Wednesday, May 21

1:30 pm–3:00 pm
101 Ethics Immersion – Part I

3:30 pm–5:00 pm
101 Ethics Immersion – Part II

Susan Hackett
Senior Vice President & General Counsel
Association of Corporate Counsel

Faculty Biography

Susan Hackett

Susan Hackett joined ACC in Washington, DC, as senior vice president and general counsel. She is currently focused on ACC's advocacy efforts including ACC's amicus program, the development of in-house legal ethics and professionalism resources, testimony and representation before decision-making authorities, in-house corporate responsibility initiatives and, multi jurisdictional practice (MJP) reform. She also focuses on attorney-client privilege protection, revision of the Federal Sentencing Guidelines, e-discovery evidentiary reform, and civil justice reform initiatives. Corporate pro bono and diversity initiatives, including diversity pipeline projects, and liaisons with the bars of color.

Before joining ACC, she was a transactional attorney at Patton Boggs, a large DC law firm, and clerked for several DC employers while in law school and sitting for the bar.

Ms. Hackett is a former member of the boards of directors of Equal Justice Works and Street Law, Inc., and the Minority Corporate Counsel Association (MCCA). She has been an appointed liaison to several ABA presidential commissions and task forces, including: the commission on the multijurisdictional practice of law, the commission on alternatives to the billable hour, the joint committee on lawyer regulation, the ABA task force on Sarbanes-Oxley Section 307, and the attorney-client privilege task force.

She is a graduate of a dual B.A. from James Madison College at Michigan State University, and a graduate of the University of Michigan Law School.

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We can't cover everything, but …

Topics we'll cover: Part One

- Admissions/Licensing - MJP and lawyer mobility
- "Who's the Client?" Issues:
  - The interests of management and the interests of the entity
  - Conflicts - when "only one" client is involved
  - Conflicts due to business situations
  - Conflicts in lawyer mobility
- Corporate Counsel Wearing Legal and Business Hats
- Other (Misc.) conflicts issues:
  - Supervisory responsibilities when outsourcing: outside counsel, vendors, off-shoring
  - Suing the employer/retaliatory discharge

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In-house Ethics: "Greatest Hits" (Cont.)

Topics we'll cover: Part Two

- Duties to the employer/client and challenges they present on a practical level:
  - Confidentiality and privilege
  - Fiduciary Responsibilities
  - Reporting up the Ladder: Rule 1.13 and Sarbox 307
- In-depth discussion of privilege challenges
  - In the adversarial context / in the audit context
- Gatekeeping and emerging theories of liability

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Ethics and Professional Regulation

- The rules were created with outside practice in mind
- Representing a single client entity poses challenges that the rules don't address, and many courts and regulatory authorities don't understand in-house practice
- From the date of your admission to the moment you realize that you're practicing business decision-making, and not law, in-house counseling presents challenges you must navigate.
- A small comfort: in-house counsel are empirically least likely to be brought up on disciplinary charges (we'll get to the bad news -- the *increasing* likelihood you'll be scrutinized in a criminal context -- later in our discussion).

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Gatekeeping challenges in the Post-Enron prosecutorial environment:

- Post-Enron, public opinion of companies has never been lower … and expectations are higher and scrutiny stronger.
- Has the role of lawyers actually changed post-Enron, or has the scrutiny applied to their actions (or inactions) simply increased or changed focus?
- A "sea change" for legal ethics: Professional responsibility has always been concerned with the lawyer's behavior, but is increasingly focused on the lawyer's responsibility for the client's behavior.
- The "gut test" is a dangerous strategy.

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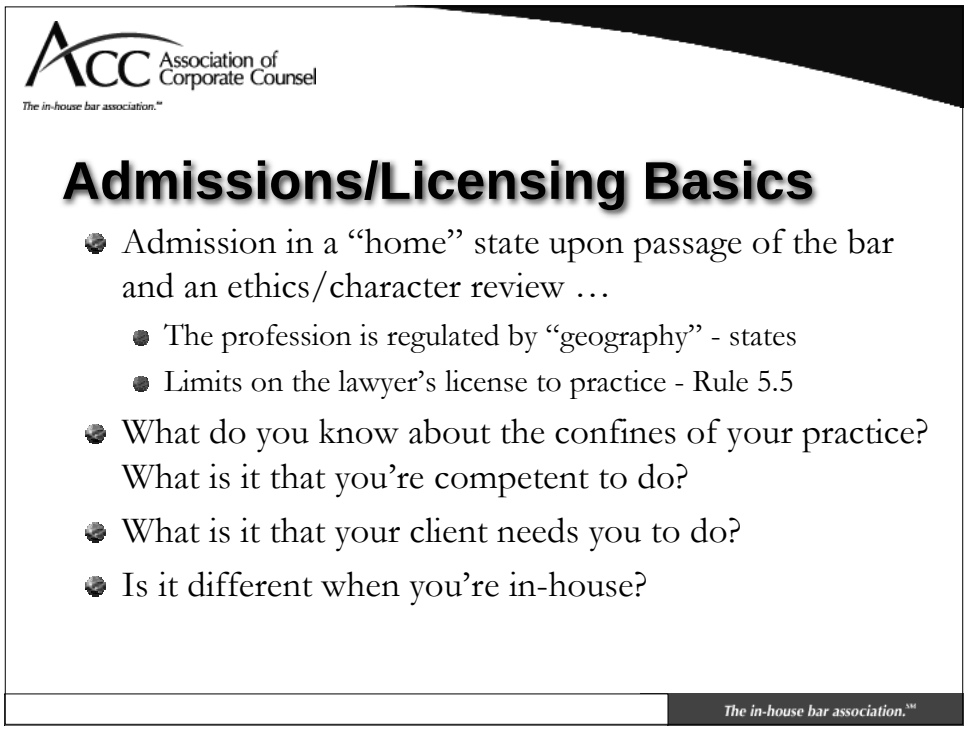

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MJP Exam - raise your hand…

- Have you ever traveled to a state in which you are not admitted and worked on a client matter or returned client phone calls?
- Have you participated in pre-trial preparations or settlement discussions in another jurisdiction?
- Have you retained outside counsel to represent you "nationally"?
- Do you counsel clients located in a facility or anywhere outside of your "home" state?

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So what … who's watching?

Birbrower brings it home:

- **The California Supreme Court holds that a NY law firm can't collect its fees for work done in CA; MJP gains national attention.**

Guerilla warfare tactics:

- **The UPL rules used -- not for the protection of the public -- but as a "gotcha" tactic between opponents.**

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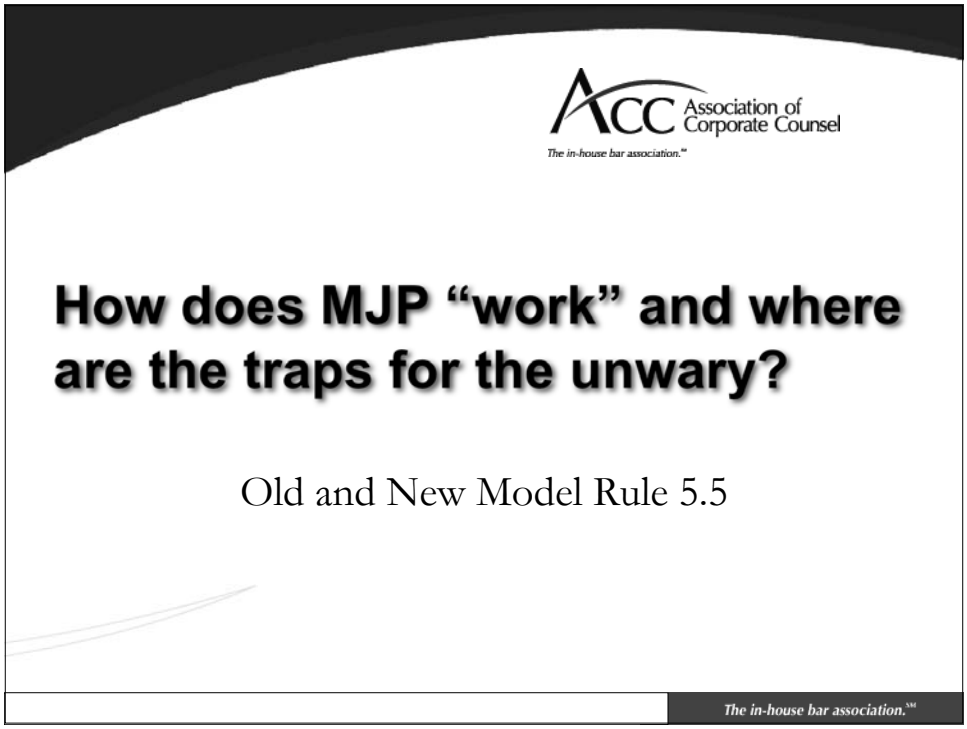

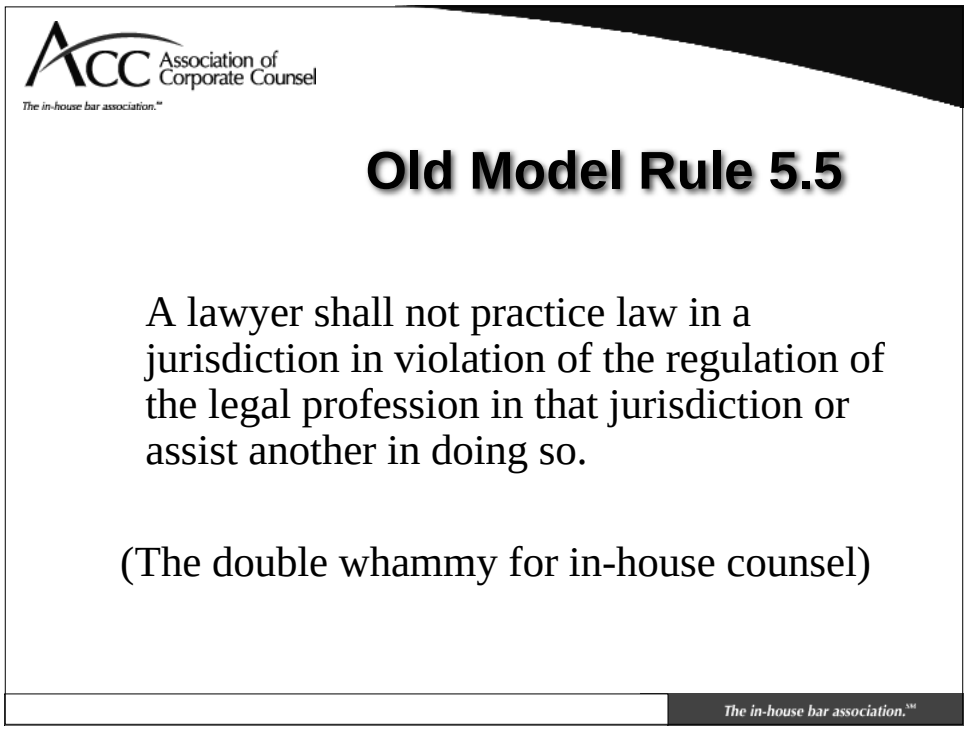

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New Model Rule 5.5

5.5(a) A lawyer shall not practice law in a jurisdiction in violation of the regulation of the legal profession in that jurisdiction or assist another in doing so.

5.5(b) A lawyer who is not admitted to practice in this jurisdiction shall not:

(1) except as authorized by these Rules or other law, establish an office or other systematic and continuous presence in this jurisdiction for the practice of law; or

(2) hold out to the public or otherwise represent that the lawyer is admitted to practice law in this jurisdiction.

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5.5(c) [temporary incursions]

A lawyer admitted in another United States jurisdiction, and not disbarred or suspended from practice in any jurisdiction, may provide legal services on a temporary basis in this jurisdiction that:

(1) are undertaken in association with a lawyer who is admitted to practice in this jurisdiction and who actively participates in the matter;

(2) are in or reasonably related to a pending or potential proceeding before a tribunal in this or another jurisdiction, if the lawyer, or a person the lawyer is assisting, is authorized by law or order to appear in such proceeding or reasonably expects to be so authorized;

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5.5(c) [temporary incursions, continued]

(3) are in or reasonably related to a pending or potential arbitration, mediation, or other alternate dispute resolution proceeding in this or another jurisdiction, if the services arise out of or are reasonably related to the lawyer's practice in a jurisdiction in which the lawyer is admitted to practice and are not services for which the forum requires pro hac vice admission; or

(4) are not within paragraphs (2) or (3) and arise out of or are reasonably related to the lawyer's practice in a jurisdiction in which the lawyer is admitted to practice.

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5.5(d) [permanent practice]

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 by federal or other law to provide in this jurisdiction.

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What is a temporary incursion under 5.5(c)? What are its limitations?

- How long?
- Recurring?
- What about incursions in other states that haven't passed these rules, or non-US incursions?

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Is 5.5(d)(1) a 'complete' authority? IHC registration Rules ….

State bars passing 5.5 often adopt an IHC registration rule even tho it's not required by the rule.

State bars' discomfort with unregistered presence

"Model" registration rules…Which rules are better than others? ABA Model

Is "no rule" a good rule?

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MJP basics to remember:

- 5.5(d) Authorization or Registration for "permanent practice" by IHC
- Temporary Incursion Authorization in states that have passed 5.5 reforms (outside of court)
- Temporary Incursion Authorization for outside counsel who represent you (outside of the courtroom)
- Pro Hac Vice Admission when necessary
- Foreign Counsel Rules: inadequate but evolving
- No good guidance on "virtual" counseling
- Watch for "guerilla warfare" tactics: gotcha!
- Remember supervisory responsibilities [5.1 & 5.5(a)]
- Avoid complacency: No one cares until they move.

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What about boundaries beyond the 50 states?

The globalization of firm and dept. practice:

What to watch for:

- not just an issue of local admission, but whether IHC are recognized by the bar/authorized to practice (e.g., Akzo)

Impact on client perceptions of IHC value

When giving cross-border advice, remember privilege and related concerns

GATS and other "treaty-level" discussions

ACC's IPA - a helpful resource

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Which states have adopted rules?

- Depending on how you count them, about 37 states have adopted MJP reforms
- What about those that haven't?
- Prospects for further reform and regulation?
  - Model registration rule
  - Foreign counsel rules
  - Admission on motion/Regional pacts?
  - ACC's 25 year plan - national admission

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Okay, so now you're properly authorized to practice ….

… just who the heck are you practicing for?

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Who's the Client? Model Rule 1.13

- Management "*versus*" Entity: the conundrum:

  The "entity" is a fiction. The board does not run the daily operations of the company. Yet the entity, as represented by the board, is your client.

  Management is made up of (fallible) folks you counsel all day, who think of you as "their lawyer." They may look to you to be a gas pedal or think of you as an unnecessary brake. You are a cost center in the company. And you get to remind them you aren't their lawyer the minute the stuff hits the fan.

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Who's the Client? Model Rule 1.13

- While this may not make you popular, it's relatively clear. The problem is:

  How do you decide when employees, executives, and even the board are acting within the best interests of the entity?

  - What is appropriate risk (ERM)? different companies have different appetites, and it doesn't make them criminals, does it?
  - When should you exercise the "legal, but stupid" rule and assert your business judgment over the client's? (fiduciary role)
  - Are you protecting shareholders? The public? What is their interest? Can that be determined without 20/20 hindsight?
  - Is your obligation to "stop" clients and how: when do you need to withdraw or report them?

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Who's the Client? Sarbox 307

Post-Enron, Congress decided that state ethics rules weren't getting the job done: Sarbox 307 regulates attorneys "appearing and practicing" before the SEC (effectively all public co. lawyers):

- This is law : criminal sanctions attach [17 CFR Part 205]
- Basically codifies Model Rule 1.13 "reporting up" requirements, with some added specificity.
- Sarbox 307 dictates are now the "reasonable" standard under 1.13; so even if you're not in a public company ….
- Most notable: this is a wake up call … lawyers are now firmly part of the governance process. (We're going to talk in greater depth about gatekeeping later on.)

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Who's the Client? / Conflicts

Representing a corporate family - Model Rule 1.7

Most folks learn 'conflicts' issues in the law firm context: current client/past client: when you can take on a new client/matter and when you can't.

In the corporate family context, issues arise when your work for the parent or your employer-entity entails your work with subs, affiliates and ventures - the rules suggest you can treat wholly-owned subs / affiliates as divisions of your entity-employer.

So what are the issues?

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Who's the Client? / Conflicts

- How can subs' interests diverge from the employer-entity?
- Do we all agree that it's valuable to represent subs/affiliates even when they're not wholly-owned?
- Are there measures you can consider to avoid problems and help diffuse conflicts that do arise? Best practices to employ?
- *BCE v Teleglobe*: Judge Ambro's excellent advice.
- Joint defense agreements / scope of representation letters

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Who's the Client? / Conflicts

A few final conflicts considerations:

• who's the client when financial troubles are leading to insolvency/bankruptcy?
• who's the client in a takeover or merger situation?
• who's the client in derivative litigation?

(See John Villa's excellent materials for more info…)

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Working for Competitors/Mobility

- Conflicts issues you may not have considered:
  - Strict rules regulating lawyers moving from firm to firm – the rules don't just apply in the outside context. When you move, you carry the same responsibilities.
  - Non-disclosure and non-compete agreements:
    - Everybody signs them, but they're technically unenforceable
    - You shouldn't convey to your client that you can abide by their terms
    - Supervising lawyers shouldn't ask their subordinate lawyers to sign documents that are not consistent with professional requirements.
    - Is there a form that can be developed for lawyers? That incorporates the rules' requirements to avoid conflicts and breaches of confidentiality? A professional standards manual signed by lawyers upon entry to the dept?

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Business Versus Legal

- Fundamental value of IHC is their integration into the business and their intimate "knowledge" of the client
- Ethics programs for in-house counsel used to be relatively simple: we talked about how to take off your business hat and put on your legal hat and vice versa.
- Now your hats are piled on top of each other for governance, fiduciary and criminal liability standards, but ethical regulations still assume that the two will always be separately worn.

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Business vs Legal: (foreshadowing the next session)

- There are many discussions re the rules we could engage in here:
  - MRPC 4.1 (re the duties regarding misrepresentation of facts that affect counsel engaged in negotiations)
  - MRPC 3.1 - 3.7 (regarding duties of zealous advocacy and their limits in the counseling context); we won't cover them all.
- The emerging role of internal audit and compliance functions that are business and not legal functions.
  - What is the lawyer's role as preventive counsel when there's a titled CCO?
  - Who's on first? Problems of coordination/responsibility/staffing?
  - What does this mean for privilege and defense rights of the client?
  - Can lawyers establish, manage, evaluate, and improve compliance programs, and then objectively defend them when they are challenged?

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Suing the Employer

- What happens when the lawyer's employment rights conflict with her duties under the rules?
  - The *Balla v. Gambro* case as illustration
  - Cases often arise in the context of an argument over poor performance (management's view) vs. allegations of wrongdoing ignored (discharged lawyer's view).
  - Can outside counsel sue their clients who fire them for any reason? Do we want our employment status to make us less attractive as lawyers?
  - Classic conflict between professional responsibility and lawyers' personal interests: which wins the day? And why?

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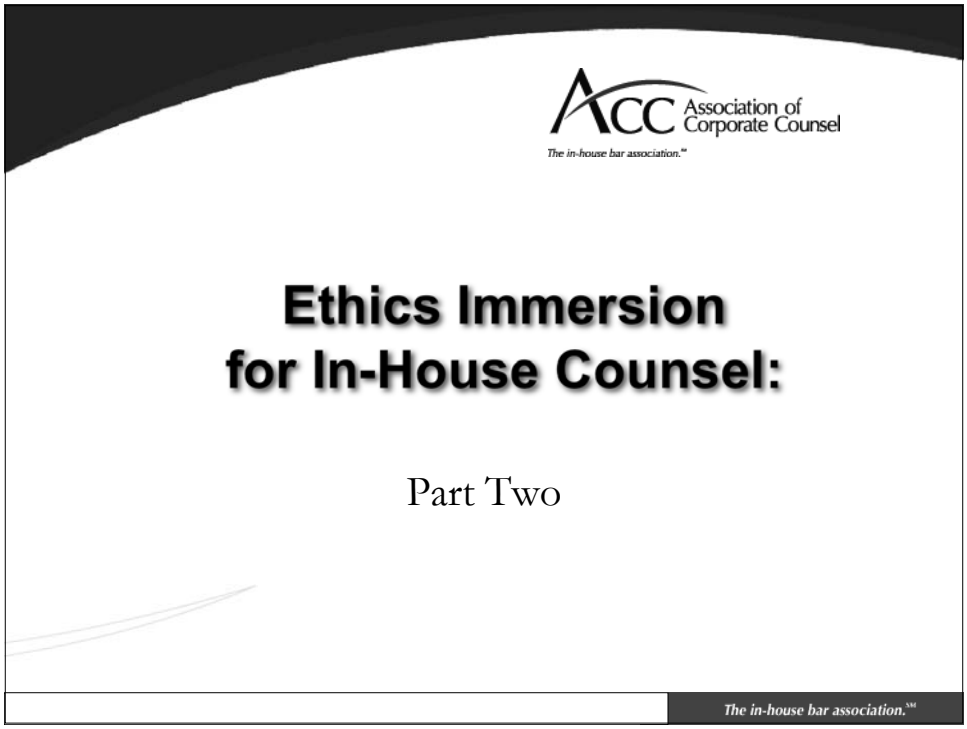

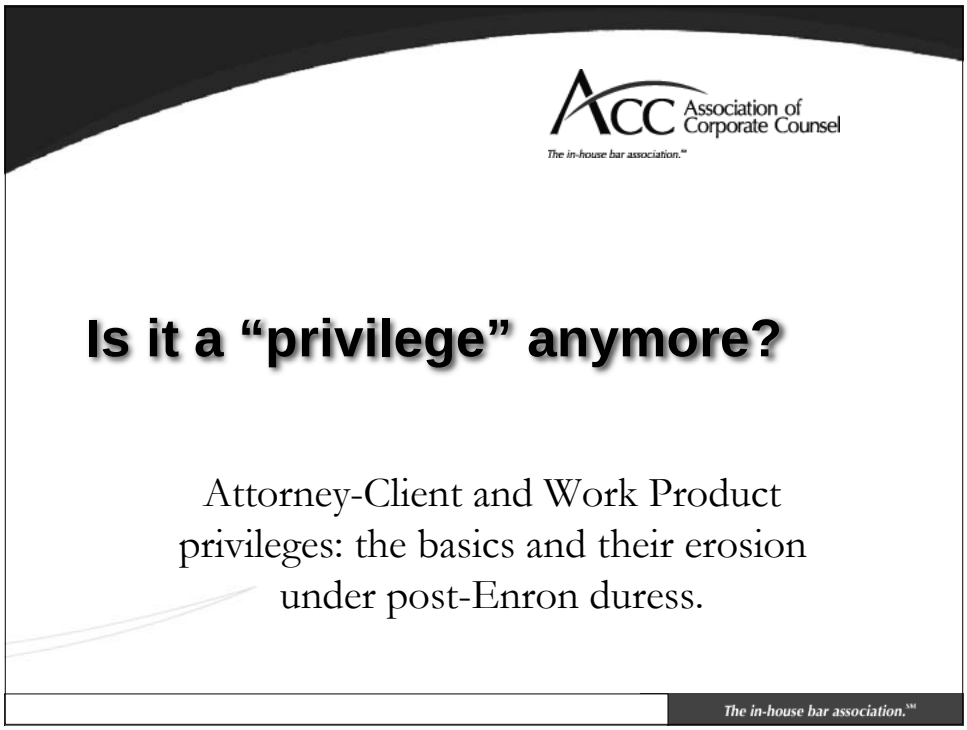

Second verse, begins like the first!

LAWYERS AND GATEKEEPING:

- Post-Enron, public opinion of companies has never been lower … and expectations are higher and scrutiny stronger.
- Has the role of lawyers actually changed post-Enron, or has the scrutiny applied to their actions (or inactions) simply increased or changed focus?
- A "sea change" for legal ethics: Professional responsibility has always been concerned with the lawyer's behavior, but is increasingly focused on the lawyer's responsibility for the client's behavior.
- The "gut test" is a dangerous strategy.

Conflicting duties come to a head: protecting attorney-client privilege

When the client entity is under the microscope, everyone expects the company and its lawyers to cooperate fully: "full frontal transparency." Does that means producing privilege?

