Criminalization Of Noncompliance:

How Do GC's Protect Their Companies and Themselves?

CHRISTINE JEGAN

Increasingly, general counsels' advice and actions have resulted in their criminal prosecution. Gathered to discuss this issue were Walter F. Brown, Jr. chair of Orrick, Herrington & Sutcliffe's national white collar defense; Eugene Illovsky, managing partner of Morrison & Foerster's Walnut Creek office and a member of the firm's securities litigation enforcement and white collar defense group; Patrick D. Robbins, a partner at Shearman & Sterling, LLP, who represents companies, officers, and directors in corporate criminal and enforcement matters; Mark C. Holscher, a partner at Kirkland & Ellis, whose practice focuses on white collar criminal defense and criminal and civil trials; Robert D. Rose, who heads Sheppard Mullin's white collar practice group from the San Diego office; and Brian Martin, senior vice president and general counsel and corporate secretary of KLA-Tencor.

MODERATOR: Let's first lay out the landscape. What's the current regulatory climate for inhouse attorneys?

MARTIN: Allow me to start with the usual disclaimer: the comments I'm going to make here today are my own and should not be attributed to my company. When you look at the regulatory climate for inhouse counsel some features are newer and some are not. What's new is the idea of inhouse attorneys as corporate gatekeepers and failure in that role providing the basis for regulatory attention. Consequently, what's also new is the regularity of private and governmental actions against in-house counsel. But amidst all of the new attention given to inhouse counsel, there's an important principle that's not new and it sits at the heart of most of the actions brought against inhouse counsel: The inhouse counsel's client is the corporation. When inhouse attorneys do not act consistent with that obligation, they find themselves as viable targets of lawsuits or other actions.

ROSE: Every two years, 400-plus Congressional incumbents and close to a third of the Senate return home to run for

reelection. Nothing plays as well with the constituents than having put your name on a crime bill. As one example, the hysteria generated by pretexting at H-P has generated a new federal crime for identity theft. Under consideration are new crimes for disaster fund fraud and stiffer penalties for wartime profiteering.

HOLSCHER: Inhouse lawyers are facing potential investigations on garden-variety mail fraud, wire fraud, obstruction of justice.

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The Department of Justice and SEC are reflecting a more populous view, which is anti-corporate. Major corporate criminal prosecutions now go deeper and wider. The DOJ looks at anybody in the company, including inhouse counsel, as potential targets. This doesn't just apply to DOJ Washington. There are 93 U.S. Attorney's Offices across the country, they act independently, even more so based upon what's been going on in the last few months.

BROWN: It used to be that the U.S. Attorney's Office and the SEC conducted investigations. But we've seen this creep towards companies being expected to play the role of the government. It reached a fevered pitch in the last year with the wave of stock options investigations and created a cottage industry of private investigators doing the bidding of the government.

ROBBINS: Five years ago, the President called every U.S. Attorney to Washington. The Administration had just formed the Corporate Fraud Task Force and decided to put more resources into prosecuting white collar crime. Included within the discussion was the perceived need to co-opt lawyers. The Administration concluded there were two ways to do that. One was to invade the privilege as much as possible; the other was to create a deterrent for lawyers by prosecuting lawyers who participate in corporate crime.

But it looks like a bill is going to pass in Congress prohibiting prosecutors from asking for privilege waivers. And although the government has had some significant victories, it has had some setbacks too. There were acquittals in some of the Enron prosecutions and in other corporate fraud cases brought around the country.

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Brian Martin
Senior Vice President and general counsel and Corporate secretary
KLA-Tencor

HOLSCHER: I would say though, it's a different world. We do jury research, and what it shows is jurors want to convict senior executives whether they knew or because they should have known of criminal conduct. Then you poll potential jurors on lawyers: their view is that lawyers are generally complicit and do what the senior execs want them to do. It gets even worse when you start polling jurors' views of advice of counsel defenses.

ILLOVSKY: The inhouse lawyer has so many roles and wears so many hats, and each one triggers a different kind of problem and a complication of your job. You're a business adviser and a legal adviser; you're a manager of your department; you're the corporate secretary, which long ago used to be, "Okay, I'll sign it," now it's "I signed it what did I do?" We see that in backdating. You're a compliance officer, possibly; you could be a government affairs officer; you may be a risk manager; you could be an ethics officer, and now thanks

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to the SEC and the government, you're a gatekeeper to the marketplace. You're a government agent; you're an issue spotter under insanely obscure federal criminal statutes that you had no idea even existed; and you're got to learn how to be a gumshoe; and an investigator. So take that list, take it to your boss or the board and explain to them why that next raise is so deserved.

