoverable

2. Corporate Investigations

Most corporate counsel are painfully aware that one of the most challenging tasks that can be placed on their plate is the need for an internal corporate investigation.

Corporate counsel can be called upon to conduct or supervise an inquiry into allegations of workplace discrimination or harassment, which can be sensitive for all involved and of real moment to the company's ultimate liability exposure. Or

88 Christopher Cox, Speech by SEC Chairman: Address to the 2007 Corporate Counsel Institute, March 8, 2007, available at http://www.sec.gov/news/speech/2007/spch030807cc.htm.

a company lawyer can be tasked with an arcane examination of allegedly inaccurate financial information or misleading accounting practices, which may present technical questions beyond the ordinary experience of counsel. Or, on a really bad day, corporate counsel could realize her employer had need of an investigation into allegations of criminal behavior by company officials, whether triggered by a government investigation, an anonymous whistleblower complaint, a media headline, or otherwise. On top of all that, companies can also become mired in litigation, or disputes that may lead to litigation, that require investigations outside of formal discovery ranging from the mundane to the terribly sophisticated. Each has its challenges, most of which are outside the scope of our analysis.[89]

What was less clear until recently is that there may be more danger of personal liability for corporate counsel than previously realized arising from activity surrounding these investigations of any kind, including coordinating a company's response to an official investigation.

Over the course of the last few years, however, a discernible pattern has begun to emerge: Regulators, prosecutors, and courts appear to be putting lawyers, whether inside counsel or private practitioners, under heightened scrutiny for their conduct in connection with investigations. And while painting this portrait requires a slight detour outside the immediate world of corporate counsel, we believe it matters.

Although the number of corporate counsel involved has remained small, a series of recent developments supports the conclusion that a pattern is beginning to emerge. Consider them for yourself:

- *The Hewlett-Packard Fiasco.* At the top of this list is clearly the corporate leak investigation that claimed Hewlett-Packard Company's General Counsel, Ann Baskins, by resignation, and tarnished the career of one of the company's other in-house lawyers, Kevin T. Hunsaker,[90] by way of a criminal indictment, later

89 There are a number of fine sources on the appropriate conduct of internal corporate investigations, especially including the portion of John Villa's two-volume publication that addresses these issues. See John K. Villa, 2 Corporate Counsel Guidelines chap. 5 (ACC and Thomson/West 2006 ed.). One other noteworthy and helpful source is the small portion of the New York City Bar's otherwise massive 2006 corporate governance report, which provides some good current thinking on the context within which internal corporate investigations are now being conducted and the best practices for conducting them. See also Robert S. Bennett, Alan Kriegel, Carl S. Rauh, and Charles F. Walker, Internal Investigations and the Defense of Corporations in the Sarbanes-Oxley Era, 62 The Business Lawyer 55 (Nov. 2006); Report of the Task Force on the Lawyer's Role in Corporate Governance at 143-180, Association of the Bar of the City of New York (Nov. 2006).
ACC has hundreds of resources on internal investigations and responding to a government investigation. Search our website by key words or go to http://www.acc.com/vl/index.php?action=search&full=yes&anytext=&subject%5B%5D=62, for top resources to get started.

90 The media seemed to take perverse pleasure in pointing out that Hunsaker was H-P's director of ethics. See, e.g., Ellen Lee, In HP probe, focus shifts to a figure in the background – director of ethics, SFGate.com, Oct. 1, 2006, available at
http://www.sfgate.com/cgi-bin/article.cgi?file=/c/a/2006/10/01/MNGN9LFRSM1.DTL.

dismissed.[91] The wayward investigation began as a result of an apparently legitimate management concern about leaks of confidential information from meetings of the H-P board of directors, but eventually grew to include the use of "pretexting" – used here to denote the conduct of outside investigators for H-P who obtained otherwise confidential billing information about board members' and journalists' telephone usage from their telephone carriers by misrepresenting their identities to the carriers.

H-P's counsel were, at the least, aware of the questionable conduct of the investigators as or before it happened: Baskins appears to have at least been aware of the type of techniques being used, and Hunsaker was alleged to have directed one phase of the investigation and provided assurances within H-P that the techniques being used were legal, after researching the legality of the practice.[92] Congressional hearings and embarrassing national media attention for H-P and its leadership followed.[93]

California prosecutors ultimately did not agree that "pretexting" was a lawful investigative technique, and they charged Hunsaker (though not Baskins) and other participants in the investigation with fraudulent wire communications, wrongful use of computer data, identity theft, and conspiracy. Hunsaker entered a no-contest plea to misdemeanor charges of fraudulent wire communications, with the charges to be dropped, upon performing community service hours and making restitution.[94] H-P itself paid $14.5 million to settle a lawsuit by the California attorney general to settle a lawsuit over its investigative tactics.[95]

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91 Hewlett-Packard Co. Form 8-K (filed Sept. 27, 2006), available at http://www.sec.gov/Archives/edgar/data/47217/000110465906063490/a06-20344_18k.htm; Hewlett-Packard Co. Form 8-K (filed Sept. 28, 2006), available at http://www.sec.gov/Archives/edgar/data/47217/000110465906063569/a06-20427_18k.htm.

92 Id.

93 Susan Beck and Justin Scheck, Sonsini Grilled During House Committee Hearing on HP Spying Scandal, The Recorder (Sept. 29, 2006), available at http://www.law.com/jsp/article.jsp?id=1159434332185; Benjamin Pimentel, HP's Tough Day in Congress, San Francisco Chronicle (Sept. 29, 2006), available at http://sfgate.com/cgi-bin/article.cgi?file=/c/a/2006/09/29/MNG4VLF7O81.DTL; Sue Reisinger, Did Ann Baskins See No Evil at HP?, Corporate Counsel (Dec. 18, 2006), available at http://www.law.com/jsp/ihc/PubArticleIHC.jsp?id=1166004327826; The Boss Who Spied on Her Board, Newsweek (Sept, 18, 2006) (cover story).

94 Ellen Nakashima and Yuki Noguchi, Dunn, Four Others Charged in Hewlett Surveillance Case, Wash. Post, Oct. 5, 2006, available at http://www.washingtonpost.com/wpdyn/content/article/2006/10/04/AR2006100401072.html. Peter Waldman and Don Clark, California Charges Dunn, 4 Others In H-P Scandal, Wall St. J., Oct. 5, 2006, available at http://online.wsj.com/article/SB115997015390082371.html; Matt Richtel, Charges Dismissed in Hewlett-Packard Spying Case, N. Y. Times, Mar. 15, 2007, available at http://www.nytimes.com/2007/03/15/technology/15dunn.html?ex=1188532800&en=74019616c0498648&ei=5070; Charges Dropped Against Ex-HP Chairwoman; 3 Others Charged In Hewlett-Packard Boardroom Spying Scandal Will Avoid Jail Time Under Plea Deal, CBS News, Mar. 14, 2007, available at http://www.cbsnews.com/stories/2007/03/14/business/main2568938.shtml; Judge drops last charges in HP boardroom spying case, San Jose Mercury News, June 28, 2007, available at http://www.google.com/search?q=cache:jrkbduimQAkJ:www.siliconvalley.com/news/ci_6252746+Judge+drops+last+charges+in+HP+boardroom+spying+case&hl=en&ct=clnk&cd=1&gl=us.

95 Damon Darlin, H.P. Will Pay $14.5 Million to Settle Suit, N. Y. Times, December 8, 2006, available at http://www.nytimes.com/2006/12/08/technology/08hewlett.html?_r=1&oref=slogin.

In the wake of the scandal, new laws that more expressly addressed and criminalized "pretexting" have been introduced or passed at both the state and national level.[96] The fallout is not complete, however, as reporters (and their family members) whose telephone records H-P's outside investigators obtained through pretexting have filed a number of lawsuits against the company, its former chairwoman, and Hunsaker.[97]

- *Obstruction of Justice, Perjury and Related Charges.* Largely buried within the recent wave of regulatory and prosecutorial pursuit of corporate counsel discussed elsewhere in this article[98] were a number of charges brought against in-house counsel for alleged misbehavior in responding to government investigations, some of which were directly related to the conduct of corporate investigations sparked by or leading to these government investigations. We have identified several:

Steven Woghin, general counsel of Computer Associates International, Inc., pled guilty to federal obstruction of justice charges (as well as securities fraud conspiracy) arising out of the SEC and DOJ investigation of a fraudulent scheme by which the company manipulated the timing of its recognition of revenue, largely by artificially extending months to capture additional revenue to meet earnings estimates. Inside CA, this was allegedly called the "35-day month."[99]

Specifically, Woghin was charged with lying to the company's outside law firm, which was charged by the company with investigating the revenue-recognition scheme for the purpose of presenting the results of the investigation to federal authorities. He was also charged with coaching company employees before interviews with law enforcement and regulatory authorities, so as to encourage them not to disclose the existence of the "35-day month" practice.

For these offenses, Woghin was sentenced to two years in prison and three years of supervised release.[100]

96 See, e.g., Telephone Records and Privacy Protection Act of 2006 (H.R. 4709), codified at 18 U.S.C. § 1039.

97 Reporters sue Hewlett-Packard over spying, International Herald Tribune, Aug. 16, 2007, available at http://www.iht.com/articles/2007/08/16/business/hp.php.

98 See infra at Section III.C.2.

99 U.S. Department of Justice press release, Former Computer Associates Executives Indicted on Securities Fraud, Obstruction Charges; Former General Counsel Pleads Guilty, Company Enters Into Cooperation Agreement (Sept. 22, 2004), available at http://www.usdoj.gov/opa/pr/2004/September/04_crm_642.htm; U.S. v. Steven Woghin, 04-CR-847 (ILG) (E.D.N.Y. Sept. 21, 2004) (Information), available at http://fl1.findlaw.com/news.findlaw.com/nytimes/docs/ca/uswoghin904inf.pdf. See also SEC Litigation Release No. 18891 (Sept. 22, 2204), available at http://www.sec.gov/litigation/litreleases/lr18891.htm; SEC v. Steven Woghin, 04 Civ. 4087 (ILG) (E.D.N.Y. Sept. 22, 2004) (complaint), available at http://www.sec.gov/litigation/complaints/comp18891-wog.pdf.

100 Stephen Taub, Ex-CA Lawyer Gets Two Years, CFO.com, Jan. 16, 2007, available at http://www.cfo.com/article.cfm/8546432.

Bruce G. Hill,[101] general counsel of Inso Corp., was charged with and convicted by a jury in federal court of committing perjury in investigative testimony before the SEC, though the jury deadlocked on the five remaining counts.[102] The SEC was investigating whether fraud had been committed in connection with the reporting of revenue by the company. In sworn testimony, Hill disavowed any knowledge of a fraudulent certificate that purported to reflect the company board of director's approval of the issuance of $4 million in letters of credit used to further the appearance of the company's receipt of $3 million in revenue. The government offered proof at trial that Hill had personally directed the preparation of the certificate and approved its signing. Hill was sentenced to a prison term of a year and a day, supervised release to follow that of one year, ordered to perform community service, and fined $75,000.[103]

Franklin C. Brown,[104] vice chairman and chief legal officer of Rite Aid, was charged with and convicted in federal court of various offenses, including making false statements to the SEC, witness tampering, and obstruction of justice.[105] The accounting fraud scheme involved massive overstatements of revenue for every quarter for two years, involving numerous different techniques, leading to a restatement of $2.3 billion in pre-tax income and $1.6 billion in net income, then the largest restatement ever recorded. He was sentenced to ten years in prison and ordered to pay a $20,000 fine.[106]

- *The Anthony Pellicano Investigation.* Federal criminal charges remain pending against a prominent Los Angeles entertainment lawyer, Terry Christensen – not in-house counsel, admittedly – as well as against Anthony Pellicano, the high-profile investigator he used, arising from the investigator's alleged use of illegal wiretaps and confidential law enforcement records in various matters. The two-count indictment against Christensen, filed in February 2006, alleged that he had paid Pellicano at least $100,000 to record and report on telephone conversations between Lisa Bonder Kerkorian and her attorney in 2002. At that time, Christensen represented billionaire Kirk Kerkorian, the former head of MGM Studios, in a child support dispute with Lisa Bonder Kerkorian. The indict-

101 See infra Section III.B.7.

102 SEC Litigation Release No. 19253, Former General Counsel of Inso Corp. Convicted of Perjury in Testimony Before the Securities and Exchange Commission, June 7, 2005, available at http://www.sec.gov/litigation/litreleases/lr19253.htm.

103 SEC Litigation Release No. 19617, Court Enters Final Judgment by Consent Against Former General Counsel of Inso Corp. in Accounting Fraud Case, Mar. 21, 2006, available at http://www.sec.gov/litigation/litreleases/lr19617.htm.

104 See infra at Section III.B.3.

105 SEC press release, SEC Announces Fraud Charges Against Former Rite Aid Senior Management, June 21, 2002, available at http://www.sec.gov/news/press/2002-92.htm; Stephen Taub, Jury Conviction for Former Rite Aid Exec, CFO.com, Oct. 21, 2003, available at http://www.cfo.com/article.cfm/3010659.

106 Ex-Executive at Rite Aid Sentenced to 10 Years, N. Y. Times, Oct. 15, 2004, available at http://query.nytimes.com/gst/fullpage.html?res=9B05EFDC173AF936A25753C1A9629C8B63; SEC Litigation Release No. 19409, SEC Settles Fraud Case Against Rite Aid's Former Lawyer, Sept. 30, 2005, available at http://www.sec.gov/litigation/litreleases/lr19409.htm.

ment alleged that Christensen and Pellicano discussed how long the wiretap should stay in place and when it should stop.[107]

The scandal is extremely colorful, especially due to the flamboyance of Pellicano, its central character, and his reported ties to, and work for, a host of A-list Hollywood power brokers and stars. For our purposes, however, the story is illustrative because of the involvement of a respected, establishment lawyer, who is targeted for trouble by virtue of his use of this prominent PI and the PI's apparent use of clearly illegal techniques to gather evidence.[108]

- *"Ordinary" Litigation Investigations Can Bite In-House Counsel, Too.* It may be that corporate counsel are becoming more visible to courts as actors within their clients when their clients are litigants (see our discussion of e-discovery issues, for example[109]); we're just not sure. But in one recent decision, a federal magistrate judge expressly included in his opinion a reprimand to both inside and outside defense counsel for an investigation gone very bad.

In *Allen v. International Truck and Engine*,[110] a class action employment discrimination case brought by a number of named African-American employees alleging racial harassment, the defendant, through counsel, hired private undercover investigators who posed as employees and contacted and communicated about the facts with named plaintiffs and potential class members.

The defendant's general counsel, Robert Boardman, hired the private investigation company. The court found that both outside counsel for defendant, attorneys with Littler Mendelson P.C., and inside counsel, including Boardman and Gary Savine, were actively involved in all stages of the investigation, including its design, execution, and conclusion. In fact, three Littler Mendelson partners and inside counsel each reviewed daily summaries of the investigation. It didn't help the defendant's cause that defense counsel attempted to downplay their involvement in the investigation, to such an extent that the court found that outside counsel had made misrepresentations to the court.

Declining plaintiffs' request for disqualification of Littler Mendelson, the court instead recommended that Boardman and Savine, along with several outside counsel, be publicly reprimanded for their involvement in the misconduct, specifically including violations of the ethical prohibitions on contact with represented

107 Kellie Schmitt, Attorney Terry Christensen Indicted in Case Involving Hollywood PI Pellicano, The Recorder, Feb. 17, 2006, available at http://www.law.com/jsp/law/LawArticleFriendly.jsp?id=1140084309769; U.S. v. Anthony Pellicano et al., Case No. CR 05-1046(D)-DSF (C.D. Calif.).

108 For background on the investigation, focusing on private investigator Pellicano's role, see Bryan Burrough & John Connolly, Talk of the Town, Vanity Fair, June 2006, pp. 88-105, available at http://www.vanityfair.com/fame/features/2006/06/pellicano200606?currentPage=1; In Court Files, Hollywood's Mr. Fix-It at Work, N. Y. Times, May 21, 2007, available at http://www.nytimes.com/2007/05/21/business/media/21pellicano.html.

109 See infra at Section III.C.4..

110 No.1:02-CV-0902-RLY-TAB, 2006 WL 2578896 (S.D. Ind. Sept. 6, 2006).

parties, improper contacts with unrepresented parties, improper supervision of the investigators, and use of deception in the investigation. Similar public reprimands were recommended against the defendant's outside counsel, and monetary sanctions were recommended against their law firm. In a footnote, the magistrate wrote about inside counsel:

With respect to Boardman and Savine, the Court is mindful that in some instances they acted in good faith upon advice from Littler Mendelson counsel and finds that this is a mitigating factor that weighs against any additional sanction. Nevertheless, the Magistrate Judge finds a public reprimand fitting for Boardman and Savine. Although they are not counsel of record for the Defendant, this Court may properly sanction them. As general counsel, Boardman was the Defendant's agent for litigation purposes, and participated as the Defendant's representative at various proceedings. Savine served as senior counsel for the Defendant for litigation purposes, and signed a misleading affidavit filed with the Court.[111]

The court's docket reflects that the district court's review of the magistrate's order was rendered moot by entry of an order of settlement in June 2007.

- *A Connecticut Lawyer's Criminal Prosecution for Obstruction of Justice.* Though not receiving as much national attention as our other examples, prominent Connecticut criminal defense attorney Philip D. Russell was indicted on federal charges of obstruction of justice based on his destruction of a computer containing child pornography that belonged to an employee of his client, a Greenwich church.[112] The facts, as alleged in the indictment, are simple. In fact, they may resemble fact patterns sometimes presented to corporate counsel as the cause for an internal investigation.[113] And the case is made more pertinent by the fact that it is the first significant prosecution under 18 U.S.C. § 1519, a new, broad obstruction of justice provision enacted as a part of the Sarbanes-Oxley legislation.

The employee in question was the longtime choir director of the church. Illegal child pornography was discovered on the employee's laptop by another church employee doing church-related work on it, and this fact was very promptly brought to the church's attention. The church quickly hired Russell to advise it on the employment issues involved. The church then "sealed and wrapped" the employee's laptop, "treating it as evidence," according to the indictment. The choir director was then allowed to resign. Apparently in his capacity as lawyer for the church, Russell took possession of the laptop and, within a day, allegedly took the laptop apart intending to destroy the pornographic images on it.

111 Id. at *14 n.17.

112 U.S. v. Russell, Case No. 3:07CR31(AHN) (D. Conn.).

113 Superseding Indictment (filed July 18, 2007), U.S. v. Russell, Case No. 3:07CR31(AHN) (D. Conn.). A copy of Russell's subsequent plea agreement is available at http://lawprofessors.typepad.com/whitecollarcrime_blog/files/plea_agreement.pdf. The plea agreement includes an agreed statement of the facts as an exhibit.

The indictment alleged that a federal investigation of the employee's possession of child pornography began one day before the discovery of the child pornography by a church employee and three days before Russell destroyed it. Significantly, the indictment does not allege that Russell or the church knew anything at all about the investigation.

Of more interest even than the facts of the case was that the indictment charged Russell under two counts of obstruction of justice, one of which was plead under 18 U.S.C. § 1519, the new Sarbanes-Oxley obstruction of justice provision.[114]

Russell pled not guilty and took the position, in a motion to dismiss the indictment, that he could not be prosecuted for obstructing a hypothetical future federal proceeding that he did not, and could not, have known about. The district court denied the motion to dismiss, finding that the indictment alleged a sufficient nexus between the act of destruction and the investigation, without any necessity to show any specific knowledge on Russell's part. The court also rejected Russell's argument that the indictment insufficiently alleged his intent. Similarly rejecting his assertion that Section 1519 was unconstitutionally vague, the court wrote that, "because the allegations in the indictment indicate that Russell's destructive act was done with the purpose of effecting, or with an expectation that, a federal investigation might ensue, his alleged conduct falls squarely within the prohibitions of the statute and it is not void for vagueness as applied."[115] Indeed, the natural implication is that the government need not prove any knowledge of any pending investigation by the government – merely some sort of expectation that an investigation will, or might, subsequently begin.

As work on this article was being concluded, not much more than one month

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114 Section 1519 provides in full as follows:

§ 1519. Destruction, alteration, or falsification of records in Federal investigations and bankruptcy
Whoever knowingly alters, destroys, mutilates, conceals, covers up, falsifies, or makes a false entry in any record, document, or tangible object with the intent to impede, obstruct, or influence the investigation or proper administration of any matter within the jurisdiction of any department or agency of the United States or any case filed under title 11, or in relation to or contemplation of any such matter or case, shall be fined under this title, imprisoned not more than 20 years, or both.

Russell was also indicted under Section 1512(c)(1) for the same conduct. This section provides:

(c) Whoever corruptly—
(1) alters, destroys, mutilates, or conceals a record, document, or other object, or attempts to do so, with the intent to impair the object's integrity or availability for use in an official proceeding; or
(2) otherwise obstructs, influences, or impedes any official proceeding, or attempts to do so,
shall be fined under this title or imprisoned not more than 20 years, or both.