An increased focus on detecting and reporting frauds and failures can make lawyers and the privilege they (cannot) protect targets of prosecutors and pariahs to clients.

When lawyers act as regulators, it's impossible to balance confidentiality, employee reliance, and stakeholder interests.

Ever-shifting sands of determining who is the client, who controls the privilege, and what is in the client's best interest at any given moment, long or short term.

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Reports of privilege protection problems on the rise

ACC surveys show that when the company is under scrutiny:

- Waiver is expected and the price of admission for leniency/survival
- Waiver requests are increasing
- Erosions in the protections of the privilege have a negative effect on preventive compliance.

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What is Attorney-Client Privilege?

Confidentiality is protected under 3 distinct doctrines:

Lawyer conduct regulations

1. ABA MRPC 1.6 - Confidentiality

Evidentiary Privileges (a client's right to exclude documents in a discovery dispute):

2. Attorney-client privilege
3. Work product protections

Exceptions to Privilege:

Cannot facilitate fraud • Does not survive waiver • Does not protect facts

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Privilege in the corporate context

- *Upjohn* is the law. It acknowledges privilege in the corporate context
- Prosecutors and regulators bypass clients' rights by "requiring" waivers; companies can't afford to push back
- Just the facts: that's all investigators want, right? What about facts in A/C or W/P docs or conversations/interviews?

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Employees and Privilege

- The entity is your client, but employees act as the entity's reps so long as they are in concert with the entity's interests.
- The Thorny Problem: application of privilege to employee statements:
  - Corporate policies require EE cooperation
  - Balanced against 5th/6th Amendment rights
  - Presumption of innocence?
  - EE's lawyering up … when should you encourage them to get their own counsel: advancement of fees, joint defense agreements
  - Who decides when an employee has left the zone of the entity's best interests?
  - Investigators target employee interviews

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US v. Stein: the KPMG Case

Illustrates how employee issues in the context of investigation can create lawsuits and liability on their own (in which counsel's advice and actions will be front and center):

- Advancement of fees
- Sharing documents
- Joint defense agreements
- Discipline/termination of targeted EEs

The Result:

KPMG is now being sued for doing what the government coerced its counsel to do to throw EEs under the bus; there's a new CLO.

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Privilege and work product protections outside of the courtroom context -

Today it's unlikely that there will be a impartial third party court poised to protect your client's privilege rights.

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DOJ / SEC "Cooperation" Standards

- **Holder Memo** (1999) - an effort to educate prosecutors and create a common standard: nine criteria established.
- **Thompson Memo** (2003) - a mandatory checklist for prosecutors. Waiver requests become routine.
- **Seaboard Memo** - SEC's cooperation standards … other agencies following suit. Waiver assumed.
- **McNulty Memo** - DOJ Main attempts to procedurally address a problem that's really a "field" issue.
- **Attorney-Client Privilege Protection Act of 2007** - focused on "push back" rights of companies and protection of employee rights in an investigation.
- **The Filip Memo?** (stay tuned)

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Is Limited Waiver the "answer"?

- DOJ/SEC would like you to think so
- FRE 502: Federal Courts' study committee addresses the problem: a majority of courts don't recognize limited waiver; 502 moving forward does not codify waiver, but does help in some e-discovery/inadvertant disclosure contexts
- Audit/some regulatory contexts: is disclosure really a waiver when there's no adversary? (common interest doctrine)
- Subject matter waivers: long-term consequences.
- Third party plaintiffs.

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Privilege Issues in the Audit Context

- **Internal audit issues: exert care**
- **The Audit Committee of the Board**
- **External Auditors -**
  - The ABA/AICPA "Treaty" is functionally dead.
  - Post-Andersen and under PCAOB rules, no stone left unturned
  - If confidential files are divulged to auditors, privilege is waived
  - Audit results threatened/withheld or qualified/no opinion offered if full disclosures or access to confidential docs is not granted

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So what can you do to protect privilege?

ACC MEMBER LEADING PRACTICES / IDEAS:

There's no answer:

Some companies assert that the best policy is to act as if privilege no longer applies: one option - give it up.

Investigatory context:

• Under McNulty, push back

• Set up a "privilege database" with lawyers-only access

• Run parallel factual and privileged investigations with separate reports: one produced, one protected.

• Use outside counsel for increased privilege credibility with enforcement officials

• Use non-lawyers to conduct internal investigations - no privilege, but no waiver either.

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So what can you do to protect privilege?

Document Management Context:

- Labeling and retention policies: Ensure proper privilege designations so that privilege is not over-asserted (over-asserted privilege gives false client security and undermines your serious claims).
- Establish separate and inaccessible privilege document filing systems.
- Monitor and control employee communications to avoid overly candid discussions about sensitive issues that are preserved in writing.
- Ensure that the earliest work product designation regarding a given piece of litigation matches the time that the business organization issued a "do not destruct" / litigation hold memo.
- Establish a comprehensive e-mail policy that among other things prohibits certain topics from being discussed.

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So what can you do to protect privilege?

Employee Relations Context:

- Establish a training program for lawyers and non-lawyers about the interview process and employee rights
- Establish a strict *Upjohn* warning process prior to interviewing any employee
- Encourage employees to nonetheless fully cooperate in the interview
- Have a witness in the room when the lawyer gives the warning
- Issue the warning in writing
- Include the obligation to cooperate with internal investigations in all employment contracts, codes of conduct and handbooks, with termination a penalty
- When appropriate, offer to provide the employee with independent counsel; offer the employee a joint defense opportunity
- Establish a corporate bylaw or policy and practice to indemnify or advance legal fees to at least a subset of executives "to the fullest extent allowed under applicable law"

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So what can you do to protect privilege?

In the Context of Selective Waiver:

• Ask for opportunity to provide enforcement officials with the information they want without waiving privilege - find out what would be "sufficient"

• Discuss enforcement strategies with senior management before the pressure of a federal or state investigation forces them to do things they regret with after-thought.

• Insist on a court order that turning over docs pursuant to limited waiver agreement does not constitute waiver with respect to third parties before any limited waiver / confidentiality agreement is signed.

• Don't ever explicitly waive privilege even if you're turning over documents – preserve the argument and live to fight another day

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Additional Issues:

- Educate clients about privilege and waiver issues. Discuss when privilege waiver demands may be made / consider options before confronted with a situation.
- Privilege waiver at the board level:
  - When board members "lawyer up" and share their concerns with their own counsel
  - Who can decide to waive the company's privilege - individual directors, the entire board?
- Avoid executing affidavits that controvert accusations or you may become a fact witness.
- Consider entering an appearance in matters where you're concerned you may be "swept" into the line-up because you carry business responsibilities within the area that failed
- Watch out for "advice of counsel" defenses.

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What to do before the "knock"

Prepare employees/executives/board in advance by discussing:

- government tactics, search warrants, subpoenas
  - office *and home*
  - preparation for all staff, esp. admins and receptionists.
- interviews by company investigators / the government
  - what to anticipate
- advice re employee "obligations" (not obligated to speak to government, but obligated to aid internal investigations)
- document management policies / holds: training and input
- Board member education and policies

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What to do before the "knock"

- Whistleblowing / reporting processes and effective compliance programs that can be documented
  - Regular metrics collection and evaluation
  - Responses to failures or dysfunctional operations
  - Everyone's responsible and no one's exempt
- Document retention policies:
  - balancing the needs of business with regulatory obligations and future litigation concerns
  - Work with IT on policies, retrieval, archiving, segregating
  - Train, train, train
- Pre-select independent counsel / others to be retained

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The debate from our previous discussion

- Is compliance better "sited" outside the legal department?
  - If privilege can't be protected when lawyers are responsible for compliance, then is the solution to make someone else responsible for it?
  - Is compliance a business or legal function, and what is its purpose?
  - The rise of the CCO - where is she housed and who does her work?
  - Compliance and Conflicts of Interest

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Corporate Counsel in the Crosshairs:

Emerging Theories of Liability, Culpability, and Responsibility for In-House "Gatekeepers"

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Let's all agree at the outset:

- I'm not about to suggest that lawyers should not be gatekeepers, or should be less than aggressive in their roles.
- My focus is on the difficulty in navigating your role in the Post-Enron practice environment, and on offering practical advice to avoid landmines that could land you in the crosshairs of unwanted scrutiny.
- And the risk of being targeted has exponentially increased, even if it's still a relatively unusual event. The greater likelihood is that your involvement will be used to "roll" you against your client's interests.

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Why are IHC increasingly in the crosshairs?

• Regulators/prosecutors like the idea of going after them: Lawyers know the law; it's easier to suggest they knew they were violating it.

• They're senior executives - they have management's ear and trust

• They likely have unparalleled access to clients and events (though not as much knowledge as prosecutors often think)

• They often carry corporate functional (read: fiduciary or strict liability) responsibility for ethics and compliance initiatives.

• They come with strings that are more easily pulled: they're professionally regulated by defined rules and higher standards.

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IHC Liability for Corporate Failures

- ACC's extensive research into this subject (100+ pages of it in your written materials)
- Emerging theories of liability:
  culpability, "omissions," obstruction
- Increasing criminalization of corporate failures
- Lawyers and financial fraud : are we competent?
- "Advice of counsel" defenses

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IHC Liability–3 disturbing examples

- **"When nothing less than the C-Suite will do": Purdue and OxyContin -** The lead prosecutor: "I think we had a responsibility to bring cases against everyone who was making money." No proof of knowledge or criminal intent or involvement necessary. To avoid entity indictment, the execs plead to misdemeanors.
- **"Gatekeeping moves from rhetoric to reality": Scott Monson and the SEC -** lawyer liability for failing to prevent his clients from engaging in activity it is acknowledged he counseled against.
- **"There but for the grace of God, go I": Tenet Healthcare and Christie Sulzbach -** liability based on the absence of language in the MD&A (non-disclosure). Deciding whether/how/when to disclose something are quintessential judgments that lawyers make daily. ClubFed rewards await bad decisions in 20/20 hindsight.

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What can we learn from cases involving lawyers targeted by the SEC?

- In SEC actions, the Commission takes dramatically different approaches to pursuing inside and outside counsel for their roles:
  - they decline to initiate enforcement actions against outside counsel unless the lawyer has been held civilly or criminally liable, or has been disciplined by the bar.
  - They pursue inside counsel, however, without regard to whether there has been an independent finding of misconduct.
  - A general summary of findings includes the following:

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What can we learn from cases involving lawyers targeted by the SEC?

- Rule #1: The top lawyer is almost always the target.
- Rule #2: Inside lawyers who rely on outside counsel advice are seldom (but not never) SEC targets.
- Rule #3: Being caught with your hand in the cookie jar is not necessary to prompt SEC enforcement.
- Rule #4: Disclosures, and particularly omissions in disclosures, are usually the problem.

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What do you need to know about protecting yourself from SEC charges ….

1. They want you: past practices have been more respectful of your role; current strategies are increasingly focused on sending messages and teaching lessons.
2. Insurance and indemnification policies may not help you if you require a defense.
3. They often target counsel to get to their real targets; they want your testimony as evidence against those you counsel or to encourage the real target to roll.
4. Even if the SEC doesn't pursue you, subsequent securities fraud class actions may target you and can be much more painful.

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Criminal prosecutions of IHC

- Increasingly, the rhetoric of lawyers as "gatekeepers" is becoming reality.
- Perceptions of what is accepted conduct can change rapidly.
- Big losses increase the risk of criminal prosecution.
- Wearing two or more hats carries real risks for corporate counsel.
- Wearing only one hat may be less of an excuse for ignorance than it used to be.

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Criminal prosecutions of IHC, cont.

- Some recent liability experiences of IHC suggest an element of "bystander liability" for lawyers near the scene of a business disaster.
- A demonstrable ethical culture matters more today than ever: how the prosecutor is pre-disposed to view your company (essentially law abiding or rogue) is critical
- Check your license and your colleagues' licenses so they don't wreck you

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How can you protect yourself?

1. As noted in the SEC discussion, current strategies often focus on sending messages and teaching lessons, so plan accordingly.
2. Many prosecutors are less experienced than their counterparts at the SEC. And practices in the field (US-A/AG offices) vary widely. Get better acquainted with local prosecutors and regulators. If they know and love you prior to a problem it makes them less like to think you're an ogre when accusations fly.
3. Remember: you're often not the real target, but a "card" to be played in an effort to get to the real targets … if the focus is on you and you think it's to get others, respond accordingly.
4. Watch out for "advice of counsel" defenses raised by white collar targets - they can drag you and your privilege into the limelight.

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How can you protect yourself?

5. Since insurance and indemnification policies may not help you, what will? Reliance on outside counsel? Joint defense agreements? Pre-approved counsel and fees?
6. Avoid "drive-by" blessings of any document/issue of import: this includes more focus on "reliance" and whether you can afford it.
7. Client expectations should be informed and realistic: you need to set expectations before problems arise.
8. Your department's initial responses will often be determinative in how prosecutors view any one lawyer's role, influence, or supervisory responsibilities.
9. Lawyer and department ethical education, training and policies need to improve -- IHC can no longer be governed by the "gut test," nor can they claim they were out of their depth, or just generalists.

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How can you protect yourself?

10. Corporate counsel must exercise care when carrying strong fiduciary roles in addition to their legal roles. Serving these roles may be good for you and for the company, but remember that they add layers of complexity to potential liability problems.
11. Lawyers need to become far more aware of the company's finances and understand how they work. You're increasingly liable for this knowledge. No excuses.
12. It's all about 20/20 hindsight. How will something that looks entirely innocent now be viewed in light of a subsequent failure? Preventive compliance is no longer about keeping the company out of trouble, it's about anticipating what might appear "off" later in the event of an unanticipated failure.

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"Gatekeeping" is a natural extension of what in-house counsel are particularly well-trained and well-situated to do.

We work in difficult times, but I believe that gatekeeping is on balance a strategic opportunity for in-house lawyering, rather than a liability.

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HOMESTRETCH: Legal ethics and the rules of evidence don't provide much navigational or reliable guidance

Indeed, mixing legal ethics and some kinds of compliance / fiduciary responsibilities leaves lawyers exposed to unresolved and significant contradictions in their daily responsibilities.

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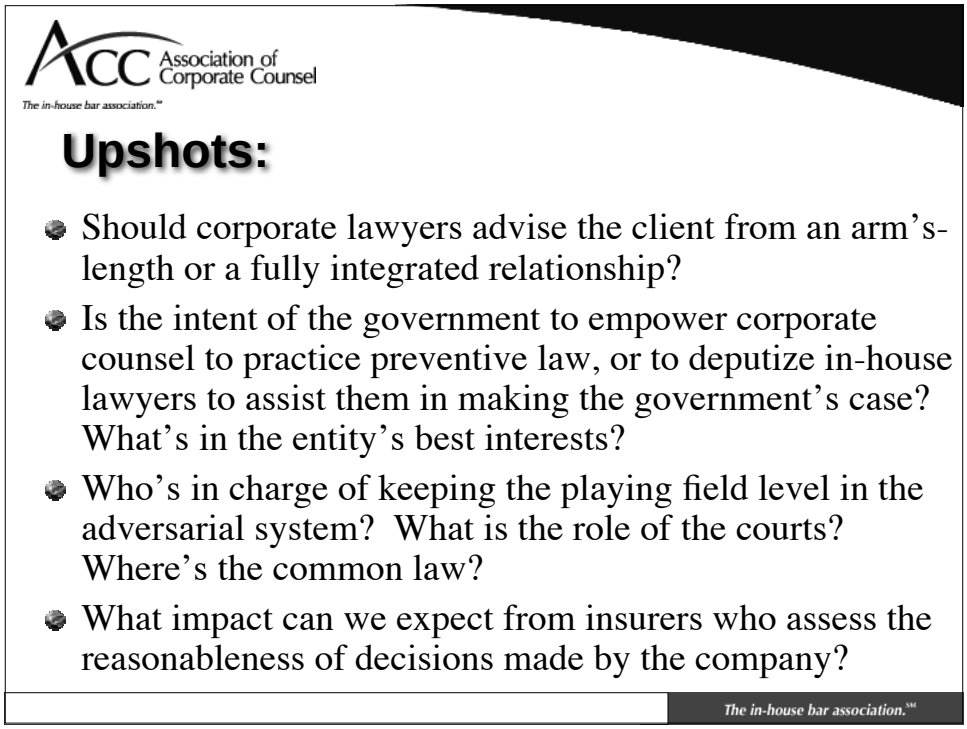

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Attorney-Client Privilege Erosion in the In-House Context

(Last Updated 3/08)

Supplemental Material
Provided by Susan Hackett
This bibliography can be found (and is regularly updated) online at
http://acc.com/public/article/attyclient/acc-ac-biblio.pdf

General Information:

ACC's Attorney-Client Privilege homepage: (offers articles, resources, testimony, links, etc.)
http://www.acc.com/php/cms/index.php?id=84

ACC's Pragmatic Practices in Privilege Protection:
http://www.acc.com/public/attyclientpriv/pragpract.pdf

ACC's Attorney-Client Privilege InfoPAK (a manual summarizing the privilege):
http://www.acc.com/resource/v6327

"Wither" Attorney-Client Privilege
An ACC Docket article by ACC's General Counsel, Susan Hackett, on Privilege in the In-house Context Post-Enron: http://www.acca.com/protected/pubs/docket/sept05/wither.pdf

ACC Acts to Protect the Privilege:

ACC Statement: US House Adopts HR 3013 - Attorney-Client Privilege Protection Act of 2007
http://acc.com/php/cms/index.php?id=34&action=item&item_id=20071113_7537

ACC's 2005 survey: Is the Privilege Under Attack?
http://www.acca.com/Surveys/attyclient.pdf

ACC's 2006 survey: The Decline of the Attorney-Client Privilege in the Corporate Context
http://www.acca.com/Surveys/attyclient2.pdf

The Veasey Report – ACC's 2007 member survey pipelining privilege and prosecutorial abuse stories relayed by respected neutral Former Chief Justice of Delaware E. Norman Veasey.
http://acc.com/public/veasey.pdf.

Attorney Client Privilege Protection Act of 2007 (endorsed by ACC and its coalition partners): The same legislation introduced in December of 2006 was reintroduced in 2007 by Senator Specter as S.186: identical legislation was introduced on July 12, 2007, in the House as H.R. 3013: http://acc.com/public/s186.pdf or http://www.acc.com/public/attyclientpriv/hr3013.pdf.

ACC and its Coalition's Executive Summary of Why Congress Should Act to Protect the Attorney-Client Privilege:
http://www.acc.com/public/policy/attyclient/attyclientcoalitionmcnultyrebuttal.pdf

ACC and its Coalition partners' testimony before the US Senate's Judiciary Committee hearings, September 18, 2007
- Coalition to Protect the Attorney-Client Privilege's statement on the hearings (ACC's statement):
http://acc.com/public/coalition-statement.pdf
- Statement of former Attorney General Dick Thornburgh
http://acc.com/public/thornburgh-testimony.pdf
- Statement of Andrew Weissmann, former head of the DOJ's Enron Task Force
http://acc.com/public/senatejudiciary.pdf
- ABA written submission to the Senate for the hearings:
http://acc.com/public/aba-testimony.pdf

ACC and its Coalition partners' testimony before the US House Judiciary Committee's Subcommittee on Crime, Terrorism and Homeland Security, March 12, 2007:
- Testimony of ACC Board Chairman Richard T. White:
http://www.acc.com/public/policy/attyclient/richardwhitemcnultytestimony.pdf
- Testimony of Andrew Weissmann, former DOJ Enron Task Force Chairman:
http://www.acc.com/public/policy/attyclient/weissmanhousetestimony.pdf
- Testimony of ABA President Karen Mathis:
http://www.acc.com/public/policy/attyclient/abatestimonytohousejudsubcomm.pdf
- Testimony of William Sullivan, Partner, Winston & Strawn:
http://judiciary.house.gov/media/pdfs/Sullivan070308.pdf
- Testimony of Barry Sabin, US Department of Justice:
http://judiciary.house.gov/media/pdfs/Sabin070308.pdf

ACC and its Coalition partners' testimony before the US Senate Judiciary Committee, September 12, 2006:
http://www.acca.com/public/attyclientpriv/coalitionsenjudtestimony.pdf

Testimony and Statements made at the Senate Hearings (Sept. 12, 2006):
http://www.acca.com/public/attyclientpriv/writtentestimonyussenate.pdf

ACC and its Coalition partners' testimony before the US House of Representatives Judiciary Subcommittee on Crime, Terrorism and Homeland Security, March 7, 2006:
http://www.acca.com/public/accapolicy/coalitionstatement030706.pdf

Letter from former DOJ officials re the need for action on legislation (2007):
http://acc.com/public/attyclientprivissue.pdf
Letter from former senior DOJ officials criticizing the Thompson Memo (2006):
http://www.acca.com/public/attyclientpriv/agsept52006.pdf
Letter from former senior DOJ officials - US Sentencing Commission (re Thompson) (2005):
http://www.acca.com/public/policy/attyclient/doj.pdf

ACC Policies and Comments/Testimony on Attorney-Client Privilege Issues:
http://www.acca.com/public/article/attyclient/debate.pdf
http://www.acca.com/public/comments/attyclient/privilege.pdf
http://www.acca.com/public/accapolicy/corpresponspolicy.pdf
http://www.acca.com/public/accapolicy/attyclient.pdf

ACC's Comparison "Chart" The Thompson and McNulty Memos and S. 186/H.R. 3013:
http://www.acc.com/public/attyclientpriv/mcnultychart.pdf

ABA Attorney-Client Privilege Task Force homepage:
This page contains the reports of the Task Force to the ABA House of Delegates, which are law review type articles that give a great outline of privilege issues, including the two most recent resolutions on privilege passed by the ABA House in August of 2006, focusing on privilege erosion in the context of audits and problems associated with employee or individual rights (a la the KPMG issues; it also has a resources section on which collected material resides, and info on Task Force activities. ACC is a member of the Task Force and supports their efforts.
http://www.abanet.org/buslaw/attorneyclient/home.shtml

Department of Justice/Prosecutorial Practices Eroding the Attorney-Client Privilege

DOJ Charging Policies Used to Assess Corporate Cooperation – Chronological Order

The DOJ's Holder Memorandum (1999) is at:
http://www.usdoj.gov/criminal/fraud/policy/Chargingcorps.html

Establishment of the DOJ's Corporate Fraud Task Force (2002) (Executive Order 13271):
http://www.usdoj.gov/dag/cftf/execorder.htm

The DOJ's Thompson Memorandum (2003) is at:
http://www.usdoj.gov/dag/cftf/corporate_guidelines.htm

The DOJ's response to the ABA regarding proposals to amend the Thompson Memo:
http://www.acca.com/public/attyclientpriv/dojresponsetoaba.pdf

"Then-US Attorney Jim Comey's Guidance on Interpretation of the Thompson Memo, and other DOJ discussions of the government's Corporate Crime/Fraud Task Force (2003)"
http://www.justice.gov/usao/eousa/foia_reading_room/usab5106.pdf

The DOJ's McCallum (2005) Memorandum is at:
http://www.acca.com/public/attyclntprvlg/mccallumwaivermemo.pdf

The McNulty Memo (2006) (amending the Thompson Memo):
http://www.usdoj.gov/dag/speeches/2006/mcnulty_memo.pdf
- Deputy AG McNulty's prepared remarks on release of the Memo:
http://www.usdoj.gov/dag/speech/2006/dag_speech_061212.htm
- DOJ Executive Summary of the McNulty Memo:
http://www.acc.com/public/policy/attyclient/dojexecsummary.pdf

The "Morford" Memo on DPAs and NPAs / Monitors (3/08)
http://www.acc.com/resource/v9595

Info on the DOJ's Corporate Fraud Task Force
http://www.usdoj.gov/dag/cftf/

Review Significant Criminal Cases and Charging Documents of the DOJ against corporate targets
http://www.usdoj.gov/dag/cftf/cases.htm

DOJ's Fact Sheet report on the Corporate Fraud Task Force Fifth Anniversary
http://www.usdoj.gov/opa/pr/2007/July/07_odag_507.html

Securities and Exchange Commission Practices Eroding the Privilege

SEC's Seaboard Report [the internal document setting policy on (non-) "recognition" of privilege]:

http://www.sec.gov/litigation/investreport/34-44969.htm

SEC Proceedings Against In-House Counsel
http://www.acca.com/protected/article/ethics/seccrimproceed.pdf

SEC speeches particularly informative to the attorney-client privilege and gatekeeper debate:

SEC's general counsel explains the 307 rules and their context:
http://www.sec.gov/news/speech/spch040304gpp.htm

SEC's director of enforcement speaks on lawyers' responsibilities as gatekeepers of client conduct and shareholder interests*:* http://www.sec.gov/news/speech/spch092004smc.htm

SEC Commission Atkin's Remarks before the Federalist Society (see about page 6):
http://www.sec.gov/litigation/investreport/34-44969.htm

Privilege in the Audit Process

ACC's Interim Report of the Working Group to Improve the Relationship Between Lawyers and Auditors: http://www.acc.com/php/cms/index.php?id=368

ACC and the Courts: Privilege as a Court-Protected Doctrine

Conference of Chief Justices Statement Supporting the Attorney-Client Privilege (and instructing States's Courts to Create Commissions to examine erosion issues):
http://ccj.ncsc.dni.us/resol9StateCommitteesOnAttorneyClientPrivilege.html

ACC's Comments to the Federal Courts' study committee examining proposed FRE 502 and its limited waiver provisions:
June of 2006: http://www.acca.com/resource/v7465
January of 2007: http://www.acc.com/public/policy/attyclient/accfre502comments.pdf

All ACC Amicus (listing and links) on privilege-related issues:
http://www.acc.com/php/cms/index.php?id=291

ACC's amicus in U.S. v. Textron, supporting privilege in the audit process and encouraging the court to rule that documents divulged to auditors in the course of assuring financial integrity should not be deemed as waived to the government or third parties.
http://www.acc.com/resource/v9669

ACC's Amicus in a Texas Supreme Court case regarding the confidentiality of privileged documents produced to an auditor by a client during the regular audit process and then sought in discovery by a third party in litigation against the client.
http://www.acca.com/public/amicus/txamicus.pdf

ACC's amicus brief on limited waiver concerns: (QWEST)
http://www.acca.com/public/amicus/qwest.pdf

ACC's amicus briefs on the issue of government pressure on companies to deny employees' indemnification and fee advancement under corporate policies:

in the *US v. Stein*/KPMG case (3 amicus on related issues as requested by Judge Kaplan):
http://www.acc.com/public/amicus/steinbrief.pdf
http://www.acca.com/public/amicus/acckpmgamicusbrief.pdf and
http://www.acca.com/public/attyclientpriv/suppl-us-stein.pdf

Judge Kaplan's decision in KPMG finding the Thompsom Memo unconstitutional:
http://www.acc.com/public/attyclientpriv/kpmg_decision.pdf

Judge Kaplan's dismissal of the charges against 13 of the 16 KPMG defendants:
http://www.acc.com/public/amicus/opiniondismissingcase.pdf

in the *Lake/Wittig* case: http://www.acca.com/public/amicus/lakewittig.pdf

ACC's amicus in *Teleglobe v. BCE* case, in which privilege accorded to the parent company client of in-house lawyers working for both the parent and affiliates in the corporate family is discussed (ACC's brief is cited by the court as arguing dispositively on several crucial points: http://www.acc.com/feature.php?fid=1238)

Other Related Issues:

ACC's Gatekeeper/Liability homepage:
http://www.acc.com/php/cms/index.php?id=371

Corporate Counsel: Caught in the Crosshairs
http://www.acca.com/protected/article/attyclient/crosshair.pdf

ACC's Leading Practices Profile: Indemnification and Insurance Coverage for In-House Lawyers
http://www.acc.com/resource/getfile.php?id=6300

ACC's "Paradise Tarnished: Today's Sources of Liability Exposure for Corporate Counsel"
http://www.acc.com/resource/getfile.php?id=4960

ACC Reports: Corporate Counsel in the Liability Crosshairs
http://acc.com/resource/v8918

ACC's Sarbox 307 – Part 205 Rules homepage: This is the site of a significant number of primary and commentary resources on the SEC's new attorney conduct rules promulgated under the authority given in Sarbanes-Oxley Section 307, and codified at 17 CFR Part 205.
http://www.acca.com/legres/corpresponsibility/attorney.php

Lawyers as Whistleblowers: The Emerging Law of Retaliatory Discharge of In-house Counsel
http://www.acca.com/protected/article/governance/wrong_discharge.pdf
The appendix to this article contains the ABA Model Rules of Professional Conduct 1.6 (Confidentiality) and 1.13 (Organization as Client), which are most relevant to this discussion. The issue of lawyers as whistleblowers raises privilege questions in the context of privileged attorney-client conversations and information that the plaintiff lawyer would wish to introduce in order to make his or her case for retaliatory discharge.

Responsive Measures for Government Investigations
http://www.acca.com/protected/policy/compliance/respond.pdf

ACC's InfoPAK on Responding to a Government Investigation:
http://www.acc.com/resource/v4738

ACC's InfoPAK on Conducting an Internal Investigation:
http://www.acc.com/resource/v4737

If you are an in-house counsel and not an ACC member, and therefore need a temporary password to access some of these documents, please contact Susan Hackett at hackett@acc.com.

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Selected Bibliography of Resources
Susan Hackett (hackett@acc.com)

Last updated: March 2008

"Corporate Counsel in the Crosshairs: Emerging Theories of Liability, Culpability and Responsibility as the Role of In-House Lawyers as Gatekeepers Evolves Post-Enron"

ACC's webpage on gatekeeping / liability issues:
http://www.acc.com/php/cms/index.php?id=371

General Reading

ACC Reports: In-House Counsel in the Crosshairs (2007) – a report on liability trends affecting in-house counsel in recent civil and criminal prosecutions
http://acc.com/resource/getfile.php?id=8918

How Can Corporate Counsel Avoid Getting Caught in the Crosshairs? (ACC 2005)
http://www.acc.com/resource/v6367

Paradise Tarnished: Today's Sources of Liability Exposure For Corporate Counsel (ACC by Lucian T. Pera; Brian S. Faughan, 2004)
http://www.acc.com/resource/v4960

Corporate Crime: New Voices Question Corporate Criminal Liability, by Audrey Strauss, NYLJ 07-05-2007:
http://www.law.com/jsp/ihc/PubArticleIHC.jsp?id=1183971981717

"General Counsel Under Attack," by Yuri Mikulka and John Horan of Howrey LLP for the ABA Committee on Corporate Counsel Section of Litigation, Sept. 12, 2007:
http://www.abanet.org/litigation/committees/corporate/docs/2007_materials_underattack.pdf

In-House Counsel as Gatekeepers

Speech by SEC Staff: The Themes of Sarbanes-Oxley as Reflected in the Commission's Enforcement Program By Stephen M. Cutler; Director, Division of

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Enforcement, U.S. Securities and Exchange Commission (September 20, 2004) – the introduction of the Gatekeeper role for lawyers and the coining of the term.
http://www.sec.gov/news/speech/spch092004smc.htm

In-House Counsel Responsibilities In The Post-Enron Environment (ACC Docket 2003) : http://www.acc.com/resource/v6289

Teaching Enron, Milton C. Regan, Jr., 74 Fordham L. Rev. 1139-1249 (2005).

How GCs Can Avoid Being Caught in the Middle, Ben W. Heineman Jr. (law.com March 29, 2007)
:http://www.law.com/jsp/ihc/PubArticleFriendlyIHC.jsp?id=1175072635813

Liability Issues: Is the SEC Targeting In-house Attorneys?, John Villa / ACC Reports (2005):
http://www.acc.com/protected/article/ethics/seccrimproceed.pdf

Speech by SEC Staff: Giovanni P. Prezioso; General Counsel, U.S. Securities and Exchange Commission (April 28, 2005)
http://www.sec.gov/news/speech/spch042805gpp.htm

In-house Attorneys as Gatekeepers: Practical Advice for Navigating in the Post Enron Era, James B. Moorhead and Jeffrey E. McFadden Partners, Steptoe & Johnson LLP (2007) : http://www.acc.com/resource/v8339

Metamorphosis of In-House Counsel Continues, Susan F. Friedman (law.com February 22, 2007) :
http://www.law.com/jsp/ihc/PubArticleIHC.jsp?id=1172052183126

In-House SEC Gatekeepers Should Watch Their Backs, Jay A. Dubow and Jill L. Mandell (law.com, March 1, 2006) :
http://www.law.com/jsp/ihc/PubArticleIHC.jsp?id=1141121112314

The Trial of St. Mark, David Hechler / Corporate Counsel (law.com, March 20, 2008):
http://www.law.com/jsp/ihc/PubArticleIHC.jsp?id=1205923902026

Former Enron In-House Counsel Look Backward ... and Forward, David Hechler / Corporate Counsel (law.com, February 22, 2006) :
http://www.law.com/jsp/ihc/PubArticleIHC.jsp?id=1140516315050

Setting an Example, Tamara Loomis / National Law Journal (law.com February 1, 2005)
http://www.law.com/jsp/ihc/PubArticleIHC.jsp?id=1105364102703

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Blowing the Whistle: Guidance to In-House Lawyers in England and Whales on Whistleblowing and Corporate Governance, Commerce & Industry Group (April 2007) : http://www.cigroup.org.uk/assets/whistle_blowing.pdf

Corporate Governance Programs for Reporting Concerns: What Companies are Doing (ACC Leading Practice Profile, 2005) : http://www.acc.com/resource/v6527

Monson Case:
ALJ: in re Monson : http://www.ALJ_In_re_Scott_Monson(SEC_15June07)[2].pdf
Monson Opening Brief : Monson - Opening Brief[2].pdf

Other material on liability related subjects

Lawyers as Whistleblowers: The Emerging Law of Retaliatory Discharge of In-house Counsel (Lucian Pera for ACC, 2004) : http://www.acc.com/resource/v4951

In-House Counsel as Whistleblower / Sarbanes-Oxley Whistleblowers: Avoiding the Nightmare Scenario (ACC Docket 2006) : http://www.acc.com/resource/v7106

Sarbox 307 Up-The-Ladder Reporting and Attorney Professional Conduct Programs (ACC Leading Practice Profile, 2003) : http://www.acc.com/resource/v6328

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Selected Bibliography of Resources By John K. Villa

Conflicts of Interest Issues Involving Outside Counsel
(By John K. Villa, 2001)
http://www.acc.com/resource/v833

Ethics & Privilege: Investigative Attorneys and the Reporting Obligations under the SEC's Professional Conduct Rules
(ACC and West by John K. Villa, 2004)
http://www.acc.com/resource/v6354

Perils of Joint Representation of Corporations and Corporate Employees
(By John K. Villa, 2001)
http://www.acc.com/resource/v813

Resolving Multinational Ethical Issues: What Law Applies?
(By John K. Villa, 2002)
http://www.acc.com/protected/pubs/docket/jj02/ethics1.php

Representing Business Competitors: A Conflict or Not?
(By John K. Villa, 2002)
http://www.acc.com/resource/v588

What Can You Tell Your Employees When the Feds Arrive to Question Them?
(By John K. Villa, 2002)
http://www.acc.com/protected/pubs/docket/jf02/ethics1.php

Corporate Counsel Guidelines
(West Group and ACC by John K. Villa, 1999)
Corporate Counsel Guidelines is a two-volume treatise written expressly for in-house counsel. It applies general principles to the corporate bar, providing specific guidelines. This treatise tackles the most common issues facing corporate counsel, even those issues that have no guiding precedent or ethics opinions.

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SEC AND CRIMINAL PROCEEDINGS AGAINST INSIDE CORPORATE COUNSEL

JOHN K. VILLA
WILLIAMS & CONNOLLY LLP
WASHINGTON, D.C.

SEPTEMBER 2005

I. Introduction and Summary

Over the past four years, there has been a stream of news reports describing SEC enforcement actions and criminal prosecutions of inside corporate lawyers. Many in the corporate bar have questioned whether there are in fact a large number of such actions against corporate lawyers or whether the news coverage exaggerates the frequency of these cases. A related question is whether there are common factors that have prompted these proceedings. If there are, of course, inside lawyers could take preventive steps to reduce their risks.

This analysis undertakes to answer both of these questions. For the first time, to my knowledge, all or virtually all SEC proceedings against inside counsel and the criminal prosecutions of inside counsel since 1998 are collected and described, thus quantifying these such actions. Although the reader can draw his or her own conclusions from the descriptions, the paper also attempts to distill common elements and themes from the cases.

A. SEC Actions

The SEC has taken a dramatically different approach to inside lawyers than it has to outside counsel. Since the early 1980's, the SEC has declined to initiate enforcement action against outside counsel unless the lawyer has either been held civilly or criminally liable, or has been disciplined by the bar.[1] The SEC, however, pursues inside counsel without regard to whether there has been an independent finding of misconduct. These actions against inside counsel are collected and described in detail in Part II and are summarized in the following paragraphs.

Rule #1: The Top Lawyer is Nearly Always the Target. The most obvious common element in the SEC actions is that nearly all of them are brought against the chief legal officer of the company. The occasional case brought against a lawyer other than the chief legal officer usually involves the most senior lawyer in charge of a project or a disclosure document.

Rule #2: Inside Lawyers Who Relied On Outside Counsel Advice are Seldom SEC Targets. The factor most notable by its absence is that there are very few SEC enforcement actions where the defendant/respondent relied upon the advice of an outside law firm. One can divine from this fact either that inside lawyers who rely upon outside counsel rarely make mistakes or, what's more likely, that where the SEC finds that inside counsel followed the advice of an outside law firm, successful enforcement action would be unlikely. We think the latter is surely the correct conclusion and that the inside lawyers' "advice-of-outside-counsel" defense must have a significant impact on the exercise of enforcement discretion.

Rule #3: Putting Money in Your Pocket is Not Necessary to Prompt SEC Enforcement. An unexpected observation is the relatively small role that financial rewards apparently plays in the SEC's exercise of discretion. One might have expected that the SEC would take enforcement action

[1] See Edward F. Greene, General Counsel, Securities and Exchange Commission, Lawyer Disciplinary Proceedings Before the Securities and Exchange Commission, Remarks to the New York County Lawyers' Ass'n (Jan. 18, 1982), reported in 14 Sec. Reg. & L. Rep. (BNA) (Jan. 20, 1982) (stating that the SEC would not pursue Rule 2(e) administrative proceedings against lawyers unless a federal court had first found the lawyer guilty of violating the securities laws); see generally Simon M. Lorne and W. Hardy Callcott, "Administrative Actions Against Lawyers Before the SEC," 50 Bus. Law. 1293 (August 1995).

only where inside counsel received unreasonably high compensation or bonuses, or benefited through increased stock value. That does not prove to be accurate. Many inside lawyers appear to have been the target of enforcement action where it appears their only motive was, in the SEC's view, a misguided attempt to help their corporate employer.

Rule #4: Disclosures, Particularly Omissions in Disclosures, are Usually the Problem. Turning to the underlying conduct that has drawn enforcement attention, many of the cases against inside counsel involve allegedly false and misleading disclosures – more often than not, omissions. While there are some instances of outright fraud alleged – such as totally fictitious offshore operations or sham contracts – in others, the SEC has pursued inside lawyers on decisions that involve matters of professional judgment.

Rule #5: A Generalist Lawyer Serving as General Counsel Must Seek Out Sound Advice or Pay the Price. Although there are very few cases in which the SEC has brought an action where the inside lawyer appears to have relied on outside counsel,[2] the SEC has chosen to bring actions where the inside lawyer claimed not to be an expert on a technical issue and either relied, unjustifiably, on an inside technical expert or saw a red flag and failed to seek outside legal advice. Put another way, 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 "I am just a generalist lawyer" defense is *not* well-received, especially if the general counsel is on notice of a potentially serious problem. 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. There are echoes of the SEC's new attorney conduct regulations,[3] in which the SEC suggests that the question of whether counsel should have

[2] In the case of Franklin Brown of Rite-Aid, the SEC alleges that Brown obtained an opinion letter from outside counsel. According to the SEC, Brown convinced outside counsel to include in the letter the erroneous statement that a litigation settlement was binding and enforceable as of a prior date, even though Brown knew that it was not binding and enforceable as of that date because of its contingent nature. See n. 96 and n. 97, infra, and accompanying text.

[3] Pursuant to 17 C.F.R. § 205.3(b), an attorney's duty to report evidence of a material violation is triggered when the attorney "becomes aware" of such evidence, which is defined as "credible evidence, based upon which it would be unreasonable, under the circumstances, for a prudent and competent attorney not to conclude that it is

been aware of evidence of a "material violation" so as to trigger the reporting obligations under the regulations may depend on whether there were other lawyers available with whom counsel could have consulted on the matter.[4]

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. There are a few factors that appear to increase the likelihood of enforcement action but the data is too limited to draw firm conclusions. For example, holding a position as inside counsel and director seems to increase the enforcement risk. In addition, large losses also increase the risk – probably because the SEC is more likely to investigate those matters than other situations where there are no losses. One can speculate that in the situations where the company has failed or nearly failed, and the inside counsel does not have the resources for vigorous representation and defense, the likelihood of consented-to enforcement action also increases. Finally, the SEC seems to attach significance to whether an inside lawyer raised troublesome issues with the Board; those who choose not to do so are judged more harshly.

B. Criminal Prosecutions

The criminal prosecutions are described in Part III. With only about a dozen prosecutions from which to draw, it is difficult to discern distinct patterns to the criminal prosecution of inside counsel in securities fraud and related cases. Some themes, however, emerge.

Rule #1: Chief Legal Officers are Criminal Targets, Too. The focus of criminal prosecutions seems to be almost entirely on the chief legal officers. There are no subordinate in-house counsel who have been charged with federal criminal violations.

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reasonably likely that a material violation has occurred, is ongoing, or is about to occur." Id. at § 205.2(e).

[4] See 68 Fed. Reg. 6296, 6302 (Feb. 6, 2003) (discussing the definition of "evidence of a material violation," see n. 3, supra, and noting that one of the circumstances that may inform counsel as to whether he or she is obligated to report certain information up-the-ladder is "the availability of other lawyers with whom the lawyer may consult.").

Rule #2: Big Losses Increase Risk of Prosecution. No surprises here. The size of the losses sharply increases the likelihood of criminal prosecution, with several of the prosecutions resulting from the largest restatements and corporate failures in America.

Rule #3: Having Outside Counsel Can Make a Big Difference. Again, there is an almost total absence of outside counsel involvement in the conduct that led to criminal indictments. This is predictable as an inside lawyer could effectively deflect criminal criticism by showing reliance on a law firm – whose incentive to engage in or approve criminal conduct by a client is doubtful.

Rule #4: Perjury and Obstruction Often Become the Crime Charged. A recurring theme in the prosecution of lawyers is allegations of cover-ups – obstruction of justice and perjury. Obstruction came from directing employees to lie or mislead investigators.

Rule #5: Mere Knowledge of Conduct Later Deemed Criminal is Typically Not Enough. Perhaps the most important observation is that mere knowledge of the conduct and decisions that are later deemed to be financial fraud does not appear sufficient to charge in-house counsel with criminal conduct. One can discern this by examining many corporate failures and massive restatements that have occurred over the past four years and comparing that number to the small number of criminal indictments of inside counsel to reach this conclusion. Direct and active involvement of in-house counsel in the questionable conduct, with knowledge that the conduct is fraudulent, is necessary to bring federal charges.

Rule #6: Counsel Are Seldom Charged Where the Alleged Fraud is Complex and Its Propriety Debatable. Conversely, a criminal prosecution of an inside lawyer has never resulted where the alleged fraud is complex and its propriety is debatable. The indicted cases have all alleged (at least some were not proven) 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.

Rule #7. The Prosecutors' True Goal: Undermine the Executive's Advice-of-Counsel Defense. Indeed, even in those cases where the in-house counsel is charged with broad misconduct, there are pleas to much lesser offenses with much lighter sentences. The most likely explanation for

this is that in-house counsel are most often targeted in order to secure their cooperation against the real target – the CEO or very senior management. The presence of the in-house lawyer is a factor that many executives who are targets of investigations rely upon to argue that their conduct was presumptively not illegal. After all, the in-house lawyer knew everything but failed to object! One effective way to strip a potential defendant of this quasi-advice-of-counsel-defense is to pursue the lawyer and give him the option of cooperating against the targeted executive or becoming a defendant himself.

II. SEC Proceedings and Orders Against Inside Corporate Counsel

A. Introduction

The corporate financial failures of late 2001 and the subsequent enactment of corporate governance measures, such as the Sarbanes-Oxley Act of 2002,[5] have unquestionably resulted in an increase in SEC enforcement activity directed at inside counsel. In the past two years alone, the SEC has initiated more than 30 enforcement actions[6] against corporate attorneys, most of which have been directed at those working in-house.[7] And, according to Stephen Cutler, then Director of the SEC's Division of Enforcement, the number of new enforcement actions against corporate counsel is expected to increase, due primarily to the SEC's "stepped up" scrutiny of corporate counsel[8] in what has been characterized as their role as "gatekeepers" or "sentries of the marketplace."[9]

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[5] Pub. L. No. 107-204, 116 Stat. 745 (July 30, 2002).

[6] For purposes of this paper, an enforcement action includes both a civil injunctive action brought in federal district court, as well as a public administrative proceeding brought before the Commission.

[7] See Stephen M. Cutler, Director, Division of Enforcement, SEC, "The Themes of Sarbanes-Oxley as Reflected in the Commission's Enforcement Program," Speech before UCLA School of Law (September 20, 2004), available at www.sec.gov/news/speech/spch092004smc.htm.

[8] As explained by Cutler:

> [W]e have stepped up our scrutiny of the role of lawyers in the corporate frauds we investigate.
>
> . . . .
>
> Based on our current investigative docket, I think you can expect to see one or more actions against lawyers who, we believe, assisted their clients in engaging in illegal late trading or market timing arrangements that harmed mutual fund investors. We are also considering actions against lawyers . . . who assisted their

Even before the highly publicized corporate breakdowns of 2001, the SEC brought isolated enforcement actions against inside counsel. The SEC's admitted focus on corporate counsel explains the growth in the number of enforcement actions from 1998-2001 to 2002-04. Are there, however, any similarities in the actions from both periods, such as the role of the defendant lawyer, the nature of alleged violations, the theories of liability, or the gravity of the sanctions, that may inform counsel on how best to protect themselves against the threat of an SEC enforcement action? To address this question, the following discussion presents a chronological summary of the enforcement actions, with an emphasis on those elements that appear common or recurring in these actions.

Attempting to distill patterns from the enforcement actions is an imprecise and hazardous undertaking for several reasons. First, the descriptions of counsel's conduct is provided, in most instances, only by the SEC. There is, in nearly all *contested* cases, another and much more innocent side to the story that is not reflected in the SEC's complaint. So, we are looking at the facts only through the eyes of the regulators. While this view admittedly slants the facts, we must also recognize that the SEC's perception of the facts is nearly as important as the "true facts" because it reveals the issues that presumably prompted enforcement action.

Second, the descriptions of counsel's conduct in *consent* proceedings may also slant the facts but in the opposite direction:[10] defendants or respondents often negotiate for a less damaging description of the facts as a condition of consenting to the charges. For these two reasons, the allegations in a filed SEC proceeding may overstate or understate the nature of the underlying conduct that prompted regulatory action. This cautions against reading too much into the lessons

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companies or clients in covering up evidence of fraud, or prepared, or signed off on, misleading disclosures regarding the company's condition. One area of particular focus for us is the role of lawyers in internal investigations of their clients or companies. We are concerned that, in some instances, lawyers may have conducted investigations in such a manner as to help hide ongoing fraud, or may have taken actions to actively obstruct such investigations.

[9] Id.

[10] By consent proceedings, we mean proceedings where the SEC and the respondent reach a settlement before the filing of the complaint or notice of charges, Typically, one important aspect of the prefiling settlement is to "tone down" the allegations in the complaint or notice of charges in order to secure the defendant's agreement.

of a single case and requires an observer to examine a large number of cases over a longer time period to identify accurately the underlying themes and trends.

Third, one must recognize that the SEC occasionally will bring a proceeding to raise the public awareness of its priorities – one could say it is "making an example" of one private party – but the standard applied in that case is not in fact being applied across-the-board to all similarly situated parties. This consciousness-raising proceeding is, nonetheless, important because it does identify issues of concern to the SEC and may signify changes in enforcement perspectives and approaches.

Fourth, and perhaps most significantly, the proceedings described below represent those where the SEC chose to act, thus prompting the question "what factors were present in the many matters where the SEC chose *not* to bring enforcement proceedings"? While this analysis necessarily involves some degree of speculation, there are some obvious factors that are notable by their absence which we will discuss below – for example, reliance upon the advice of outside counsel.