CHRISTINE JEGAN

Robert D. Rose
Sheppard, Mullin, Richter & Hampton, LLP

MODERATOR: Given this climate, how does an inhouse lawyer go about differentiating between the ethical, the unethical, and illegal? What signals should trigger further inquiry?

ROBBINS: Don't listen to any outside lawyer who says, 'That's how it's always done.' No one could have predicted two years ago what happened with pretexting at Hewlett Packard. You have to look for what the government calls the badges of fraud: for concealment; efforts to constrain the circle of people who get to know about something; efforts to keep something from the auditors, efforts to keep something from the board or the audit committee – those are strong red flags. Seek advice from key constituencies. It is very hard for a prosecutor to make a case on a lawyer who openly speaks with the audit committee or auditors about an issue, because there's no concealment, there's no deception.

MARTIN: But it's difficult for inhouse counsel to identify the badges of fraud in accounting, for example, if you're not an accountant. The gatekeeper role has vastly expanded the subject matter that an inhouse counsel needs to master. The key to this challenge is to harness your internal expertise. For example, in the accounting area, you must have very strong relationships with those in your finance department, treasury, internal audit, controller, the audit committee. You should find someone who will have the patience to explain things. An inhouse counsel simply cannot defer on technical issues and rest on a lack of knowledge.

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HOLSCHER: You don't want to be involved in email traffic in which the email says, 'How are we going to present this to KPMG?' 'How are we going to pitch this to outside accountants?' The response is, "We don't pitch anything." There's also a real suspicion of the government when senior management is involved on both sides of any transaction. The government is particularly interested in trying to figure out if people are looking the other way.

ROSE: A lot of decision-making can be guided by the answer to this simple question: Does this seem right or wrong? Would this pass the *New York Times* front page test? Is there somebody else I can talk to, while still preserving the privilege, that could give me a second opinion?

ILLOVSKY: But trying to determine whether something is illegal or unethical is a devilishly complicated task. You have to develop an internal compliance program so that employees in all parts of the organization are making the right decision in connection with that same imprecise, impossi-

ble judgment as well. As we all know, the idea of good ethics has found its way into law and regulation such that under the sentencing guidelines now, it is expressly noted that one of the reasons for having a good compliance program is to create on organizational culture that promotes ethical decision-making.

ROBBINS: The most positive thing a GC can do is to create a direct line to the audit committee. The companies that get high marks from the SEC for compliance have the GC reporting directly to the audit committee, and not where the GC talks to the audit committee a few times a year. If that's the model, it's not going to work.

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>
> ***— Mark C. Holscher***

HOLSCHER: But I'd add the caveat that to go to the board on an issue is a major event and a major potential blow up at significant cost to you and your department if you are wrong.

BROWN: One of the few areas of compliance where you can get outside guidance is the Foreign Corrupt Practices Act. For any company that has operations beyond the United States, there is a procedure at the Department of Justice Fraud Section where you can actually present a set of facts and they will give you a nonbinding opinion.

MODERATOR: Let's talk for a moment about email.

HOLSCHER: We've all been involved in cases where there were people inhouse, either lawyers or non-lawyers, who felt they really needed to shake up people to have them pay attention to the problem and say, "Look, this could be criminal." If you have one takeaway from this discussion, don't send that email to try to get attention to an issue that is unclear at the time. If you are going to raise an issue, do it in a nuanced, lawful way and don't exaggerate the problem. "I'm looking at this issue, I have some questions, we should talk about it."

ROSE: Here's the simplest piece of advice I can offer: Knock off the use of email for anything and everything that people should say to each other in person or over the phone. It is simply too easy for a prosecutor to overcome a presumption of innocence by merely rearranging emails.

HOLSCHER: Any time you're carbon copied on an email, the prosecutors assume you have read it, you agree with it, and unless you send something in response, that is the record. I call it conviction by cc or carbon copy. Everyone at this table has sat down with the U.S. Attorney and said, "Do you know that my client receives 850 emails every three days and that he didn't read these emails?" The prosecutors respond, "Tell that to the jury."