18 U.S.C. § 1512(c)(1). Note that Section 1512(c)(1) uses the word "corruptly" to describe the offender's mens rea. Section 1519 includes no such requirement.

115 Ruling on Motion to Dismiss Indictment (Aug. 22, 2007), U.S. v. Russell, Case No. 3:07CR31(AHN) (D. Conn.).

after his motion to dismiss was denied, Russell plead guilty to the reduced charge of misprision of a felony, an admission that he took action to conceal the commission of a felony that he was aware of and did not report the crime to authorities. He could get up to 14 months in prison.[116]

Altogether, those lawyers, especially including corporate counsel, who were aware of these developments, were braced by the increased scrutiny of the legal and ethical implications of techniques they can be called on to use or supervise in their day-to-day work.

A Little More Context

So, that was the year – or a few – of investigating dangerously. What can corporate counsel learn from all this?

To better understand the implications of these circumstances for corporate counsel, it may help to consider first the sources of the apparently increased scrutiny investigative conduct now receives. Several trends have converged to place all lawyers at greater risk in connection with their role in conducting or supervising investigations, whether directly associated with litigation or not.

First, though not often mentioned, developments in technology and society at large have clearly led to greatly increased concerns by citizens for their privacy rights, both real and imagined.

Second, these increased privacy concerns have led Congress, state legislators, courts, and regulators to adopt new laws, regulations, and interpretations of law that regulate, directly or indirectly, the legal limits on investigative activity. The law is a moving target, and it's moving toward more restrictions, at various levels, on investigations.

Third, more specifically, tucked away in an obscure part of the Sarbanes-Oxley legislation, the basic federal law on obstruction of justice received a significant overhaul and broadening.[117] It was this very statute upon which Connecticut lawyer Phillip Russell, discussed in the immediately preceding section, was indicted. Critically, it now appears that proving obstruction of justice does not require any knowledge of the actual existence of an investigation, only some form of intent directed at a future investigation, and perhaps some expectation of such an investigation (and perhaps no such expectation). Since in-house lawyers are not only <u>engaged in, but</u> often lead their company's efforts in such areas as document reten-

116 Lawyer pleads guilty to destroying evidence, Connecticut Post Online, Sept. 27, 2007, available at http://www.connpost.com/localnews/ci_7017099; Lawyer Shifts Course, Admits Guilt, Hartford Courant, Sept. 28, 2007, available at http://www.courant.com/news/local/hc-ctlawyer0928.artsep28,0,871691.story. A copy of Russell's plea agreement is available at http://lawprofessors.typepad.com/whitecollarcrime_blog/files/plea_agreement.pdf.

117 See 18 U.S.C. § 1512(c).

tion and destruction, including implementing litigation holds and document and data collection for discovery, and since issues such as obstruction of justice, destruction of evidence, and concerns over proper administration of litigation dance across the stage of in-house counsel's nightmares every evening, it makes sense to take these kinds of emerging charges and theories of liability very seriously.

Fourth, even apart from the new federal obstruction of justice statute, the law on obstruction of justice and spoliation has become more demanding, more visible to courts, and prosecutors appear to be more willing to use these tools, as well as perjury laws, to pursue those who they feel misbehave in the midst of their investigations. Corporate counsel would do well to be particularly aware of the law of spoliation, a traditionally little-noticed doctrine that in some jurisdictions gives rise to tort liability and in almost all jurisdictions is taking on new life in the context of discovery of electronic data and documents.[118]

What to do?

Armed with this context, what should corporate counsel do?

First, know and follow the law. From new pretexting prohibitions, to workplace privacy rules, to wiretapping laws, to computer security statutes, to invasion of privacy law, a myriad of overlapping civil and criminal statutory law, regulations, and case law make many investigations a potential minefield, particularly as continuing advances in surveillance technology collide with unsettled expectations of targets of investigations, not to mention courts and regulators. There is no substitute for thorough knowledge of the law, as H-P's Kevin Hunsaker discovered to his chagrin. Oh, and did we mention the ethics rules? Yes, indeed, there are a few that are particularly pertinent to lawyers supervising investigations – for example, in almost all jurisdictions, no deception or misrepresentation by lawyers is allowed. Read the rules.[119]

Second, consider getting professional help, whether in the form of outside counsel or professional investigators. For at least some types of investigations, there is recognized expertise, whether it is in locating reclusive witnesses, or conducting an internal EEO investigation.

Third, if you do hire it out, know who you hire before you do, know their expertise and limitations, know what they're up to, and take reasonable steps to ensure that they follow the law and any applicable ethics rules. Most corporate counsel have no need, as Perry Mason apparently did, to have private investigator Paul

118 See infra at Section III.C.4. (discussion of e-discovery issues).

119 For an excellent, thorough review of recent events and the ethics authorities as they stood in late 2006, see Joyce E. Cutler & Christopher Brown, Misrepresentation: Scandals Involving Investigators Ensnare Lawyers, ABA/BNA Lawyers' Manual on Professional Conduct: Current Reports, 22 Law. Man. Prof. Conduct 507 (Oct. 18, 2006).

Drake on call every day, but some businesses do have recurring needs – for example, companies that aggressively police their trademarks or copyrights. And regardless of the brevity or length of the relationship with the outside law firm or investigator used, establish rules of the road for them in advance and then continue to push these rules throughout the course of the retention (through reminders and requested reports). Don't find yourself accused of clearly "not wanting to know" or avoiding information that a more diligent lawyer might have sought.

Fourth, consult human resources or other expertise to tap into the learning out there on best practices on the conduct of investigations – especially internal investigations.[120] Don't rely on investigators themselves to tell you what's acceptable and what may cause problems – some may not have sufficient interest in curbing practices that serve them well.

Fifth, consider avoiding steps that would make you an actor or a witness. If actions must be taken that are likely to be considered directly relevant in later legal proceedings – perhaps securing evidence or having a particularly important communication with a witness as part of any investigation, consider whether a lawyer should be involved. In some instances, it may be a very positive thing for a lawyer to be directly involved; in others, perhaps another corporate employee, advised by a lawyer, should take action. With the growth of compliance functions and internal audit departments in the company outside of the legal department, it is not the strain it once was to find competent supervisors who are not lawyers to run investigations and to operate in coordination with or even under the supervision of lawyers in the department, as necessary.

Sixth, protect the privilege. No one in the company is more responsible for maintaining the sanctity of the attorney-client privilege and, as all the authorities tell us, there is much danger in these waters. Study up and think through how to protect it.

As we cautioned at the outset, however, this is clearly a non-exhaustive list, not intended to provide any sort of comprehensive guidance on supervision of corporate investigations. Be careful out there.

Practical Guidance

- Know and follow the law.
- Consider hiring it out.
- If you hire it out, supervise intelligently.
- Consult the experts or expert resources.
- Think about whether you really need a lawyer in charge of this.
- Protect the privilege.

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See supra at Section III.A.2.

3. Licensure status of corporate counsel

It has now been almost a decade since a seminal 1998 California Supreme Court decision[121] awakened lawyers, courts, ethics committees, and clients to the issues of multi-jurisdictional practice ("MJP") – that is, the ways in which our modern practice of law across state lines butts up against traditional notions of the unauthorized practice of law and state licensure requirements. Over those years, most lawyers, including corporate counsel, have become sensitized to these problems, and many jurisdictions have followed the lead of the American Bar Association and ACC to reform the law, providing clearer guidelines to lawyers about when their unlicensed practice is authorized, and when it is not.[122] One would think that, after so many years and so much activity in this area, MJP issues would simply be a minor, almost forgotten, part of everyday life for corporate counsel. Well, think again.

Over the past several years, a few notable public displays of the licensure problems of several high-profile corporate counsel have led to fresh concern that, notwithstanding all the public furor, some otherwise sophisticated corporate counsel have not paid attention to the most core MJP issue of them all: Whether they are properly authorized to practice in the state in which they maintain an office.

And the problem appears to be widespread. An article that ran just months ago in the *National Law Journal* reached this conclusion and actually named names of well-respected general counsel who were not properly licensed.[123] The list included GCs at companies ranging from General Mills Inc. to Entergy Corp. to Humana Inc. Most of these GCs freely admitted to the oversight, noting that they were licensed in the state in which they originally practiced law, and explained the steps they were taking to become licensed in the states in which they now have offices. But one GC who had let his license lapse altogether suggested that he was doing nothing wrong because he was essentially acting as an executive, rather than as a lawyer. As discussed below, this is a very dangerous approach, which rests on a view unlikely to be shared by most bar admission or bar disciplinary authorities.

The confusion is, perhaps, not surprising. The revised ABA Model Rules of Professional Conduct expressly provide, as a part of the MJP reform effort, that

121 See Birbrower, Montalbano, Condon & Frank v. Superior Court, 949 P.2d 1 (Cal. 1998) (holding that a New York law firm, which previously drafted for a California client a contract governed by California law, by offering legal services in connection with the drafted agreement, committed unauthorized practice of law and was barred from recovering legal fees).

122 For the most current rules and careful assessments of where these reform efforts stand, the two best sources are the ABA's and ACC's websites. See http://www.abanet.org/cpr/jclr/home.html (links to charts concerning status of reform efforts and comparison of new provisions of various jurisdictions' laws under "Multijurisdictional Practice"); and http://www.acc.com/php/cms/index.php?id=229 (extensive collection of information about MJP rules and other law in all jurisdictions as they pertain to corporate counsel).

123 Elizabeth Amon, GCs Forget One Detail: Their License, Nat'l L. J., April 5, 2007.

an in-house counsel need not be admitted in her host state if she is admitted in her home state. ABA Model Rule of Professional Conduct 5.5(d).[124] In-house counsel might be forgiven, therefore, for thinking that they are above the MJP fray. After all, some corporate counsel may have been lulled into a false sense of security because they don't usually appear in court in their home state, and if they do, they know they have to be admitted *pro hac vice*.

But it is not that simple. A majority of states (actually, at 26, barely a majority) have rules that require in-house counsel to be authorized formally in their new home state, even if they are already licensed in another state. That, at least to some, will seem the bad news.[125] The good news, on the other hand, is that the requirements in most of these states are generally quite easy to meet (at least compared with the problems and hassle of re-taking the bar exam to gain authorization the old-fashioned way). These states' rules generally provide for limited admission of in-house counsel, requiring only (1) a law school degree, (2) admission in another state, (3) absence of prior conduct problems, (4) a certificate of good standing from each jurisdiction to which the lawyer is admitted, (5) a sworn statement that the lawyer will limit her practice to her employer's business, and (6) a statement from the employer verifying the lawyer's status as in-house counsel.[126] Of course, the bar authorities in those states can and do add additional inconveniences to the paperwork process, from recommendations to required fees to drivers' license records to fingerprinting to taking an ethics exam.

While the process can be inconvenient, the consequences for failing to meet the states' requirements can be, at least theoretically, severe and life-long. First, there is the very real possibility of being professionally embarrassed. Corporate watchdogs, from reporters to unions, have obviously grasped upon licensing as a hot-button issue that they can push to shame a corporation and its in-house counsel.[127]

At the annual meeting of Smithfield Foods, labor union representatives, who were embroiled in a dispute with management, caught the company off-guard when they asked questions about the company's general counsel's "unlicensed" status. Smithfield reacted to the union's charges by changing the general counsel's title

124 ABA Model Rule of Professional Conduct 5.5(d) provides, "A lawyer admitted in another United States jurisdiction, and not disbarred or suspended from practice in any jurisdiction, may provide legal services in this jurisdiction that: (1) are provided to the lawyer's employer or its organizational affiliates and are not services for which the forum requires pro hac vice admission; or (2) are services that the lawyer is authorized to provide by federal law or other law of this jurisdiction."

125 John Iole and Rebekah Kcehowski, Bar License Requirements for In-House Counsel, In-House Counselor, American Health Lawyers Association In-House Counsel Practice Group, Fall 2006, Vol. 12, Issue 3, at 6-13.

126 Id.

127 For example, a Wisconsin blog called, "MilwaukeeWorld," publicly criticized the general counsel of four Wisconsin-based companies for failure to be admitted to practice law in that state, available at http://www.milwaukeeworld.com/blog/2006/10/unlicensed -corporation-lawyers-found.html

and, apparently, removing his legal duties.[128]

Furthermore, this risk of public embarrassment can arise at the most inopportune time. Just ask Judge Thomas B. Griffith, former general counsel of Brigham Young University and current judge on the United States Court of Appeals for the D.C. Circuit. During the Senate confirmation process, Griffith was publicly scrutinized for failing to maintain a license to practice law in Utah during the five years he served as general counsel of BYU.[129] Though Griffith was ultimately confirmed by the Senate, the licensure issues from his past rose to the forefront of his confirmation debate, undoubtedly resulting in added scrutiny regarding his professionalism that he could have done without.[130]

Second, in some states, the unauthorized practice of law is a crime, though usually merely a misdemeanor. While it is unlikely that a lawyer licensed to practice in some jurisdiction somewhere would be prosecuted for failure to become licensed in her new state, it has, in fact, happened. In 2004 a North Carolina grand jury indicted two Georgia lawyers for the alleged unauthorized practice of law.

These Georgia lawyers had drafted a report critical of certain aspects of the Gardener-Webb University basketball program. Apparently displeased with the report, a North Carolina lawyer with ties to the university complained to the North Carolina State Bar, alleging that the lawyers were engaged in the unauthorized practice of law.[131] The bar only issued a warning, but the local district attorney proceeded with the indictment. While there may be few things other than North Carolina basketball and heated labor disputes that will motivate such an attack, the message is clear: There is no reason to run a risk of criminal prosecution when it is so easily avoided.[132]

Third, the practice of law by corporate counsel in a jurisdiction in which he is not properly licensed can haunt a lawyer for the rest of his career, threatening to be a barrier to admission to practice in other states, or to admission without the need

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128 Id.

129 Statement of Senator Patrick Leahy on the Nomination of Thomas B. Griffith; June 13, 2005 ("In all that time he has not been licensed to practice law in Utah, nor has he followed through on any serious effort to become licensed. He has hidden behind a curtain of shifting explanations, thrown up smokescreens of letters from various personal friends and political allies, and refused to acknowledge what we all know to be true: Mr. Griffith should have taken the bar.")

130 Jonathan Turley, There's Room for Compromise on Judicial Posts, Cincinnati Post, April 26, 2005, at A13.

131 ABA/BNA Lawyers' Manual on Professional Conduct, 20 Law. Man. Prof. Cond. 203.

132 Depending upon what version of the ethical rules the respective states have adopted, an in-house lawyer who is not properly licensed may also be subject to discipline not only by the host state, but also by her home state. See ABA Model Rule of Professional Conduct 8.5(a).

to take a bar examination,[133] for years to come. Almost every jurisdiction inquires carefully into the professional and practice history of any lawyer who applies for admission to their bar. Assume, for example, that a lawyer has served for a few years as corporate counsel inside a company in, say, Tennessee, without benefit of license or other authority from the Tennessee authorities. When that lawyer moves to California to take a new position as in-house counsel, the California authorities may well question why this lawyer was engaged in UPL in Tennessee and, on that basis, deny admission in California. ACC is aware of quite a few instances in which corporate counsel have been required to respond in detailed fashion to such inquiries, and in some cases were denied entry to a bar on admission on motion or for the new state's corporate counsel registration system. Many bar authorities will be less sympathetic to excuses in 2007 admission applications than they were over the last few years, when ignorance seemed more understandable.

Finally, as if all this were not enough, there is a risk that the attorney-client privilege may not be upheld. However, as long as a lawyer is licensed in some state, this risk appears to be remote. The general rule is that the attorney-client privilege applies whenever a person speaks with someone for the purpose of obtaining legal assistance who he reasonably believes to be a lawyer.[134] This approach makes sense; a person should not have to inquire of his lawyer whether he forgot to pay his bar dues or is practicing outside the jurisdiction in which he is admitted.[135]

But two problems exist: First, if the in-house lawyer, like the lawyer described above, claims as a defense that he was not engaged in the practice of law (but was an executive in charge of a legal function area) in order to avoid charges of unauthorized practice, then it will be very hard to also argue that privilege exists and must be respected in that relationship. Second, where the client is a corporation and the lawyer is its in-house counsel, a different result may be reached, at least if the lawyer is not licensed anywhere. In *Financial Technologies International, Inc. v. Smith*,[136] the court discussed this approach approvingly, agreeing that an individual cannot be expected to investigate his lawyer's credentials, but explained that a different rule should apply to corporations, at least if they fail to ascertain that their corporate counsel are licensed in some jurisdiction: "It is not unduly burdensome to require a corporation to determine whether their general counsel . . .

133 In the Matter of the Bar Admission of Mostkoff, 693 N.W.2d 748 (Wis. 2005) (denying admission by reciprocity in Wisconsin to Michigan lawyer who had practiced as corporate counsel in Ohio for several years without benefit of an Ohio license, finding no explanation for his delay).

134 See Fed. R. Evid. 503; Restatement of the Law Governing Lawyers, § 72(1) (2000).

135 See, e.g., Florida Marlins Baseball Club, LLC v. Certain Underwriters at Lloyds, 900 So. 2d 720 (Fla. Dist. Ct. App. 2005); and Georgia-Pacific Plywood Co. v. United States Plywood Corp, 18 F.R.D. 463 (S.D.N.Y. 1956) (upholding the privilege when the in-house lawyer is not licensed in the host state where he is employed). Indeed, the same result has been reached even where the lawyer was admitted only in Europe. See Mitts & Merrill, Inc. v. Shred Pax Corp., 112 F.R.D. 349, 352 (N.D. Ill. 1986).

136 No. 99 CIV 9351 GEL RLE, 2000 WL 1855131, 49 Fed. R. Serv. 3d 961 (S.D.N.Y. Dec. 19, 2000).

are licensed to perform the functions for which they have been hired."[137] On this basis, the court declined to uphold the attorney-client privilege under New York law. While the court did not explicitly say so, everything about its holding suggests that the result would have been different if the lawyer had been licensed in at least one jurisdiction.

In conclusion, this is one aspect of the current liability environment that corporate counsel should easily be able to avoid. There is simply no excuse for failing to be licensed or authorized to practice in the state in which you are working. For those working in states that have not yet passed MJP reforms that facilitate your authorization or local licensing, there are other alternatives you can consider. Visit ACC's vast MJP resources online or call our offices for more information.[138]

Practical Guidance

- Corporate counsel should check the rules of the jurisdiction where they were first licensed and where they now have their offices and ensure that they are appropriately licensed. Check the ACC website for details on each jurisdiction's rules.
- General counsel and other inside counsel with supervisory responsibility over other lawyers should confirm that the lawyers they supervise are appropriately licensed.

- Failure to be properly licensed can result in embarrassment to corporate counsel and their employers and future licensing problems for the lawyer, and, in extreme cases, could lead to misdemeanor prosecution, referral of a disciplinary action to your bar of original admission, and a lack of attorney-client privilege protection for the client's communications.

B. The liability stories of 2005: Where are they now?

In ACC's prior liability whitepaper we focused on the experiences of several corporate counsel who had found themselves in the crosshairs of the SEC or the Department of Justice or both in connection with some very high-profile corporate scandals. Because there have been a number of significant developments subsequent to our prior article affecting the fates of a few of those corporate counsel, we want to provide just a short description of those subsequent events.

137 Id. at *6.

138 ACC's MJP homepage, http://www.acc.com/php/cms/index.php?id=229, features contact information for ACC staff and local licensing authorities. We are also introducing expanded resources for members engaged in cross-border practices beyond the U.S. Our International Practice Almanac is going online in Winter of 2007/8 and is a free resource for members.

1. Jay Lapine (HBOC/McKesson)

As of March 2005, the fate of Jay Lapine, the former General Counsel of McKesson HBOC, remained up in the air as he was facing both criminal charges and a civil securities fraud lawsuit filed by the SEC related to his alleged role in McKesson HBOC's accounting scandal.[139] Lapine did not settle the criminal case against him, opting instead to go to trial. In November 2006, after six days of jury deliberations, Lapine's criminal trial ended without a single conviction against him.[140] Lapine was acquitted as to one count of securities fraud, and a mistrial was entered as to the three other counts that had been brought against him after the jury indicated that it was hopelessly deadlocked at 11 to 1 in favor of convicting.[141]

Immediately after the jury verdict, the U.S. Attorney handling the case against Lapine announced that the government intended to retry Lapine on the three counts that ended in a mistrial.[142] According to the public court docket, on February 2, 2007, Lapine filed a motion for acquittal on the six counts on which a mistrial had been declared. No ruling on that motion for acquittal has yet been made by the trial court as of September 2007.

As of the time of the writing of this article, according to the public court docket, the SEC civil proceedings against Lapine remain pending, having been stayed pending the criminal proceedings against Lapine as a result of an order entered by the trial court.