For purposes of this analysis, we are putting to one side conduct, such as insider trading, that is not integrally related to the function of an inside lawyer. In other words, any company insider who trades on material non-public information will find himself or herself subject to enforcement action and a review of those cases involving inside counsel is not likely to shed light on the SEC enforcement priorities.

B. Survey of Enforcement Actions

1. 1998-2001 Enforcement Actions

The SEC initiated enforcement actions against twelve inside counsel during the period of 1998 to 2001. Most of these actions were directed at the general counsel or the most senior legal officer directly involved in the preparation, approval, and/or signing of allegedly false financial statements or representations contained in SEC filings, securities offerings, and/or other publicly-disseminated documents. Most SEC actions were resolved by settlement. In five of the actions, inside counsel were either barred or suspended from appearing or practicing before the Commission.

In 1998, for example, the SEC filed two civil injunctive actions against inside counsel. In the first, in-house legal counsel for an infomercial marketing company was alleged to have engaged in a

fraudulent financial reporting scheme, along with the company's CEO, CFO, and a member of the company's board of directors and its audit committee.[11] According to the SEC, the other defendants caused the recording of fictitious business revenues and receivables, which they supported with false and misleading sales documents and bank records showing payment by entities that were secretly owned by the defendants.[12] The payments allegedly consisted of over $23 million taken from the company, transferred to these private entities, and then funneled back to the company.[13] The in-house legal counsel also served as corporate secretary and had been a director and member of the audit committee. He was alleged to have knowingly or recklessly prepared documents that concealed the other officers' ownership of one of the private entities and to have arranged for the receipt by one of these entities of $1.6 million in company stock, which was sold and the proceeds used as payment for one of the fictitious receivables.[14] The SEC alleged that in-house counsel received undisclosed payments from these private entities.[15]

Without admitting or denying the allegations in the complaint, the in-house counsel consented to the entry of a judgment enjoining him from future violations of these reporting statutes and rules,[16] and ordering him to disgorge $131,000 in unlawfully-obtained profits.[17] Prior to the entry of judgment in the civil enforcement action, however, he was convicted of conspiracy to

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[11] The defendants were charged with knowingly or recklessly making materially false and misleading statements, and omitting to state material information in periodic filings and registration statements filed with the Commission, in violation of 15 USC §§77q(a), 78j(b), and 78m(b)(5), and 17 CFR §§240.10b-5, 13b2-1, and 13b2-2. In addition, they were charged with controlling person liability for the company's violation of these reporting statutes. See SEC v. Arthur L. Toll, Bruce B. Edmondson, Gerald Levinson, and Elliot S. Fisher, 98-CV-2325 (HH) (E.D. Pa.), Litigation Release No. 15731 ; Accounting and Auditing Enforcement Release No. 1033 (May 4, 1998).
[12] Id.
[13] Id.
[14] Id.
[15] Id.
[16] See n. 6, supra.
[17] SEC v. Arthur L. Toll, Bruce B. Edmondson, Gerald Levinson, and Elliot S. Fisher, 98-CV-2325 (HH) (E.D. Pa.), Litigation Release No. 17880; Accounting and Auditing Enforcement Release No. 1682 (Dec. 6, 2002).

commit securities fraud and to make false and misleading statements to auditors,[18] and was subsequently suspended from appearing or practicing before the Commission as an attorney.[19]

In the second action, the SEC charged the vice-president and general counsel of a research and development company, with violating the antifraud and reporting provisions of the securities law by preparing materially false or misleading public statements in press releases, shareholder letters, and SEC filings relating to the nature and extent of the company's products and the status of the technologies being developed by the company.[20] According to the complaint, these statements represented that the company had developed certain technologies that were unqualified successes when, in fact, the technologies were only in the research and development stage.[21] The complaint further alleged that, after the dissemination of these public statements, the company's stock rose significantly in price.[22]

At the trial of the action in federal district court in New Mexico, the in-house contested the charges, but lost.[23] On appeal following the adverse judgment,[24] he disputed the district court's findings, arguing, inter alia, that he did not know that the statements were false or misleading, that he reasonably relied on information supplied by technology experts since he did not have a technological background, and that he had no reason to doubt the accuracy of the information and, therefore, did not attempt to verify it.[25] The Tenth Circuit rejected his contentions and affirmed the

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[18] United States v. Elliot Fisher, No. 98-CR-63-3 (RFK) (E.D. Pa.) (judgment entered March 16, 2001).
[19] In the Matter of Eliot S. Fisher, Esq., Admin. Proc. Rel. No. 34-46954 (Dec. 6, 2002).
[20] SEC v. Solv-Ex Corp., et al., No. Civ. 98-860-LH (D. N.M.), Litig. Rel. No. 15817 (July 20, 1998) (charging Campbell with violations of Section 17(a) [15 USC § 77q(a)], and Section 10(b) [15 USC § 78j(b)] and Rule 10b-5, and with aiding and abetting Solv-Ex's violation of Section 13(a) [15 USC § 78m(a)]).
[21] Id. (the complaint also alleged that the statements reported that the company had successfully tested one of its products when, in fact, the test was a failure).
[22] Id.
[23] Id., Litig. Rel. No. 16502 (April 5, 2000).
[24] Id. (the district court found that Campbell had violated the anti-fraud provisions and had aided and abetted the company's violation of the reporting statutes, imposed a first-tier penalty of $5,000, and enjoined Campbell from future violations of Sections 17(a), 10(b), and 13(a)).
[25] See Opening Brief of Appellant Herbert M. Campbell, Solv-Ex Corp. v. SEC, No. 00-2339 (filed March 8, 2001), 2001 WL 34720835.

judgment of the district court.[26] In a related administrative proceeding, he was permanently barred from appearing or practicing before the Commission.[27] Between January and August of 1999, the SEC brought three administrative proceedings[28] and three civil injunctive actions against inside counsel. Three of the cases involved counsel who served in specialized positions within the corporation, such as bond or securities counsel; two of the cases involved the general counsel; and one case involved an attorney on the in-house counsel staff. With the exception of this latter case, a civil injunctive action for insider trading,[29] the conduct targeted in the 1999 cases dealt either with the preparation of allegedly false or misleading public statements, or with the drafting of agreements in connection with fraudulent accounting or securities' distribution schemes. One of these cases involved an administrative disciplinary proceeding instituted after counsel's conviction of securities and wire fraud.[30]

In the first of these enforcement actions in 1999, the SEC filed an administrative cease and desist proceeding against bond counsel for the County of Orange Investment Pools.[31] According to the SEC, in preparing or assisting in the preparation of the Official Statements for certain note offerings, the in-house lawyer failed to include material information concerning the investment

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[26] SEC v. Solv-Ex Corp. et al., No. 00-2339, 2004 WL 813535 (10th Cir. April 15, 2004), cert. denied, Rendall v. SEC, 125 S. Ct. 432 (Nov. 1, 2004).

[27] In the Matter of Herbert M. Campbell II, Esq., Initial Dec. Rel. No. 266; Admin. Proc. File No. 3-10268 (Oct. 27, 2004).

[28] One of the injunctive actions discussed here is one which was dismissed but followed by the institution of an administrative cease and desist proceeding two years later. See SEC v. ICN Pharmaceuticals, Inc., Milan Panic, Nils O. Johannesson, and David C. Watt, No. 99-1016DOC (ANX) (C.D. Cal.), Litig. Rel. No. 16249 (Aug. 11, 1999), discussed infra.

[29] See SEC v. Brian Patrick Burns, Jr., No. 99CV1546 (GK) (D. D.C.), Litigation Release No. 16187 (June 15, 1999) (in-house attorney consented to entry of final judgment in action alleging violation of 15 USC § 77j(b) and Rule 10b-5 for tipping friends to possible acquisition of his company).

[30] In In the Matter of Robert D. Sichta, Admin. Proc. Rel. No. 34-41132 (March 3, 1999), Sichta, the securities counsel for U.S. Mint, pled guilty to charges that he prepared or assisted in the preparation of fraudulent statements relating to U.S. Mint's business as a provider of gaming tokens, and that he bribed registered representatives in exchange for their promotion of U.S. Mint stock, all in violation of 15 USC §§78j(b) and 78ff, and 18 USC § 1343. See United States v. Robert D. Sichta, No. 95-CR-212-S (D. Colo.) (judgment entered Jan. 29, 1997). Sichta settled the administrative proceeding, and consented to the imposition of the sanction barring him from participating in any offering of penny stock. In the Matter of Robert D. Sichta, In the Matter of Robert D. Sichta, supra.

[31] See In the Matter of Jean Costanza, Admin. Proc. Rel. No. 33-7621 (Jan. 6, 1999).

strategy, its risks, and the losses sustained by the fund.[32] Although the SEC officials had previously suggested that only "egregious" behavior should support an administrative cease and desist proceeding against an attorney,[33] the SEC charged that bond counsel knew or should have known that the Official Statements omitted material information, "that she knew or reasonably should have known about the Pools, the Notes' interest rates, and [that] the tax exempt status of the Tax-Exempt Offerings could have been jeopardized."[34] Therefore, the SEC maintained that she had violated Sections 17(a)(2) and (3) [15 USC § 77q (a)(2), (3)] of the Securities Act.[35]

Without admitting or denying the allegations, she settled the matter and consented to the entry of a cease and desist order.[36] In press statements made after entry of the order, her attorney decried the SEC's decision to bring the action, stating that the SEC, by applying a "should have known" standard, had lowered the bar for imposing liability on attorneys under Section 17(a)(2) and (3).[37] Now, he argued, mere awareness of problems or a good faith mistake will subject counsel to SEC action.[38] The SEC responded that liability will be imposed whenever counsel has knowledge of a "red flag," but fails to investigate to ensure that any subsequent disclosure is proper.[39]

Several months later, the SEC brought a civil injunctive action against the general counsel of a pharmaceutical company, and against its president and the vice-president of research and development, alleging that their failure to disclose information in a press release concerning the FDA's non-approval of the company's new drug application constituted a violation of Section 10(b)

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[32] Id. at III(B)(1).
[33] See Norman S. Johnson, "Suits Against Lawyers," Speech before the Federal Securities Law Committee of the American Bar Association (Nov. 8, 1996) (stating the he "would hope that the cease and desist remedy would be limited to those situations where the attorney's conduct was so egregious that he could properly be deemed a principal actor."), available at www.sec.gov/news/speech/speecharchive/1996/spch137.txt.
[34] In the Matter of Costanza, supra, at III(C)(1)(b).
[35] Id. at III(C)(2).
[36] Id. at IV.
[37] "Municipal Bonds: Lawyers Have Duty to Investigate, Disclose 'Red Flags' in Offerings, SEC Official Says," 31 Sec. Reg. L. Rep. (BNA) 672 (May 21, 1999).
[38] Id.
[39] Id.

[15 USC § 78j(b)] and Rule 10b-5.[40] In an amended complaint, the SEC alleged that in-house counsel had knowledge of the FDA's not-approvable letter, had discussed the letter with the other defendants, and had a primary role in drafting the offending press release.[41] The SEC dismissed the civil injunctive action against in-house counsel,[42] and subsequently instituted an administrative cease and desist proceeding for his conduct in causing the company's violation of Section 10(b) and Rule 10b-5 with respect to the press release.[43] The SEC alleged that he was a cause of the company's violation, because he allegedly participated in meetings involving the not-approvable letter and the company's public response to it, and participated in the drafting of the press release. In-house counsel, therefore, "should have known" that the release omitted important facts of material interest to investors.[44] The court further found that, because of his admitted lack of expertise with FDA procedures and policies, he should have consulted regulatory counsel "to assess the significance of the not approvable letter" and determine what disclosures were necessary.[45] Without admitting or denying the SEC's findings, he consented to the issuance of a cease and desist order.[46]

In the other enforcement actions of 1999, the SEC focused its attention on inside counsel's role in allegedly promoting or effectuating a fraudulent scheme engaged in by others who had an interest in, or position with, the corporation.

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[40] See SEC v. ICN Pharmaceuticals, Inc., Milan Panic, Nils O. Johannesson, and David C. Watt, No. 99-1016DOC (ANX) (C.D. Cal.), Litig. Rel. No. 16249 (Aug. 11, 1999).
[41] The original complaint was dismissed as to Watt, but the SEC was granted leave to amend. Watt filed a motion to dismiss the amended complaint, arguing that the SEC failed to plead a "strong inference of scienter" as required by the Private Securities Litigation Reform Act (PSLRA), Pub. L. No. 104-67, 109 Stat. 737 (Dec. 22, 1995), and failed to provide specifics as to his alleged involvement in preparing the press release. The court denied the motion, finding that the PSLRA was not applicable to civil enforcement actions brought by the SEC. See SEC v. ICN Pharmaceuticals, Inc., et al., No. 99-1016 (C.D. Cal. Order issued Feb. 2, 2000), as reported in 15 No.9 Andrews Corp. Off. & Directors Liab. Litig. Rep. 13 (March 6, 2000).
[42] See SEC v. ICN Pharmaceuticals, Inc., Milan Panic, Nils O. Johannesson, and David C. Watt, No. 99-1016DOC (ANX) (C.D. Cal.), Litig. Rel. No. 17861 (Nov. 25, 2002).
[43] See In the Matter of David C. Watt, Admin. Proc. Rel. No. 34-46899 (Nov. 25, 2002).
[44] Id. at III.
[45] Id.
[46] Id. at II.

The first case involved an allegedly fraudulent scheme to distribute unregistered securities of Market America, a direct-marketing company.[47] According to the SEC, the president of Market America and another individual, who controlled a shell corporation having no assets, entered into a sham "blank check" public offering for the shell corporation, making it appear that the shell corporation had shares that could be freely traded without registration when, in fact, the shares were owned by these two parties.[48] Afterwards, they completed a reverse merger between Market America and the shell corporation, resulting in their undisclosed ownership of most of Market America's outstanding stock.[49] Since their ownership was concealed, these individuals were able to obtain a NASD Bulletin Board listing for Market America and thereby distribute unregistered shares of its stock.[50] In a settled administrative cease and desist proceeding brought against counsel to the president of Market America,[51] the SEC alleged that in-house counsel provided substantial assistance to this fraudulent scheme in two ways: by negotiating and drafting the terms of the merger agreement, even though he was aware of the parties' oral agreement to sell their shares of Market America stock and to divide the proceeds between them on a dollar for dollar basis; and, by concealing the parties' ownership of the Market America stock from the NASD by failing to disclose this information upon inquiry by the broker-dealer sponsoring the application for the listing.[52] As a consequence, the SEC alleged that in-house counsel was a cause of the violations of the registration

[47] In the Matter of Market America, Inc. and Richard D. Hall, Jr., Admin. Proc. Rel. Nos. 33-7674; 34-41363 (May 4, 1999).
[48] Id. at III(B).
[49] Id.
[50] Id.
[51] The SEC brought a civil injunctive action against the actual parties to the fraudulent transactions, the president of Market America and the owner of the shell corporation, who consented to final judgments requiring them to pay over $2 million in disgorgement, interest, and civil penalties. See SEC v. Gilbert A. Zwetsch and James H. Ridinger, No. 99-1088 (LFO) (D. D.C.), Litig. Rel. No. 16131A (May 4, 1999).
[52] Id.

and antifraud provisions of the securities laws,[53] and ordered him to cease and desist from any further violations.[54]

The second case involved an allegedly fraudulent scheme to inflate reported revenues through the execution of undisclosed side agreements that required the company to repay amounts purportedly "paid" by the counter parties to transactions. In a settled civil injunctive action against the general counsel and secretary of the company, the SEC alleged that counsel acted in furtherance of the scheme by drafting some of these side agreements and/or by negotiating and finalizing these agreements with the legal representatives of the counter parties, all in violation of the antifraud, books and records, and internal controls provisions of the securities law.[55] The court enjoined in-house counsel from future violations of these provisions and assessed a civil penalty of $25,000.

In a related administrative proceeding, the same in-house counsel consented to the entry of an order denying him the privilege of appearing and practicing before the Commission for a period of five years.[56] In addition, he was ordered to comply with a cooperation agreement that he executed as part of his settlement with the SEC. The agreement not only imposed disclosure and document production requirements on him, but also prohibited him from asserting any evidentiary or other privilege if required to provide testimony in any proceeding.[57] Unlike the current approach in government investigations and prosecutions,[58] the in-house lawyer was not prohibited from asserting the attorney-client and work product privileges.[59]

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[53] Sections 5(a), (c) and 17(a) of the Securities Act [15 USC §§77e(a), (c); 77q(a)], Section 10(b) of the Exchange Act [15 USC § 78j(b)] and Rule 10b-5.
[54] In the Matter of Market America, Inc., Admin. Proc. Rel. Nos. 33-7674; 34-41363, at IV-V.
[55] SEC v. Jerald M. Banks, No. 99 Civ. 8855 (TPG) (S.D.N.Y.), Litig. Rel. No. 16251; Accounting and Auditing Enforcement Rel. No. 1153 (Aug. 12, 1999) (alleging that Banks' conduct constituted violations of Section 17(a) of the Securities Act [15 USC § 77q(a)], Sections 10(b) and 13(b)(5) of the Exchange Act [15 USC §§78j(b), 78m(b)(5)], and Rules 10b-5, 13b2-1, and 13b2-2).
[56] In the Matter of Jerald M. Banks, Admin. Proc. Rel. No. 34-41806; Accounting and Auditing Enforcement Rel. No. 1156 (Aug. 30, 1999).
[57] Id. at V.
[58] See generally, U.S. Department of Justice, Office of the Deputy Attorney General, Principles of Federal Prosecution of Business Organizations (Jan. 20, 2003).
[59] In the Matter of Jerald M. Banks, Admin. Proc. Rel. No. 34-41806; Accounting and Auditing Enforcement Rel. No. 1156, at V.

During the 2000-2001 period, four inside counsel were the subjects of SEC enforcement actions, together with their companies and/or other officers within the corporation.[60] In all of the actions, counsel held the top legal position, such as general counsel, and, with one exception,[61] also served in other capacities.[62]

Like the actions in previous years, these actions involved allegations of fraudulent reporting and accounting schemes engaged in by corporate officers; counsel were alleged to have assisted this conduct through knowing, reckless, or negligent preparation of materially false and misleading SEC filings, public statements, and/or undisclosed side agreements. More specifically, the complaints alleged the following wrongful conduct: knowingly or recklessly preparing documents relating to fraudulent real estate sales that had been included as assets on the company's SEC filings, and signing a Form 10-K reflecting these sales;[63] knowingly including an unauthorized audit report in a registration statement;[64] knowingly or recklessly engaging in a fraudulent financial reporting scheme by negotiating, drafting and concealing unlawful side agreements to customer contracts and by backdating documents;[65] and participating in the drafting of materially misleading press releases concerning the company's financial condition and results of operation.

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[60] An administrative proceeding was also initiated against a fifth general counsel, Herbert Campbell, after judgment was entered against him in a civil injunctive action that had been commenced in 1998. See In the Matter of Herbert M. Campbell, Esq., Admin. Proc. File No. 34-43422 (Oct. 6, 2000) and SEC v. Solv-Ex Corp., et. al., Litig. Rel. No. 15817 (July 20, 1998), discussed supra.

[61] SEC v. Jay Lapine, No. C-01-3650 (VRW) (N.D. Cal.), Litig. Rel. No. 17189; Accounting and Auditing Enforcement Rel. No. 1467 (Oct. 15, 2001).

[62] See e.g., In the Matter of Steven Wolis, Admin. Proc. Rel. No. 34-43123; Accounting and Auditing Enforcement Rel. No. 1290 (Aug. 4, 2000) (general counsel and director); SEC v. Countryland Wellness Resorts, Inc., et al., No. CV-S-00-1160-PMP (RJJ) (D. Nev.), Litig. Rel. No. 16732; Accounting and Auditing Enforcement Release No. 1327 (Sept. 27, 2000) (general counsel and director).

[63] In the Matter of Steven Wolis, Admin. Proc. Rel. No. 34-43123; Accounting and Auditing Enforcement Rel. No. 1290 (Aug. 4, 2000) (charged with violating Sections 10(b), 13(b)(5), and 13(b)(2) of the Exchange Act [15 USC §§78j(b), 78m(b)(5), (b)(2)], and Rules 10b-5, 13b-1, and 13b2-2).

[64] SEC v. Countryland Wellness Resorts, Inc., et al., No. CV-S-00-1160-PMP (RJJ) (D. Nev.), Litig. Rel. No. 16732; Accounting and Auditing Enforcement Release No. 1327 (Sept. 27, 2000) (charged with violating Section 17(a) of the Securities Act [15 USC § 77q(a)], and Section 10(b) of the Exchange Act [15 USC § 78j(b)], and Rule 10b-5).

[65] SEC v. Jay Lapine, No. C-01-3650 (VRW) (N.D. Cal.), Litig. Rel. No. 17189; Accounting and Auditing Enforcement Rel. No. 1467 (Oct. 15, 2001) (charged with violating Section

Consistent with preceding years, there was considerable variation in the nature of the enforcement actions and the extent of the sanctions imposed. Of the three actions that have been concluded,[66] two involved related administrative disciplinary proceedings resulting in consent orders barring or suspending inside counsel from appearing and practicing before the Commission.[67] The third case involved a settled administrative proceeding in which the general counsel of a public company, after cooperating with the SEC at the outset of its investigation, agreed to cease and desist from committing or causing any further violations of Section 17(a)(3) of the Securities Act.[68]

In the one case from this period that remains pending as of this writing, a civil injunctive action against the former general counsel of McKesson/HBOC, Inc.,[69] the SEC seeks to impose a broad range of penalties and sanctions. The SEC alleged that he engaged in a massive accounting fraud scheme, together with members of top management, and was unjustly enriched because of his receipt of significant bonuses that were tied to the company's meeting projected earnings.[70] It seeks

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10(b) and 13(b)(5) of the Exchange Act [15 USC §§78j(b), 78m(b)(5)] and Rules 10b-5 and 13b2-1, and with aiding and abetting the company's violation of the reporting requirements of Sections 13(a) and 13(b)(2)(A) of the Exchange Act [15 USC §§78m(a), (b)(2)(A)] and Rules 12b20 and 13a-13). See Complaint, SEC v. Jay Lapine, No. C-01-3650 (VRW) (N.D. Cal. filed Sept. 27, 2001).

[66]The enforcement action against Jay Lapine, the former general counsel of McKesson/HBOC, remains pending. See SEC v. Jay Lapine, No. C-01-3650 (VRW) (N.D. Cal.), Litig. Rel. No. 17189; Accounting and Auditing Enforcement Rel. No. 1467 (Oct. 15, 2001).

[67] In the Matter of Steven Wolis, Admin. Proc. Rel. No. 34-43123; Accounting and Auditing Enforcement Rel. No. 1290 (Aug. 4, 2000) (In 2000, Wolis consented to the entry of a permanent injunction in a civil injunctive action brought by the SEC in 1995, and, in 1998, pled guilty in a related criminal action to an obstruction of justice charge); In the Matter of Donald E. Studer, Admin. Proc. Rel. No. 34-43532; Accounting and Auditing Enforcement Rel. No. 1342 (Nov. 8, 2000) (general counsel for Countryland Wellness Resorts, Inc.).

[68] The general counsel was charged with participating in the preparation of materially misleading press releases, while other members of top management were charged as principal actors in the fraudulent "cookie jar" scheme to misrepresent the company's results of operation.

[69]SEC v. Jay Lapine, No. C-01-3650 (VRW) (N.D. Cal.), Litig. Rel. No. 17189; Accounting and Auditing Enforcement Rel. No. 1467 (Oct. 15, 2001). Lapine is also subject to a pending criminal action. See United States v. Albert J. Bergonzi, Charles W. McCall, and Jay Lapine, No. CR 00-0505-MJJ (N.D. Cal.) (Second Superseding Indictment, June 3, 2003), available at www.usdoj.gov/usao/can/press/html/2003_06_04_mckesson.html

[70] See n. 66 and accompanying text, supra.

both an injunction against future violations of the securities laws and disgorgement of any wrongfully-received profits, in addition to the imposition of civil penalties and a permanent injunction against serving as an officer or director of a publicly traded company.[71] In his defense, in-house counsel has asserted, in part, that he acted in "honest and reasonable reliance" on the advice and expertise of accounting and business professionals.[72]

2. Post 2001 Enforcement Actions

Because of the highly publicized corporate failures that began in the fall of 2001, the SEC has increasingly focused its attention on the role of inside counsel. This increased attention has resulted in a corresponding increase in the number of enforcement actions directed at inside counsel: since the beginning of 2001, approximately 19 inside counsel have been the targets of SEC enforcement actions. And, as indicated by the SEC's saber-rattling statements[73] and its issuance of Wells notices,[74] others may find themselves defendants in the near future.