CHRISTINE JEGAN

Mark C. Holscher
Kirkland & Ellis LLP

Make it known in your company that you don't review carbon copies. Or if you get a cc of something you don't like, you need to make sure you have sent back to someone, "I don't have time to look at this today, I'm happy to talk to you, I don't agree with your characterization, come see me." In the Merrill Lynch/Enron barge case, the head of investment banking of Merrill Lynch was convicted at trial on one email. There were two other senior executives who were convicted on the basis of two emails and fifteen minutes of conversations in their career. I've counseled friends to set up their own private email for private discussions. Everyone mixes their personal and professional emails, and there's always something that the

Criminalization Of Noncompliance:

How Do GC's Protect Their Companies and Themselves?

government finds quite interesting that's irrelevant that gets them excited.

MARTIN: Here's a practical training tip: Start collecting from the press examples of stupid emails and create a stupid email file for training purposes. But there's a more fundamental point here. Many of your constituents believe that they are your clients and that they have an attorney/client relationship when they walk into your office and say, 'Hey I think we have a problem.' You need to disabuse them of this idea.

CHRISTINE JEGAN

Walter F. Brown, Jr.
Orrick, Herrington & Sutcliffe LLP

MODERATOR: How does an inhouse attorney demonstrate to the government that he or she has engaged in sufficient due diligence?

BROWN: There's tension between acting in an alarmist fashion and calling your outside counsel every time a problem comes up and doing the opposite and not being proactive enough. The related question, though, is how much are you going to be able to rely upon outside counsel, and to what extent is the government going to try to argue that at some point it became part of the problem rather then the solution?

HOLSCHER: In terms of sufficient due diligence, what I've often seen in these investigations is that the company doesn't get closure on an issue. Think about how a record is left when somebody, for whatever reason, thinks there's something going on that's wrong.

MODERATOR: When should general counsel or inhouse attorneys initiate an investigation? Who should the GC involve?

ROSE: For a public corporation there are so many different things that prompt an internal investigation. The issue may be not so much "should we do an internal investigation?" as "how much of an internal investigation do we need to do and who should do it?" The key is to identify what is the problem. Get your hands around what's being alleged. You can almost bet that, if you get into an investigation and it goes on for any length of time, there's going to be a surprise—either something that you didn't know when it began or something that wasn't alleged.

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>
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ROBBINS: The problem now is that public companies have become reflexive in launching massive internal investigations involving outside counsel. The investigations cost millions of dollars and are extremely disruptive of morale. There's room for reason in choosing the level and intensity of the review, whether it's conducted by inside or outside counsel. If the investigation is going to be conducted by inside counsel, you do need to understand the Upjohn warning, the way to question people appropriately, and how to properly obtain and preserve evidence.

BROWN: Your auditors may very well have views about how an investigation should have been conducted. The question becomes when do you involve them in the design of the investigation. Auditors will typically tell you, 'We'll wait till it's finished and then we'll give you our thoughts about it.' Increasingly I've tried to involve the auditors at an early stage so there are no surprises at the end.

HOLSCHER: I can't tell you how many times we are doing an internal investigation and someone refuses to be interviewed. I look at the employee handbook and the company didn't have the employee sign the handbook. Or the handbook doesn't have the basic statement that you have an obligation to cooperate and make yourself available for any internal investigation.

MARTIN: Moreover, the casebooks are full of instances where inhouse counsel failed to provide someone whom they're interviewing with what we call the corporate Miranda. This warning assures that the employee understands the lawyer's role in the investigation and that the employee is not the lawyer's client. The Association of Corporate Counsel has an info pack on conducting internal investigations, which is an outstanding resource.

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>
> ***— Patrick D. Robbins***