2. Philip Smith (Trace International)

When we last looked at the fate of Philip Smith, the former General Counsel of Trace International, he was facing a judgment against him for more than $21 million as a result of a trial court's ruling in litigation brought by the Chapter 7 bankruptcy trustee for Trace International seeking to recoup millions of dollars for Trace's bankruptcy estate.[143] The civil litigation pursued by the trustee flowed from the theory that Trace had improperly been operated to pursue the best interests of the company's controlling shareholder, Marshall Cogan, and that the

139 Lucian T. Pera and Brian S. Faughnan, Paradise Tarnished: Today's Sources of Liability Exposure for Corporate Counsel, Association of Corporate Counsel, March 2005, at 7-10, available at http://www.acc.com/public/article/ethics/liability.pdf.

140 Justin Scheck, Jury Acquits, Hangs in Trial of McKesson's Former CEO and GC, The Recorder, Nov. 7, 2006, available at http://www.law.com/jsp/article.jsp?id=1162820126353.

141 David Kravets, Ex-McKesson Execs Acquitted of Fraud, SFGate.com, Nov. 4, 2006, available at http://sfgate.com/cgi-bin/article.cgi?f=/n/a/2006/11/03/financial/f125127S15.DTL&hw=mckesson&sn=002&sc=565;http://www.cfo.com/article.cfm/8129291?f=related.

142 U.S. not giving up after McKesson acquittal, mistrial, USA Today, Nov. 3, 2006, available at http://www.usatoday.com/money/companies/regulation/2006-11-03-mckesson_x.htm.

143 Lucian T. Pera and Brian S. Faughnan, Paradise Tarnished: Today's Sources of Liability Exposure for Corporate Counsel, Association of Corporate Counsel, March 2005, at 11-13, available at http://www.acc.com/public/article/ethics/liability.pdf.

actions of certain officers and directors, including Smith, had damaged Trace when it was in the "zone of insolvency."

On June 30, 2005, the Second Circuit reversed the trial court's decision and remanded the case for further proceedings.[144] The primary focus of the Second Circuit's decision in reversing the trial court was the notion that it had been error for the trial court to refuse to afford the defendants' a jury trial. However, the Second Circuit also further held that, on remand, the trustee lacked standing to bring claims based on any alleged violation of due care by Trace directors because of the fact that Trace had adopted a charter provision, consistent with Delaware law, that served as an exculpatory clause shielding directors from liability for any breach of the duty of care. The Second Circuit also held that the trial court had erred in using a "Cash Flow" test advocated by the trustee to determine whether Trace was insolvent.

The United States Supreme Court denied the trustee's petition for writ of certiorari on May 22, 2006.[145] According to the trial court's public docket, there has been very little activity in this case upon remand, with a pretrial conference having occurred on May 24, 2006 at which time the trial of the case was set for October 2, 2006; one of the other defendants settled and was dismissed from the case on July 25, 2006; then, another conference before the court was held on September 19, 2006 and the only other activity reflected on the docket, as of September 21, 20007, was the substitution of new counsel for the trustee on February 5, 2007.

3. Franklin Brown (Rite-Aid)

Franklin Brown, the former General Counsel of Rite-Aid, who was convicted in October 2003 of making false statements to the SEC, obstruction of justice, and tampering with a witness, is currently serving a ten-year federal sentence at Schuylkill federal prison in Pennsylvania.[146] In September 2005, Brown was able to settle the SEC civil enforcement action brought against him.[147] Pursuant to the settlement, Brown consented, without admitting or denying the allegations against him, to the entry of a final judgment against him barring him from acting as an officer or director of a public company and that permanently enjoining him from future violations of the securities laws.[148] In light of Brown's personal financial condition, however, the SEC agreed to waive any claim for disgorgement of ill-gotten gains and prejudgment interest and also did not require the imposition of

144 Pereira v. Farace, 413 F.3d 330 (2nd Cir. 2005).

145 Pereira v. Farace, 126 S. Ct. 2286, 164 L.Ed 2d 812 (U.S. 2006).

146 Gil Rudawsky, Schuylkill prison is not exactly a day at the beach, Rocky Mountain News, July 28, 2007, available at http://www.rockymountainnews.com/drmn/cda/article_print/0,1983,DRMN_23910_5648999_ARTICLE-DETAIL-PRINT,00.html.

147 SEC Litigation Release No. 19409, Sept. 30, 2005, available at http://www.sec.gov/litigation/litreleases/lr19409.htm.

148 Id.

any civil penalty against Brown.[149]

4. Rex Rogers and Jordan Mintz (Enron)

ACC's March 2005 article provided a detailed discussion of the five in-house counsel at Enron who had been singled out in the Batson Report as individuals against whom viable claims may exist.[150] Since that time, two of those lawyers – Rex Rogers and Jordan Mintz – have been subjected to charges of securities fraud in a civil enforcement action filed by the SEC on March 28, 2007.[151]

The SEC contends that both Mintz and Rogers engaged in violations of the securities laws, and aided and abetted Enron in violating the securities laws, in connection with a related party transaction between Enron and a partnership – LJM1 – owned by Enron's Chief Financial Officer, Andrew Fastow, involving a sale of Enron's interest in a Brazilian power project that included an undisclosed side agreement that served to guarantee that the Fastow partnership would not lose money on the transaction.[152] The SEC also charges that Mintz violated books and records provisions and provided materially false and misleading representations to Enron's auditor. The SEC asserts that Rogers also aided and abetted Enron CEO Kenneth Lay in violating the securities laws related to insider trading.[153] The complaint seeks permanent injunctions, disgorgement with prejudgment interest, civil monetary penalties, and officer and director bars against both Mintz and Rogers. The charges brought by the SEC against Mintz and Rogers will be discussed in more detail in the discussion of 2007 SEC enforcement actions set forth in this article below.

According to the public court docket, both Mintz and Rogers have filed motions to dismiss the complaints against them and, as of September 20, 2007, those motions to dismiss remain pending.

Media reports issued in the wake of the SEC lawsuit against Mintz and Rogers have identified the SEC as stating that its Enron investigation continues.[154] To date, no SEC or criminal charges of any kind have been brought against Enron's

149 Id.

150 Lucian T. Pera and Brian S. Faughnan, Paradise Tarnished: Today's Sources of Liability Exposure for Corporate Counsel, Association of Corporate Counsel, March 2005, at 16-28, available at http://www.acc.com/public/article/ethics/liability.pdf.

151 SEC Litigation Release No. 20058, SEC Charges Two Former Enron In-House Lawyers With Securities Fraud And Related Violations, March 28, 2007, available at http://www.sec.gov/litigation/litreleases/2007/lr20058.htm.

152 Id.

153 Id.

154 Carrie Johnson, SEC Accuses 2 Former Enron Lawyers of Assisting the Fraud, Washington Post, March 29, 2007, available at http://www.washingtonpost.com/wp-dyn/content/article/2007/03/28/AR2007032802207_pf.html.

Chief Legal Officer, James Derrick.

5. Drake Tempest (Qwest Communications)

In connection with the criminal trial of Qwest's CEO Joseph Nacchio, Tempest was listed by the prosecution as a "may call" witness, but was not called during that trial. Nacchio was ultimately convicted of 19 counts of insider trading and sentenced to six years in prison, as well as ordered to pay a $19 million fine and to disgorge $52 million in assets.[155] During the Nacchio trial, there was media speculation, purportedly based on inside sources, that Tempest had been granted immunity from prosecution.[156] In connection with a recent effort to obtain bail pending appeal, Nacchio has blamed Tempest for allegedly not telling Nacchio that the risk that Qwest would miss financial targets was material information and alleged that there was insufficient evidence to convict Nacchio.[157] On August 23, 2007, the 10th Circuit granted Nacchio's application for bail pending appeal.[158]

No SEC or criminal charges were ever brought against Drake Tempest, former General Counsel, executive vice president, and chief administrative officer for Qwest Communications. Tempest has returned to private practice and is a partner in the New York office of a major national law firm.

6. Mark Belnick (Tyco, Inc.)

After obtaining an acquittal of the criminal charges leveled against him, Mark Belnick, former General Counsel of Tyco, Inc., Belnick negotiated a settlement of the SEC civil enforcement action that had been filed against him in September 2002. Pursuant to the settlement, Belnick agreed, without admitting or denying the allegations against him, to the entry of a final judgment against him that permanently enjoins him from aiding or abetting future violations of the securities laws and that requires him to pay a $100,000 civil monetary penalty.[159] The consent final judgment also contains an officer and director bar for five years.[160]

The SEC's press release regarding the settlement also noted that Belnick

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155 http://www.thedenverchannel.com/money/13767698/detail.html.

156 Jeff Smith, Nacchio witnesses present problems, Rocky Mountain News, March 2, 2007, available at http://www.rockymountainnews.com/drmn/tech/article/0,2777,DRMN_23910_5388542,00.html.

157 Andy Vuong, Nacchio puts blame on ex-counsel, The Denver Post, July 25, 2007, available at http://origin.denverpost.com/kiszla/ci_6455418.

158 10th Circuit Opinion available at http://lawprofessors.typepad.com/whitecollarcrime_blog/files/us_v_nacchio_10th_circuit_bail_order.pdf.

159 SEC Litigation Release No. 19682, May 2, 2006, available at http://www.sec.gov/litigation/litreleases/2006/lr19682.htm.

160 Id.

settled the civil lawsuit that had been brought against him by Tyco.[161] Mr. Belnick has returned to private practice in New York City.

7. Bruce Hill (Inso Corp.)

In 2005, Bruce Hill, the former General Counsel, vice president, and secretary of Inso Corp. was facing both criminal charges and an SEC civil enforcement proceeding against him arising from allegations that he had "participated in 'a fraudulent revenue recognition scheme designed to falsely boost the amount of Inso's third quarter and annual revenues for 1998.'"[162] As discussed in our prior article, at the core of the case against Hill was an alleged sham transaction that Inso entered into with a Malaysian distributor that was documented at the end of a fiscal quarter when an anticipated sale to one of Inso's major customers failed to close as Inso had expected.[163]

In addition to charges of securities fraud, wire fraud, and making false statements to accountants, the nine-count indictment against Hill contained a perjury count that accused Hill of providing false testimony to the SEC regarding his knowledge of details of the financial arrangements between Inso and the Malaysian distributor.[164] Hill fought the criminal charges against him and, upon the conclusion of his jury trial in June 2005, was convicted only as to the perjury charge, with the jury deadlocking on the other charges resulting in a mistrial.[165] The prosecution decided not to seek a retrial on the other charges, and Hill was sentenced on January 24, 2006 to 1 year and 1 day in prison, a $75,000 fine, and a two-year period of supervised release requiring performance of 400 hours of community service each of those two years.[166]

After his sentencing on the perjury conviction, Hill agreed to the entry of a consent final judgment against him on March 2, 2006, in the SEC civil enforcement action.[167] Pursuant to the settlement, Hill neither admitted nor denied the SEC's allegations against him, but agreed to a disgorgement payment of more than $97,000, the entry of a permanent injunction against violating, or aiding and abetting violations, of certain securities laws in the future. Pursuant to the

161 Id.

162 Lucian T. Pera and Brian S. Faughnan, Paradise Tarnished: Today's Sources of Liability Exposure for Corporate Counsel, Association of Corporate Counsel, March 2005, at 50, available at http://www.acc.com/public/article/ethics/liability.pdf.

163 Id.

164 Id. at 50-51.

165 Jenna Greene, Going from General Counsel to Federal Inmate, Corporate Counsel, May 11, 2006, available at http://www.law.com/jsp/ihc/PubArticleIHC.jsp?id=1147251929806.

166 SEC Litigation Release No. 19617, March 21, 2006, available at http://www.sec.gov/litigation/litreleases/lr19617.htm.

167 Id.

agreed resolution of the matter, Hill also agreed to the entry of an order, on March 20, 2006, pursuant to Rule 102(e), suspending him from appearing or practicing before the SEC as an attorney.[168]

C. Areas of liability exposure

1. SEC violations

Although much discussion abounds over the flurry of charges and scandals involving backdated stock options, there are a wide variety of other ways that in-house counsel can find themselves targeted by the SEC. The liability environment for in-house counsel as to the SEC has been rapidly evolving over what is, relatively speaking, a fairly short period of time. The direction that the evolution appears to be headed does not portend well for in-house counsel whose traditional role was as zealous advocates and trusted advisors of the companies they represent.

In early 2005, in-house counsel were wrestling with trying to understand the message being sent by the SEC to in-house counsel through two particular enforcement actions, one involving a high-profile company and one not.[169] In one of the cases, an SEC enforcement action brought against the General Counsel of Google, Inc., Google's General Counsel, without admitting any allegations against him, consented to the entry of a cease and desist order which found that he was aware that certain registration obligations under the Securities Act of 1933 had been triggered by Google's issuance of stock options to employees and that he caused Google to violate those obligations through his failure to inform Google's Board of Directors of the substance of his legal analysis as to the registration issue and the risks associated with Google proceeding in the manner he had advised.[170]

The other case was an SEC enforcement action brought against the former General Counsel for Electro Scientific Industries, Inc. which was also resolved by consent.[171] ESI's former General Counsel, without admitting any allegations against him, agreed to pay a $50,000 civil penalty and consented to the entry of a cease and desist order against him which found that he had failed to provide important information to ESI's Board of Directors, ESI's audit committee, and ESI's audi-

168 Order instituting administrative proceedings against Mr. Hill available at http://www.sec.gov/litigation/admin/34-53517.pdf

169 SEC Litigation Release No. 18896, Sept. 24, 2004, available at http://www.sec.gov/litigation/litreleases/lr18896.htm; SEC Press Release No. 2005-6, Jan. 13, 2005, available at http://www.sec.gov/news/press/2005-6.htm.

170 In re Google, Inc. and David C. Drummond, Admin. Proc. File No. 3-111795, Jan. 13, 2005 Order Instituting Cease-and-Desist Proceedings, Making Findings, and Imposing A Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933, available at http://www.sec.gov/litigation/admin/33-8523.htm.

171 SEC Litigation Release No. 18896, Sept. 24, 2004, available at http://www.sec.gov/litigation/litreleases/lr18896.htm; SEC v. Isselmann, Complaint available at http://www.sec.gov/litigation/complaints/comp18896b.pdf.

tors regarding an accounting transaction related to a decision made by ESI's CFO to eliminate certain employee benefits and, as a result, had caused ESI to file false financial statements with the SEC, thereby violating Section 13(a) of the Exchange Act and Exchange Act Rules 13a-13 and 12b-20.[172]

In April 2005, Giovanni P. Prezioso, the General Counsel of the SEC, spoke to the Spring Meeting of the Association of General Counsel on the topic of attorney conduct and made a number of statements that could be helpful to in-house counsel trying to understand the standards they should expect to be held to by the SEC when performing as lawyers for their corporate clients.[173] In so doing, Prezioso categorized the enforcement actions against Drummond and Isselman as merely involving a continuation of long-settled principles and stated that "[t]hey do not impose sanctions on lawyers for the advice that they gave – but for their actions in situations where they in fact failed to advise their clients and became participants in prohibited conduct."[174] In so doing, Prezioso interestingly drew no distinction between the two cases despite the fact that the SEC's own complaint against Isselman acknowledged that he was not involved in making the decision to eliminate employee benefits and that ESI's CFO did not consult Isselman about that decision. Prezioso's treatment of these two cases together is also potentially difficult to reconcile with his discussion of three factors that the SEC may find relevant in evaluating lawyer conduct: (1) whether "the decision-making process depended on the lawyer;" (2) whether it is a case "where every securities lawyer ought to know the answer, or where a non-securities lawyer cannot in good faith fail to seek advice;" and (3) whether the lawyer's activities were undertaken in direct representation before the SEC or in connection with an investigation.[175]

A few months after Prezioso's speech, ACC published an article that included a comprehensive survey of all known SEC proceedings against inside counsel since 1998 and that set forth a number of "Rules" to guide corporate counsel drawn from those proceedings.[176] In this article, we have tried to build on that prior work by examining the known SEC proceedings that have occurred since publication of that article. This article will not address situations where the problem the SEC has with corporate counsel involves acts of insider trading or other similar <u>straightforward</u> issues where the fact that the person targeted by the SEC is an in-

172 In re John E. Isselmann, Jr., Admin. Proc. File No. 3-11678, Sept. 23, 2004, Order Instituting Cease-and-Desist Proceedings, Making Findings, and Imposing A Cease-and-Desist Order Pursuant to Section 21C of the Securities Exchange Act of 1934, available at http://www.sec.gov/litigation/admin/34-50428.htm.

173 Giovanni P. Prezioso, General Counsel, Securities and Exchange Commission, Remarks Before the Spring Meeting of the Association of General Counsel, April 28, 2005, available at http://sec.gov/news/speech/spch042805gpp.htm.

174 Id.

175 Id.

176 John K. Villa, SEC and Criminal Proceedings Against Inside Corporate Counsel, Association of Corporate Counsel, Sept. 2005, available at http://www.acc.com/resource/v6063.

house lawyer is merely coincidental – the type of conduct, for example, described by Prezioso as "conduct that – if carried out by any other person – would have given rise to an enforcement proceeding."[177]

2005 Enforcement Actions

Villa's article identified five corporate counsel who had been the subject of SEC proceedings initiated in 2005 – David C. Drummond of Google, Inc., Craig Scott of FFP Marketing Company, Inc., Anne P. Hovis of Phlo Corp., Jon M. Bloodworth of busybox.com, Inc., and John A. Carley of Starnet Communications International, Inc.[178] In addition to those 2005 actions by the SEC, one other SEC action was commenced later in the year against in-house counsel.

On September 14, 2005, the SEC announced its filing of a civil action against a number of executives of Biopure Corporation, including Jane Kober, Biopure's General Counsel, secretary, and senior vice-president.[179] According to the SEC, Biopure misled the investing public relating to the status of its effort to receive FDA approval for its synthetic blood product, Hemopure.[180] In April 2003, the FDA placed a clinical hold that barred clinical trials of Hemopure in trauma settings and then, in July 2003, the FDA declined to approve the use of Hemopure in orthopedic surgery and questioned the safety of Hemopure, the reliability of representations Biopure had made to the FDA in its application.[181] Despite these unfavorable events and communications from the FDA, Biopure not only did not disclose these setbacks to the public, but also made public statements about its plans to obtain FDA approval for Hemopure and actually publicly described the news it received from the FDA as being good.[182]

With respect to Kober's role in this conduct, the SEC specifically alleged that she participated substantially in the drafting, reviewing, or approving of offering documents, prospectus supplements, press releases, and certain other periodic SEC filings that did not disclose the fact of the FDA's clinical hold as to clinical trials of Hemopure in trauma settings, that did not disclose that the FDA had declined to approve the use of Hemopure in orthopedic surgery, and that otherwise described the status of Hemopure's development in a misleading manner.[183] Notably, the

177 Giovanni P. Prezioso, General Counsel, Securities and Exchange Commission, Remarks Before the Spring Meeting of the Association of General Counsel, April 28, 2005, available at http://sec.gov/news/speech/spch042805gpp.htm.

178 John K. Villa, SEC and Criminal Proceedings Against Inside Corporate Counsel, Association of Corporate Counsel, Sept. 2005, available at http://www.acc.com/resource/v6063.

179 SEC Litigation Release No. 19376, Sept. 14, 2005, available at http://www.sec.gov/litigation/litreleases/lr19376.htm.

180 Id.
181 Id.
182 Id.
183 Complaint, available at http://www.sec.gov/litigation/complaints/comp19376.pdf.

SEC complaint specifically alleged that Kober had contacted outside counsel specializing in regulatory matters before the FDA, shared a draft of one of the press releases in question, and had been told by that outside counsel that Biopure's draft press release looked "unduly optimistic."[184] The SEC complaint also alleges other instances in which Biopure appeared to be disregarding the advice of outside counsel with respect to its public statements and, perhaps most remarkably, describes how, at one point a Biopure executive claimed in email messages sent to investors that a truthful disclosure that Biopure had made about the fact that it had gotten a complete response from the FDA was a "mistake" made by a "junior lawyer at a law firm" used by Biopure.[185] During the time periods involved, the SEC alleged that by misleading the investing public about what the FDA was telling Biopure, Biopure was able to raise significant capital from investors and alleged that once the public learned the truth, Biopure's share price plummeted.[186]

The SEC charged Kober with violations of Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5, Section 17(a) of the Securities Act, and with aiding and abetting violations of Section 13(a) of the Exchange Act and Exchange Act Rules 12b-20, 13a-11, and 13a-13.