In 2002, five civil injunctive actions were filed against inside counsel, all of whom served as the top attorney within the corporation.[75] Four of the attorneys also served in other capacities, such as vice-president and secretary,[76] vice-president and chairman of the board,[77] or just vice-president.

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[71] Complaint, SEC v. Jay Lapine, No. C-01-3650 (VRW) (N.D. Cal.) (filed Sept. 27, 2001); Litig. Rel. No. 17189; Accounting and Auditing Enforcement Rel. No. 1467 (Oct. 15, 2001).

[72] Answer to Complaint, SEC v. Jay Lapine, No. C-01-3650 (VRW) (N.D. Cal.) (filed Oct. 7, 2002).

[73] See n. 9, supra.

[74] See, e.g., "Stock Markets: SEC Investigating AMEX Execs With Respect To Options Trading Probe," 36 Sec. Reg. L. Rep. (BNA) 2056 (Nov. 22, 2004) (noting that the SEC had sent Wells notices to three executives of the American Stock Exchange, including its general counsel, warning that civil enforcement proceedings could be brought against them).

[75] See e.g., SEC v. Dean L. Buntrock et. al., No. 02C 2180 (N.D. Ill.), Litig. Rel. No. 17435; Accounting and Auditing Enforcement Rel. No. 1532 (March 26, 2002) (general counsel); SEC v. Frank M. Bergonzi, Martin L. Grass, and Franklin C. Brown, No. 1:CV02-1084 (M.D. Pa.), Litig. Rel. No. 17577; Accounting and Auditing Enforcement Rel. No. 1581 (June 21, 2002) (chief legal officer); SEC v. Bruce Hill, et al., No. 02-CV-11244 (D. Mass.), Litig. Rel. No. 17578; Accounting and Auditing Enforcement Rel. No. 1582 (June 21, 2002) (general counsel); SEC v. Andrew S. Marks, No. 02 CV 12325 (JLT) (D. Mass.), Litig. Rel. No. 17871 (Dec. 3, 2002) (chief patent counsel – highest ranking attorney within company).

[76] Herbert Getz was also a senior vice-president and secretary of Waste Management. See SEC v. Dean L. Buntrock et. al., No. 02C 2180 (N.D. Ill.), Litig. Rel. No. 17435; Accounting and Auditing Enforcement Rel. No. 1532 (March 26, 2002). Bruce Hill served as a vice-

Many of the attorneys are, or have been, defendants in well-publicized criminal proceedings brought in connection with the same conduct that is the subject of the enforcement actions.[78]

As in prior enforcement actions, the 2002 actions involve allegations that inside counsel, usually in concert with other corporate officers,[79] committed securities fraud and violated, or aided and abetted the violation of, the recordkeeping and/or reporting obligations of the securities laws through fraudulent accounting[80] and revenue recognition schemes,[81] undisclosed self-dealing

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president and secretary of Inso Corporation, now known as eBT International, Inc. See SEC v. Bruce Hill, et al., No. 02-CV-11244 (D. Mass.), Litig. Rel. No. 17578; Accounting and Auditing Enforcement Rel. No. 1582 (June 21, 2002).

[77] Franklin Brown first served as both chief legal officer and executive vice-president of Rite-Aid Corporation, and then became its chairman of the board. SEC v. Frank M. Bergonzi, Martin L. Grass, and Franklin C. Brown, No. 1:CV02-1084 (M.D. Pa.), Litig. Rel. No. 17577; Accounting and Auditing Enforcement Rel. No. 1581 (June 21, 2002).

[78] United States v. Martin L. Grass, Franklin C. Brown, Franklyn M. Bergonzi, and Eric S. Sorkin, No. 1:CR-02-146 (M.D. Pa.); United States v. Graham Marshall and Bruce Hill, Crim. Action No. 03-10344 (DPW) (D. Mass.), Litig. Rel. No. 18699 (May 7, 2004); United States v. Marks, Crim. Action No. 03-10297 (DPW) (D. Mass.), Litig. Rel. No. 18360 (Sept. 24, 2003). For more discussion of the criminal proceedings, see infra at Part III.

[79] The sole exception is Andrew Marks, the chief patent counsel for a pharmaceutical company, who was charged with insider trading for liquidating all of his company stock immediately before the company's issuance of a press release announcing the suspension of a clinical trial of one of its drugs. See SEC v. Andrew S. Marks, No. 02 CV 12325 (JLT) (D. Mass.), Litig. Rel. No. 17871 (Dec. 3, 2002).

[80] See SEC v. Dean L. Buntrock, et al, No. 02C 2180 (N.D. Ill.), Litig. Rel. No. 17435; Accounting and Auditing Enforcement Rel. No. 1532 (March 26, 2002) (violations of Section 17(a) of the Securities Act [15 USC § 77q(a)], Sections 10(b) and 13(a) of the Exchange Act [15 USC §§78j(b), 78m(a)], and Rules 10b-5, 12b-20, 13a-1, and 13a-13); SEC v. Frank M. Bergonzi, Martin L. Grass, and Franklin C. Brown, No. 1:CV02-1084 (M.D. Pa.), Litig. Rel. No. 17577; Accounting and Auditing Enforcement Rel. No. 1581 (June 21, 2002) (violations of Section 17(a) of the Securities Act [15 USC § 77q(a)], Sections 10(b) and 13(b)(5) of the Exchange Act [15 USC §§78j(b), 78m(b)(5)], Rules 10b-5 and 13b2-1, 13b2-2, and controlling person liability under Section 20(a) of the Exchange Act [15 USC § 78t(a)] for the company's violations of the periodic and current reporting obligations, proxy statement requirements, and corporate recordkeeping and internal controls statutes).

[81] See SEC v. Bruce Hill, et al., No. 02-CV-11244 (D. Mass.), Litig. Rel. No. 17578; Accounting and Auditing Enforcement Rel. No. 1582 (June 21, 2002) (violations of Section 17(a) of the Securities Act [15 USC § 77q(a)], Section 10(b) of the Exchange Act [15 USC § 78j(b)] and Rule 10b-5, Section 13(b)(5) of the Exchange Act [15 USC § 78m(b)(5)] and Rules 13b2-1 and 13b2-2, and aiding and abetting the company's violations of the periodic reporting and recordkeeping requirements).

transactions, and insider trading.[82] Two of the actions were precipitated by what, at the time, were the largest corporate restatements of revenue in history.[83]

Unlike the complaints in most of the prior actions, however, the SEC's complaints in the 2002 actions focus more on financial incentive, such as inside counsel's receipt of substantial performance-based bonuses, as a motivating force for the underlying conduct.[84] In the case of Waste Management's officers, including its then general counsel, the SEC begins its complaint by specifically alleging that the financial fraud "[was] motivated by greed and a desire to preserve professional and social status."[85] According to the SEC, because of the performance-based bonus program for senior officers, the defendants manipulated the Company's reported results in order to meet targeted earnings and thereby collect substantial bonuses in return.[86] Similar allegations are included in the complaint against the general counsel and the other officers of Rite-Aid with respect to their alleged scheme to misrepresent the company's financial condition.[87] In another complaint against the general counsel of a software company, the SEC also suggests that financial incentives influenced him to engage in a fraudulent revenue recognition scheme.[88] And, in other cases,

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[82] See SEC v. Andrew S. Marks, No. 02 CV 12325 (JLT) (D. Mass.), Litig. Rel. No. 17871 (Dec. 3, 2002) (violations of Section 10(b) of the Exchange Act [15 USC § 78j(b)] and Rule 10b-5, and Section 17(a) of the Securities Act [15 USC § 77q(a)].

[83] See Complaint, SEC v. Dean L. Buntrock, et al, No. 02C 2180 (N.D. Ill. filed March 26, 2002), at ¶ 1 (alleging that company's restatement showed that profits had been overstated by $1.7 billion dollars); Complaint, SEC v. Frank M. Bergonzi, Martin L. Grass, and Franklin C. Brown, No. 1:CV02-1084 (M.D. Pa. filed June 20, 2002), at ¶ 1 (alleging that company was forced to restate its cumulative pre-tax income by $2.3 billion dollars, and its cumulative net income by $1.6 billion dollars).

[84] In its 2001 complaint against Jay Lapine, the general counsel of McKesson/HBOC, the SEC also alleges that Lapine was unjustly enriched through the unlawful revenue recognition scheme by his receipt of significant bonuses that were tied to meeting expected earnings. See n. 71 and accompanying text, supra.

[85] Complaint, SEC v. Dean L. Buntrock, et al, No. 02C 2180 (N.D. Ill. filed March 26, 2002), at ¶ 1.

[86] Id. at ¶¶1, 337.

[87] Complaint, SEC v. Frank M. Bergonzi, Martin L. Grass, and Franklin C. Brown, No. 1:CV02-1084 (M.D. Pa. filed June 20, 2002), at ¶¶1, 67-68 (noting that the scheme was implemented "with the intent to enrich themselves through performance-based bonuses of stock and cash," and itemizing the amounts actually realized in cash bonuses and the amounts that could have been realized in stock options and long-term incentive plans had the fraud not been discovered).

[88] Complaint, SEC v. Bruce Hill, et al., No. 02-CV-11244 (D. Mass. filed June 21, 2002), at ¶¶20-21 (noting that "senior management had substantial financial incentives to meet

allegations of "looting" and "egregious self-dealing transactions" are sprinkled through the SEC's complaint.

With respect to counsel's specific role in the underlying schemes, the allegations vary in their characterization of the degree of counsel's complicity.

For example, the SEC alleged a fraudulent scheme orchestrated by the CEOs, CFO, and CAO of Waste Management, involving misrepresenting financial results by improperly eliminating or deferring current expenses. The SEC describes the general counsel as having questioned the practices,[89] but then as having "blessed the Company's fraudulent disclosures."[90] Throughout the complaint the SEC alleges that the other officers engaged in a variety of improper accounting practices "with the [general counsel's] knowledge."[91] Because he attended periodic meetings with the company's outside auditor to discuss auditing issues, such as the company's lack of progress in implementing a new accounting plan (due to the fraudulent scheme of which the general counsel is alleged to have had knowledge), and because he attended all audit committee meetings, the SEC alleges that the general counsel "had the full picture of the accounting irregularities and misstatements."[92] Accordingly, since he drafted, reviewed, and authorized the disclosures in the company's periodic reports, registration statements, and press releases, the general counsel knew or recklessly disregarded facts indicating that the financial information contained or incorporated in these documents was false or misleading and omitted material information.[93]

In another case, the SEC has alleged that senior executives defrauded the company by granting themselves numerous unauthorized loans from the company and causing their forgiveness, in directing others to falsify the books and records to conceal the loans, and in engaging in other

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revenue goals," and that Hill could earn a bonus of approximately 30% of his salary if company revenue goals were met, but would not receive a bonus if these goals were not met; also alleging that Hill "experienced firsthand significant repercussions" when the goals were not met, including the drop in stock prices, job restructuring and job cuts, and no bonuses).

[89] Complaint, SEC v. Dean L. Buntrock, et al, No. 02C 2180 (N.D. Ill. filed March 26, 2002), at ¶ 9.

[90] Id., at ¶ 18.

[91] See, e.g., id., at ¶¶50-73.

[92] Id., at ¶ 330.

undisclosed related-party transactions with the company. Separately, it sets forth its allegations against inside counsel: that he demanded and received a loan from the company for which he was ineligible; that he allegedly failed to disclose these loans on internal questionnaires when he knew, or was reckless in not knowing, that disclosure was required; and, that, he knowingly or recklessly sold large amount of company stock. The complaint further alleges that counsel was responsible for supervising the company's corporate disclosure, and that, as a result of the fraudulent misrepresentations and omissions discussed in the entire complaint, the company filed false and misleading reports and proxy statements with the Commission.

In contrast to the complaints in the two foregoing SEC actions, the complaints in several other 2002 actions allege direct participation by inside counsel in the fraudulent schemes. In the case of Rite-Aid, for example, the SEC alleges that in-house counsel "originated" the idea to report the proceeds of litigation settlement prematurely in order "to help plug . . . a $100 million shortfall that otherwise would have to be reported for FY 1999."[94] He is alleged to have "convinced outside counsel to provide an opinion letter that erroneously stated that the litigation settlement was binding and enforceable" as of a prior date, when he knew that it was not yet binding because of its contingent nature,[95] and then later provided this opinion letter to the company's auditors to support the recording of the settlement in the fourth quarter (even though he allegedly knew, or recklessly disregarded, that such recording was improper because of the highly contingent nature of the deal).[96] With respect to certain related-party transactions engaged in by the CEO, in-house counsel is also alleged to have used a false email and a back-dated document in an attempt to conceal one of these transactions.[97] Similar allegations of active participation in the fraudulent scheme appear in the complaint against the general counsel of Inso Corporation.[98]

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[93] Id., at ¶¶ 330-332.
[94] Complaint, SEC v. Frank M. Bergonzi, Martin L. Grass, and Franklin C. Brown, No. 1:CV02-1084 (M.D. Pa. filed June 20, 2002), at ¶ 45.
[95] Id. at ¶ 46.
[96] Id. at ¶ 61.
[97] Id. at ¶ 56.
[98] See Complaint, SEC v. Bruce Hill, et al., No. 02-CV-11244 (D. Mass. filed June 21, 2002), at ¶¶3-4 (in order to recognize revenue within the quarter from a failed sale of software

Turning to the issue of sanctions, the SEC sought similar sanctions in 2002 as it had in prior actions: permanent injunctions against future violations, disgorgement of ill-gotten gains, and the imposition of civil monetary penalties. An additional sanction pursued with more frequently in 2002 is a prohibition against serving as an officer or director of a publicly traded company.[99]

2003 saw five SEC enforcement actions brought against inside counsel, one of which was a settled administrative cease and desist proceeding. In all of the actions, inside counsel held the position of general counsel and also served in other capacities, such as vice-president and secretary,[100] president[101] and/or CEO,[102] and compliance officer.[103] Two of the attorneys were also directors of the corporation.[104] One of these attorneys has been indicted for the same conduct giving rise to the enforcement action.[105]

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licenses, Hill entered into a transaction with a third party knowing, or recklessly disregarding facts indicating the existence of an oral side agreement relieving the purported purchaser of any obligation to pay; "orchestrated" the provision of letters of credit to the purported purchaser to finance the transaction; "caused" the making of a false board resolution authorizing the letters of credit; provided false information to the CFO and outside auditors).

[99] See, e.g., SEC v. Andrew S. Marks, No. 02 CV 12325 (JLT) (D. Mass.), Litig. Rel. No. 18956 (Nov. 2, 2004) (announcing entry of consent judgment in insider trading case, enjoining Marks from future violations of the antifraud provisions and barring him from acting as an officer or director of a publicly traded company).

[100] SEC v. Michael J. Pietrzak, Maurice W. Furlong, and Donald E. Jordan, No. 03C-1507 (N.D. Ill.), Litig. Rel. No. 18016 (March 6, 2003); SEC v. Oliver Hilsenrath and David S. Klarman, No. C-03-3252 (N.D. Cal.), Litig. Rel. No. 18275; Accounting and Auditing Enforcement Rel. No. 1831 (Aug. 6, 2003); SEC v. Heartland Advisors, Inc., et. al., No. 03 C-1427 (E.D. Wis.), Litig. Rel. No. 18505 (Dec. 12, 2003).

[101] In the Matter of Steven L. Hunt, Esq., Admin. Proc. Rel. No. 34-48330; Accounting and Auditing Enforcement Rel. No. 1840 (Aug. 13, 2003). In the Matter of Steven L. Hunt, Esq., Admin. Proc. Rel. No. 34-48330; Accounting and Auditing Enforcement Rel. No. 1840 (Aug. 13, 2003).

[102] SEC v. Tecumseh Holdings Corp., et. al., No. 03 Civ. 5490 (SAS) (S.D.N.Y.), Litig. Rel. No. 18251 (July 25, 2003).

[103] SEC v. Heartland Advisors, Inc., et. al., No. 03 C-1427 (E.D. Wis.), Litig. Rel. No. 18505 (Dec. 12, 2003).

[104] SEC v. Michael J. Pietrzak, Maurice W. Furlong, and Donald E. Jordan, No. 03C-1507 (N.D. Ill.), Litig. Rel. No. 18016 (March 6, 2003); SEC v. Tecumseh Holdings Corp., et. al., No. 03 Civ. 5490 (SAS) (S.D.N.Y.), Litig. Rel. No. 18251 (July 25, 2003).

[105] See United States v. Oliver Hilsenrath and David Scott Klarman, CR 03-0213 WH (N.D. Cal.). Klarman pled guilty to mail fraud and money laundering for his part in the fraudulent scheme. See J. Chorney, "U.S. Wireless GC Admits Fraud," The Recorder at 10 (Jan. 27, 2004).

Like the allegations in previous enforcement actions, the allegations in the complaints filed against inside counsel in 2003 involve material misrepresentations and omissions in company records, SEC filings, press releases, and other documents disseminated to the public. With the exception of one case, the complaints allege that counsel, together with other officers and employees, engaged in this conduct in furtherance of a fraudulent scheme to inflate stock prices,[106] offer unregistered or overpriced securities or bonds[107] or extract assets from the company for personal gain.[108] In the sole exception, the administrative cease and desist proceeding, no underlying scheme was alleged; instead, the SEC found that inside counsel's omission of material information concerning disciplinary action taken against an affiliate of the company was a willful act, done in violation of various provisions of the Investment Advisors Act,[109] and warranted the issuance of a cease and desist order and a temporary suspension from appearing and practicing before the SEC as an attorney.[110]

In one of the more publicized cases in 2003, the SEC charged both the general counsel, and the CEO of U.S. Wireless, with "egregious securities fraud" that allegedly led to the company's bankruptcy after a restatement of its financial results showed a $6.3 million increase in losses.[111] According to the complaint, the general counsel set up offshore entities under his ownership and control and transferred company cash and stock to these entities as purported compensation for services or as purported sales of stock for valid consideration.[112] With respect to one entity, for example, the complaint alleges that the in-house counsel signed a consulting agreement on behalf of U.S. Wireless, which stated that the entity would provide legal services to the company regarding its

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[106] See Complaint, SEC v. Michael J. Pietrzak, Maurice W. Furlong, and Donald E. Jordan, No. 03C-1507 (N.D. Ill. filed March 6, 2003).
[107] See Complaint, SEC v. Tecumseh Holdings Corp., et. al., No. 03 Civ. 5490 (SAS) (S.D.N.Y. filed July 24, 2003) (securities offerings); Complaint, SEC v. Heartland Advisors, Inc., et. al., No. 03 C-1427 (E.D. Wis.) (bond offerings).
[108] See Complaint, SEC v. Oliver Hilsenrath and David S. Klarman, No. C-03-3252 (N.D. Cal. filed July 14, 2003).
[109] 15 USC § 80b-7.
[110] In the Matter of Steven L. Hunt, Esq., Admin. Proc. Rel. No. 34-48330; Accounting and Auditing Enforcement Rel. No. 1840 (Aug. 13, 2003).
[111] Complaint, SEC v. Oliver Hilsenrath and David S. Klarman, No. C-03-3252 (N.D. Cal. filed July 14, 2003), at ¶¶1, 35-36.

overseas operations; however, no services or other consideration was provided by the entity in exchange for the cash and stock.[113] The complaint further alleges that he signed a legal opinion letter in support of a registration statement that contained false information; drafted or reviewed periodic reports from which he intentionally or recklessly omitted the fact that the company received no consideration for the cash and stock transferred to the offshore entities; drafted or reviewed periodic reports containing material statements that he knew, or was reckless in not knowing, were false; intentionally caused the recording of false information in the company's books and records; and, made statements to the company's auditors regarding related-party transactions which he knew, or was reckless in not knowing, were false.[114]

Without admitting or denying the SEC's allegations, the general counsel of U.S. Wireless has consented to the issuance of an order by the federal district court holding him liable for $3.9 million,[115] permanently enjoining him from violating or aiding and abetting violations of the antifraud and other provisions of the securities laws,[116] and prohibiting him for 10 years from serving as an officer or director of any issuer with securities registered under Section 12 of the Exchange Act or with reporting obligations under Section 15(d) of the Exchange Act.[117] In a related administrative proceeding, the SEC has accepted the general counsel's offer of settlement and has suspended him from appearing and practicing before the Commission as an attorney.[118]

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[112] Id. at ¶ 2.
[113] Id. at ¶¶11-13.
[114] Id. at ¶¶27-33. Klarman was charged with violating Section 17(a) of the Securities Act (15 USC § 77q(a)), Section 10(b) of the Exchange Act (15 USC § 78j(b)) and Rule 10b-5, and Section 13(b)(5) of the Exchange Act (15 USC § 78m(b)(5)) and Rules 13b2-1 and 13b2-2, and with aiding and abetting the company's violations of Section 13(a) of the Exchange Act (15 USC § 78m(a)) and Rules 12b-20, 13a-1, and 13a-13, and Section 13(b)(2)(A) of the Exchange Act (15 USC § 78m(b)(2)(A)). See id., at ¶¶37-56.
[115] See SEC v. Oliver Hilsenrath and David S. Klarman, No. C-03-3252 (N.D. Cal. filed July 14, 2003), Litig. Rel. No. 19286; Accounting and Auditing Enforcement Rel. No. 2267 (June 27, 2005). This amount represents $3.2 million in disgorgement of ill-gotten gains, and $700,000 in prejudgment interest. Id.
[116] Id. As to the specific provisions of the securities laws to which the injunction applies, see n. 115, supra.
[117] Id. (referencing 15 U.S.C. §§78l and 78o, respectively).
[118] See In the Matter of David S. Klarman, Esq., Admin. Proc. Rel. No. 34-51927; Accounting and Auditing Enforcement Rel. No. 2266 (June 27, 2005).