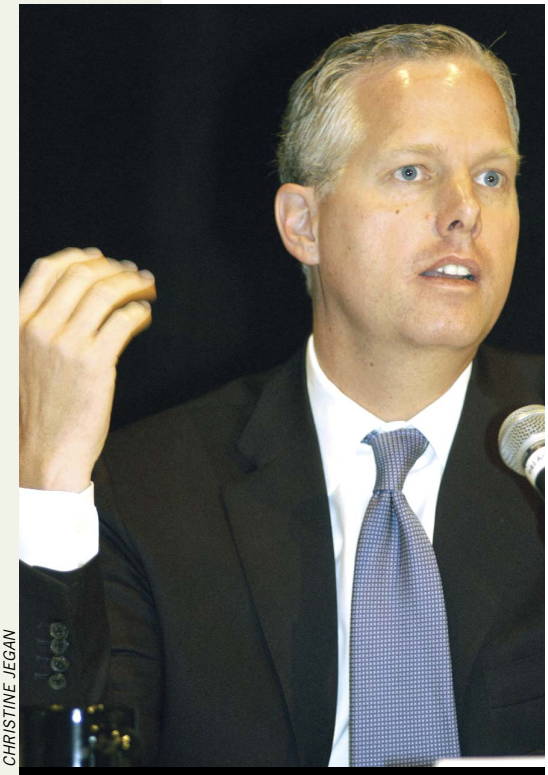
HOLSCHER: If it's a senior executive who is potentially implicated, there are a lot of reasons why in that situation you bring in an outside lawyer. You also need to make sure that if it's a significant investigation there's a view that the law firm is conducting the investigation independently. If the firm knows the person being investigated, and if it's a law firm that does significant corporate work, you need to be careful. Just keep in mind the government is skeptical. I have tearfully declined representation from clients because my firm has been lead outside counsel.

ROSE: You could look at the Thompson Memorandum, the Principles of Federal Prosecution, the Seaboard decision for lists of things to cover in your investigation.

MARTIN: To me oftentimes truly independent is synonymous with massively expensive. How do I balance the need to investigate issues with management of the costs?

ROSE: With a specific plan–what to go after, who to talk to, who'll do the talking, how it will be reported, and then what will be the report back process—costs can be controlled. I always recommend that there be stages along the way where they'll be a progress or status report.

ROBBINS: A huge portion of the cost of an internal investigation is collecting and processing electronic data. Lawyers are expensive too, but the trend is to hire an audit firm that is not the regular auditor, have it gather all the data and restore backup tapes to create a huge database. That costs millions of dollars. If you simply preserve as much of the data as possible, but filter and process only what you rationally identify as key, you can save money. You can go to the SEC and explain, 'Here's the huge universe we preserved, here's how we approached the processing and review. We can always go back and process more if you want us to.' Typically they don't ask you to do that.



CHRISTINE JEGAN

Patrick D. Robbins
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HOLSCHER: I've gone to the SEC and said these are the search terms we're using to look at documents. With a grand jury subpoena, it nicely says 'Any and all records including but not limited to the following.' You can go back and say, 'Here's what we're searching for, here's the search terms we're using, here's the employees, if there's anything else you want to adjust, let us know.' In most cases the U.S. Attorney's office and the SEC do not want these massive searches.

Criminalization Of Noncompliance:

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ROBBINS: One comment about document preservation. The Supreme Court ruled 9-0 in *Arthur Andersen* that destroying documents pursuant to a valid document retention program is not a crime. That's the good news. The bad news is Congress passed a completely different obstruction statute after *Arthur Andersen* but before the Supreme Court opinion, which is incredibly broad and still not tested. It says if you destroy documents and had in mind the possibility of an investigation that may not have started yet, you can be criminally prosecuted. What that says to me is that it's very important to have not just a valid document retention program but one that's actually followed.

CHRISTINE JEGAN

Eugene Illovsky
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MODERATOR: How does the inhouse attorney go about training upper management so the company doesn't get in trouble in the first place?

MARTIN: While training is important, perhaps more important is that inhouse counsel needs first to assure that they are affiliated with companies that possess a culture of compliance. The most effective way to avoid the ethical dilemmas we fear is to go to work with a company that will not place you in those situations. You need to talk to board members, to the management team to get a sense about the culture.

HOLSCHER: Try to get the CEO, COO, or even someone on the board to be the author of the memo that goes out asking that the training be done. When it comes from the CEO, the message is sent that it's a priority to make sure that we are in compliance.

> ***"The inhouse lawyer has so many roles and wears so many hats, and each one triggers a different kind of problem and a complication of your job."***
>
> ***— Eugene Illovsky***

BROWN: If the goal of this seminar today was to help you stay out of trouble, this is one of the most important areas for you all to think about. In the early '90s it became vogue for companies to start enacting compliance programs in response to the corporate sentencing guidelines. A lot of companies put something in writing, set it on a shelf, and left it there. If you find yourself in the crosshairs of the government, and you have a compliance program that is nothing more than something on a shelf, you are in much worse shape than if you had no compliance program at all.

ROBBINS: And the practical impact is your company will pay a lower fine to the government whether it's the SEC or DOJ, because you have a program that works.

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