On September 8, 2006, Kober consented to entry of a final judgment against her permanently enjoining her from aiding and abetting future violations of Section 13(a) of the Exchange Act and Exchange Act Rules 12b-20, 13a-11, and 13a-13 and imposing a $40,000 civil monetary penalty.[187] As part of the settlement, the SEC stipulated to the dismissal of the charges against Kober as to Section 10(b) of the Exchange Act and Section 17(a) of the Securities Act.[188] Further, although the SEC's complaint had sought an officer and director bar, the consent final judgment did not include any such bar against Kober.

2006 Enforcement Actions

In addition to the enforcement actions related to backdating of stock options discussed elsewhere in this article, and not including enforcement actions involving insider trading, we are aware of two other enforcement actions against in-house counsel by the SEC that were commenced in 2006.

184 Id.

185 Id.

186 Id.

187 SEC Litigation Release No. 19825, Sept. 12, 2006, available at http://www.sec.gov/litigation/litreleases/2006/lr19825.htm.

188 Id.

On February 2, 2006, the SEC filed a civil enforcement action against several executives of General Re Corporation, including Robert D. Graham, former assistant general counsel and senior vice president.[189] Graham is alleged to have been a participant in an arrangement between Gen Re and AIG, one of Gen Re's largest clients, to structure "two sham reinsurance transactions" that would benefit AIG in not having to report further declines in its loss reserves for the fourth quarter of 2000 and the first quarter of 2001 and that, in fact, allowed AIG to show a false increase in its loss reserves that it then proceeded to tout in press releases.[190] Prior to entering into the transactions with Gen Re, AIG had been faced with negative market reaction to its third quarter earnings release. For being willing to undertake these transactions, AIG paid Gen Re a $5 million fee.

On May 31, 2005, AIG admitted that it had improperly accounted for these two reinsurance transactions and re-characterized the transactions as deposits in its 2004 Form 10-K. The SEC alleged that Gen Re executives were aware of AIG's motivations for entering into these transactions and that Graham knowingly drafted the contracts to make it look like AIG was assuming risk and to have purposely omitted side agreements entered into by Gen Re and AIG that made clear that AIG had no risk in the transaction. In order to avoid the risk that Gen Re would have to report this transaction in a manner that was inconsistent with the way that AIG intended to report it, Gen Re arranged to do the deal through a subsidiary of theirs in Dublin, and the SEC alleged that Graham knowingly participated in routing the transaction through the Dublin subsidiary. The SEC also alleged that Graham had helped to create a paper trail that falsely made it appear that Gen Re, and not AIG, had solicited the arrangement.

The SEC's complaint asserted claims against Graham for violations of Sections 10(b) and 13(a) of the Exchange Act and Exchange Act Rules 10b-5, 12b-20, 13a-1, and 13a-13 and a claim for aiding and abetting AIG's violations of Sections 13(b)(2) and 13(b)(5) of the Exchange Act and Exchange Act Rule 13b2-1. The SEC seeks the following forms of relief against Graham: (1) entry of a permanent injunction against violating or aiding and abetting violations of certain provisions of the securities laws in the future, (2) disgorgement of any ill-gotten gains; (3) payment of a civil monetary penalty; and (4) a permanent officer and director bar under Section 21(d)(2) of the Exchange Act.

On September 25, 2006, the SEC instituted cease and desist administrative proceedings against Scott Monson, former General Counsel and corporate secretary of J.B. Oxford Holdings, Inc.[191] In pursuing the cease and desist proceedings, the SEC alleged that Monson had caused J.B. Oxford to break mutual fund trad-

189 SEC Litigation Release No. 19552, Feb. 2, 2006, available at http://www.sec.gov/litigation/litreleases/lr19552.htm.

190 Complaint, available at http://www.sec.gov/litigation/complaints/comp19552.pdf.

191 SEC Administrative Proceeding against Scott G. Monson available at http://www.sec.gov/litigation/admin/2006/ic-27497.pdf.

ing rules through his conduct in drafting agreements that allowed institutional customer clients of J.B. Oxford to trade as late as 4:45 p.m. without undertaking any substantive analysis of the relevant legal questions and without reviewing SEC rules and regulations to learn whether it would be appropriate for J.B. Oxford to accept mutual fund trades after 4:00 p.m.[192]

On June 15, 2007, the charges against Monson were dismissed by an ALJ initial decision.[193] The ALJ found that Monson, whose legal background was not in securities law but in family law, had contributed to J.B. Oxford's late-trading violations but did not know the rules and did not intentionally violate the relevant regulations and that the SEC had failed to prove, by a preponderance of the evidence, that Monson was aware, or should have been aware, of the fact that his drafts of trading agreements would cause J.B. Oxford's violations.[194] This initial ALJ decision has been appealed by the SEC, with the Division of Enforcement's petition for review having been granted on July 16, 2007. It seems likely that the SEC will seek to sharpen the focus of its claims against Monson regarding the actions it thinks he ought to have taken and, in fact, in the Opening Brief by Division of Enforcement in Support of Petition for Review filed on August 14, 2007, the Division of Enforcement has dedicated a section of its argument to the contention that Monson did not meet the standard of a "reasonable attorney in the securities industry" in that he did not perform any research or make any inquiry regarding whether key terms he allegedly inserted into the trading agreement were legal under SEC rules.

2007 Enforcement Actions

In addition to the enforcement actions related to backdating of stock options discussed elsewhere in this article, and not including enforcement actions involving insider trading, we are aware of three other enforcement actions against in-house counsel by the SEC that were commenced, to date, in 2007.

In March 2007, just a few weeks before the filing of the three enforcement action against in-house lawyers filed so far this year, Christopher Cox, the Chairman of the SEC, spoke to the 2007 Corporate Counsel Institute at the Georgetown Law Center and explicitly stated his view that in-house counsel and the SEC are "partners" who have a shared "mission to protect investors."[195] For those who might scoff that Chairman Cox's words may have been a mere rhetorical flourish, a few more excerpts of his speech might serve to diminish any skepticism as to whether

192 Id.

193 SEC Administrative Proceeding against Scott G. Monson (Initial Decision), available at http://www.sec.gov/litigation/aljdec/2007/id331rgm.pdf.

194 Id.

195 Christopher Cox, Chairman, Securities and Exchange Commission, Address to the 2007 Corporate Counsel Institute, March 8, 2007, available at http://sec.gov/news/speech/2007/spch030807cc.htm.

he used the term "partners" purposefully:

> "It is only through your efforts that we'll be successful in protecting the interests of investors. Only through your efforts can we raise the standards for the protection of market participants, while at the same time making those markets more efficient."
>
> "In the securities realm, 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."
>
> "In every transaction you handle, every governance problem you tackle, and every shareholder communication you write, keep in mind that America's investors are depending on you."
>
> "Thank you, each of you, for pursuing a vocation in our capital formation process – and for your work, your ideas, and your integrity. We at the SEC are doing our part to meet your needs as practitioners, and to fulfill our statutory mandate to protect investors and promote capital formation. And we're proud to be your partners."[196]

Just three weeks after that "partners" speech by Chairman Cox, the SEC commenced civil enforcement proceedings against two former Enron lawyers, Jordan Mintz and Rex Rogers.

According to the "Summary" section of the SEC's complaint, Mintz, vice-president and General Counsel of Enron's Global Finance Group, and Rogers, Enron's former Associate General Counsel and vice-president, were "involve[d]" in a "fraudulent scheme . . . to make material misrepresentation in, and to omit material disclosures from, Enron's public filings" and the disclosures that the SEC alleged should have been made were for allegedly reportable events occurring in 2000 and 2001 concerning "Enron's related party transactions with partnerships controlled by its then Chief Financial Officer, Andrew Fastow, and undisclosed insider stock sales by Enron's then Chairman, Kenneth Lay."[197]

The related-party transaction that Mintz and Rogers are alleged to have conspired to avoid disclosing was the sale of Enron's interest in a power project in Cuiaba, Brazil to LJM1, one of the partnerships controlled by Enron's CFO Andrew Fastow, where there was also an undisclosed oral side agreement through which a guarantee was made that LJM1 would not lose money on the deal by selling the Cuiaba interest back to Enron at a profit. The complaint asserts that it was Fastow who offered the position of General Counsel of EGF to Mintz and that Mintz

196 Id.

197 Complaint, available at http://www.sec.gov/litigation/complaints/2007/comp20058.pdf.

then earned more than $1.8 million in that position in 2001. The complaint also asserts that Rogers earned more than $1.6 million in 2001 as Enron's top securities and disclosure counsel with the responsibility for the timing and content of all Enron legal disclosure matters, including all SEC filings.

Among the allegations made against Mintz, the SEC alleges that Mintz knew, or was reckless in not knowing, of the oral side agreement and knowingly or recklessly documenting and closing the buyback from LJM1. It is also alleged that Mintz failed to disclose the buyback as a "currently proposed" transaction in Enron's 2000 Proxy Statement, which was filed just one day before the buyback agreement was executed. Mintz's lawyer has been quoted publicly as saying "If you can find someone at Enron who did more to regulate the relationship between Fastow and Enron, please let me know who it is."[198] In fact, the SEC's complaint ironically points out that Mintz came to public attention as a result of his acts in raising questions about the propriety of Fastow's actions and his compensation.[199]

Among other allegations leveled at Rogers, the SEC alleges that Rogers, a former SEC enforcement lawyer who had responsibility for reviewed Enron's public disclosures and security filings, let pass inadequate and incorrect information provided by Enron to investors and failed to cause Kenneth Lay, the late Chairman and CEO of Enron, to reveal tens of millions of dollars in stock sales that Lay made using an Enron line of credit during the waning months of the life of the corporation.[200]

The SEC complaint charges Mintz and Rogers with violations of Section 17(a) of the Securities Act of 1933, Sections 10(b) and 14(a) of the Securities Exchange Act of 1934 and Exchange Act Rules 10b-5 and 14a-9 and that Mintz and Rogers aided and abetted violations of Sections 10(b), 13(a), and 14(a) of the Exchange Act and Exchange Act Rules 10b-5, 12b-20, 13a-1, 13a-13, and 14a-9. The complaint also charges Mintz with violating Section 13(b)(5) of the Exchange Act and Exchange Act Rules 13b2-1 and 13b2-2 and aided and abetted Enron's violation of Section 13(b)(2)(A) of the Exchange Act. The complaint further charges that Rogers aided and abetted Kenneth Lay's violations of Section 16(a) of the Exchange Act and Exchange Act Rules 16a-2 and 16a-3.

On April 2, 2007, an SEC civil enforcement action was filed against Tenet Healthcare Corporation and several of its executives, including Christi R. Sulzbach, its former General Counsel and Chief Compliance Officer.[201] The SEC has asserted

198 Carrie Johnson, SEC Accuses 2 Former Enron Lawyers of Assisting the Fraud, Washington Post, March 29, 2007, available at http://www.washingtonpost.com/wp-dyn/content/article/2007/03/28/AR2007032802207_pf.html.

199 Complaint, available at http://www.sec.gov/litigation/complaints/2007/comp20058.pdf

200 Id.

201 SEC Litigation Release No. 20067, April 2, 2007, available at http://www.sec.gov/litigation/litre-

that, from 1999-2002, Tenet engaged in efforts to inflate its revenues through exploitation of a Medicare-reimbursement loophole involving outlier payments. Outlier payments are designed to compensate hospitals for caring for extraordinarily sick Medicare patients. The SEC alleges that Tenet was able to inflate its revenue from outlier payments by just increasing one number used in the Medicare formula for outlier payments – the gross charges listed by a hospitals.[202] According to the SEC, Tenet's failure to disclose its strategy as to outlier payments, the impact that strategy was having on its revenue and earnings, and the fact that its strategy was unsustainable misled investors.

With respect to Sulzbach, the SEC's complaint specifically alleges that she either knew, or was reckless in not knowing, about Tenet's strategy for inflating its revenues through outlier payments and that Sulzbach had been approached by others at Tenet, as early as 1999, with questions and concerns about the legality of "implementing gross charge increases to trigger additional outlier payments."[203] According to the SEC, Sulzbach communicated to Tenet's COO and co-president that "the critical issue to her analysis was the intent behind the gross charge increases" and that a "15% gross charge increase was defensible because, in part, the increase was based on what she understood to be legitimate business objectives."[204] According to the SEC, Sulzbach continued to hear concerns raised by others at Tenet and, by 2002, had "requested, received, and discussed data showing that Tenet's outlier payments were a significant portion of its Medicare revenue,"[205] and had directed Tenet's head of internal audit to route an internal audit report reviewing Tenet's receipt of outlier payments directly to her – when Sulzbach received it, she labeled it attorney-client privileged and no one else then received a copy of the report.[206] The SEC also alleges that Sulzbach was substantially involved in preparing, reviewing, and approving a number of Tenet's SEC filings, including 10-Ks, 10-Qs, and a prospectus supplement that omitted material information regarding these efforts to manipulate outlier payments and the impact those efforts were having on Tenet's financial performance.[207]

Tenet's alleged efforts to manipulate Medicare outlier payments came to public attention when an analyst with UBS Warburg published a report, in approximately October 2002, that suggested that the financial success of Tenet was likely being

leases/2007/lr20067.htm.

202 See Securities and Exchange Commission v. Tenet Healthcare Corporation, David L. Dennis, Thomas B. Mackey, Christi R. Sulzbach, and Raymond L. Mathiasen, SEC complaint ¶ 5, available at http://www.sec.gov/litigation/complaints/2007/comp20067.pdf.

203 Id. ¶ 67.

204 Id. ¶ 68.

205 Id. ¶ 8.

206 Id. ¶ 74.

207 Id. ¶¶ 13, 17, 158-166.

driven by acts of manipulation with respect to Medicare outliers.[208]

Tenet agreed to settle the charges as against it by paying a $10 million civil penalty, and a number of other Tenet executives, but not Sulzbach, have also agreed to settle the charges against them. The SEC complaint charges Sulzbach with violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5, as well as with aiding and abetting Tenet's violations of Section 13(a) of the Exchange Act and Exchange Act Rules 12b-20, 13a-1, and 13a-13 and seeks the entry of a permanent injunction against future violations of these provisions, disgorgement with prejudgment interest, payment of a civil penalty, and a bar against service in the future as an officer or director of a public company.[209]

Sulzbach has been vigorously defending the charges against her. Her motion to dismiss the SEC's complaint against her appears, from the public docket, to be fully briefed and awaiting a ruling from the court.

Recent Developments in Enforcement Proceedings Commenced Before 2005

There have also been recent developments that have occurred in three SEC enforcement actions against in-house corporate counsel discussed and analyzed in the 2005 Villa article that had been commenced prior to 2005.

One was the SEC proceeding commenced in 2003 against Michael J. Pietrzak, the former General Counsel, secretary, and executive vice-president of Hexagon Consolidated Companies of America, Inc.[210] In that lawsuit, the SEC alleged that Pietrzak had been involved in a scheme to inflate Hexagon's stock prices – more specifically, the SEC had alleged that Pietrzak and Hexagon's CEO, chairman, and president Maurice W. Furlong, had led the public to believe that Hexagon, which in reality was virtually worthless, was an entity with substantial assets. In August 2007, after a jury trial, Pietrzak was adjudged liable for securities fraud and other charges.[211] A further hearing will take place in order to determine the appropriate relief to be entered against Pietrzak.

The second was the SEC enforcement action commenced against Charles B. Spadoni, the former General Counsel and vice-president of Triumph Capital Group, Inc.[212] That SEC action against Spadoni was commenced back in 2000, the same

208 Id. ¶ 11, 191-201.

209 SEC Litigation Release No. 20067, April 2, 2007, available at http://www.sec.gov/litigation/litreleases/2007/lr20067.htm.

210 John K. Villa, SEC and Criminal Proceedings Against Inside Corporate Counsel, Association of Corporate Counsel, Sept. 2005, available at http://www.acc.com/resource/v6063.

211 SEC Litigation Release No. 20223, Aug. 3, 2007, available at http://www.sec.gov/litigation/litreleases/2007/lr20223.htm.

212 John K. Villa, SEC and Criminal Proceedings Against Inside Corporate Counsel, Association of

year that a related criminal indictment was handed down against him.[213] Having already entered an order in 2004 barring Spadoni from associating with any broker, dealer, or investment adviser, after Spadoni pled guilty to the criminal charges against him,[214] the SEC entered an order, under Rule 102(e), suspending him from appearing or practicing before it as an attorney on November 17, 2006.[215] Thereafter, on February 27, 2007, a consent final judgment was entered against Spadoni, resolving the SEC action filed against him in 2000 and permanently enjoining Spadoni from committing future violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Exchange Act Rule 10b-5 and from aiding and abetting violations of Sections 206(1) and (2) of the Investment Advisers Act of 1940.[216]

The third SEC enforcement action involves Chris Gunderson, General Counsel of Universal Express, Inc.[217] In 2004, the SEC filed a civil enforcement action against Gunderson accusing him of helping to facilitate an illegal unregistered distribution of 500 million shares of company stock by preparing false legal opinions and backdating stock purchase letters to auditors.[218] On February 21, 2007, Gunderson was found liable for violations of Section 5 and Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Exchange Act Rule 10b-5, and a final judgment against him permanently enjoining him from future violations of those securities laws on April 2, 2007.[219] After Gunderson filed a notice of appeal in June 2007, the SEC ordered that he be temporarily suspended from appearing or practicing before the SEC.[220]

Any Reason to Revisit Villa's SEC Rules?

Have the events of the last several years yielded any new developments that would lead us to revise Villa's Rules regarding corporate counsel and SEC actions? Let's

Corporate Counsel, Sept. 2005, available at http://www.acc.com/resource/v6063.

213 SEC Litigation Release No. 16759, Oct. 10, 2000, available at http://www.sec.gov/litigation/litreleases/lr16759.htm.

214 SEC Administrative Proceeding against Charles B. Spadoni, available at http://sec.gov/litigation/admin/34-50300.htm.

215 SEC Administrative Proceeding against Charles B. Spadoni, Order of Suspension, available at http://www.sec.gov/litigation/admin/2006/34-54774.pdf.

216 SEC Litigation Release No. 20027, Final Judgment by Consent Entered as to Charles B. Spadoni, March 2, 2007, available at http://www.sec.gov/litigation/litreleases/2007/lr20027.htm.

217 John K. Villa, SEC and Criminal Proceedings Against Inside Corporate Counsel, Association of Corporate Counsel, Sept. 2005, available at http://www.acc.com/resource/v6063.

218 Id. at 33-34 and n. 152-153.

219 SEC Litigation Release No. 20027, ,March 2, 2007, available at http://www.sec.gov/litigation/litreleases/2007/lr20027.htm.

220 SEC Administrative Proceeding against Chris G. Gunderson, Order Imposing Temporary Suspension, available at http://www.sec.gov/litigation/admin/2007/34-55869.pdf.

consider.

Rule #1: The Top Lawyer is Nearly Always the Target.

In 2005, Villa elaborated on this Rule by explaining that the fact that nearly all of the SEC enforcement actions he reviewed were brought against the chief legal officer of the company was "[t]he most obvious common element" in those actions and that the occasional cases pursued against lawyers other than the chief legal officer "usually involve[d] the most senior lawyer in charge of a project or a disclosure document."[221]

The SEC enforcement actions commenced against in-house counsel in 2005, 2006, and 2007 appear to provide further support for this Rule. Kober, Monson, Mintz, and Sulzbach each held the title of General Counsel. Although Rogers' title was Assistant General Counsel, he was the lead lawyer for Enron, having primary responsibility for reviewing securities filings and disclosures. Graham was only an Assistant General Counsel at Gen Re and does not appear to have been the lead lawyer on the issues presented in the SEC enforcement proceeding. But, after all, the Rule does say "nearly always."

Rule #2: Inside Lawyers Who Relied on Outside Counsel Advice are Seldom SEC Targets.

Villa explained the import of this Rule as follows, "inside lawyers' 'advice-of-outside-counsel' defense must have a significant impact on the exercise of enforcement discretion."[222]

There is nothing visible in the more recent SEC enforcement actions discussed above that would serve to undermine the validity of this Rule. It does not appear, based on the factual allegations set forth by the SEC, that Monson, Graham, Mintz, Rogers, or Sulzbach were relying on advice from outside counsel with respect to the underlying matters from which the SEC charges arose. In fact, the factual allegations involved in the enforcement action against Kober provide strong support for this Rule, at least indirectly, given that the SEC's allegations paint a picture of Kober disregarding the advice of outside counsel. As discussed above, the SEC's complaint specifically alleges that Kober had contacted outside counsel specializing in regulatory matters before the FDA, shared a draft of one of the press releases in question, and had been told by that outside counsel that Biopure's draft press release looked "unduly optimistic."[223] Similarly, the efforts of other executives at Biopure to publicly trash their outside counsel's advice as to

221 John K. Villa, SEC and Criminal Proceedings Against Inside Corporate Counsel, Association of Corporate Counsel, Sept. 2005, at p. 2, available at http://www.acc.com/resource/v6063.

222 Id.

223 Id.

whether the FDA had provided a "complete response" letter also provides indirect support for the continued vitality of this Rule.