In the remaining enforcement actions for 2003, the SEC makes similar allegations with respect to inside counsel's direct participation in the underlying scheme. For example, in its action against the general counsel of a financial services company as well as its president and CEO, the SEC alleges that he was responsible for the management and operation of the company and was aware of all aspects of the company, including its accounting and financial issues.[119] The complaint further alleges that as a lawyer, he devoted all of his professional time to the company's legal work and wrote, or directed the writing of all of the company's offering memoranda as well as its newsletters and other investor communications.[120] Notwithstanding his knowledge of the company's history of losses and lack of profits, he is alleged to have knowingly or recklessly prepared offering memoranda and other public releases containing materially false and misleading statements and omissions pertaining to a variety of matters, such as anticipated profits, the payment of dividends, the return on investments, the use of investment funds, and NASD's approval of the company's acquisition of a broker-dealer.[121] Because of his role in the company, he was charged with violations of the securities laws both directly and as a controlling person.[122]

In its complaint against the general counsel of what the SEC describes as a company "professed to be in various businesses . . . none [of which] were ever operational,"[123] the SEC alleges that he and the company's CEO shared responsibility for keeping the company's books, records, and accounts, and for maintaining its internal controls.[124] In order to inflate the price of its stock and the value of the company, the complaint alleges that the general counsel participated in the following wrongful conduct: recording, as assets, several transactions having no basis on which to

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[119] Complaint, SEC v. Tecumseh Holdings Corp., et. al., No. 03 Civ. 5490 (SAS) (S.D.N.Y. filed July 24, 2003), at ¶ 51.
[120] Id.
[121] Id., at ¶¶2, 28-50.
[122] See id., at ¶¶54-60, 64-66, and 71-73 (charging Milling directly and as a controlling person with violating Section 17(a) of the Securities Act (15 USC § 77q(a)), Section 10(b) of the Exchange Act (15 USC § 78j(b)), and Rule 10b-5, with violating Sections 5(a) and 5(c) of the Securities Act (15 USC § 77e(a), (c)), and with aiding and abetting the company's violation of Section 17(a) of the Securities Act and Rules 17a-3 and 17a-4).
[123] Complaint, SEC v. Michael J. Pietrzak, Maurice W. Furlong, and Donald E. Jordan, No. 03C-1507 (N.D. Ill. filed March 6, 2003), at ¶ 28.
[124] Id. at ¶ 50.

assign a value;[125] recording certain real estate as an asset, even though he knew that the company never controlled the property, never derived an economic benefit from the property, never obtained legal title to the property, never obtained an appraisal of the property, and knew that the property was the subject of litigation;[126] recognizing and valuing advertising credit without obtaining the requisite support for the valuation from a broker or other qualified individual;[127]failing to ensure that the company's internal controls prevented certain assets from being recorded in a manner that did not conform to GAAP;[128] recognizing and valuing notes receivable when he had no basis to believe that the notes were collectible;[129] preparing false and misleading press releases relating to assets that had been improperly recognized and valued;[130] selling company stock knowing, or recklessly disregarding the fact, that the registration statements, reports, press releases and shareholder letters contained inflated values of the company's assets;[131] and, failing to properly file certain periodic reports with the SEC.[132] As a consequence of these allegations, the complaint charges in-house counsel with a range of securities law violations.[133]

The final enforcement action against inside counsel in 2003 involves the general counsel of an investment company, whom the SEC alleges engaged in a scheme to sell municipal bond mutual funds at a fraudulently overvalued price. According to the SEC, the in-house counsel shared responsibility for assuring that the bonds were priced at fair value, and was "integral" in preparing SEC filings and promotional materials since she was responsible for reviewing all prospectuses,

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[125] Id. at ¶¶4, 50-51, 61-63.
[126] Id. at ¶¶87-91
[127] Id. at ¶¶104-106.
[128] Id. at ¶ 107.
[129] Id. at ¶¶117-118.
[130] Id. at ¶¶125-128.
[131] Id. at ¶¶163-166.
[132] Id. at ¶¶170-177.
[133] See id., at ¶¶180-187, 193-197, 202-209 (charging Pietzrak with violations of Section 17(a) of the Securities Act (15 USC § 77q(a)), Section 10(b) of the Exchange Act (15 USC § 78j(b)) and Rule 10b-5, and Section 13(b)(5) of the Exchange Act (15 USC § 78m(b)(5)) and Rules 13b2-1, and with aiding and abetting the company's violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act (15 USC §§78m(a), 78m(b)(2)(A) and (B)) and Rules 12b-20, 13a-1, 13a-11, 13a-13, and 13b2-1).

statements, and sales literature concerning the funds prior to their dissemination to the public.[134] In its complaint, the SEC alleges that the lawyer, together with others, knowingly or recklessly made material misrepresentations and omissions in these documents concerning a number of matters, including the risks of investing and the efforts undertaken to minimize the risks.[135] With respect to the overvaluation of the funds, the complaint alleges that she knew that the price of the funds were inflated, but failed to take corrective action to ensure that the prices reflected the bonds' fair value.[136] Instead, the SEC alleges that counsel attempted to conceal the pricing fraud by urging the other defendants to eliminate certain materials, including any materials dealing with valuation issues.[137]

Consistent with prior civil injunctive actions, the sanctions sought in 2003 included permanent injunctions against future violations, as well as disgorgement and the payment of civil monetary penalties. In two of the actions, the SEC also seeks an order barring participation in any penny stock offering,[138] and, in one action, the SEC sought the imposition of a permanent officer and director bar.[139] The SEC also obtained preliminary injunctive relief that included an asset-freeze order.[140]

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[134]Complaint, SEC v. Heartland Advisors, Inc., et. al., No. 03 C-1427 (E.D. Wis. Filed Dec. 11, 2003), at ¶¶29, 36.
[135] Id. at ¶¶37-40.
[136] Id. at ¶¶52-60.
[137] Id. at ¶ 59. The SEC alleges that Bauer's activities violated Sections 17(a)(1) – (a)(3) of the Securities Act (15 USC § 77q(a)(1)-(a)(3)), Section 10(b) of the Exchange Act (15 USC § 78j(b)) and Rule 10b-5, and Sections 34(b) and 36(a) of the Investment Company Act (15 USC §§80a-33b, 80a-35b), and aided and abetted the company's violations of Sections 206(1) and 206(2) of the Advisers Act (15 USC §§80b-6(1), (2)). Bauer was also charged with insider trading for selling her shares in one of the funds in order to avoid losses upon the funds' devaluation. Id. at ¶¶90-100.
[138] See Complaint, SEC v. Michael J. Pietrzak, Maurice W. Furlong, and Donald E. Jordan, No. 03C-1507 (N.D. Ill. filed March 6, 2003); Complaint, SEC v. Tecumseh Holdings Corp., et. al., No. 03 Civ. 5490 (SAS) (S.D.N.Y. filed July 24, 2003).
[139] Complaint, SEC v. Oliver Hilsenrath and David S. Klarman, No. C-03-3252 (N.D. Cal. filed July 14, 2003).
[140] SEC v. v. Tecumseh Holdings Corp., et. al., No. 03 Civ. 5490 (SAS) (S.D.N.Y.), Litig. Rel. No. 18353 (Sept. 17, 2003).

During 2004, the SEC initiated six enforcement actions against inside counsel, all of whom appear to have held the top legal position within the corporations.[141] Four inside counsel also served in other capacities within the corporation, such as vice-president and secretary,[142] or just vice-president,[143] and one inside counsel had been a member of the board of directors.[144] In two of the cases, criminal actions were brought against inside counsel for conduct related to the subject of the civil enforcement action.[145]

Most of the actions in 2004 involve inside counsel's alleged complicity in securities law violations allegedly engaged in by others within the corporation. Like actions in preceding years, these actions reflect varying degrees of alleged participation by counsel in conduct targeted by the SEC in these actions, which ranges from the alleged failure to disclose material information or to correct materially false and misleading information in company reports and filings, to the drafting of opinion letters or transactional documents containing allegedly false or misleading information.

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[141] Chris Gunderson is referred to as his company's in-house counsel, suggesting that he is the legal officer within the company. See SEC v. Universal Express, Inc., et. al., No. 04 CV 02322 (S.D.N.Y.), Litig. Rel. No. 18636 (March 24, 2004).

[142] See e.g., SEC v. Henry C. Yuen, et al., No. CV 03-4376 NM (MANx) (C.D. Cal.), Litig. Rel. No. 18530; Accounting and Auditing Enforcement Rel. No. 1937 (Jan. 6, 2004) (Jonathan Orlick was general counsel, executive vice-president, and secretary of Gemstar-TV Guide); SEC v. Symbol Technologies, Inc., et. al., No. CV 04 2276 (LDW) (WDW) (E.D.N.Y.), Litig. Rel. No. 18743; Accounting and Auditing Enforcement Rel. No. 2029 (June 3, 2004) (Leonard Goldner served as executive vice-president, secretary, and general counsel).

[143] SEC v. Steven Woghin, No. 04 Civ. 4087 (E.D.N.Y.), Litig. Rel. No. 18891; Accounting and Auditing Enforcement Rel. No. 2106 (Sept. 22, 2004).

[144] SEC v. Henry C. Yuen, et al., No. CV 03-4376 NM (MANx) (C.D. Cal.), Litig. Rel. No. 18530; Accounting and Auditing Enforcement Rel. No. 1937 (Jan. 6, 2004) (Jonathan Orlick).

[145] Steven Woghin is one of the attorneys, see Press Release of October 6, 2004, United States Attorney's Office for the Eastern District of New York, "Former Computer Associates Executives Indicted on Securities Fraud, Obstruction Charges, Former General Counsel Pleads Guilty, Company Enters into Cooperation Agreement," available at www.usdoj.gov/usao/nye/pr/2004oct06a.htm, and Leonard Goldner is the other attorney. See Press Release of October 27, 2004, United States Attorney's Office for the Eastern District of New York, "Former General Counsel of Symbol Technologies Pleads Guilty to Conspiring to Obstruct the Internal Revenue Service in the Collection of Income Tax," available at www.usdoj.gov/usao/nye/pr/2004oct27a.htm.

In its first enforcement action for the year, for example, the SEC charged the former general counsel of Gemstar-TV Guide,[146] with securities fraud in connection with a scheme to inflate licensing and advertising revenue that resulted in an overstatement of revenue in the amount of approximately $248 million.[147] According to the SEC, he participated in the company's manipulation of its financial results in the following ways: he knew that the company was improperly recognizing and recording licensing revenue from two companies, but omitted to disclose that information; he repeatedly signed management representation letters to the company's auditors that contained false information regarding the status of negotiations with one of the companies; and, he failed to disclose material information relating to certain revenue.[148] The SEC also charged him with lying to the company's auditors.[149] Without admitting or denying the allegations, the in-house counsel consented to the issuance of an order permanently enjoining him from future violations of the securities laws.[150] In a related administrative disciplinary proceeding, he consented to an order suspending him from appearing or practicing before the SEC as an attorney.[151]

In another action, the SEC instituted an administrative cease and desist proceeding against the chief legal officer of a public company. According to the SEC, the in-house counsel became aware that certain corporate assets were significantly overvalued and he was advised by the auditors that the company would therefore be required to restate its financial statements. The company

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[146] Orlick was fired from Gemstar "for cause" in June of 2003, just before the SEC filed its first action against Gemstar executives. Subsequently, he filed a defamation against Gemstar, claiming that the "for cause" designation indicated that he had been convicted of a felony or had been found guilty of fraud or embezzlement . See "Former Gemstar counsel sues for defamation," Los Angeles Business from bizjournals (July 9, 2003), available at http://losangeles.bizjournals.com/losangeles/stories/2003/07/07/daily30.html.

[147] See SEC v. Henry C. Yuen, et al., No. CV 03-4376 NM (MANx) (C.D. Cal.), Litig. Rel. No. 18530; Accounting and Auditing Enforcement Rel. No. 1937 (Jan. 6, 2004).

[148] Id.

[149] Id. In all, Orick was charged with violations of Section 10(b), 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act (15 USC §§78j(b), 78m(a), 78m(b)(2)(A), and 78m(b)(2)(B)), and Rules 10b-5, 12b-20, 13a-1, 13a-13, 13b2-1, and 13b2-2. Id.

[150] Id., Litig. Rel. No. 19047 (Jan. 21, 2005) (also ordering him to pay disgorgement of $150,000, reflecting a portion of bonuses received during the course of the scheme, interest of $5,510, and a civil penalty of $150,000).

[151] In the Matter of Jonathan B. Orlick, Esq., Admin. Proc. Rel. No. 34-51081; Accounting and Auditing Enforcement Rel. No. 2177 (Jan. 26, 2005).

restated but allegedly mischaracterized the reasons in its SEC filings. The SEC alleged that the inside counsel effectively approved the filing when he knew or should have known that the filing mischaracterized the reason for the restatement. The SEC alleged that the in-house counsel reviewed and signed another SEC filing that he knew or should have known did not accurately reflect the company's cash and debt. Without admitting or denying the SEC's findings that the lawyer aided and abetted the company's violation of the reporting statutes, the lawyer consented to the entry of the cease and desist order, and agreed to refrain from preparing, reviewing, or signing any filings for a two-year period.

The three following enforcement actions allege active roles by inside counsel in the alleged fraudulent schemes.

In its enforcement action against the in-house counsel for a developmental stage company, the SEC alleges he engaged in the company's fraudulent stock distribution scheme by disguising the nature of the transactions through the preparation of false documentation, including the following: consulting agreements purporting to obligate the re-sellers of unlawfully-issued stock to perform services in exchange for the stock; legal opinions containing false assertions as to coverage of the stock under the company's registrations for its common shares; and fraudulent stock purchase agreements.[152] He is also alleged to have provided the company's auditors with misleading information about the stock issuances and with backdated stock purchase letters.[153] To underscore its view as to the severity of the charges, the SEC seeks third-tier civil monetary penalties against all of participants in the scheme, including in-house counsel.[154] Thus, in-house counsel faces a civil money penalty not to exceed the greater of $100,000, or the gross amount of pecuniary gain

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[152] Complaint, SEC v. Universal Express, Inc., et. al., No. 04 CV 02322 (S.D.N.Y. filed March 24, 2004), at ¶¶23-28.
[153] Id. at ¶¶36, 38.
[154] Gunderson is charged with the following violations: Sections 5(a) and (c) of the Securities Act (15 USC § 77e(a) and (c), Section 17(a)(1), (a)(2), and (a)(3) of the Securities Act (15 USC § 77q(a)(1), (a)(2), and (a)(3)), Section 10(b) of the Exchange Act (15 USC § 78j(b)) and Rule 10b-5, Section 13(b)(5) of the Exchange Act (15 USC § 78m(b)(5)) and Rule 13b2-1, and aiding and abetting the company's violations of Sections 13(a) and 13(b)(2) of the Exchange Act (15 USC §§78m(a), (b)(2)), and Rules 12b-20, 13a-1, and 13a-3. See id. at ¶¶86-109.

received from his wrongful conduct if it "involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; and . . . directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons."[155]

Similarly, with respect to a fraudulent revenue recognition scheme engaged in by the top executives at a large software company, the SEC alleged that the company's general counsel participated in the scheme by signing SEC filings when he knew, or recklessly disregarded the fact, that they contained materially false and misleading information concerning the company's prior revenue and earnings per share; by approving backdated contracts and drafting contracts with misleading dates; and, by permitting the legal department, which he oversaw, to approve contracts when he knew, or recklessly disregarded the fact, that the contracts contained false and misleading signature dates and that the company would recognize revenue from those contracts in the wrong quarter.[156] Additional allegations included charges that he obstructed internal and government investigations by instructing employees as to the manner in which they were to respond to questions when interviewed by outside counsel or the government.[157] As in its action against the in-house lawyer of the developmental stage company,[158] the SEC sought the imposition of third-tier civil monetary penalties for his violations of the securities laws[159] – i.e., a maximum penalty of either $100,000, or the gross amount received from his wrongful conduct if warranted by the nature of the violation and the extent of the losses sustained by others as a result of the conduct.[160] Without admitting or denying the allegations, he consented to the entry of an order permanently enjoining

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[155] 15 U.S.C. §§77t(d)(2)(C), 78u(d)(3)(B)(iii).
[156] Complaint, SEC v. Steven Woghin, No. 04 Civ. 4087 (E.D.N.Y. filed Sept. 21, 2004), at ¶¶24-34.
[157] Id., at ¶¶35-36.
[158] See n. 153, supra.
[159] Woghin was charged with violating Section 17(a) of the Securities Act (15 USC § 77q(a)), Sections 10(b) and 13(b)(5) of the Exchange Act (15 USC §§78j(b), 78m(b)(5)) and Rules 10b-5 and 13b2-1, and with aiding and abetting the company's violation of Sections 10(b), 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act (15 USC §§78j(b), 78m(a), 78m(b)(2)(A), and (2)(B)) and Rules 10b-5, 12b-20, 13a-1, and 13a-13. Id. at ¶¶37-54.
[160] See n. 156, supra.

him from future violations, and, in a related administrative disciplinary proceeding, he consented to an order suspending him from appearing and practicing before the SEC as an attorney.[161]

And, in its enforcement action against Symbol Technologies and several of its former officers, the SEC has alleged that its then general counsel, "devised and directed" a fraudulent practice with respect to the company's stock option program during the course of a fraudulent accounting scheme.[162] Without connecting the lawyer to the accounting scheme, the SEC alleges that he manipulated stock option dates by calculating the cost of the exercise on the basis of a date that was more advantageous than the actual exercise date.[163] To conceal this "look-back" practice, the SEC alleges that he instructed his staff to backdate the requisite transactional documents and to use the false exercise dates on the forms on which the executives reported their acquisitions to the SEC.[164] The SEC further alleges that, in registration statements filed with the SEC, in-house counsel failed to disclose the "look-back" practice, and, therefore, filed false and misleading statements.[165] In addition to a permanent injunction against future violations of the securities laws,[166] the SEC also seeks an order requiring the payment of third-tier civil monetary penalties.[167]

The final enforcement action for 2004 represents a significant departure from all prior actions against inside counsel. Although acknowledging that the in-house counsel did not have any involvement in a fraudulent financial reporting scheme engaged in by his company and some of its senior executives, such as the CFO, the SEC has alleged that he violated one of the reporting

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[161] In the Matter of Steven Woghin, Esq., Admin. Proc. Rel. No. 34-50653; Accounting and Auditing Enforcement Rel. No. 2133 (Nov. 10, 2004).
[162] Complaint, SEC v. Symbol Technologies, Inc., et. al., No. CV 04 2276 (LDW) (WDW) (E.D.N.Y. filed June 3, 2004), at ¶ 122.
[163] Id.
[164] Id.
[165] Id. at 125-128.
[166] The complaint charges Goldner with violations of Sections 10(b), 13(a), 13(b)(2), 13(b)(5), 14(a), 16(a), of the Exchange Act (15 USC §§78j(b), 78m(a), 78m(b)(2), 78m(b)(5), 78n(a), 78p(a)), Section 17(a) of the Securities Act (15 USC § 77q(a)), and Rules 10b-5, 12b-20, 13a-1, 13a-13, 14a-3, 14a-9, and 16a-3.
[167] See n. 156 and accompanying text, supra.

regulations by failing to fulfill his role as corporate gatekeeper.[168] According to the SEC, he failed to provide important information to the company's audit committee, Board of Directors, and independent auditors concerning an accounting transaction that resulted in the recording of a profit rather than a loss. The SEC alleges that at a meeting regarding the transaction, the elimination of benefits for the company's Asian employees, he failed to question the CFO's false statement that legal counsel had reviewed the decision to terminate the benefits. When he subsequently learned that the CFO's decision was not legally supportable, contrary to what had been told to the audit committee and outside auditors, the SEC alleges that in-house counsel failed to convey this information to the audit committee, outside auditors, or the board. The fact of the elimination of benefits was subsequently included in the company's quarterly report which he reviewed. For this reason, the SEC alleges, he was a cause of the company's filing of a false or misleading report.[169]

Without admitting or denying the allegations, the inside counsel settled the enforcement action and consented to an injunction against similar violations and to an agreement to pay a civil penalty of $50,000.[170] In statements made after settlement of the action, he expressed surprise at the charges against him, saying that, as general counsel, he was a "generalist" who covered a variety of areas, and did not understand accounting issues but relied on the accountants and auditors to spot issues for him.[171] As noted by his lawyer, the SEC has essentially created a strict liability offense, with no need for the SEC to establish intent or negligence.[172]

In January 2005, the SEC continued its close scrutiny of inside counsel by charging the general counsel of Google, Inc., with aiding and abetting Google's violation of Section 5(a) and 5(c)

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[168] Complaint, SEC v. John E. Isselmann, Jr., No. CV 04-1350 MO (D. Ore. Filed Sept. 21, 2004), at ¶¶1, 18-21 (charging violations of Rule 13b2-2); see Litig. Rel. No. 18896; Accounting and Auditing Enforcement Rel. No. 2109 (Sept. 24, 2004).
[169] Complaint, SEC v. John E. Isselmann, Jr., No. CV 04-1350 MO (D. Ore. Filed Sept. 21, 2004), at ¶¶7-17.
[170] See Litig. Rel. No. 18896; Accounting and Auditing Enforcement Rel. No. 2109 (Sept. 24, 2004). In a related administrative proceeding, Issellman consented to the issuance of a cease and desist order. In the Matter of John E. Issellman, Jr., Admin. Proc. Rel. No. 34-50428; Accounting and Auditing Enforcement Rel. No. 2108 (Sept. 23, 2004).
[171] T. Loomis, "SEC Gores GC in Sarbanes-Oxley Dust-Up," Legal Times, p. 18 (Jan. 24, 2005).
[172] Id.

of the Securities Act [15 U.S.C. § 77e(a), (c)], by failing to register the issuance of stock option grants to employees or to provide certain information to the option recipients, as required by the securities laws.[173]

The SEC alleged that Google had granted stock options to its employees as a form of compensation since its inception, and did not register those securities with the SEC, relying on the exemption provided in Rule 701[174] for securities that are issued under compensatory benefit plans and whose value does not exceed $5 million over a one-year period.[175] When Google became aware that its issuances might exceed the $5 million threshold in September of 2002, the SEC alleges that Google temporarily stopped issuing the stock options because it "viewed the public disclosure of its detailed financial information as strategically disadvantageous" and was concerned that the information could reach its competitors.[176]

Several months later, however, Google reconsidered the issue of compensatory stock option benefits. As alleged by the SEC, the general counsel upon learning that the options being considered might exceed $5 million, thereby triggering the registration and disclosure requirements of Rule 701, consulted with outside counsel and personnel within Google's legal department, and determined that other exemptions applied that permitted issuance of the options without having to comply with the registration and disclosure requirements.[177] Even if his analysis of the applicable exemptions was found to be incorrect, the SEC states that the inside lawyer determined that the company counsel could make an offer of rescission.[178] Accordingly, the SEC alleges that in-house counsel advised the Board to approve a new stock option plan, but did not report that the issuances might exceed the $5 million threshold of Rule 701, and that other exemptions, such as the one provided in Rule

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[173] SEC News Digest, "SEC Charges Google, General Counsel for Illegally Issuing Over $80 Million in Stock Options," Issue 2005-9 (Jan. 13, 2005), available at www.sec.gov/news/digest/dig011305.txt.
[174] 17 C.F.R. § 230.701.
[175] In the Matter of Google, Inc. and David C. Drummond, Admin. Proc. Rel. No. 33-8523 (Jan. 13, 2005) at III(C)(6).
[176] Id. at III(C)(7).
[177] Id. at III(C)(8).
[178] Id.

506,[179] would be relied upon to preclude application of the registration and disclosure requirements.[180] Subsequently, the in-house lawyer is alleged to have learned that Google "probably" had exceeded the threshold amount and that the Rule 506 exemption did not apply, but believed that the options might be exempt under Section 4(2) of the Securities Act.[181] The SEC further alleges that at a meeting in June of 2003, during which the Board adopted two new stock option plans, he did not advise the Board that the additional option grants would exceed the $5 million threshold, or that there was a risk that the exemptions he believed applied would not apply.[182] In August of 2004, Google filed Form S 1 with the SEC, registering its offer to rescind the stock option grants and the purchases of shares in exercise of these options that were made between September of 2001 and June 2004.[183]

Without admitting or denying the SEC's findings, Google's inside lawyer settled the matter and consented to the issuance of a cease and desist order.[184] In public statements following disclosure of his settlement, SEC officials stated that he caused Google's violations "[b]y deciding Google could escape its disclosure requirements, and [by] failing to inform the Board of the legal risks of his determination."[185] The SEC disputed that it pursued him because of the advice that he provided to Google; instead, it pursued him because of his conduct.[186] The SEC also warned attorneys that "where [they] become actors in transactions, their conduct will be subject to sanctions, just as other participants' conduct."[187]

In February of 2005, the SEC initiated civil enforcement proceedings against the general counsel/chief financial officer of a corporation that owns and operates convenience stores and gas

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[179] 17 C.F.R. § 230.506.
[180] In the Matter of Google, Inc. and David C. Drummond, supra, at III(C)(10).
[181] Id. at III(C)(13) (referring to 15 U.S.C. § 4(2)).
[182] Id. at III(C)(15).
[183] Id. at III(C)(18).
[184] Id. at II.
[185] SEC News Release, No. 2005-6, "SEC Charges Google and its General Counsel David C. Drummond with Failure to Register over $80 Million in Employee Stock Options Prior to IPO."
[186] Pamela Atkins, "Attorneys: SEC Officials Warn Lawyers of Going Beyond Advisory Role," 20 Corp. Counsel Weekly Newsletter (BNA) 07 d3 (Feb. 16, 2005).
[187] Id.

stations.[188] According to the SEC's complaint, outside auditors concluded in December of 2001 that the credit card receivables account was potentially overstated and recommended a review of the account.[189] The SEC alleges that, upon an initial review of the account for the period of January and February of 2002, the controller concluded that the account was overstated by almost $2 million, but, in order to close the books for 2001, he provisionally entered the balance of the account as $1.964 million and notified the general counsel/CFO of this entry.[190] The SEC alleges that in March of 2002, the controller initiated an extensive review of the account which, in mid-April, resulted in a finding that faulty bookkeeping resulted in both an overstatement in the credit card receivables account as well as an overstatement of net income affecting 1999, 2000, and the first three quarters of 2001.[191]

The complaint further alleges that in late March of 2002, the general counsel/CFO realized that the company would not be able to meet the Form 10-K filing deadline due to the ongoing review of the credit card receivables account, and, therefore, he prepared, signed, and caused the company to file a notice of late-filing (Form 12b-25) with the SEC on April 1, 2002.[192] According to the SEC, this notice was false and misleading in the following particulars: first, the notice fraudulently omitted to disclose that the cause of the delay in filing the periodic reports was due to an internal review into the credit card receivables account that appeared to be overstated by more that $1.9 million;[193] and second, the notices falsely attributed anticipated losses to certain business conditions, rather than to the write-down of credit card receivables recorded by the controller and

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[188] See SEC v. Craig Scott, Civil Action No. 3-05 CV 0302 P (N.D. Tex.), Litig. Rel. No. 19077 (Feb. 14, 2005).
[189] Complaint, SEC v. Craig Scott, Civil Action No. 3-05 CV 0302 P (N.D. Tex. Filed Feb. 14, 2005), at ¶ 7.
[190] Id. at ¶ 8.
[191] Id. at ¶ 9.
[192] Id. at ¶ 10.
[193] Id. at ¶ 12. Instead, the SEC alleges that the general counsel/CFO stated that reason the company could not make a timely filing of its Form 10-K was based on its inability to obtain the requisite financial and other data prior to the filing date. Id. at ¶ 11.

reported to the general counsel/CFO at the end of February.[194] In addition, the SEC alleges that the general counsel/CFO prepared, signed, and caused the company to file another late-filing notice on May 15, 2002, in connection with its inability to file a timely Form 10-Q.[195] According to the SEC, this notice failed to disclose that the company would be restating its financial statements, even though the general counsel/CFO was aware of this fact at the time he prepared, signed, and caused the company to file the notice.[196] Because of his conduct with respect to the preparation, signing, and filing of these two notices (Form 12b-25), the SEC alleges that the general counsel/CFO committed securities fraud in violation of Section 10(b) of the Exchange Act and Rule 10b-5, and aided and abetted the company's violation of the reporting requirements under Rules 12b-20 and 12b-5.[197]

Without admitting or denying the SEC's allegations, the general counsel/CFO has settled the enforcement action and has agreed to pay a civil money penalty of $25,000.[198] In a related administrative proceeding,[199] the general counsel/CFO has consented to the issuance of a cease and desist order[200] as well as to an order denying him the privilege of appearing and practicing before the Commission either as an attorney or as an accountant.[201] After three years, however, he may seek renewal of the privilege of appearing and practicing before the Commission as an accountant and as an attorney.[202]

In April of 2005, the SEC instituted administrative and cease and desist proceedings against a beverage corporation and two of its officers, including its general counsel who also serves as vice-

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[194] Id. at ¶ 15. According to the SEC, reasons given for the anticipated losses included a decrease in gross margin on retail sales of motor fuels and on sales of merchandise, and an increase in general and administrative expenses. Id. at ¶ 14.
[195] Id. at ¶ 16.
[196] Id.
[197] Id. at ¶¶17-23.
[198] See Litig. Rel. No. 19077 (Feb. 14, 2005).
[199] See In the Matter of FFP Marketing Company, Inc., Warner Williams, and Craig Scott, CPA, Admin. Proc. Rel. No. 34-51198; Accounting and Auditing Enforcement Rel. No. 2185 (Feb. 14, 2005).
[200] Id. at Part IV(C). The only other individual subject to an administrative cease and desist order in connection with this matter is the controller of the company, Warner Williams, who supervised the accounting department. See id. at Part IV(B).
[201] Id. at Part IV(D).

president, secretary, and director.[203] According to the SEC, the company had registered with the SEC as a transfer agent in 2002, and, in the fall of 2003, the SEC's Office of Compliance Inspection and Examination (OCIE) commenced a cause examination of the company's transfer agent activities.[204] The SEC alleges that the company refused to provide documents to the OCIE pursuant to a document request, and that the company's general counsel told the OCIE that the company could not make its transfer agent books and records available for examination.[205] The SEC further alleges that the company has failed to make periodic filings with the SEC.[206] Because of its conduct in connection with its transfer agent obligations, the SEC alleges that the company has violated Sections 17A(d)(1) and 17(b)(1) of the Exchange Act[207] and Rules 17Ad-2 and 17Ad-5, and that the general counsel has willfully aided and abetted and caused the company's violations of these statutes and regulations.[208] The action remains pending.

In late June of 2005, the SEC filed a civil injunctive action against the general counsel and several top officers of busybox.com, Inc., a now defunct company that sold photographs, film footage and video over the Internet, in connection with an allegedly fraudulent scheme to close an IPO.[209] The general counsel also served as a vice-president, secretary, and a director of the company.[210] According to the complaint, the defendants entered into an underwriting agreement with a firm, pursuant to which the firm agreed to purchase all of the shares of the offering at an underwriter's discount of 9% and the company agreed to pay the firm an expense allowance of 3%

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[202] Id. at Part IV(E) – (G).
[203] See In the Matter of Phlo Corp., James B. Hovis, and Anne P. Hovis, Admin. Proc. File No. 3-11909 (April 21, 2005).
[204] Id. at ¶ 7. The complaint alleges that several months after registering as a transfer agent, the company sought to withdraw all of the company's shares held by an entity that was responsible for retaining custody of two million securities issues. The entity refused to release the shares since only shareholders of record were permitted to withdraw the shares. Subsequently, the company failed to fulfill its obligations as a transfer agent with respect to share certificates sent to the company by the entity. Id. at ¶¶5-6.
[205] Id. at ¶¶7-8.
[206] Id. at ¶ 9 (noting that the company's president and CEO was the sole signatory on all periodic reports, and was responsible for overall management of the company).
[207] 15 U.S.C. §§78q-1(d)(1) and 78q(b)(b)(1), respectively.
[208] In the Matter of Phlo Corp., James B. Hovis, and Anne P. Hovis, supra, at ¶¶10, 11.
[209] See Complaint, SEC v. Patrick A. Grotto, Mark B. Leffers, and Jon M. Bloodworth, No. O5 CV 5880 (GEL) (S.D.N.Y. filed June 24, 2005).

of the gross proceeds.[211] When the defendants learned through the company's outside counsel and the president of the underwriting firm that the firm could not sell all of the IPO securities to bona fide investors, the SEC alleges that the defendants devised a scheme to close the IPO.[212] Under this alleged scheme, the defendants agreed to purchase the unsold IPO securities by using unearned and undisclosed payments from the company, which they characterized as "bonuses."[213] In addition, the SEC alleges that the defendants agreed to pay their outside counsel an inflated and undisclosed legal fee using the unsold IPO securities.[214] The complaint further alleges that the underwriting firm financed these transactions and the defendants caused the company to repay the firm out of its IPO proceeds.[215] None of the defendants, the SEC alleges, used any of their own funds for the purchase of these securities.[216] As a consequence of their undisclosed purchase of the IPO securities, the SEC charges that the defendants received approximately 20% of all the securities offered in the IPO,[217] which they used to benefit themselves at the expense of the company.[218]

According to the SEC, all of the defendants participated in the preparation of the registration statements filed in connection with the IPO.[219] The SEC alleges, therefore, that all of the defendants knew, or were reckless in not knowing, that the registration statements were materially false and misleading in that they failed to disclose several matters, including the following: (i) the actual nature of the underwriting agreement; (ii) the fact that the defendants would be

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[210] Id. at ¶ 13.
[211] Id. at ¶ 20.
[212] Id. at ¶¶3, 24.
[213] Id. The SEC alleges that, in order to facilitate the scheme, the defendants opened cash brokerage accounts at the underwriting firm which were used solely for accepting the IPO securities. Id. at ¶ 25.
[214] Id. at ¶¶3, 24, 28. Outside counsel has been subject to both civil and criminal sanctions for his role in this scheme, see SEC v. Thomas T. Prousalis, Jr. and Robert T. Kirk, Jr., No. 04 Civ. 0081 (S.D.N.Y.), Litig. Rel. No. 19150 (March 22, 2005) (announcing the entry of judgment against the defendants in the SEC's civil injunctive action, and noting that Prousalis is serving a term of imprisonment after having pled guilty to related criminal charges), and has been barred from appearing and practicing before the Commission. See In the Matter of Thomas T. Prousalis, Jr., Admin. Proc. Rel. No. 34-50986 (Jan. 6, 2005).
[215] Id.
[216] Id.
[217] Id. at ¶¶3, 27.
[218] Id. at ¶ 6.

acquiring company stock in order to close the IPO; (iii) the fact that the company would be paying out unearned "bonuses" in order to compensate the defendants for purchasing the stock; (iv) the fact that the company would be paying outside counsel in company stock in order to close the IPO; (v) the fact that the net IPO proceeds available to the company would be reduced by $2.1 million; and (vi) the fact that the net proceeds would be further reduced by $2.8 million due to planned but undisclosed expenditures within one week of the closing of the IPO.[220] The SEC further alleges that on the day after their receipt of the undisclosed IPO securities, the defendants certified that the registration statements were truthful in all material respects and that there had been no development that would materially affect their accuracy.[221]

Because of the allegedly fraudulent scheme to close the IPO, the SEC has charged the general counsel and all of the other defendant officers with violations of Section 17(a) of the Securities Act,[222] and with violations of Section 10(b) of the Exchange Act[223] and Rule 10b-5.[224] In its prayer for relief, the SEC seeks a permanent injunction against further violations of these statutes, an order requiring the defendants to disgorge all ill-gotten gains, and an order requiring the payment of civil money penalties.[225]

In July of 2005, an administrative law judge issued an initial decision in a matter involving four officers of an Internet company, including the general counsel who also served as a treasurer and as a director of the company.[226] The SEC alleged that the officers sold millions of dollars worth of the company's stock without registering the stock and without making the requisite disclosures concerning the sales; in addition, the SEC alleged that certain officers, including the general counsel, failed to file beneficial ownership reports as required by the securities laws.[227] The judge found, *inter*

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[219] Id. at ¶¶5, 36.
[220] Id. at ¶¶4, 37-42.
[221] Id. at ¶¶5, 36.
[222] 15 U.S.C. §77q(a).
[223] 15 U.S.C. § 78j(b).
[224] SEC v. Patrick A. Grotto, Mark B. Leffers, and Jon M. Bloodworth, supra, at ¶¶43-50.
[225] Id.
[226] See Initial Decision, In the Matter of John A. Carley, et al., Admin. Proc. File No. 3-11626 (July 18, 2005).
[227] See "John Carley Initial Decision," SEC News Digest, Issue 2005-137 (July 19, 2005).

alia, that the general counsel violated Sections 5(a), 5(c), and 17(a) of the Securities Act,[228] Sections 10(b), 13(a), and 16(a) of the Exchange Act,[229] and Rules 10b-5, 12b-20, 13a-1, 13a-11, and 16a-3, and ordered him to cease and desist from further violations of these statutes and rules.[230] The judge also ordered the general counsel to disgorge approximately $1.4 million of ill-gotten gains.[231]

As the foregoing summary shows, the SEC has increased its actions against inside counsel but, for the most part, has relied on traditional theories for imposing liability. The two exceptions to date are its 2004 action, predicated on the gatekeeper concept of Sarbanes-Oxley, and its 2005 action against the general counsel of Google.[232] Whether this new theory suggests the beginning of a new trend in enforcement actions remains to be seen, but inside counsel has been put on notice that the SEC is focusing its enforcement activity on their conduct within the corporation.[233]

III. CRIMINAL PROSECUTIONS OF INSIDE CORPORATE COUNSEL

A. Introduction

Prior to the creation of the Corporate Fraud Task Force ("Task Force") in July of 2002,[234] the Justice Department did not have a unit devoted to the pursuit of corporations or their executives for criminal violations of the securities laws.[235] According to one former prosecutor, the Justice Department deferred to the SEC with respect to securities fraud cases, and focused its attention on "terrorism, money laundering, [and] drugs."[236] The establishment by Executive Order of the Task Force changed the priorities.[237] As a consequence, there has been a sharp increase in the

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[228] 15 U.S.C. §§77e(a), (c), 77q(a).
[229] 15 U.S.C. §§78j(b), 78m(a), and 78p(a).
[230] Initial Decision, supra, at 82.
[231] Id. at 82-83.
[232] The SEC has reportedly advised attorneys to look at the Drummond case if they are unclear about their gatekeeper obligations under the Sarbanes-Oxley rules. See Michael Bologna, "SEC Enforcement: Officials Cite 'Gatekeeper" Duties of Lawyers for Public Companies," Sec. L. Daily (BNA) d10 (April 18, 2005).
[233] See n. 9, supra.
[234] Exec. Order No. 13,271, 67 Fed. Reg. 46,089 (July 11, 2002).
[235] See Tamara Loomis, "The Fraud Squad," Corporate Counsel (Jan. 12, 2005).
[236] Id. (quoting Jacob Frenkel, now in private practice).
[237] Exec. Order No. 13,271, supra, 67 Fed. Reg. at 46,091 (directing the Attorney General to establish the Task Force, the purpose of which is "to strengthen the efforts of the Department of

number of executives including in-house counsel who have been indicted and/or convicted of corporate fraud since the inception of the Task Force almost three years ago.[238] Although each prosecution of an in-house counsel has attracted nationwide attention, the numbers remain surprisingly low even after the Task Force's inception. This section will examine the Task Force–era prosecutions as well as the pre-2002 prosecutions. Note that nearly all in-house counsel who were prosecuted were also subject to SEC administrative sanctions.[239]

B. Survey of Criminal Prosecutions of Inside Corporate Counsel

1. Pre-2002 Prosecutions

In the six years immediately preceding the creation of the Task Force, the Justice Department brought approximately five criminal actions against in-house counsel for their role in fraudulent securities schemes engaged in by other officers or employees of their respective corporations.[240] Many of these defendants were originally indicted for substantive securities law

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Justice and Federal, State, and local agencies to investigate and prosecute significant financial crimes, recover the proceeds of such crimes, and ensure just and effective punishment of those who perpetrate financial crimes.").

[238] See Loomis, supra (noting that, since creation of the Task Force, the government has obtained convictions or guilty pleas of 4 former general counsels); see generally Corporate Fraud Task Force, Second Year Report to the President at 2.2 (July 20, 2004) (noting that, through the end of May of 2004, the Task Force had indicted over 900 defendants, and had obtained over 500 corporate fraud convictions). The financial failures of 2001 may also have generated an increase in state prosecutions of corporations and their top executives, especially in New York. See Jonathan C. Dickey, "Current Trends in Federal Securities Litigation," SK027 ALI-ABA 241, 245 (2004) (noting that other states have also become more active in this area, including California, which has recently granted its attorney general broader powers to investigate and prosecute securities fraud).

[239] These attorneys have also been made defendants in SEC enforcement actions, most of which are discussed in Part II(B), supra.

[240] Another action that may be of interest but is not included in this discussion due to the nature of the charges is the prosecution of Charles Spadoni, the former general counsel of a Boston investment firm, for bribery and racketeering in connection with a scheme involving the Connecticut state treasurer and the state's pension fund. See United States v. Triumph Capital Group, Inc., et al., Crim. No. 3:00CR-217 (BBB) (D. Conn.) (indicted October 10, 2000; convicted, July 16, 2003). In a subsequent administrative proceeding brought by the SEC, Spadoni was barred from associating with any broker, dealer, or investment adviser. See In the Matter of Charles B. Spadoni, Admin. Proc. Rel. No. 34-50300; Investment Adviser's Act of 1940 Rel. No. 2291 (Sept. 1, 2004).

violations,[241] and pled guilty to conspiracy to commit securities fraud. Several defendants also pled guilty to obstruction of justice -- an increasingly frequent addition to the indictment at the urging of the SEC.[242] One might conclude that the nature of the charges reflects the government's view that the in-house lawyers' blameworthy conduct prevented disclosure of primary criminal conduct by others.

One of the first prosecutions for this period represents a departure from the general overview given above. In 1995, the securities counsel for U.S. Mint, Inc., was indicted for the substantive offense of securities fraud arising out of his role in causing the collapse of the company which allegedly damaged more than 1000 small investors.[243] According to the indictment, he prepared or assisted in the preparation of fraudulent statements relating to the extent of U.S. Mint's business, including statements claiming that the company was the largest supplier of gaming tokens in the United States.[244] In addition, the indictment alleged that he bribed registered representatives in exchange for their promotion and sale of U.S. Mint stock.[245] He pled guilty to one count of securities fraud in violation of Sections 10(b) and 32 of the Exchange Act,[246] and to one count of wire fraud in violation of 18 U.S.C. § 1343.[247] Although he faced 10 years imprisonment and a fine of almost $1 million, Sichta's cooperation with the government led prosecutors to recommend a reduced sentence.[248] Based on his fraud conviction, Sichta was subsequently disbarred by the Colorado Supreme Court.[249]

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[241] Not all indictments are available in these particular actions; therefore, information pertaining to the exact charges alleged against an in-house counsel, as opposed to the charges to which counsel pled guilty, is based either on SEC releases or on media reports.
[242] Lisa I. Fried, "SEC Swats at Fraud; Faster Enforcement and Deterrence are Sought," 221 N.Y. L. J. 5 (March 4, 1999).
[243] United States v. Sichta, No. 95-CR-212-S (D. Colo.); see John Accola, "Attorney Pleads Guilty to Fraud in Stock Scam; Sichta Sold Insider Shares to the Public," Rocky Mountain News 3B (Aug. 23, 1996).
[244] See In the Matter of Robert D. Sichta, Admin. Proc. Rel. No. 34-41132, at ¶ III(C) (March 3, 1999).
[245] Id.
[246] 15 U.S.C. §§78j(b) and 78ff, respectively.
[247] In the Matter of Robert D. Sichta, supra, at ¶ III(B).
[248] Accola, supra, n. 244.
[249] "Court Suspends One Lawyer, Disbars 2 More," Rocky Mountain News (Dec. 3, 1997).

In 1996, the government indicted the general counsel of a publicly traded Florida company in connection with a scheme to misrepresent the financial condition of the company by falsely reporting that the company had earned a profit of almost $5 million on the sale of certain real estate parcels.[250] As related by the SEC, he was alleged to have assisted in the scheme by preparing fraudulent real estate documents that reflected these purported sales and by signing a SEC filing that also reflected these sales.[251] For his role in the scheme, he was charged with multiple securities law violations, including conspiracy to defraud the SEC, to file false reports, and to commit securities, mail, and wire fraud, as well as with four counts of filing false reports with the SEC, and with perjury and obstruction of justice.[252] He subsequently pled guilty to one count of obstruction of justice,[253] alleging, inter alia, that he made false and misleading statements while testifying as a witness in a formal SEC investigation, and was sentenced to one year of probation conditioned upon 60 days of home confinement.[254] Because dishonesty and personal gain underscored the conduct giving rise to the offense to which he pled guilty, he was disbarred by the Florida Supreme Court.[255]

In 1997, an in-house lawyer was indicted in the Southern District of New York for his participation in a scheme involving the fraudulent sale of promissory notes that defrauded investors of more than $470 million.[256] According to the indictment, the in-house attorney of a bill collection company assisted in drafting financial statements that falsely represented that the company was in sound financial condition when, in fact, it had sustained enormous losses.[257] The

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[250] See United States v. Hugh Keith and Steven Wolis, No. 96-5204-CRIM-ZLOCH (S.D. Fla.), SEC Litig. Rel. No. 15186 (Dec. 12, 1996).
[251] Id.
[252] Id.; see also Florida Bar v. Wolis, 783 So. 2d 1057, 1058 (Fla. 2001).
[253] Wolis pled guilty to a violation of 18 U.S.C. § 1505, which proscribes misrepresenting or falsifying oral testimony before a government department or agency with the intent to avoid, evade, prevent, or obstruct compliance with any civil investigation.
[254] See Florida Bar v. Wolis, 783 So. 2d at 1058; see generally "Attorneys: Florida High Court Disbars Lawyer in Wake of Guilty Plea over Stock Scam," 33 Sec. Reg. & L. Rep. (BNA) 696 (May 7, 2001).
[255] Fla. Bar v. Wolis, 783 So. 2d at 1060.
[256] See "Two Ex-Executives of Towers Financial Indicted in Fraud Case," Wall Street Journal (April 18, 1997), at A5A; see also Fried, supra, 221 N.Y.L.J. at 5.
[257] See Wall Street Journal, supra; see also SEC v. Michael Rosoff, 96 Civ. 7064 (WK) (S.D.N.Y.), SEC Litig. Rel. No. 15053; Accounting and Auditing Enforcement Rel. No. 816 (Sept. 17, 1996).

indictment charged him with several offenses, including conspiracy to commit securities fraud, perjury, and obstruction of justice, and, upon conviction, he was sentenced to 87 months imprisonment.[258]

In December of 1998, the in-house counsel of a Pennsylvania infomercial company, together with the company's CEO and CFO, was indicted for his role in a scheme to inflate the company's stock through the false reporting of revenue from bogus transactions with entities secretly controlled by the CEO and CFO.[259] Counsel, who also served as corporate secretary and had been a director and member of the audit committee, had previously been charged by the SEC with knowingly and recklessly preparing documents that concealed the other officers' ownership of these entities and with arranging the transfer of company stock to one of these entities, which was then funneled back to the company as purported payment for a sales transaction.[260] In the indictment, he was charged with conspiracy to commit securities fraud and to make false and misleading statements,[261] while the CEO and CFO were charged with the substantive offenses of securities fraud as well as mail and wire fraud.[262] According to media reports of the case, he pled guilty to the conspiracy charges and agreed to cooperate with the government's continued investigation.[263] A judgment of conviction was entered almost two years later, at which time he was sentenced to six months in prison, with three years of supervised release, and was ordered to pay a criminal fine of $10,000, and restitution of $340,000.[264]

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[258] See In the Matter of Michael Rosoff, Admin. Proc. Rel. No. 34-50556 at II(B) (Oct. 18, 2004); see also Fried, supra, 221 N.Y.L.J. at 5 (noting that Rosoff was also convicted of two substantive counts of securities fraud involving the company's fraudulent sale of more than $270 million in promissory notes).
[259] See Shannon P. Duffy, "Fraud Indictment Charges In-House Counsel, Execs," 219 The Legal Intelligencer 5 (Dec. 4, 1998).
[260] See SEC v. Arthur L. Toll, Bruce B. Edmondson, Gerald Levinson, and Elliot Fisher, 98-CV-2325 (HH) (E.D. Pa.), Litig. Rel. No. 15731; Accounting and Auditing Enforcement Rel. No. 1033 (May 4, 1998). See discussion of this case, Part II(B), supra.
[261] See United States v. Fisher, No. 98-CR-63-3 (RFK) (E.D. Pa.), as noted in In the Matter of Elliot S. Fisher, Esq., Admin. Proc. Rel. No. 34-46954 at II(B) (Dec. 6, 2002).
[262] See Duffy, supra, 219 The Legal Intelligencer at 5.
[263] Shannon P. Duffy, "Former Infomercial Co. CEO Pleads Guilty; Defendant Charged in Stock Scheme to Defraud Public," 221 The Legal Intelligencer 3 (Aug. 9, 1999).
[264] In the Matter of Elliot S. Fisher, Esq., Admin. Proc. Rel. No. 34-46954 at II(B)-(C).

The final criminal action in this period involved the in-house counsel of a professional sports agency business who, along with the owner and several other individuals, was indicted for participation in a Ponzi scheme in which money purportedly invested with the company by professional sports player-clients was channeled into an illegal car-title loan company.[265] The inside lawyer pled guilty to one count of conspiring to commit wire fraud and to obstruct the SEC's parallel investigation, and one count of conspiring to commit money laundering.[266] The court sentenced him to a 54 month term of imprisonment, which was to be served concurrently with a 32 month sentence imposed by another federal court for a money laundering conviction in a related criminal action, and ordered him to pay$12 million in restitution.[267] According to the SEC, the court's sentence represented a substantial downward departure from federal sentencing guidelines due to Franklin's post-indictment cooperation.[268]

2. Post-2001 Prosecutions

Since the beginning of 2002, at least eight criminal actions have been brought against in-house counsel for various violations of the securities law, which represents a significant increase over the number brought in the preceding six-year period. Most of these actions have received considerable publicity due to the magnitude of the losses sustained by the companies and their investors, and the extent of the personal profits realized by the parties to the wrongful conduct. With one exception, all of the actions involve fraudulent securities and accounting schemes engaged in both by in-house counsel and by other officers and/or employees.[269] One of the actions remains pending; the rest have been resolved through one acquittal, two convictions, and four pleas of guilty.