Rule #3: Putting Money in Your Pocket is Not Necessary to Prompt SEC Enforcement.

As to this Rule, Villa explained that the SEC did not appear to be taking "enforcement action only where inside counsel received unreasonably high compensation or bonuses, or benefited through increased stock value" and that many inside counsel found themselves in the SEC's crosshairs "where it appears their only motive was, in the SEC's view, a misguided attempt to help their corporate employer."[224]

The more recent SEC enforcement actions do not appear to call this Rule into any serious question. The complaint against Kober does not make any allegations of personal financial gain for Kober. Nor do the complaints against Graham and Monson. The action against Graham is further worthy of note in this context because the underlying transactions that Gen Re was involved in were more about helping AIG, one of its largest clients, and only indirectly about helping Gen Re itself.

The actions against Rogers and Mintz are not ones in which the lawyers are alleged to have obtained ill-gotten gains directly, but it is worthy of note that the SEC does make specific allegations regarding the high levels of compensation ($1.8 million for Mintz and $1.6 million for Rogers) each received during the periods in which their challenged conduct occurred. The action against Sulzbach appears to be the only one that contains a specific allegation indicating some level of direct monetary gain by in-house counsel from the underlying conduct in that it alleges that Sulzbach received a bonus of almost $1 million for 2002 (an amount that was almost exactly twice her base salary) that was "discretionary and tied to Tenet's annual earnings growth through a complex formula impacted by the portion of earnings derived from Tenet's inflated outlier revenue."[225]

Rule # 4: Disclosures, Particularly Omissions in Disclosures, are Usually the Problem.

In explaining this Rule, Villa offered that many of the cases he had reviewed "involved allegedly false and misleading disclosures – more often than not, omissions" and that, in some of those, "the SEC has pursued inside lawyers on decisions that involve matters of professional judgment."[226]

224 Id. at 3.

225 See Securities and Exchange Commission v. Tenet Healthcare Corporation, David L. Dennis, Thomas B. Mackey, Christi R. Sulzbach, and Raymond L. Mathiasen, SEC complaint ¶¶ 184-187, available at http://www.sec.gov/litigation/complaints/2007/comp20067.pdf.

226 John K. Villa, SEC and Criminal Proceedings Against Inside Corporate Counsel, Association of

There can be no question that this Rule as a guiding principle remains valuable. The SEC cases against Kober, Graham, Mintz, Rogers, and Sulzbach all involved problems with company disclosures in one form or another, and more specifically mostly in the nature of allegations about what was left out of the disclosures in question. Only the action against Monson was not about disclosures.

Rule #5: A Generalist Lawyer Serving as General Counsel Must Seek Out Sound Advice or Pay the Price.

In explaining this Rule, Villa offered the following guidance, "the SEC appears to be willing to impose on an inside lawyer the obligation to seek expert legal and technical advice, or, face enforcement action. . . . The message seems to be that if one chooses to become the general counsel of a public company, one is obliged to learn the rules or seek guidance from those who do."[227]

This appears to remain a Rule. Of the new SEC enforcement actions, only the case against Monson directly confronts this issue of a generalist who did not seek out expert legal or technical advice about securities trading issues. Even though the initial ALJ decision in his case dismissed the SEC charges against him, in part, on the basis that his background was as a family lawyer and that he did not know the rules as to late-trading, Monson still was subjected to an SEC enforcement action and, undoubtedly, incurred significant expense in having to defend against the charges lodged against him. Further, the final outcome is not yet clear as the SEC has appealed the initial ALJ decision and continues to press its argument that Monson acted negligently by neither researching pertinent questions himself nor sought out the advice of outside counsel with pertinent securities trading expertise.

Rule #6: If You Hold Several Corporate Offices, Your Company Failed, or You Sat on a Serious Problem You Could Have Taken to the Board, Your Risk Increases

Although Villa stressed that his data was "too limited to draw firm conclusions," he explained with respect to this Rule that things like holding more than one corporate officer or also serving as a company director, as well as large losses can enhance the risk of in-house counsel being subjected to an enforcement action.[228]

Other than Sulzbach, whose only other title was Chief Compliance Officer, all of the other in-house counsel targeted in the more recent SEC enforcement actions also either held positions as Secretary for the Board or had the vice-president or senior vice-president titles. Kober, in fact, was both Secretary and a senior vice-president.

Corporate Counsel, Sept. 2005, at p. 3, available at http://www.acc.com/resource/v6063.

227 Id. at 3-4.

228 Id. at 4.

As to large losses being involved, nothing more needs to be said as to Mintz and Rogers then that they were in-house counsel for Enron. As for the action against Graham, the AIG restatement that ultimately resulted once the details of the two reinsurance transactions were disclosed reduced shareholder equity in AIG by over $2.25 billion.[229] Likewise, with respect to the action against Sulzbach, after the details of Tenet's approach to outlier payments became publicly-known, Tenet's shareholders lost over $11 billion in market capitalization.[230]

2. Criminal charges

Much ink has been spilled over the Department of Justice's increased focus on prosecuting corporate fraud since the creation of the Corporate Fraud Task Force in July 2002, which was created by Executive Order No. 13,271.[231] The increased scrutiny that the SEC has been imposing on in-house counsel not surprisingly has also contributed to an increase in criminal prosecutions given that the combination of a violation of the federal securities laws and the requisite level of intent in committing that violation translates to a criminal violation.[232] Also likely contributing to an increasing number of federal prosecution of in-house counsel is what appears to be the growing willingness of the Department of Justice to bring, or at least threaten to bring, such intent-based criminal charges in an effort to try and get corporate counsel to roll over on other corporate executives who may be viewed as "bigger fish."

Villa's 2005 article for ACC referred to above, also contained a comprehensive review of prosecutions of in-house counsel both before and after the creation of the Corporate Fraud Task Force and discussed each of the above issues.[233] Based on examination and analysis of those criminal prosecutions, Villa's 2005 ACC piece set forth Seven Rules regarding criminal prosecutions:

Rule #1: Chief Legal Officers are Criminal Targets, Too.
Rule #2: Big Losses Increase Risk of Prosecution.
Rule #3: Having Outside Counsel Can Make a Big Difference.
Rule #4: Perjury and Obstruction Often Become the Crime Charged.
Rule #5: Mere Knowledge of Conduct Later Deemed Criminal is Typi-

229 Complaint ¶ 15, available at http://www.sec.gov/litigation/complaints/comp19552.pdf

230 See Securities and Exchange Commission v. Tenet Healthcare Corporation, David L. Dennis, Thomas B. Mackey, Christi R. Sulzbach, and Raymond L. Mathiasen, SEC complaint ¶ 12, available at http://www.sec.gov/litigation/complaints/2007/comp20067.pdf.

231 Federal Register, 46,089 (July 11, 2002).

232 See, e.g., 15 U.S.C. §§ 77x, 78ff, 80a-48, and 80b-17.

233 John K. Villa, SEC and Criminal Proceedings Against Inside Corporate Counsel, Association of Corporate Counsel, Sept. 2005, available at http://www.acc.com/resource/v6063.

cally Not Enough.
Rule #6: Counsel Are Seldom Charged Where the Alleged Fraud is Complex and Its Propriety Debatable.
Rule #7: The Prosecutors' True Goal: Undermine the Executive's Advice-of-Counsel Defense.[234]

Since 2005, more corporate counsel have found themselves defending criminal charges filed against them. In this article, we have tried to build on that prior work by examining the known criminal prosecutions that have occurred since publication of that article. We also discuss a couple of criminal prosecutions of in-house counsel that happened prior to 2005 and were not discussed in Villa's article that we consider potentially instructive beyond simply confirming things that competent, ethical corporate counsel have always known, such as that theft, back-dating documents or otherwise falsifying records, lying to auditors, insider trading, and tampering with witnesses are all illegal and that corporate counsel who commit such acts risk criminal prosecution. For similar reasons, we have not undertaken to review all criminal prosecutions against corporate counsel for conduct that falls into categories of actions such as theft or insider trading where the fact that the person charged with a crime happens to be corporate counsel is merely coincidental.

2005 Criminal Prosecutions

Villa's article identified one corporate counsel who had been the subject of a criminal prosecution initiated in 2005 – Scott Wiegand of PurchasePro.com.[235] In addition to the action against Wiegand, which ended in an acquittal as discussed below, we have identified four other criminal prosecutions against in-house counsel that were commenced in 2005.

Although most of the ink was devoted to discussions of the fate of Conrad Black, two in-house counsel at Hollinger International, Inc. also were each convicted of three counts of mail fraud and are awaiting sentencing, facing the possibility of serving up to fifteen years in prison and up to $750,000 in fines.[236] Mark Kipnis, who was the top in-house counsel in Hollinger's Chicago base, and who was also a vice-president, was indicted on August 18, 2005.[237] Two additional counts were brought against Kipnis in a subsequent November 17, 2005 indictment. Peter

234 Id. at 4-6.

235 Id.

236 Richard Siklos, Conrad Black Found Guilty in Fraud Trial, N.Y. Times, July 14, 2007, available at http://www.nytimes.com/2007/07/14/business/13cnd-black.html?_r=1&ex=1187668800&en=47177f84c4d9bcd8&ei=5070&oref=slogin.

237 DOJ Press Release, Two Hollinger Executives, Ravelston Company Accused of Selfdealing in US-Canada Cororate Fraud Indictment, Aug. 18, 2005, available at http://www.usdoj.gov/usao/iln/pr/chicago/2005/pr0818_01.pdf.

Atkinson, the former General Counsel of Hollinger, Inc. and vice-president of Hollinger International, Inc. was indicted on November 17, 2005.[238] A further indictment was brought against both Kipnis and Atkinson on August 17, 2006 that added two counts of willfully causing Hollinger to file false tax returns.[239]

The improprieties alleged to have taken place at Hollinger that were relevant to the prosecutions against Atkinson and Kipnis involved an alleged plan that was implemented for the purpose of allowing millions of dollars of payments to be made to Black and other executives out of the proceeds of sales of Hollinger newspapers. Documentation was created for these payments to appear to be made in exchange for agreements by individual Hollinger executives not to compete with the new owners of the newspapers. According to the government's allegations, the actual transactions were lacking in any business purpose and hurt Hollinger because the purchasers of the newspapers had not actually asked for, or been interested in, securing such noncompete agreements from the individual executives.[240]

Although Peter Atkinson and Mark Kipnis were both in-house counsel, the roles that they played in connection with the Hollinger fraud were quite different. Atkinson's role was that of a principal – he received compensation for entering into noncompetes. Kipnis, however, was not a party to the noncompetes and did not receive any noncompete payments; rather, his role was to create the paperwork that made the noncompete payments possible. In the words of the prosecution during opening statements in the criminal trial, "If there is a document to be signed to complete this scheme, you'll see that Mark Kipnis has a pen in his hand."[241]

In the government's view, Kipnis should have known these were crooked deals and should not have enabled them to happen. At one level, the charges and conviction of Kipnis can be viewed as troubling because the focus of Kipnis' alleged misconduct appears to be about doing things that lawyers typically do. Kipnis created a "template" that was then put into use in future transactions. But, there are problems in trying to view Kipnis' role as merely that of a scrivener who was just doing the bidding of executives and deferring to their business judgment.

The noncompete agreements were backdated to December 31, 2000; the government's position was that there was no legitimate justification for these noncompete agreements given that by the time they were signed, Hollinger Int'l had sold all of

238 DOJ Press Release, Hollinger Chairman Conrad Black and Three Other Executives Indicted in US-Canada Corporate Fraud Schemes, Nov. 17, 2005, available at http://www.usdoj.gov/usao/iln/pr/chicago/2005/pr1117_01.pdf.

239 United States v. Black, 469 F. Supp. 2d 513, 517 (N.D. Ill. 2006).

240 Black, 469 F. Supp. 2d at 520-26.

241 Susan Chandler, Paperwork places attorney in middle of Hollinger mess, Chicago Tribune, May 13, 2007.

the newspapers, save one, with which it could have competed.[242] These payments were initially questioned by a bank's outside counsel during the course of a due diligence inquiry.[243] Further, Kipnis was alleged to have originally told the Board that the acquirer had requested the noncompete fees, but then, after the Board had already approved payment of the fees to the individual executives, Kipnis explained to the Board that the buyer had not specifically asked that the individual executives get paid and said that this discrepancy was inadvertent. Then, Kipnis still recommended that the executives should still get the fees and the Board approved those payments a second time. Although he did not get paid any of the noncompete monies, he did get paid a $100,000 bonus the same day that he directed that millions in checks to executives be cut.[244]

According to news reports, Kipnis was offered a deal, during the trial, to plead guilty to one count of filing a false tax return in exchange for having all other charges against him dropped, but he declined to accept the prosecution's offer.[245]

In connection with the highly-publicized KPMG criminal tax fraud case, Steven Gremminger, former Associate General Counsel of KPMG was named as a criminal defendant in an October 17, 2005 superseding indictment.[246] In addition to being charged with the same 39 counts of tax evasion in violation of 26 U.S.C. § 7201 that all other defendants in the case were charged with, Gremminger was also charged with two counts of violations of 26 U.S.C. 7212(a), corruptly obstructing the due administration of Internal Revenue laws by lying to the IRS.[247] All of the charges against Gremminger were dismissed on July 16, 2007, for constitutional violations regarding the denial of his right to counsel of his choice stemming from the government's actions in interfering with KPMG's decision-making through coercion with respect to KPMG's normal practice in paying attorney fees for employees and former employees.[248]

242 DOJ Press Release, Two Hollinger Executives, Ravelston Company Accused of Selfdealing in US-Canada Cororate Fraud Indictment, Aug. 18, 2005, available at http://www.usdoj.gov/usao/iln/pr/chicago/2005/pr0818_01.pdf.

243 DOJ Press Release, Hollinger Chairman Conrad Black and Three Other Executives Indicted in US-Canada Corporate Fraud Schemes, Nov. 17, 2005, available at http://www.usdoj.gov/usao/iln/pr/chicago/2005/pr1117_01.pdf.

244 First Superseding Indictment, available at http://fl1.findlaw.com/news.findlaw.com/nytimes/docs/hllngr/usblack1105ind.pdf.

245 Rick Westhead, First words from guilty "St. Mark", The Toronto Star, July 21, 2007, available at http://www.thestar.com/article/238312.

246 DOJ Press Release, October 17, 2005, available at http://www.usdoj.gov/opa/pr/2005/October/05_tax_547.html.

247 U.S. Attorney, Southern District of New York Press Release, October 17, 2005, available at http://www.usdoj.gov/usao/nys/pressreleases/October05/kpmgsupersedingindictmentpr.pdf.

248 United States v. Stein, 2007 U.S. Dist. LEXIS 52053 (S.D.N.Y., July 16, 2007).

We are aware of one other criminal prosecution of inside counsel commenced in 2005 worth mentioning in order to err on the side of caution, the criminal prosecution of Thomas A. Cattani, the General Counsel, vice-president of Whitewing Environmental Corp. Cattani was charged in August 2005 with six counts of unlawful conduct under Pennsylvania's Solid Waste Management Act and six counts of improper management of hazardous waste.[249] Whitewing is alleged to have been illegally operating a hazardous waste storage facility in Pennsylvania, operating it without the required permit from the Pennsylvania Department of Environmental Protection. It is alleged that, despite repeated inspections, notices of violation, and orders from DEP, Cattani and Whitewing's president, who was also charged, continued to operate the facility and were storing thousands of gallons of used automotive antifreeze, oil, and solvent.[250] It appears that the charges against Cattani likely stem more because of his role as vice-president of the company than as general counsel, but the actual charging documents were not subject to review.

As mentioned above, at the time of the 2005 Villa article, Scott E. Wiegand, the former General Counsel and senior vice-president of PurchasePro.com, was awaiting trial on federal criminal charges against him alleging conspiracy, securities fraud, making false statements to auditors, and making false statements to the FBI.[251] In a somewhat unconventional, but ultimately successful, trial tactic, Wiegand's counsel waived his right to be tried by a jury, and on December 20, 2005, Wiegand was acquitted on all charges against him when the trial judge determined that Wiegand had done his best in a difficult situation and had tried to expose the fraud that was going on at PurchasePro.com.[252]

2006 Criminal Prosecutions

In addition to the any criminal prosecutions related to backdating of stock options discussed above and not including any prosecutions for offenses such as insider trading, we are aware of five criminal prosecutions commenced against in-house counsel in 2006.

In the first few months of 2006, two in-house corporate counsel at two different companies were indicted on charges involving the misbranding of drugs. In January 2006, Daniel Adkins, the former General Counsel of Xpress Pharmacy Direct was indicted and charged with 3 counts of introducing misbranded drugs into interstate commerce, 1 count of conspiracy to distribute and dispense controlled

249 DEP Press Release, August 10, 2005, available at http://www.depweb.state.pa.us/compliance/cwp/view.asp?a=3&q=491207&pp=12&n=1.

250 Id.

251 John K. Villa, SEC and Criminal Proceedings Against Inside Corporate Counsel, Association of Corporate Counsel, Sept. 2005, at p. 61-62 available at http://www.acc.com/resource/v6063.

252 Sue Reisinger, Getting Back in the Saddle, Corporate Counsel, Feb. 24, 2006, available at http://www.law.com/jsp/ihc/PubArticleIHC.jsp?id=1140689113031.

substances, and 3 counts of unlawful distribution of a controlled substance.[253] The allegations against Adkins were related to claims that Xpress Pharmacy Direct was involved in the illegal operation of an Internet pharmacy and appear to have focused upon charges that Adkins approved the use of pharmacy contracts containing material misrepresentations about Xpress' business and, with knowledge of the illegal nature of Xpress' operation, prepared and approved the sending of a letter to pharmacies that were raising concerns that made a number of false representations and that stated that Xpress' operation was "both legal and authorized by federal and state statutes."[254] Adkins fought the criminal charges against him and, after a jury trial, was acquitted of all charges against him on November 22, 2006.[255]

In March 2006, Howard R. Udell, the former General Counsel and executive vice-president of Purdue Pharma, L.P., was indicted based on allegations that he was involved in fraudulently marketing OxyContin through false claims that it was less addictive, less likely to be abused, and less likely to lead to withdrawal issues than other pain medications. Udell pled guilty, on May 10, 2007, to a misdemeanor count of misbranding a drug in violation of 21 U.S.C. §§ 331(a) and 333(a)(1).[256] At that time, other Purdue Pharma executives, as well as The Purdue Frederick Company, Inc., an affiliate of Purdue Pharma, also pled guilty to felony charges of misbranding OxyContin.[257] As part of his plea deal, Udell agreed to pay a $5,000 criminal fine and to disgorge $8 million by transferring that amount to the Virginia AG's Medicaid Fraud Control Unit.[258] Ultimately, Udell was sentenced, on July 20, 2007, to three years' probation and required to perform 400 hours of community service.[259] The size of the fine agreed to by Udell drew media attention and raised questions regarding why such a fine was doled out in response to a guilty plea for a federal misdemeanor.[260] Given the size of the fine, and the fact that Pur-

253 Lawyer Indicted for Alleged Role in Internet Pharmacy Case, Jan. 26, 2006, available at http://www.law.com/jsp/article.jsp?id=1138183510537.

254 United States v. Smith et al., Third Superseding Indictment, available at http://www.spamsuite.com/node/196.

255 DOJ Press Release, Prior Lake Man Sentenced to Federal Prison for Operating Illegal Internet Pharmacy, Aug. 1, 2007, available at http://www.usdoj.gov/usao/mn/press/major/major0119.pdf.

256 U.S. v. Udell, No.07-CR-29 (W.D. Va. May 10, 2007) (Plea Agreement), available at http://www.vawd.uscourts.gov/PurdueFrederickCo/Plea-Agreement-Udell.pdf

257 USAO Press Release, The Purdue Frederick Company, Inc. and Top Executives Plead Guilty To Misbranding OxyContin; Will Pay Over $600 Million, May 10, 2007, available at http://www.usdoj.gov/usao/vaw/press_releases/purdue_frederick_10may2007.html.

258 Id.

259 Sue Lindsey, Judge Fines OxyContin Maker and Three Executives, Wash. Post, July 21, 2007, at D03, available at http://www.washingtonpost.com/wp-dyn/content/article/2007/07/20/AR2007072001714.html.

260 Jill Nawrocki, Oxycontin Flap to Cost Purdue Pharma GC $8M, Corporate Counsel, available at http://www.law.com/jsp/ihc/PubArticleIHC.jsp?id=1182503148067.

due Frederick, but not Purdue Pharma, pled guilty certainly appears to point in the direction that pleas of officers of Purdue Pharma may have been necessary in order to avoid Purdue Pharma being indicted – an event which, if it had occurred, would have jeopardized Purdue Phama's ability to sell pharmaceuticals under rules of the Federal Drug Administration. The situation is made even more curious by the fact that a spokesman for Purdue Pharma, even after Udell's guilty plea, issued a written statement asserting that Udell "took steps to prevent any misstatements in the marketing or promotion [of Oxycontin]" and "neither engaged in nor tolerated the misconduct at issue in this investigation."[261]

Earlier in this article, we discussed the SEC civil enforcement proceedings filed against Robert D. Graham, former Assistant General Counsel and senior vice president of Gen Re. In addition to being sued by the SEC, Graham was indicted on February 2, 2006 for his alleged involvement in the "sham reinsurance transactions" between Gen Re and AIG which served to allow AIG, one of Gen Re's biggest clients, to fraudulently report an increase to its loss reserves.[262] On September 20, 2006, Graham was named in a superseding indictment that charged him with 7 counts of securities fraud, 5 counts of false statements to the SEC, 3 counts of mail fraud, and 1 count of conspiracy to violate the federal securities laws and to commit mail fraud.[263]

Prosecutors have essentially alleged that Graham knew the transaction was improper but reached the conclusion that only AIG would get into legal trouble over it.[264] Graham has argued that his knowledge of the transactions was limited, but Graham's co-defendants have argued that they relied upon his expertise as a lawyer to draft the contracts at issue.[265] With respect to Graham's knowledge, there appear to be two pieces of potentially damaging evidence for Graham discussed in the SEC complaint against him that likely played a significant role in the bringing of criminal charges against him as well: (1) an email that Graham wrote saying: "How AIG books it is between them, their accountants and God" and that Gen Re's CEO and other top executives "have been advised of and accepted the potential reputational risk that US regulators (insurance and securities) may attack the

261 Id.

262 DOJ Press Release, Three Former Gen Re And One Former AIG Senior Executives Charged in Connection with Fraud Scheme, Feb. 2, 2006, available at http://www.usdoj.gov/opa/pr/2006/February/06_crm_057.html.

263 USAO Press Release, Gen Re and AIG Excecutives Charged in Superseding Indictment, Sep. 20, 2006, available at http://www.usdoj.gov/usao/ct/Press2006/20060920.html; Superseding indictment available at http://www.usdoj.gov/usao/ct/Documents/FERGUSON_SS_Indictment.pdf.

264 Sue Reisinger, Not the GC? You're Still a Target, Corporate Counsel, March 27, 2006, available at http://www.law.com/jsp/ihc/PubArticleIHC.jsp?id=1143207013275.

265 David Dankwa, Judge Upholds Fraud Charges Against Former Gen Re, AIG Execs, BestWire, Jan. 29, 2007; David Dankwa, Finite Re Case Turns on Testimony of Former Colleagues, BestWire, Sept. 25, 2006.

transaction and our part in it"; and (2) an audiotape of him saying "our own skirts are clean, but they [AIG] have issues."[266]

As is the case with the SEC civil enforcement proceedings, the criminal proceedings against Graham remain pending at this time.

Richard T. Nelson, the former General Counsel and senior vice-president of Peregrine Systems, Inc., was indicted on July 19, 2006, and accused of being involved in Peregrine's alleged accounting scheme to book revenue through a number of improper methods in order to inflate revenues and meet financial targets.[267] Eleven individuals with Peregrine have pled guilty; four others were tried to a mistrial.[268] Nelson is alleged to have assisted Peregrine in manipulating its financial appearance by "causing Peregrine to fraudulently erase accounts receivable from its books through acquisition; causing Peregrine to fraudulently book revenue from 'swap' transactions; misrepresenting Peregrine's financial condition to acquisition targets and potential suitors; and concealing evidence of the fraudulent practices at Peregrine."[269] Nelson is still awaiting trial on the charges against him.

As discussed elsewhere in more detail in this article, Kevin T. Hunsaker, Senior Counsel and Chief Ethics Officer of Hewlett-Packard Company, came into the public spotlight as a result of his role in the Hewlett-Packard boardroom spying scandal – the scandal that served to educate the public as to the practice of "pretexting."[270] Hunsaker was named as a defendant in a criminal complaint filed by the California Attorney General on October 4, 2006.[271] The state criminal proceeding against Hunsaker set forth charges of fraudulent wire communications, wrongful use of computer data, identity theft, and conspiracy.[272]

In March 2007, Hunsaker settled the criminal case against him by agreeing to enter a no contest plea to misdemeanor charges of fraudulent wire communications. Pursuant to the arrangement agreed to by Hunsaker and the prosecutor, the

266 http://www.sec.gov/litigation/complaints/comp19552.pdf

267 USAO Press Release, July 19, 2006, available at Ihttp://www.usdoj.gov/usao/cas/press/cas60719-1.pdf.

268 Bruce V. Bigelow, Peregrine's In-House Lawyer Added to Indictment, San Diego Union-Tribune, May 2, 2007, available at http://www.signonsandiego.com/uniontrib/20070502/news_1b2prgn.html.

269 USAO Press Release, July 19, 2006, available at Ihttp://www.usdoj.gov/usao/cas/press/cas60719-1.pdf.

270 Frank Ahrens, When a Stranger Calls, Beware of the Pretext, The Washington Post, Sept. 9, 2006, available at http://www.washingtonpost.com/wp-dyn/content/article/2006/09/08/AR2006090801856.html.

271 Ellen Nakashima and Yuki Noguchi, Dunn, Four Others Charged in Hewlett Surveillance Case, Wash. Post, Oct. 5, 2006, at A01, available at http://www.washingtonpost.com/wp-dyn/content/article/2006/10/04/AR2006100401072.html.

272 Id.

charges against Hunsaker would be dismissed if Hunsaker had made restitution and completed 96 hours of community service by September 2007.[273]

2007 Criminal Prosecutions

In addition to the any criminal prosecutions related to backdating of stock options discussed above and not including any prosecutions for offenses such as insider trading, we are aware of one other criminal prosecution against in-house counsel launched in 2007.

Eric P. Deller, who both worked under, and ultimately replaced Richard T. Nelson (indicted in 2006 and discussed above) as General Counsel of Peregrine Systems was indicted on April 25, 2007, seven weeks after Peregrine's former Chairman and CEO, Stephen P. Gardner, pled guilty to federal criminal charges.[274] The Third Superseding Indictment details that, in addition to serving as General Counsel, Deller was assistant secretary to Peregrine's Board of Directors.[275]

Deller's indictment charges him with multiple felony charges involving securities fraud, wire fraud, bank fraud, and conspiracy to commit fraud and alleges that Deller played "a substantial role in documenting contracts for the sale of Peregrine software."[276] The indictment against Deller also specifically alleges criminal liability for his participation in multiple conference calls with investors and securities analysts in 2001-02 and for his role in the issuance of a number of press releases.[277] Deller is still awaiting trial on the charges against him.

Recent Developments in Criminal Prosecutions Commenced Before 2005

There have also been some recent developments in a number of criminal prosecutions against in-house corporate counsel that had been commenced prior to 2005, one of which was discussed in the 2005 Villa article.

The criminal case against, and resulting guilty plea of, Stephen Woghin, the former General Counsel of Computer Associates was reviewed in the 2005 Villa article, but, at that time, Woghin had not yet been sentenced.[278] In January 2007,

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273 Charges Dropped Against Ex-HP Chairwoman, CBSNews.com, March 14, 2007, available at http://www.cbsnews.com/stories/2007/03/14/business/main2568938.shtml.

274 Bruce V. Bigelow, Peregrine's In-House Lawyer Added to Indictment, San Diego Union-Tribune, May 2, 2007, available at http://www.signonsandiego.com/uniontrib/20070502/news_1b2prgn.html.

275 Third Superseding Indictment ¶ 15, United States v. Crook, No. 04-CR-2605 (S.D. Cal.)

276 Id.

277 Id ¶ 60.

278 John K. Villa, SEC and Criminal Proceedings Against Inside Corporate Counsel, Association of Corporate Counsel, Sept. 2005, at p. 59-61 available at http://www.acc.com/resource/v6063.

Woghin was sentenced to two years in prison and three years of supervised release.[279]

Thomas Grabinski, former General Counsel of the Baptist Foundation of Arizona, was indicted in 2001 in connection with what was billed as one of the largest affinity fraud cases in American history.[280] The allegations against Grabinski involved his role in the Baptist Foundation's effort effort to shift bad debt and overvalued property to off-the-books companies in order to hide losses and be able to continue to publish favorable financial statements which were used to allow the Foundation to continue to raise money from mostly elderly, and mostly Baptist, investors.[281] Grabinski was ultimately convicted of fraud and racketeering and sentenced in 2006 to concurrent prison terms of five years and six years and ordered to pay $159 million in restitution; because the jury concluded that Grabinski had not personally profited from the fraud and racketeering in which he was involved, he was acquitted of theft charges.[282]

Rex Wingerter, an in-house counsel with Global Recruitment and Immigration Services, Inc. was indicted in 2004. On August 26, 2005, Wingerter pled guilty to misprision of felony in violation of 18 U.S.C. § 4 and, on November 18, 2005, was sentenced to four months in prison, six months of community confinement, and fined $70,000.[283] Apparently, Wingerter participated in conduct intended to conceal the fact that Global Recruitment was committing immigration fraud and knew that his own signature was being forged on immigration documents, that signatures of immigration clients of Global Recruitment were also being forged, and that hundreds of immigration applications were being submitted by Global Recruitment for an employer that did not have capacity to hire such large numbers of immigrants.[284] In 2007, Wingerter was disbarred in Maryland as a result of his guilty plea.[285]

We mention Wingerter's case, even though he was not discussed in the 2005

279 Stephen Taub, Ex-CA Lawyer Gets Two years, CFO.com, Jan. 16, 2007, available at http://www.cfo.com/article.cfm/8546432.

280 Arizona Attorney General Press Release, May 4, 2001, available at http://www.azag.gov/victims_rights/BFA/caseinfo.html.

281 Michael Kiefer, 2 given prison for fraud involving Baptist group, The Arizona Republic, Sept. 30, 2006, available at http://www.azcentral.com/arizonarepublic/local/articles/0930bfa-sentence0930.html.

282 Id.; Michael Kiefer, Guilty verdicts cap Baptist case, The Arizona Republic, July 25, 2006, available at http://www.azcentral.com/arizonarepublic/news/articles/0725bfa0725.html.

283 U.S. Attorney, Eastern District of Virginia Press Release, Nov. 18, 2005, available at http://www.usdoj.gov/usao/vae/Pressreleases/11-NovemberPDFArchive/05/20051118wingerternr.pdf.

284 Attorney Grievance Comm'n v. Wingerter, Court of Appeals of Maryland, Misc. Docket No. 71, opinion available at http://www.courts.state.md.us/opinions/coa/2007/71a05agx.pdf.

285 Id.

Villa article for this reason: Misprision of a felony is a potentially fertile ground for claims against in-house corporate counsel in this environment where there is such an intense focus upon corporate counsel's role as a gatekeeper. 18 U.S.C. § 4 makes it a crime to "hav[e] knowledge of the actual commission of a felony cognizable by a court of the United States" and to "conceal[s] and [] not as soon as possible make known the same to some judge or other person in civil or military authority under the United States" punishable by a fine and by imprisonment for not more than three years.

Any Reason to Revisit Villa's Criminal Rules?

Have the events of the last several years yielded any new developments that would lead us to revise Villa's Rules regarding corporate counsel and criminal exposure? Let's consider.

Rule #1: Chief Legal Officers are Criminal Targets, Too.

In 2005, Villa elaborated on this Rule by asserting that, at that time, there were "no subordinate in-house counsel who have been charged with federal criminal violations."[286] The rule certainly remains on target, in as much as Atkinson, Cattani, Adkins, Udell, Nelson, and Deller each held the title of General Counsel or Chief Legal Officer, and even Kipnis, although not a General Counsel was the top lawyer for Hollinger's Chicago base. However, in light of the prosecutions against Graham and Gremminger, it can no longer be categorically stated that no subordinate in-house counsel have been charged with federal criminal violations. Hunsaker was also not a General Counsel or Chief Legal Officer at Hewlett-Packard, but he was Hewlett-Packard's Chief Ethics Officer. Further, he was only prosecuted at the state level; no federal criminal charges were brought against him.

Rule #2: Big Losses Increase Risk of Prosecution.

This still is a good and obvious rule. As mentioned earlier in this article, the AIG restatement that ultimately resulted once the details of the two reinsurance transactions in which Graham was involved were disclosed reduced shareholder equity in AIG by over $2.25 billion.[287] The accounting scandal at Peregrine, where first Nelson and then Deller served as General Counsel, cost Peregrine shareholders as much as $4 billion.[288] A number of the most recent instances of criminal prosecutions against in-house counsel do not necessarily fit into this mold, however, as they do not appear to be driven by financial loss incurred by public investors, such as the prosecutions of Kipnis and Atkinson of Hollinger, the prosecution of

286 John K. Villa, SEC and Criminal Proceedings Against Inside Corporate Counsel, Association of Corporate Counsel, Sept. 2005, at p. 5 available at http://www.acc.com/resource/v6063.

287 Complaint ¶ 15, available at http://www.sec.gov/litigation/complaints/comp19552.pdf.

288 Third Superseding Indictment ¶ 4, United States v. Crook, No. 04-CR-2605 (S.D. Cal.).

Gremminger of KPMG, and the prosecution of Hunsaker of Hewlett-Packard. Further, a few of the larger market losses that were present with respect to SEC actions pursued against in-house counsel, such as Tenet's $11.3 billion loss in market capitalization, have not also translated to any criminal prosecutions.

Rule #3: Having Outside Counsel Can Make a Big Difference.

Villa explained that the near total absence of involvement of outside counsel in conduct leading to the criminal indictments he examined in his 2005 article was "predictable" because an in-house counsel could use the notion of having relied upon a law firm to "deflect criminal criticism."[289] Most of the criminal prosecutions against in-house counsel over the last few years discussed above again are notable for the absence of involvement of outside counsel.

The prosecution of Gremminger of KPMG, however, deviates from this rule somewhat because outside counsel was involved. Yet, at the same time, the involvement of that outside counsel, Robert J. Ruble, a lawyer with a New York law firm, does not call into question this Rule's premise – that an in-house counsel in the crosshairs could point to reliance upon outside counsel as a basis for deflecting criminal charges – because Ruble was also indicted for his role in the alleged criminal tax fraud scheme.[290] Similarly, at first blush, the prosecution of Hunsaker at H-P might appear to be contrary to this rule, given that Hunsaker appears to have claimed, in part, to have reached the conclusion that the "pretexting" that occurred was not illegal in reliance upon the opinion of a lawyer that did not work for Hewlett-Packad, but the outside lawyer pointed to was not a lawyer that had been retained by Hewlett-Packard, but rather was a lawyer representing the private investigator that Hewlett-Packard had hired.[291]

Rule #4: Perjury and Obstruction Often Become the Crime Charged.

Villa explained that allegations of cover-ups had become a "recurring theme" in prosecutions of in-house counsel.[292]

The most recent prosecutions of in-house counsel discussed above provide one more data point in support of this Rule. In addition to the other criminal

289 John K. Villa, SEC and Criminal Proceedings Against Inside Corporate Counsel, Association of Corporate Counsel, Sept. 2005, at p. 5 available at http://www.acc.com/resource/v6063.

290 U.S. Attorney, Southern District of New York Press Release, October 17, 2005, available at http://www.usdoj.gov/usao/nys/pressreleases/October05/kpmgsupersedingindictmentpr.pdf.

291 Michelle Kessler, Jon Swartz, and Sue Kirchhoff, HP execs on spying: It wasn't me, USA Today, September 29, 2006, available at http://www.usatoday.com/money/industries/technology/2006-09-28-hp-testimony_x.htm.

292 John K. Villa, SEC and Criminal Proceedings Against Inside Corporate Counsel, Association of Corporate Counsel, Sept. 2005, at p. 5 available at http://www.acc.com/resource/v6063.

charges against him, Gremminger was charged with 2 counts of lying to the IRS regarding KPMG's involvement with certain shelters and regarding KPMG's compliance with summons received from the IRS.[293]

Rule #5: Mere Knowledge of Conduct Later Deemed Criminal is Typically Not Enough.

With respect to this Rule, Villa explained in 2005 that it appeared that "[d]irect and active involvement of in-house counsel in the questionable conduct, with knowledge that the conduct is fraudulent, is necessary to bring federal [criminal] charges."[294]

The more recent prosecutions of in-house counsel do nothing to raise any serious questions about the validity of this Rule.

Rule #6: Counsel Are Seldom Charged Where the Alleged Fraud is Complex and Its Propriety Debatable.

Although Villa used "seldom" in the black-letter of his Rule in 2005, his elaboration on this Rule went a little further to say in-house counsel had never been criminally prosecuted where the alleged fraud was complex and of debatable propriety and to explain that the reviewed cases against the insider lawyers who had been indicted involved allegations of "out-and-out frauds involving sham companies, hidden financial interests, and phony documents where the lawyer not only knew and understood that the conduct was fraudulent but was an essential participant in it."[295]

Based on the allegations present in each of the more recent prosecutions of in-house counsel discussed above, the trend continues to hold that the in-house counsel being prosecuted are those against whom the government can level allegations that the lawyer was both an essential participant in fraudulent conduct and knew and understood at the time that the conduct was fraudulent.

Rule #7: The Prosecutors' True Goal: Undermine the Executive's Advice-of-Counsel Defense.

In explaining the genesis of this Rule, Villa focused on two points in his 2005 article: (1) in-house counsel who have been charged with broad misconduct have been able to plead to "much lesser offenses with much lighter sentences;" and (2)

293 U.S. Attorney, Southern District of New York Press Release, October 17, 2005, available at http://www.usdoj.gov/usao/nys/pressreleases/October05/kpmgsupersedingindictmentpr.pdf.

294 John K. Villa, SEC and Criminal Proceedings Against Inside Corporate Counsel, Association of Corporate Counsel, Sept. 2005, at p. 5 available at http://www.acc.com/resource/v6063.

295 Id. at 6.

that pursuing in-house counsel can be an effective approach to preempting the ability of other executives to point to an in-house counsel's failure to object to conduct as support for a presumption that the conduct was not illegal.[296]

Given that prosecutors are highly unlikely to ever publicly admit this type of motivation if it is present in a decision to indict in-house counsel, the ability to evaluate whether the continuing validity of this Rule will likely always be more anecdotal than scientific. Of the more recent cases against in-house counsel discussed above, the prosecution of Kipnis in the Hollinger matter in which prosecutors also pursued Conrad Black certainly does nothing to cause one to question this Rule. Likewise, the light punishment visited on Udell, at least with respect to the lack of any prison time, in connection with his guilty plea and the ultimate acquittal of Adkins seem to provide further grist for the mill as to this Rule.

The only one of the recent prosecutions that seems unsusceptible to fitting within this Rule is the bringing of criminal charges against Deller, given that he was indicted only after the Peregrine Chairman and CEO had pled guilty.

3. Lawsuits brought by others

a. Shareholder derivative suits and securities class actions

In addition to pursuit of criminal or SEC actions, another frequent source of liability exposure for in-house counsel when a scandal hits their corporate employer is being named as a individual defendant in a shareholders derivative action or a securities class action under the Private Securities Litigation Reform Act (PSLRA). In the earlier ACC liability article, we spent some time discussing that in-house counsel embroiled in certain high-profile corporate scandals also found themselves as named defendants in securities fraud class actions or shareholder derivative suits.[297]

Obviously, given the personal stakes in play for in-house counsel when the actions are being brought by prosecutors or by the SEC, exposure in securities fraud class actions and shareholder derivative is, to some extent, something that will always be an afterthought for corporate counsel and not a primary motivator. Although defense costs involved in such proceedings can add to the financial burden for in-house counsel, typically such actions gets resolved, one way or another without in-house counsel having to contribute any settlement amounts or pay any judgments.

Christine Sulzbach, the former General Counsel and Chief Compliance Officer of Tenet Healthcare provides yet another example of corporate counsel finding

296 Id.

297 Lucian T. Pera and Brian S. Faughnan, Paradise Tarnished: Today's Sources of Liability Exposure for Corporate Counsel, Association of Corporate Counsel, March 2005, at 10-11(Lapine), 15(Brown), 22-23(Derrick and Rogers), and 31-32(Tempest), available at http://www.acc.com/public/article/ethics/liability.pdf.

themselves named in parallel litigation brought by shareholders of their corporate employer. Sulzbach was a named defendant in the *In re Tenet Healthcare Corporation Derivative Litigation* that was pending in California state court and in the In re Tenet Healthcare Corp. Securities Litigation that was pending in California federal court.[298] The derivative litigation contained allegations that the defendants had breached their fiduciary duties by failing to oversee Tenent's receipt of outlier payments from Medicare and failing to monitor Tenet's accounting practices that were also the subject of SEC proceedings, as well as some other issues regarding Tenent's patient procedures.