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[265] United States v. William H. Black, et al., No. 1:00CR15 SPM (N.D. Fla.), SEC Litig. Rel. No. 17604 (July 9, 2002) (announcing sentence imposed by court).
[266] United States v. William H. Black, et al., supra, SEC Litig. Rel. No. 17604.
[267] Id.
[268] Id.
[269] The one exception is Andrew Marks, the chief patent counsel for Vertex Pharmaceuticals, a biotechnology company, who was charged in a one-count information with insider trading in violation of Sections 10(b) and 32 of the Exchange Act (15 U.S.C. §§78j(b) and 78ff), and Rule 10b-5. See United States v. Marks, No. 03 CR 10297 (DPW) (D. Mass.) (Information filed Sept. 9, 2003). Marks pled guilty to the charge, see id., SEC Litig. Rel. No. 18409 (Oct. 14, 2003), and was sentenced to one year plus one day in prison

The first of the high-profile criminal actions to be commenced during this period involved the chief legal officer of Rite-Aid, who was indicted in June of 2002 in the Middle District of Pennsylvania.[270] According to the indictment, Rite-Aid had been portrayed in its financial statements as a profitable company but, due to a fraudulent accounting scheme "devised, organized, and implemented" by inside counsel and the company's CEO and CFO, the company's expenses were significantly understated and its income overstated by hundreds of millions of dollars.[271] Because of the fraud, the company was forced to restate its financial results by $1.6 billion, which, at the time, was reportedly the largest restatement in history.[272] In addition to the accounting fraud scheme, the indictment alleged that inside counsel and his co-defendants engaged in schemes to defraud vendors and financial institutions, and schemes designed for personal enrichment.[273] Specific charges against him included conspiracy to commit,[274] and the commission of, the substantive offenses of fraud in the purchase and sale of securities in violation of Sections 10(b) and 32 of the Exchange Act, 15 U.S.C. §§78j(b) and 78ff, and Rule 10b-5;[275] false statements to the SEC in violation of 18 U.S.C. § 1001;[276] mail and wire fraud in violation of 18 U.S.C. §§1341 and 1343;[277] obstruction of grand jury proceedings and government agency proceedings in violation of 18 U.S.C. §§1503 and 1505;[278] and, tampering with a witness in violation of 18 U.S.C. § 1512(b)(1)(2).[279]

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and to two years of supervised release, and was ordered to pay a fine of $3,000. See id., SEC Litig. Rel. No. 18548 (Jan. 21, 2004).

[270] See Indictment, United States v. Martin L. Grass, Franklin C. Brown, Franklyn M. Bergonzi, and Eric S. Sorkin, No. 1:CR-02-146 (M.D. Pa. filed June 21, 2002).

[271] Id. at ¶ 31.

[272] Id. at ¶ 48.

[273] Id. at ¶ 49. In addition to receiving annual bonuses which they would not have received if the true earnings of the company had been revealed, Id. at Count I, ¶ 17, the defendants allegedly devised schemes to increase the amounts awarded under the company's long term incentive plan, id. at ¶¶25-28 and Brown allegedly executed a deferred compensation agreement that was not disclosed in Rite-Aid's proxy statements. Id. at ¶ 32-34.

[274] The conspiracy charges are set forth in Counts 1 and 33.

[275] Id. at Count 2.

[276] Id. at Counts 3-15.

[277] Id. at Counts 16-31.

[278] Id. at Counts 34 and 35.

[279] Id. at Count 36.

Unlike his co-defendants who pled guilty, inside counsel went to trial. Although portrayed by his attorney as a "zealous company lawyer"[280] who "did nothing wrong" but, instead, engaged in what would ordinarily have been considered normal business transactions in a different environment,[281] a jury convicted him of conspiracy to defraud, conspiracy to obstruct justice, obstruction of grand jury proceedings, obstruction of government-agency proceedings, witness tampering and five counts of lying to the SEC.[282] He was subsequently sentenced to 10 years in prison and fined $21,000.[283]

In 2003, the year following the creation of the Task Force, the top legal officers of three corporations became defendants in highly-publicized criminal actions alleging their complicity in fraudulent accounting and securities schemes.[284]

One, a state prosecution, involved a general counsel who was charged with grand larceny, securities fraud, and falsifying business records in connection with receipt of interest-free loans from the company, receipt of large special bonuses, and receipt of millions in profits from the sale of his shares. The indictment alleged that both the CEO and the CFO engaged in this scheme and received similar benefits which were concealed from investors and the board. According to the prosecution, the general counsel received the loans and bonuses because of his assistance in covering up the CEO's and CFO's misconduct.

At trial, the defense asserted that the company had a reputation for awarding performance and that the general counsel had earned his bonus. It further argued that the general counsel relied

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[280] Stephen Taub, "Jury Conviction for Former Rite-Aid Exec," CFO.com (Oct. 21, 2003).
[281] "Ex-Lawyer for Rite Aid Is Found Guilty," New York Times, Sec. C (Oct. 18, 2003). With respect to certain claims relating to accounting and securities fraud, the defendant has argued in post-trial motions that he had no accounting experience and was not an expert in securities law. See Memorandum of Law in Support of Defendant's Motion for Judgment of Acquittal and for a New Trial, United States v. Martin L. Grass, Franklin C. Brown, Franklyn M. Bergonzi, and Eric S. Sorkin, No. 1:CR-02-146 (M.D. Pa.).

[282] See id. (also noting that he was acquitted of wire fraud).
[283] See "Sentence Handed Down for Rite Aid Exec," abc27 (Oct. 14, 2004) (www.abc.27.com).

upon the CEO's representation that the CEO had authority with respect to setting compensation. Moreover, since the general counsel was a litigator rather than a securities lawyer, the defense argued that he deferred to the CFO on issues relating to the disclosure of loans or bonuses on proxy statements. As summarized in one analysis of the case, "the central argument of the defense throughout the case . . . was that the prosecution's case was built on a fundamental misunderstanding of the general counsel's role in ferreting out corporate fraud."[285] The jury apparently agreed with the defense and acquitted the general counsel of all charges.

In June of 2003, the general counsel of McKesson/HBOC was indicted for his role in a fraudulent scheme to inflate revenue and earnings that was discovered after the merger of McKesson and HBOC and resulted in a substantial loss in value of the company's stock.[286] According to one of the cooperating defendants, the general counsel and other executives agreed to inflate reported revenues in the following manner: by recording revenue on contracts subject to undisclosed side agreements that permitted customer cancellations; by backdating contracts in order to record revenue in a prior quarter; and, by recording revenue as sales that were, in fact, exchanges of cash and inventory.[287] In addition to conspiracy to commit securities fraud, he has been charged with substantive securities fraud in violation of Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b), and Rule 10b-5, filing false SEC reports in violation of Section 32 of the Exchange Act, 15 U.S.C. § 78ff, falsifying the books, records, and accounts of HBOC and McKesson/HBOC in violation of pertinent provisions of Sections 13 and 32 of the Exchange Act, 15 U.S.C. §§78m(b)(2)(A),

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[284] In a fourth prosecution commenced in 2003, the highest ranking attorney within the corporation was charged with insider trading. See United States v. Marks, No. No. 03 CR 10297 (DPW) (D. Mass.) (Information filed Sept. 9, 2003), discussed at n. 270, supra.
[285] Jay K. Musoff and Adam S. Zimmerman "Ethics and Off-Switches: What Next?" ¶ 2 N.Y.L.J. (Sept. 20, 2004), available at www.law.com.
[286] Press Release (June 4, 2003), Office of the United States Attorney for the Northern District of California, available at www.justice.gov/usao/can/press/html/2003_06_04_mckesson.html. See Second Superceding Indictment, United States v. Charles W. McCall, Albert J. Bergonzi, and Jay Lapine, No. CR-00-0505-MJJ (N.D. Cal. filed June 3, 2003).
[287] Press Release (June 4, 2003), Office of the United States Attorney for the Northern District of California, available at www.justice.gov/usao/can/press/html/2003_06_04_mckesson.html (paraphrasing

78m(b)(5), 78ff, and Rule 13b2-1, circumventing internal controls in violation of pertinent provisions of Sections 13 and 32 of the Exchange Act, 15 U.S.C. §§78m(b)(2)(B), 78m(b)(5), and 78ff, and falsifying a registration statement in violation of Sections 17(a) of the Securities Act, 15 U.S.C. § 77q(a).[288]

Although this prosecution remains pending at the time of this writing, several co-defendants have pled guilty with respect to their respective roles in the fraudulent accounting scheme and have agreed to cooperate with the government in its prosecution of the general counsel and the other remaining defendant, the former chairman of the board of McKesson/HBOC.[289] One of the hotly contested preliminary issues that has been raised in this case is the right of the defendants to the release of an investigative report that was prepared by the company's outside lawyers and shared with the government pursuant to a confidentiality agreement.[290] While the district court has found that the report is not protected by the attorney-client privilege and should be shared with the defendants,[291] the company, as intervenor, has appealed that decision.[292]

The third criminal action in 2003 involved the general counsel of U.S. Wireless, whose alleged participation in a fraudulent scheme resulted in the bankruptcy of U.S. Wireless after a restatement of its financial condition disclosed a $6.3 million increase in losses.[293] The indictment alleges that he, together with the CEO of U.S. Wireless, caused the company to issue stock options, stock shares, and cash payments to offshore entities under their ownership and control as purported consideration for services under bogus consulting agreements.[294] The indictment further alleges that

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statement of Jay Gilbertson, the former CFO of HBOC, who pled guilty to charges that he conspired with Lapine and other defendants to inflate HBOC's revenues and earnings).

[288] Second Superceding Indictment, supra, Counts 1-2, 4-8.

[289] See Jason Hoppin, "Another GC Readies for Trial," 3 Corp. Counsel 17 (Dec. 2003).

[290] Id.

[291] United States v. Bergonzi, et al., 216 F.R.D. 487 (N.D. Cal. 2003).

[292] United States v. Bergonzi , No. 03-10511 (9th Cir. appeal filed Sept. 2004); see Hoppin, supra; see also Eriq Gardner, "Share and Share Alike Rule Likely in Scandal Audits," The Legal Intelligencer 4 (Sept. 17, 2004).

[293] Press Release (July 14, 2003), Office of the United States Attorney for the Northern District of California, available at www.justice.gov/usao/can/press/html/2003_07_14_uswireless.html.

[294] See Indictment, United States v. Oliver Hilsenrath and David Scott Klarman, No. CR-03-0213 WH (N.D. Cal. filed July 14, 2003), at ¶¶4-11.

these options, shares, and wire transfers of cash were issued and sent without board approval or knowledge, and were concealed by the defendants from the company and from the SEC through materially false and misleading statements in financial reports and filings.[295] Following receipt of the options and shares, the indictment alleges that the defendants caused the offshore entities to sell the stock and to transfer the proceeds to themselves, their families, and third parties.[296]

In addition to three counts securities fraud in violation of Section 32 of the Exchange Act, 15 U.S.C. § 78ff, he was charged with 16 counts of wire fraud in violation of 18 U.S.C. §§1343 and 1346.[297] He subsequently entered a plea agreement with federal prosecutors in which he pled guilty to mail fraud and money laundering for his role in the fraudulent scheme,[298] and agreed to cooperate with the government.[299] While awaiting sentencing, he also agreed to place $5 million in an escrow account.[300]

During 2004, federal prosecutors indicted three former in-house counsel for various securities law violations. All of the defendants held the position of general counsel, and were implicated in a fraudulent scheme involving other executives of the corporation.

In the first indictment issued in May of 2004 the general counsel for a now defunct software company known as Inso Corporation was charged with multiple offenses arising out of a fraudulent revenue recognition scheme.[301] According to the indictment, his co-defendant, a vice-president of the company, arranged a sham transaction with a Malaysian distributor for the purchase of software licenses for approximately $3 million dollars.[302] The purpose of the transaction was to create the

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[295] Id. at ¶¶12, 14.
[296] Id. at ¶ 13.
[297] Id. at ¶¶15-23, 26-27.
[298] Jeff Chorney, "U.S. Wireless GC Admits Fraud," The Recorder (San Francisco) (Jan. 27, 2004), at 10; "High-Tech Exec Pleads Guilty to Mail Fraud, Money Laundering," Silicon Valley/San Jose Bus. J. (Jan. 27, 2004), available at www.bizjournals.com/sanjose/stories/2004/01/26/daily32.html.
[299] "High-Tech Exec Pleads Guilty to Mail Fraud, Money Laundering," Silicon Valley/San Jose Bus. J., supra.
[300] Chorney, supra.
[301] See Superseding Indictment, United States v. Graham James Marshall and Bruce Gordon Hill, No. 03-10344-DPW (D. Mass. filed May 5, 2004); see also SEC Litig. Rel. No. 18699; Accounting and Auditing Enforcement Rel. No. 2003 (May 7, 2004).
[302] Superseding Indictment, supra, at ¶¶14-18.

false appearance that Inso had sold the software and realized the revenue from the sale during the third quarter of 1998 in order to meet targeted revenue projections.[303] In order to create this appearance and conceal the circumstances surrounding the purported transaction, the general counsel allegedly executed a series of agreements with the distributor and arranged for Inso to provide $4 million in letters of credit in exchange for the $ 3 million payment for the software.[304] The letters of credit were obtained through false documentation prepared by Inso employees under the alleged direction of the general counsel.[305] Following a drop in share price in January of 1999 and the announcement that Inso would have to restate its revenues, the SEC began an investigation, during the course of which he is alleged to have provided false testimony as to the Malaysian transaction.[306]

In addition to securities fraud in violation of Sections 10(b) and 32 of the Exchange Act, 15 U.S.C. §§78j(b) and 78ff, and Rule 10b-5, he has been charged with wire fraud in violation of 18 U.S.C. § 1341, false statements to accountants in violation of Sections 13(b)(5) and 32 of the Exchange Act, 15 U.S.C. §§78m(b)(5) and 78ff, and Rules 13b2-1 and 13b2-2, and two counts of perjury in connection with an SEC investigation in violation of 18 U.S.C. § 1621.[307] According to some commentators, his alleged perjury may have prompted the government's decision to prosecute him for his involvement in the underlying scheme.[308] Following a jury trial in a federal district court in Massachusetts, the general counsel was convicted of only one count of perjury in connection with his testimony before the SEC during its investigation into whether fraud was committed with respect to the company's decision to restate its revenues.[309] As to the remaining counts – one count

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[303] Id. at ¶ 15.
[304] Id. at ¶¶17, 58-75.
[305] Id. at ¶ 75.
[306] SEC Litig. Rel. No. 18699, supra, n. 302.
[307] Superseding Indictment, supra, at ¶¶1, 4, 6, 8, 9.
[308] See Tamara Loomis, "Tangled Web," Corp. Counsel (July 2004), at 26.
[309] See United States v. Graham James Marshall and Bruce Gordon Hill, No. 03-10344-DPW (D. Mass.), SEC Litig. Rel. No. 19253; Accounting and Auditing Enforcement Rel. No. 2256 (June 7, 2005). According to the SEC, federal prosecutors presented evidence that contravened Hill's sworn investigative testimony and showed that Hill personally directed the preparation of fraudulent certificates purportedly reflecting the Inso board's approval of the issuance of $4 million in letters of credit, thereby creating the appearance

of securities fraud, two counts of wire fraud, one count of false statements to accountants, and a second count of perjury – the jury deadlocked and the court declared a mistrial.[310] The general counsel now faces a maximum penalty of 5 years imprisonment, followed by 3 years of supervised release, and a fine of $250,000.[311]

In June of 2004, federal prosecutors indicted the general counsel of Symbol Technologies, in connection with a widespread accounting fraud scheme engaged in by top executives of the company, a leading manufacturer of wireless and mobile computing devices.[312] The indictment alleged that the CEO, the CFO, the CAO, and other officers of the company employed an array of fraudulent accounting manipulations in order to allow the company to meet performance targets that were established, and aggressively enforced, by the CEO.[313] These manipulations included the premature recognition of revenue, "tango adjustments" or top-side journal entries in the corporate books and records, the fabrication and use of improper restructuring expenses and the creation of "cookie jar" reserves, and the creation of fraudulent accounting entries in the customer service accounts of the company's books and records.[314] As a consequence of the accounting fraud, Symbol was required to restate its revenues which, for a three-year period, totaled approximately $4.1 billion.[315]

In a separate scheme, not expressly linked to the overall accounting scheme, the indictment alleged that he devised and carried out a scheme to defraud Symbol and evade the payment of income tax through the improper exercise of stock options granted by the company.[316] According to the indictment, he manipulated stock option exercise dates for certain executives who were given a

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of Inso's receipt of $3 million in payment of the reported third quarter sale of software. Id.

[310] Id.

[311] Id.

[312] See Press Release (June 3, 2004), Office of the United States Attorney for the Eastern District of New York, available at www.usdoj.gov/usao/nye/pr/2004jun3.htm.

[313] Indictment, United States v. Tomo Razmilovic, et al., Cr. No. CR04519 (E.D.N.Y. filed June 3, 2004), at ¶ 23 (alleging that the CEO would reward those divisions that met these targets, and punish those divisions that failed to meet them, and further noting that many of the executive's bonuses and salaries were tied to meeting these targets).

[314] Id. at ¶ 24.

[315] Id. at ¶ 1.

"look-back" period of 30 days from which to choose an advantageous exercise date based on the price of the stock on that day.[317] This practice allowed the executive to minimize the tax paid or maximize the profit made upon their exercise of the option,[318] and caused the company to receive a smaller tax deduction than it would otherwise receive.[319] Because the "look-back" scheme was prohibited under the terms of the stock option plans, the indictment alleged that he took steps to conceal the practice, such as by failing to disclose it in SEC filings, and to hinder its discovery.[320]

The in-house counsel was charged with the following offenses: conspiracy to commit, and the commission of, the substantive offenses of mail and wire fraud in violation of 18 U.S.C. §§371, 1341, and 1343; conspiracy to impair, impede, obstruct, and defeat the Internal Revenue Service in violation of 18 U.S.C. §§371 and 3551 et seq.; income tax evasion in violation of 26 U.S.C. § 7201 and 18 U.S.C. §§3551 et seq.; and false filing in violation of 26 U.S.C. § 7206(1) and 18 U.S.C. §§3551 et seq.[321] After initially pleading not guilty,[322] he eventually pled guilty but only to the charge of conspiring to obstruct the IRS in the collection of income tax.[323] He faces a sentence of up to five years imprisonment and a maximum fine of $250,000 or a fine amounting to twice the loss that he caused, whichever is greater.[324]

In the final criminal action brought against in-house counsel in 2004, the United States Attorney for the Eastern District of New York charged the general counsel, president, and senior vice-president of Computer Associates, for his role in a fraudulent revenue recognition scheme.[325]

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[316] Id. at ¶ 77.
[317] Id. at ¶ 88.
[318] Id. at ¶¶88-89.
[319] Id. at ¶ 90.
[320] Id. at ¶¶94-95 (alleging, for example, that Goldner encouraged other officers to prevent the expansion of the investigation into the accounting fraud scheme so as to avoid discovery of the "look-back" scheme).
[321] Id., Counts 15-24.
[322] See "Ex-Symbol Counsel Pleads Not Guilty to Fraud Charge," available at www.nysscpa.org/printversions/nysscpa/2004/604/2week/printversion34.htm.
[323] Press Release (Oct. 27, 2004), Office of the United States Attorney for the Eastern District of New York, available at www.usdoj.gov/usao/nye/pr/2004oct27a.htm.
[324] Id.
[325] Information, United States v. Steven Woghin, Cr. No. 04-847 (E.D.N.Y. filed Sept. 22, 2004); see also Press Release (Sept. 22, 2004), Office of the United States Attorney for the Eastern District of New York, available at www.usdoj.gov/usao/nye/pr/2004oct06a.htm.

According to the information, numerous officers and executives at the company, which was one of the largest suppliers of computer software for business use,[326] engaged in a practice of falsely and fraudulently recording and reporting revenue from certain license agreements, even though the agreements had not been finalized or signed within the quarter.[327] Known as the "35-day month" practice because it extended the reporting month beyond the end of the month, its purpose was to meet or exceed projected quarterly revenues and earnings.[328] The general counsel, it is alleged, participated in the scheme by negotiating, drafting, and approving agreements after the calendar-end of a fiscal quarter and backdating their execution dates to a date within the quarter.[329] The information further alleges that he obstructed internal and governmental investigations into the "35-day month" practice by failing to disclose or falsely denying the existence of the practice, and by instructing employees as to how they should respond to questions posed by the government during the investigation.[330]

Based on the allegations in the information, the general counsel was charged with several conspiracy offenses, including conspiracy to commit securities fraud in violation of Sections 10(b) and 32 of the Exchange Act, 15 U.S.C. §§78j(b) and 78ff, and Rule 10b-5; conspiracy to falsify the company's books and records in violation of Section 13 of the Exchange Act, 15 U.S.C. §§78m(b)(2)(A), 78m(b)(5), 78ff and Rule 13b2-1; and conspiracy to circumvent internal accounting controls in violation of Section 13 of the Exchange Act, 15 U.S.C. §§78m(b)(2)(B), 78m(b)(5), and 78ff.[331] In addition, he was charged with obstruction of justice in violation of 18 U.S.C. §§1512(c)(2) and 3551 et seq.[332] At the time of the unsealing of the information, he pled guilty to these charges.[333]

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[326] Information, supra, at ¶ 1.
[327] Id. at ¶ 12.
[328] Id. at ¶¶13-14.
[329] Id. at ¶¶15-16.
[330] Id. at ¶¶17-22.
[331] Id., Count One.
[332] Id., Count Two.
[333] Press Release (Sept. 22, 2004), Office of the United States Attorney for the Eastern District of New York, supra.

In a recent indictment involving officers of PurchasePro.com ("PurchasePro"), a federal grand jury has charged the general counsel of PurchasePro in connection with a scheme designed, inter alia, to fraudulently increase the reported revenue of PurchasePro.[334] According to the indictment, PurchasePro had formed a strategic partnership for the development of a business-to-business Internet marketplace that would generate revenue for it and a business partner.[335] When revenue was not realized,[336] the indictment alleges that the defendants conspired, to conceal the true financial condition of PurchasePro through various types of transactions, arrangements, and devices.[337] The general counsel is alleged to have participated in the fraudulent scheme in several ways, including: by making, or authorizing others to make, undisclosed side deals with other purchasers of its marketplace software license; by recording sales in the wrong quarter; by creating, or authorizing others to create, a back-dated contract reflecting payment by others to PurchasePro for work purportedly undertaken in a prior quarter; by issuing materially false and misleading statements to the public and to PurchasePro's auditors, and by making false statements to the FBI.[338] With respect to this latter conduct, the indictment alleges that he asked a member of PurchasePro's technology department to delete his e-mails, but falsely stated otherwise in an interview with the FBI.[339]

In response to these charges, his lawyer contends that he was not involved in the fraudulent scheme; instead, he was a whistleblower who tried to expose the fraud to the government and

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[334] News Release (Jan. 10, 2005), Office of the United States Attorney for the Eastern District of Virginia, available at www.usdoj.gov/usao/vae/ArchivePress/JanuaryPDFArchive/05/11005AOLPR.pdf.
[335] Indictment, United States v. Christopher J. Benyo, and Scott E. Wiegand et al., Crim. No. 1:05CR12 (E.D. Va. Filed Jan. 10, 2005), at ¶ 30.
[336] Id. at ¶ 33
[337] Id. at Count I.
[338] Id. at Counts One-Five, Twenty-Nine and Thirty (charging Wiegand with conspiracy in violation of 18 U.S.C. § 371, with two counts of securities fraud in violation of Sections 10(b) and 32 of the Exchange Act, 15 U.S.C. §§78j(b) and 78ff, and Rule 10b-5, with two counts of making false statements to auditors in violation of Sections 32 and 13 of the Exchange Act, 15 U.S.C. §§78ff and 78m(a), (b), and Rule 13b2-2, and with two counts of making false statements to the FBI in violation of 18 U.S.C. §§1001(a)(2) and 3551 et seq.).
[339] Id. at Count Thirty.

cooperated in its investigation of the company.[340] Perhaps the SEC concurs, since it has brought related civil enforcement proceedings against all of the defendants – with the exception of the general counsel.[341] In prior criminal actions against in-house counsel, cooperation by the corporate entity itself appears to have resulted in fewer trials and more pleas.[342]

[340] Heidi Moore, "No Credit for Whistle-Blowing," Corp. Counsel (March 2005).
[341] See SEC v. Charles Johnson, Jr., Chris Benyo, Michael Kennedy, John Tull, and Kent Wakeford, No. 1:05 CV-0036-GK (D. D.C.), Litig. Rel. No. 19029 (Jan. 10, 2005).
[342] See Michael Bobelian, "Symbolic Victory," 4 Corp. Counsel 28 (Dec. 2004).