That litigation, as well as a securities fraud class action against Tenet in California federal court, were ultimately settled without any contribution to the $215 settlement amount from Sulzbach.[299]

Despite our prior speculation to the contrary,[300] no litigation against in-house counsel along those lines really appears to have broken any significant new ground worthy of focus at this time.

A few recent developments, and upcoming developments at the United States Supreme Court level are worthy of note and will certainly have a significant impact on in-house counsel's liability exposure in the future with respect to securities fraud class actions and shareholder derivative actions. On June 21, 2007, the United States Supreme Court issued its opinion in *Tellabs, Inc. v. Makor Issues & Rights, Ltd.* that held that "[t]o qualify as 'strong' within the intendment of § 21D(b)(2) [of the PSLRA], we hold, an inference of scienter must be more than merely plausible or reasonable – it must be cogent and at least as compelling as any opposing inference of nonfraudulent intent."[301] The ruling in *Tellabs* will likely serve to make it more difficult for plaintiffs in securities class actions to survive motions to dismiss, which certainly is a helpful development for in-house counsel who may find themselves in the cross-hairs.

An upcoming decision from the United States Supreme Court in another case *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc., 06-43*, in which oral arguments took place on October 8, 2007,[302] could have a substantial impact on

298 In re Tenet Healthcare Corporation Derivative Litigation, Notice of Proposed Settlement, available at http://securities.stanford.edu/1026/THC02-02/200636_o02n_01098905.pdf; In re Tenet Healthcare Corp. Securities Litigation, Stipulation and Agreement of Partial Settlement, available at http://securities.stanford.edu/1026/THC02-02/2006111_r01x_028462.pdf.

299 Tenet Healthcare Corp. Form 8-K Miscellaneous Exhibit, Jan. 12, 2006, available at http://www.secinfo.com/d11MXs.v1Qy.d.htm; Tenet Healthcare Corp. Form 10-Q, Aug. 9, 2006, available at http://sec.edgar-online.com/2006/08/09/0001104659-06-053113/Section12.asp.

300 Id. at 42-44.

301 Tellabs, Inc. v. Makor Issues & Rights, Ltd., No. 06-484, slip op. available at http://www.supremecourtus.gov/opinions/06pdf/06-484.pdf.

302 Enron and other shareholder lawsuits hinge on Supreme Court decision in Stoneridge case, International Herald Tribune, Oct. 9, 2007, available at http://www.iht.com/articles/ap/2007/10/09/america/NA-

the scope of potential liability for in-house counsel as well. The question presented before the United States Supreme Court in *Stoneridge* is, "Whether . . . *Central Bank, N.A. v. First Interstate Bank, N.A.*, 511 U.S. 164 (1994), forecloses claims for deceptive conduct under § 10(b) of the Securities Exchange Act of 1934 . . . and Rule 10b-5(a) and (c) . . . where Respondents engaged in transactions with a public corporation with no legitimate business or economic purposes except to inflate artificially the public corporation's financial statements, but where Respondents themselves made no public statements concerning those transactions."[303] Any opinion in the Stoneridge case will likely address whether there are any circumstances where shareholders who have been damaged by securities fraud should be allowed to sue third parties such as law firms, banks, and accountants under a theory that is often referred to as "scheme liability."

b. False Claims Act liability

One potential new frontier has extremely recently become worthy of mention and further evaluation. While this article was being finalized, on September 18, 2007, the Dep't of Justice filed a new lawsuit against Sulzbach, but not a criminal case – a qui tam complaint seeking statutory damages and civil penalties against her under the False Claims Act.[304] The allegations leveled against Sulzbach do not relate to the SEC charges against Sulzbach described above, but rather involve claims that Sulzbach provided false declarations to the government in 1997 and 1998 in connection with a corporate integrity agreement.[305] At the times of the allegedly false declarations, Sulzbach was Tenet's Corporate Integrity Program Director, but only an associate general counsel, not yet having been promoted to the general counsel position.[306]

Many things are unclear about this latest development, such as whether Sulzbach's liability exposure is really more about her role as Tenet's Corporate Integrity Program Director than her role as in-house counsel. At least one short article has already been written sounds the alarm that this is a dramatic new liability development for in-house counsel.[307] What does seem clear, even at this early stage in the proceeding, however, is that this latest action against Sulzbach appears to

FIN-US-Supreme-Court-Enron.php

303 http://www.supremecourtus.gov/qp/06-00043qp.pdf.

304 United States Attorney's Office, Southern District of Florida, Press Release, September 18, 2007, available at http://www.usdoj.gov/usao/fls/PressReleases/070918-05.html.

305 United States of America v. Christi R. Sulzbach, United States District Court, Southern District of Florida Case No. 07-61329, Complaint available at http://www.usdoj.gov/usao/fls/PressReleases/Attachments/070918-05.Complaint.pdf.

306 Id. ¶ 2.

307 Dan Small, In-House Counsel, Beware!, Nat'l L. J., October 16, 2007, available at http://www.law.com/jsp/ihc/PubArticleIHC.jsp?id=1192439002822.

have been made possible only because Tenet agreed, in connection with a $900+ million 2006 settlement with the government over claims that it had defrauded and overcharged Medicare, to turn over to the government documents that it had previously withheld as privileged. Included among these documents Tenet turned over to the government are the documents that the Department of Justice now contends demonstrate that Sulzbach's 1997 and 1998 declarations were known by her to be false.[308] Stay tuned.

4. Litigation Sanctions

For those in-house lawyers, probably the majority, who are not on the front line in litigation, one benefit would seem to be a much lower risk of being sanctioned by a court. But there are actually two types of sanctions that are at least as likely for in-house counsel as they are for retained counsel on the front line.

E-Discovery

Before e-discovery was e-discovery, Judge Shira Scheindlin of the United States District Court for the Southern District of New York handed down two decisions in the now-famous *Zubulake* case regarding discovery of documents, particularly electronic documents, that may be routinely destroyed if affirmative steps are not taken. While there are doubtless many lessons that can be drawn from the numerous decisions entered in *Zubulake*, one less-noticed aspect of these decisions, mirrored in the subsequent case law under the revised Federal Rules of Civil Procedure, is the significantly increased burden that Judge Scheindlin and other courts are now placing on in-house counsel to assure that corporate documents are appropriately and timely preserved and produced.

Laura Zubulake, an equities trader, had filed a charge with the EEOC against her former employer, UBS Warburg LLC, for gender discrimination and retaliation. Immediately after the charge was filed, UBS's in-house counsel orally instructed UBS employees not to destroy material potentially relevant to Zubulake's claims, but rather to provide them for review. UBS, however, did not stop recycling back-up tapes until they were specifically requested by Zubulake. Moreover, notwithstanding the instructions from in-house counsel, some of UBS's employees deleted e-mails that were potentially relevant to Zubulake's claims. Still other materials were not provided until Zubulake's counsel learned of their existence in depositions.

While a detailed discussion of the various *Zubulake* opinions is beyond the scope of this article, in *Zubulake IV*, Judge Scheindlin ruled that once a company reasonably anticipates litigation, "it must suspend its routine document retention/destruction policy and put in place a 'litigation hold' to ensure the preservation of

308 Complaint ¶ 6, United States v. Sulzbach, No. 07-61329 (S.D. Fla.).

relevant documents."[309] A year later, in Zubulake V, Judge Scheindlin elaborated on the procedures that should be followed:[310]

- Once a party reasonably anticipates litigation, it must suspend its routine document retention/destruction policy and put in place a "litigation hold" to ensure the preservation of relevant documents;
- In furtherance of the "litigation hold," counsel must become fully aware of the client's document retention policies and data retention architecture;
- Counsel must communicate with the "key players" to understand how they store information and to obtain any potentially relevant information they have; and
- Counsel must follow up to ensure that the "litigation hold" is followed, including that all relevant information is actually identified, segregated, maintained, and information responsive to an opposing party's requests is provided.

These duties obviously fall on both in-house and retained counsel, but there are several reasons why the role of in-house counsel is particularly important. First, it will often be in-house counsel, not retained counsel, who has the first notice of threatened litigation. Second, from her position within the company, in-house counsel will often have – or be expected by a later reviewing court to have – superior knowledge of the client's existing documents and data, document retention policies, and data retention architecture. Third, in-house counsel will often have the closest contact with the client's "key players." Fourth, in-house counsel may well be in the best position to follow through to ensure that the above procedures are actually followed. Finally, if the client relies upon an "advice of counsel" defense, the advice may well be that of in-house counsel, and this may in turn lead to discovery focused on that defense.

All of this and more was vividly demonstrated in an opinion released earlier this year in *Cache La Poudre Feeds LLC v. Land O'Lakes, Inc.*[311] The opinion is lengthy, well-written, and worth reading by any in-house lawyer who bears any responsibility for discovery or document retention. Cache La Poudre Feeds, LLC ("CLPF") sued Land O'Lakes, Inc. ("LOL") for trademark violation of a line of animal feed products. After several years of what the Magistrate Judge described as an "acrimonious history," CLPF alleged numerous discovery violations against LOL and requested appointment of a Special Master at LOL's expense to oversee discovery, additional depositions to explore allegations of spoliation, an adverse inference jury instruction, a fine paid to the court, and an award of fees and costs. The court denied most of this relief, but only after finding that LOL, and specifically its in-house counsel, had, in some respects, not fully discharged their duties.

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309 Zubulake v. UBS Warburg, LLC, 220 F.R.D. 212 (S.D.N.Y. 2003) ("Zubulake IV").

310 Zubulake v. UBS Warburg, LLC, 229 F.R.D. 422 (S.D.N.Y. 2004) ("Zubulake V").

311 No. 04-cv-00329, 2007 WL 684001 (D. Colo. Mar. 2, 2007).

The court first discussed CLPF's charge that, despite receiving notice of a dispute that could lead to litigation, LOL continued to routinely eliminate e-mail and overwrite backup electronic media. The court conducted a detailed analysis of the early communications between in-house counsel for both companies. On this issue, the court ruled for LOL, finding that early correspondence between the companies portended an amicable resolution more than it did a lawsuit, and, therefore, that LOL was not wrong in failing to institute a litigation hold until suit was filed.

The court next considered CFPL's allegation that LOL failed to locate, preserve and produce all relevant materials. Here the court found that in-house counsel relied too much on the employees' discretion to identify relevant documents. Moreover, the court found that in-house counsel did not fully understand his own company's system of maintaining monthly and annual backup tapes from which it could have pulled additional responsive documents. The court concluded that both in-house counsel and retained counsel "failed in many respects to discharge their obligations to coordinate and oversee discovery," and that in-house counsel, in particular, erred in failing to take "independent action to verify the completeness of the employees' document production."[312]

The court next considered CLPF's allegation that LOL failed to produce specific documents, including daytimers and notes relating to LOL's advice-of-counsel defense. The court agreed with CLFP that these documents had to be produced by LOL.

In the end, while the court sided with CLFP on many of these issues, it denied all of the requested sanctions other than ordering LOL to pay the sum of $5,000, as well as court reporter fees and costs, associated with the corporate deposition of LOL's in-house counsel. The opinion therefore teaches an inexpensive, but very important, lesson: When it comes to discovery and the obligations set forth in Zubulake, adopted to a large extent by the recent e-discovery amendments to the Federal Rules of Civil Procedure, in-house counsel must take affirmative steps to ensure that these obligations are fulfilled.

Restricting an Opposing Party's Access to Evidence

Another risk of litigation sanctions that falls directly on in-house counsel relates to the ethical obligations not to restrict an opposing party's access to evidence. *See* ABA Model Rule of Professional Conduct Rule 3.4.[313] Often a key witness will

312 Id. at *17.

313 ABA Model Rule of Professional Conduct 3.4 provides, in pertinent part:

A lawyer shall not:
(a) unlawfully obstruct another party's access to evidence or unlawfully alter, destroy or conceal a document or other material having potential evidentiary value. A lawyer shall not counsel or assist another person to do any such act;
(b) falsify evidence, counsel or assist a witness to testify falsely, or offer an inducement to a witness that is

be someone over whom the client can exercise powerful persuasion. Naturally, a party may wish to dissuade such a person from lending assistance to an opposing party. This task will often fall to in-house counsel. But in-house counsel presented with this situation should proceed with extreme caution.

This is the lesson of *Massachusetts Institute of Technology v. ImClone Systems, Inc.,* decided this year.[314] MIT brought a patent infringement suit against ImClone relating to a highly profitable cancer treatment drug. One of the inventors, and therefore a key witness, was Dr. Stephen Gillies, a former MIT professor. MIT moved for sanctions against ImClone arguing, among other things, that its in-house counsel had contacted Dr. Gillies' current employer, Merck, to "shutter" him from testifying voluntarily for MIT. MIT asked for not only monetary sanctions, but also that MIT be permitted to present evidence at trial of ImClone's counsel's alleged misconduct.

The court reviewed in detail the e-mails between ImClone's and Merck's in-house counsel, after which Merck's counsel advised MIT that Dr. Gillies had decided that he would no longer cooperate with MIT in the prosecution of the lawsuit. The court found a "deliberate strategem to deprive MIT of Dr. Gillies' service as an expert witness," and criticized ImClone's "attorney-agents" for depriving MIT "of the cooperation of the witness who as a principal inventor of the 281 patent was arguably the person most knowledgeable about the validity of MIT's claims against ImClone."[315] Based in part upon these findings, the court (1) prohibited ImClone from communicating with Dr. Gillies or Merck about the lawsuit without court permission; (2) granted MIT's request that it be permitted to offer evidence of the improper conduct of ImClone's attorneys to lay a foundation for an adverse inference instruction; and (3) ordered ImClone to pay MIT's fees and costs for bringing the motion.[316]

The lesson here is clear. While it may seem quite natural to expect that an employee of a business partner would not voluntarily assist an opposing party, in-house counsel should think twice before exerting influence over anyone not to testify.

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prohibited by law; . . . or
(f) request a person other than a client to refrain from voluntarily giving relevant information to another party unless:
(1) the person is a relative or an employee or other agent of a client; and
(2) the lawyer reasonably believes that the person's interests will not be adversely affected by refraining from giving such information.

314 490 F. Supp. 2d 119 (D. Mass. 2007)

315 Id. at 127.

316 Although it did not focus on the role of in-house counsel, Massachusetts Institute of Technology v. ImClone was recently followed in Synergetics, Inc. v. Hurst, No. 4:04CV318 CDP, WL 2422871(E.D. Mo. Aug. 21, 2007).

Practical Guidance

- Corporate counsel who supervise litigation should assume that they must personally comply with e-discovery requirements and, therefore, should take heed of the teaching of Zubulake:
  - Once a party reasonably anticipates litigation, it must suspend its routine document retention/destruction policy and put in place a "litigation hold" to ensure the preservation of relevant documents;
  - In furtherance of the "litigation hold," counsel must become fully aware of the client's document retention policies and data retention architecture;
  - Counsel must communicate with the "key players" to understand how they store information and to obtain any potentially relevant information they have; and
  - Counsel must follow up to ensure that the "litigation hold" is followed, including that all relevant information is actually identified, segregated, maintained, and information responsive to an opposing party's requests is provided.
- While it may seem natural for corporate counsel to dissuade persons over whom the corporation has influence from assisting an opposing party, corporate counsel should take care that they are not unwittingly violating the ethical rules in doing so.

5. Legal malpractice and related claims

We have see that corporate counsel are increasingly put in the position of gatekeeper for their clients; fortunately, however, they are still very seldom put in that even less desirable position of legal malpractice defendant.[317] Our most recent searches of reported cases, as well as news reports and the accounts of the other liability situations addressed in this article, reveal that few companies choose to sue their corporate counsel, even when they quite possibly would be sued had they worked instead for an outside law firm. Other authors whose research has revealed the same lack of reported claims have suggested two reasons: (1) company-employers do not want to risk disclosure of client confidences, and (2) there is a limited opportunity for financial recovery.[318] These explanations are undoubtedly true. Yet there is probably another, more important reason: Filing malpractice claims against in-house counsel is simply inconsistent with the corporate culture that prevails at most companies.

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317 See ACC's Leading Practices Profile on Indemnification and Insurance Coverage for In-House Lawyers: What Companies are Doing," available at http://www.acc.com/protected/article/insurance/lead_liability.pdf.

318 Mark Nozette, Susan Lawshe and John Villa, Individual Liability for the Corporate Lawyer § 6.02, 1999 ACCA Annual Meeting. See also Ronald E. Mallen & Jeffrey M. Smith, 3 Legal Malpractice § 25.7, at 325 (Thomson West 2005).

Even though there are few reported malpractice claims against corporate counsel, the number of corporate counsel who are requesting or insisting on legal malpractice insurance coverage as a condition of employment appears to be on the rise. While it is hard to portray this as a negative development, it does raise the question of whether an age-old maxim of the insurance industry – that claims follow coverage – will hold true in this setting. It is conceivable that claims will increase as, in more and more scenarios, there may be an insurance carrier that can be pursued to fund a settlement or pay a judgment, and corporate clients (or, more realistically, former corporate clients) may fee less inhibited from suing where they can believe that insurance, rather than a lawyer's personal assets, will cover any judgment, settlement, or defense costs.

Similarly, it is possible the erosion of the attorney-client privilege may serve to remove a potentially serious disincentive to such suits. As more enforcement actions are filed against companies, and as law enforcement authorities insist that the privilege be waived by companies to demonstrate full cooperation, or, alternatively, as corporate counsel are pressured to "turn on" their employer company to defend themselves, the attorney-client privilege may effectively be nullified or further eroded. In such situations, a company's concern about maintaining the attorney-client privilege may no longer be a disincentive to a malpractice claim.

While both of these trends may be serving to increase the number of malpractice claims against corporate counsel, any increase appears to be incremental. Even with some disincentives to claims being lessened, there are still very few such claims being filed. Of course, for every rule there are exceptions, and this is true here. The scenarios where claims are brought against corporate counsel are worth reviewing to determine what, if any, lessons can be learned.

The first scenario is entirely predictable; if corporate counsel is actually terminated, his former corporate employer may have much less disincentive to sue for malpractice. This was the case in *Dash v. Chicago Insurance Company*.[319] That case actually adjudicated the in-house counsel's claim against his professional liability insurer, which he won. The backdrop was a jury verdict in favor of the corporate employer against its former in-house counsel, but this opinion is apparently unreported. On the other hand, in *J&G Industries, Inc. v. Abood*,[320] the in-house lawyer defeated the claim brought by his former corporate employer. The court found that, contrary to the company's allegations, the in-house lawyer could not be liable for failing to insist on a particular clause in a contract for the simple reason that the sole shareholder had entered into the contract without any advice from the in-house lawyer.

The second scenario is where corporate counsel are alleged not to have simply

319 No. 00-11911-DPW, 2004 WL 1932760 (D.Mass. Aug. 23, 2004).

320 No. L-02-1062, 2002 WL 31420110 (Ohio App. 6 Dist. Oct. 25, 2002).

breached the standard of care, but to have affirmatively damaged the company. This was the situation in two of the more high-profile claims against corporate counsel discussed in our prior article, *Paradise Tarnished*.[321] The first involved the claims brought by the bankruptcy trustee of Trace International against its general counsel, Philip Smith. As discussed ____,[322] [above/below] Smith was found liable by the trial court based on a theory that he had breached his fiduciary duty by participating in a scheme to favor a controlling shareholder over the company itself while it was in the "zone of insolvency."[323] The Second Circuit, however, reversed.[324] Most relevant here is its finding that the bankruptcy trustee stood in the shoes of the bankrupt company and, therefore, that his claim of breach of fiduciary duty was barred by the exculpatory clause in the company's certificate of incorporation.[325]

The second case involved Tyco's suit against its former general counsel, Mark Belnick. After Belnick was acquitted of all criminal charges he still faced suit by Tyco for breach of fiduciary duty for participating in a scheme to favor others (as well as himself) over the interests of the company. As explained above,[326] Belnick has since settled this suit, thereby shedding little light on what would have happened had the suit proceeded.

The lesson from these suits is obvious: If corporate counsel participates in a scheme to favor himself or other individuals at the expense of the company, he should expect not only the possibility of criminal prosecution or other enforcement actions, but also a civil suit filed by his company employer (or its bankruptcy trustee) for fraud and breach of fiduciary duty.[327] Of course, given the volume of SEC actions and criminal prosecution, one could probably also conclude that a civil suit by his former employer is less likely than these development, for what little comfort that may bring.

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321 Lucian T. Pera and Brian S. Faughnan, Paradise Tarnished: Today's Sources of Liability Exposure for Corporate Counsel, Association of Corporate Counsel, March 2005, available at http://www.acc.com/public/article/ethics/liability.pdf.

322 See supra at Section III.B.2.

323 Pereira v. Cogan, 294 B.R. 449, 470 (S.D.N.Y. 2003).

324 Pereira v. Farace, 413 F.3d 330 (2d Cir. 2005).

325 Id. at 342.

326 See supra at Section III.B.6.

327 Another recent opinion that falls into this category is JP Morgan Chase Bank v. Winnick, 406 F. Supp. 2d 247 (S.D.N.Y. 2005). There the administrative agent for lenders sued the borrowers' officers, directors and in-house counsel alleging that they intentionally misrepresented certain financial covenants as part of an effort to induce the lenders to extend credit. The court denied in-house counsel's motion to dismiss under Fed. R. Civ. Proc. 12(b)(6), but it noted that the claims may not survive summary judgment and, in fact, that they did "not strike the Court as particularly potent…." Id. at 259.

Finally, a third scenario does not really involve claims by a former corporate employer at all, but rather claims brought by third parties. The general rule in most jurisdictions, of course, is that a legal malpractice claim can be brought only by a client.[328] But where corporate counsel are alleged to have undertaken the representation of third parties, or where third parties can muster a basis to pursue an argument that they are represented by corporate counsel, they may be able to prosecute a claim for malpractice. These third parties will typically be constituents of the company (e.g., officers, directors or shareholders) or perhaps another company engaged in a joint venture with the company employer.[329]

The way for corporate counsel to avoid this form of exposure is, of course, to make certain that it is clear that she has only one client – the company. Thus, for example, whenever a situation implicates the interests of a company's officers or controlling shareholders, it is critical for corporate counsel to confirm, preferably in writing to all affected, that they are not her clients, but rather that she represents only the company. This is especially important for officers who may be accustomed to giving directions to corporate counsel and who may, therefore, regard themselves as clients.

Insurance and Indemnity

The time for corporate counsel to protect themselves against claims is before they have been instituted. Indeed, in the case of investigations by the Department of Justice, arrangements for indemnity and defense made between a company employer and its corporate counsel may at that point be seen as indicia of a lack of cooperation.[330] Instead, corporate counsel should ensure that they are protected at the earliest possible date, ideally before they are hired.

Some corporate counsel may feel that a carefully written defense and indemnity agreement provided by the company employer may suffice. However, while such an agreement may provide protection to corporate counsel against third parties' claims, it is questionable whether it can include a release by the company itself. While these agreements are permitted in some states, ABA Model Rule of Professional Conduct 1.8(h) generally prohibits an advance release of malpractice exposure. Moreover, even as to third parties' claims, many corporate counsel will want more protection than a defense and indemnity agreement. This additional protection is particularly advisable where (1) the company is a start-up company or its

328 Mark Nozette, Susan Lawshe and John Villa, Individual Liability for the Corporate Lawyer § 6.02, 1999 ACCA Annual Meeting.

329 Id.

330 See Memorandum from Deputy Attorney General Larry D. Thompson to United States Attorneys, Section VI (January 20, 2003). However, in United States v. Stein, 435 F. Supp. 2d 330, 381-82 (S.D.N.Y. 2006), the district ourt held that the government violated the constitutional rights of former KPMG employees by deciding whether to indict them based in part upon whether KPMG would advance them attorney fees.

viability is questionable for other reasons; (2) the company is in an industry where officers, directors and lawyers are regularly scrutinized in the case of failures; (3) the company is in a volatile market that results in shareholder litigation; (4) the company is involved in joint ventures; or (5) corporate counsel gives legal advice to third parties, including even *pro bono* clients.

Although the types of insurance products available to corporate counsel continue to evolve, there are essentially two types of coverage: Directors' and Officers' ("D&O") liability insurance and employed lawyers' coverage. Often, D&O policies will cover only general counsel, if they cover any in-house counsel. Accordingly, if in-house counsel is depending upon a D&O policy for coverage, she needs to carefully analyze the policy. Sometimes D&O insurers will make changes to the policy to provide better coverage to in-house counsel.

The employed lawyers' coverage may be a better option.[331] This coverage is tailored to in-house counsel, providing coverage for such things as violations of the Sarbanes-Oxley Act, punitive damages, and for personal legal services provided to officers or other employees of the company. Note that while both D&O and employed lawyer coverage may provide a defense for claims brought by the company, they may exclude coverage for employer claims so as not to encourage companies to purchase this coverage only to pursue claims against their own in-house counsel.

Practical Guidance

- Malpractice claims against corporate counsel are rare, but may increase incrementally as more corporate counsel are insured and as the attorney-client privilege erodes.
- The single most important way for corporate counsel to avoid malpractice claims is to confirm that her only client is the company and that she does not represent, for example, officers, directors or shareholders of the company in situations where their interests are affected.
- Corporate counsel may want to consider obtaining not only a defense and indemnity agreement, but also insurance coverage, in order to ensure that they are as well protected as possible.

331 Note that ACC has an Alliance partnership with Chubb Insurance to provide ACC members with employed lawyers' coverage. More information is online at http://www.acc.com/php/cms/index.php?id=225#chubb.

6. Lawyer discipline

Lastly, we turn to the small, but important, role of lawyer discipline in the new liability environment facing corporate counsel.

The short version is simple: The potential for disciplinary action of some type upon a lawyer's license appears to be only a small, though significant, aspect of the new liability environment for corporate counsel, and there are no meaningful signs of any significant change originating from this arena. To the extent that any change is visible in this area, it appears to be solely as a result of discipline that follows, almost automatically, upon the imposition of other sanctions upon a lawyer, such as a criminal conviction or an SEC sanction.[332]

The Lawyer Disciplinary System and Corporate Counsel

For all practical purposes, corporate counsel are generally all but invisible to lawyer disciplinary authorities.

Of course, every lawyer, in order to be and remain a lawyer, must be licensed to practice law by some jurisdiction. That licensing jurisdiction, as well as others, always has the power and authority to impose discipline on the lawyer, and to suspend or disbar them. All lawyers are aware that this disciplinary function is vested in some government agency, staffed by prosecutors ("disciplinary counsel") and overseen usually by an arm of an integrated state bar or of the jurisdiction's court system.

By custom and tradition, as well as by the necessity of their workload, lawyer disciplinary authorities are highly reactive – probably much more so than, for example, the SEC and the DOJ. Lawyer disciplinary authorities typically respond to or investigate only complaints filed with them or sometimes to referrals made to them by government agencies. Rarely do disciplinary counsel, on their own initiative, mount an investigation of a particular kind of alleged misconduct by a particular lawyer or set of lawyers.

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332 While your authors have used a number of sources, both formal and informal, to research instances of discipline imposed by lawyer disciplinary authorities against corporate counsel, a small word of caution is in order about sources and methods. There are few areas of the law that remain obscure and quite inaccessible, despite the advent of the internet and computer-assisted legal research. See, e.g., Vesna Jaksic, Attorney discipline Web data uneven, Nat't L. J., Sept. 10, 2007, available at http://www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=1188982953543.
In many jurisdictions, even basic, public disciplinary decisions about individual lawyers by lawyer disciplinary authorities are not readily available on the court system's or the lawyer disciplinary authority's website. Further, these decisions are not uniformly available for all jurisdictions in Lexis or Westlaw.
Further, some significant portion of the disciplinary sanctions imposed on lawyers in some jurisdictions are imposed by private sanctions of one type or another and are simply not available publicly to anyone other than the lawyer disciplined, and perhaps the complainant.
Notwithstanding the unavailability of standard or uniform sources for such decisions, your authors are reasonably confident that they have identified the bulk of any such recent decisions that are noteworthy for purposes of this analysis.

Though there are not national statistics available, every indication is that the number of complaints filed with lawyer disciplinary authorities against corporate counsel is very small, and that the proportion those complaints make up of the overall universe of complaints against lawyers is likewise very small. There are doubtless many reasons for this, but they surely include the fact that most corporate counsel simply do not regularly interact with the typical sources of complaints against lawyers, including especially disgruntled clients and opposing parties of lawyers with consumer-oriented practices (e.g., consumer bankruptcy, collection work, personal injury plaintiff's work). Thus, the "background" volume of disciplinary complaints against corporate counsel is very low.

Lying, Cheating and Stealing

While corporate counsel may be nearly invisible to lawyer disciplinary authorities, our research reveals a not-surprising set of cases in which lawyers who are employed in-house were found to be guilty of some form of disciplinary violation and sanctioned. The conduct involved in these and similar cases we have seen is not particularly unique to in-house counsel, nor does it seem to implicate or be related to the larger changing liability environment surveyed in this article. We set forth merely a sampling of these cases in the footnotes.[333]

As best we can tell without any available national statistics on disciplinary complaints or actions against corporate counsel, the nature of the facts reported in these matters and their number and frequency do not suggest any significant change in the wake of the corporate scandals of 2001-02 and the Sarbanes-Oxley legislation. The unfortunate truth is that corporate counsel, like their lawyer brethren everywhere, do sometimes engage in what might be considered "ordinary" misconduct, and they sometimes get sanctioned for it. In our opinion, these cases offer little in the way of lessons to be learned, except that the ethics rules apply to all lawyers equally.

333 In re Reinstatement of Ramirez, 719 N.W.2d 920 (Minn. 2006) (reinstating lawyer's license where she, as in-house lawyer, pled guilty to theft and was disbarred for submitting false reimbursement requests totaling $30,000); In re Tucker, 2004 Ill. Atty. Reg. Disc. LEXIS 492 (Ill. Sept. 24, 2004) (in-house counsel pled guilty to theft of more than $300,000 of employer's funds; disbarred in Illinois as a matter of reciprocal discipline after being disbarred in Virginia); Counsel for Discipline v. Moorer, 268 Neb. 496 (2004) (general counsel was fired and asked to leave the company's premises; she refused to go quietly, and police had to be called; she resisted and had to be restrained; after charges of trespass and resisting arrest were sent to pretrial diversion, she was public reprimanded); Disciplinary Counsel v. DeLong, 98 Ohio St. 3d 470, 2003 Ohio 1743 (Ohio 2003) (lawyer was administratively suspended for CLE non-compliance, but continued to practice law as general counsel for nine years; suspended for 18 months); In re Conway, 559 S.E.2d 481 (Ga. 2002) (in-house counsel stole funds entrusted to his employer; suspended for three years); Ohio State Bar Ass'n v. Kanter, 715 N.E.2d 1140 (Ohio 1999) (one in a series of three cases involving a scheme for the payment of kickbacks by company's outside counsel to its in-house counsel for the referral of the company's legal work); Disciplinary Counsel v. Linick ,705 N.E.2d 667 (Ohio 1999) (same; in-house lawyer suspended); Ohio State Bar Ass'n v. Zuckerman, 699 N.E.2d 40 (Ohio 1998) (same).

Follow-on Discipline

For our purposes, the most significant aspect of lawyer discipline is the fact that the SEC violations and criminal charges we have discussed earlier in this article often lead directly, (indeed, almost automatically) to disciplinary sanctions against a lawyer's license. Thus, the lawyer disciplinary process has a tendency to amplify some of the trends we have seen in this article by expanding the liability imposed on lawyers who are, for example, subjected to SEC sanctions or criminal penalties. In many situations, for procedural reasons, the process by which this amplification occurs can almost be automatic.[334]

The ethics rules in every state make the commission of certain serious crimes by lawyers a violation of the lawyer ethics rules. ABA Model Rule of Professional Conduct 8.4(b) is the usual formulation, making it lawyer misconduct to "commit a criminal act that reflects adversely on the lawyer's honesty, trustworthiness or fitness as a lawyer in other respects."[335] Though many states do not require that a lawyer self-report a criminal conviction, many jurisdictions have requirements or routine procedures for courts to report such convictions to lawyer disciplinary authorities.[336] This is one of the few areas in which lawyer disciplinary authorities may well respond to published reports by opening investigations, without any complaint being filed with them.

Not surprisingly, we have seen a number of examples of corporate counsel convicted of serious crimes who have subsequently been disciplined by their lawyer disciplinary authorities, some of which are set forth below.[337] Given the ease of

334 For the sake of clarity, let us emphasize that this "amplification" is exactly the same effect that occurs when a lawyer pleads guilty to other serious crimes, whether related to her law practice or not. Lawyers who are convicted of offenses ranging from failing to file their tax returns to possession of child pornography are subject to losing their law licenses in precisely the same way, regardless of their practice setting.

335 Of course, the commission of a crime may also violate other lawyer ethics rules, such as those prohibiting "engag[ing] in conduct involving dishonesty, fraud, deceit or misrepresentation" and "engage[ing] in conduct that is prejudicial to the administration of justice." ABA Model Rule of Professional Conduct 8.4(c) and (d).

336 See, e.g., ABA Model Rule for Lawyer Disciplinary Enforcement 19, available at http://www.abanet.org/cpr/disenf/contents.html.

337 See, e.g., Attorney Grievance Comm'n v. Wingerter, Misc. Docket (Subtitle AG) No. 71 (July 30, 2007) (in-house counsel for immigration services company pled guilty to a federal charge of misprision of felony, based on his knowledge and awareness, and failure to report, numerous instances of fraud and crimes with his employer, including forgery of signatures (including his own and those of immigration clients) on immigration documents and submission of fraudulent document regarding immigration matters to government; he also took active steps to conceal his role; sentenced to six months of imprisonment and six months of community confinement; subsequently disbarred by Maryland authorities); see also Conviction for Concealing Employer's Fraud Results in Disbarment for Maryland Attorney, 23 Law. Man. Prof. Conduct 462 (Sept. 5, 2007); In re Myron F. Olesnyckyj, 2007 N.Y. App. Div. LEXIS 8445 (N.Y. App. Div. July 12, 2007) (general counsel of Monster Worldwide; facts discussed supra in Section II.A.1; after both guilty plea to criminal charged and settlement of SEC charges arising from stock options backdating, disbarred based on allocution on charge of securities fraud); In re Moen, No. A04-1071 (Minn. Mar. 28, 2005) (indefinite suspension of general counsel after guilty plea to wire fraud and computer-related fraud, including manipulating airline tickets and accessing competitors, computer files to obtain information); In re Moen, No. A05-925 (Minn.

proof of any underlying lawyer misconduct, such disciplinary proceedings are often perfunctory affairs, sometimes involving the lawyer consenting to discipline.

Though the provisions and language of the rules vary a good bit from jurisdiction to jurisdiction, virtually every American jurisdiction provides for what is termed, "reciprocal discipline." These rules typically: (1) requires that a lawyer who is sanctioned by another jurisdiction in which he is admitted to practice promptly self-report this fact to his home jurisdiction's disciplinary authority, and (2) has some procedure by which the disciplinary authority then considers whether to impose its own discipline on the lawyer, based on the same facts.

For example, ABA Model Rule of Disciplinary Enforcement 22.A. provides that, "[u]pon being disciplined . . . in another jurisdiction," the lawyer must promptly report this discipline to her home disciplinary authority.[338] Thus, a lawyer licensed in two states, and suspended in one, must clearly report this to the disciplinary authority in the other jurisdiction in which she is licensed.[339] But what if she is "disbarred" from practice before the SEC? Must she self-report?

There is little authority, but what authority there is strongly suggests that a lawyer must treat any agency before which she is "admitted to practice" in any meaningful sense as a "jurisdiction" under this rule, and report any discipline back to her home lawyer disciplinary authority.[340] Of course, most lawyers faced with such a decision would not care to risk not reporting.

Upon such a report, the rules in most jurisdictions then invoke a specific proce-

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Feb. 10, 2006) (order granting reinstatement); In re Weidner, Bar Docket No. 11349 (Kan. Sept, 10, 2003) (president, CEO, and general counsel of bank pled guilty to two felony counts of making false bank entries, while being convicted of additional felonies involving conspiracy, an additional count of making false bank entries and money laundering); In re Palmer, 2002 WL 31713971 (La. 2002) (general counsel for insurance companies uncovered serious financial irregularities, took actions significantly furthering the schemes, including preparing and filing false reports and backdating documents; on guilty plea in federal court to charge of conspiracy to defraud U.S., Palmer got five years' probation, six months in a halfway house, and $50,000 restitution required; Louisiana Supreme Court disbarred him, cooperation with government); Florida Bar v. Wolis, 783 So. 2d 1057 (Fla. 2001) (in-house counsel for company investigated by SEC was disbarred; pled guilty to one federal felony obstruction of justice charge, after being named in 64-count federal indictment, alleging multiple securities law violations, perjury, false statements, and obstruction of justice relating to the SEC's investigation; sentenced to one year's probation, including 60 days' home detention).

338 ABA Model Rule of Disciplinary Enforcement 22.A., available at http://www.abanet.org/cpr/disenf/contents.html.

339 Of course, a lawyer licensed in multiple jurisdictions may well be required to make multiple reports, one to each licensing jurisdiction.

340 For example, reciprocal discipline has been imposed by various jurisdictions based on disciplinary actions by the U.S. Patent and Trademark Office. See, e.g., In re Pierce, 128 P.3d 443 (Nev. 2006) (citing cases and noting an inability to find authority declining to accord USPTO lawyer discipline the same dignity as that of an other state). See also ABA Panelists Assess How Sarbanes-Oxley, SEC Rules will Change Practice and Ethics, 19 Law. Man. Prof. Cond. 100 (Feb. 12, 2003) (reporting from ABA seminar soon after Sarbanes-Oxley was enacted the suggestion that such reporting would be required).

dure for the disciplinary authority to reach a decision about what, if any, discipline to impose for the conduct in question. Jurisdictions vary on the extent to which they will simply impose the same discipline as the other, disciplining jurisdiction, or whether they will permit or require a full-blown hearing on the same conduct. The ABA model rule and the jurisdictions that follow it largely defer to the original jurisdiction and aim at imposing identical discipline;[341] other jurisdictions seem willing to allow re-litigation of the entire matter.[342]

One example of follow-on discipline after an agreed SEC sanction arise this year in Oregon. Following an in-house lawyer's self-report subsequent to his settlement of SEC charges, the Oregon Supreme Court suspended for 120 days James A. Fitzhenry, as a corporation's in-house lawyer, approved a report to the company's auditors knowing that it contained false information.[343] Having settled with the SEC, agreeing to sanctions including a bar on SEC practice for five years, Fitzhenry's self-report led to a disciplinary proceeding in which the primary contested issue was his contention that he had not known of the falsity of the information at the time. Unfortunately for counsel, his testimony in the bar disciplinary matter was found by the court to be contradicted by his testimony in the SEC investigation, and the court largely credited his earlier account, rejecting his change in testimony as "deceptive" and "mendacious." If this case demonstrates anything, it is the practical fact that the consequences of in-house lawyer conduct in lawyer disciplinary exposure will sometimes follow, and may largely be dictated by both the fact of, and the record developed in connection with, the underlying liability or sanction.

341 For example, the ABA Model Rule provides that the identical discipline should be imposed in the home licensing jurisdiction:

unless disciplinary counsel or the lawyer demonstrates, or this court finds that it clearly appears upon the face of the record from which the discipline is predicated, that:

(1) The procedure was so lacking in notice or opportunity to be heard as to constitute a deprivation of due process; or

(2) There was such infirmity of proof establishing the misconduct as to give rise to the clear conviction that the court could not, consistent with its duty, accept as final the conclusion on that subject; or

(3) The discipline imposed would result in grave injustice or be offensive to the public policy of the jurisdiction;

(4) The reason for the original transfer to disability inactive status no longer exists.

ABA Model Rule of Disciplinary Enforcement 22.D., available at http://www.abanet.org/cpr/disenf/contents.html. The ABA rule also provides that the prior adjudication is largely conclusive on the facts and misconduct underlying the discipline imposed in the other jurisdiction. ABA Model Rule of Disciplinary Enforcement 22.E., available at http://www.abanet.org/cpr/disenf/contents.html.

342 See, e.g., Discipline by Some Tribunals Elsewhere Doesn't Support Reciprocal Action in D.C., 22 Law. Man. Prof. Cond. 583 (Nov. 29, 2006) (reporting a decision of the D.C. Court of Appeals declining to impose identical discipline based on earlier discipline in Maryland and Massachusetts).

343 In re Fitzhenry, 162 P.3d 260 (Ore. 2007).

Lessons?

Finally, in terms or lessons learned or practical guidance that can be drawn from recent disciplinary matters involving corporate counsel, it is difficult to offer meaningful pro-active suggestions to in-house lawyers. The greatest risks of lawyer discipline for in-house counsel are, as we have seen, "ordinary" misconduct such as any lawyer might be found guilty of and follow-on discipline after imposition of liability in another proceeding, such as an SEC or criminal proceeding. In the form situation, practical guidance runs mostly along the lines of, "Do the right thing." In the latter, no guidance separate from that related to the underlying liability exposure seems possible.

IV. Conclusion

Half a decade on from the corporate scandals of 2001-2002 and the enactment of Sarbanes-Oxley, much has changed for corporate counsel. Some of this change may be more perceived than real; some may be real, but hard to measure; and some tangible and real. Over the last several years, especially as a result of the widespread fallout from the stock options backdating scandal, the changes in the potential liability environment for corporate counsel have begun to settle into the latter category – tangible and real. In this article we have begun, with the date now available to take some measure of its dimensions and meaning. Some answers have emerged, but only continuing developments will tell the tale.