



ACC'S CLO ThinkTank Series 2005

“CORPORATE LIABILITY IN THE PRIVATE COMPANY CONTEXT: TRENDS & TACTICS”

Hosted by Steve Euler, CLO of Cargill, Incorporated

**December 2, 2005
10:00 a.m. – 2:00 p.m.
The Grand Hotel- Minneapolis MN**

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Participants' Briefing Materials

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Summary/ Outline of Discussion Topics
CORPORATE LIABILITY IN THE PRIVATE COMPANY CONTEXT: TRENDS & TACTICS

The following outline is intended to provide a short overview of some of the issues at the heart of this discussion topic. There may be other issues we've not identified or perspectives on the identified issues that are not adequately represented in the outline: you should feel free to raise these additional thoughts, as you like. *The outline is merely intended as a starting point to help you identify discussion topics and tee up your conversation.*

A. Corporate Liability

1. Justice Department factors for criminally charging organizations- *The Thompson Memorandum.*

Factors include in summary form:

- Nature and seriousness of the offense
- Pervasiveness of wrongdoing (including complicity/condonation of wrongdoing by management)
- History of similar corporate conduct
- Cooperation and self-disclosure—including, if necessary, waiver of attorney-client privilege and work product protection
- Compliance program- existence and adequacy of
- Remedial actions
- Collateral consequences (including disproportionate harm to shareholders, pension holders, and employees not proven personally culpable and impact on public)
- Adequacy of prosecution of individuals
- Adequacy of remedies such as civil or regulatory enforcement actions

2. State Attorney General Actions

- Targeting industries
- Concept of “no stone unturned” in protecting the public
- Motivating factors and personalities vary - impacts and implications

3. U.S. Sentencing Guidelines for Organizations

- Amended as of November 1, 2004; Guideline status- permissive references rather than mandatory guidelines per 2004-5 case law in *Blakely*, *Booker* and *Fanfan* cases. Empirical evidence since 2004 shows us that judges are still following guidelines as before.
- Emerging activity on Capitol Hill suggests reasonably strong interest in tracking the effectiveness of the guidelines post-Booker; if amendments are needed or reauthorization sought by the Justice Department, strategic starting point is likely to be the current guidelines

- Define minimum criteria for an Effective Compliance and Ethics Program (ECEP)- relevant both as mitigating sentencing factor and as charging factor; amended guidelines take an “all-or-nothing” approach to having an ECEP
 - Practically speaking, companies that are subject to Guideline application (which are few) and those who are subject to Guideline threats (from prosecutors who suggest that settlement would be preferable to sentencing – and which are many) find that the Guidelines do not support their interests or reward their compliance efforts: there are many more opportunities for demerits to apply to the company’s case than there are opportunities for the company to show good-faith efforts.
 - Guideline Credits – limited as they may be – are entirely unavailable to companies that don’t cooperate; cooperation linked to waiver of attorney-client privilege and attorney work product doctrines (New Commentary Application Note 12 to 8C2.5 :“Waiver of attorney-client privilege and of work product protections is not a prerequisite to reduction of the culpability score... unless such waiver is necessary in order to provide timely and thorough disclosure of all pertinent information known to the organization.” ACC has argued to the Sentencing Commission that the impact of this provision is that the exception swallows the rule, and the “unless” clause should be deleted, at a minimum.)
 - Provision disallowing reduction in culpability score if organization doesn’t make a timely report of the offense to governmental authorities—even if the organization has an ECEP
 - Provision disallowing culpability score reduction if high-level personnel participated in, condoned or were willfully ignorant of the violation
 - Challenges/Opportunities for Change: are there provisions in the amended guidelines that present challenges and require modification or clarification?
- 4. Compliance and Ethics Program- factor in corporate charging decisions and as a mitigating factor for organizational sentencing**
- New and expanded provisions defining an ECEP included in the Sentencing Guidelines- the program must also promote an organizational culture that encourages ethical conduct and a commitment to compliance with law
 - Demonstrating existence of an ECEP; policies and structure
 - Organizational structure for compliance and reporting relationship to the law department and/or the Board; handled within the law department vs. stand-alone business model?
 - Implications of CLO as Chief Compliance Officer and compliance committee participant; changes to role or structure in light of recent prosecutorial trends? Practical strategies for tracking roles and advice?
 - Mechanisms and role of Board in implementing program oversight; circumstances and approaches for consulting with outside counsel

5. Cooperation- factor in both corporate charging decisions and as a mitigating factor for sentencing

- Charging factor in Thompson Memorandum: “In gauging the extent of the corporation's cooperation, the prosecutor may consider the corporation's willingness to identify the culprits within the corporation, including senior executives; to make witnesses available; to disclose the complete results of its internal investigation; and to waive attorney-client and work product protection.”
- Credit factor in U.S. Sentencing Guidelines: cooperation of the organization must be timely (e.g., begin essentially at the same time officially notified of a criminal investigation) and thorough
- Process/policy for cooperation: who within the company decides the overall approach to cooperation and how is this communicated to the organization? How is cooperation communicated to the government?
- Governmental Inquiries/Investigations: What does the public company experience with the SEC suggest to private companies facing other state and federal regulatory scrutiny (See number 9 below)? How are government agencies – led by the SEC -- communicating their standards for cooperation? Is waiver of privilege being demanded?
- Multiple enforcers interested in a single failure leads to frustration at companies trying to respond to varying standards/expectations/tactics: lack of prosecutorial coordination

6. Internal Investigations- impacts on process and role of in-house lawyers

- With cooperation as both a charging factor and a “credit” factor for sentencing, what are the implications for conducting internal investigations? Are investigations conducted with an understanding that the results and/or a written report will likely be provided to the government? Are reports provided or underlying facts discussed?
- How does this impact the scope and approach for conducting the investigation?
- Can a company facing an allegation or just conducting the regular course of business afford to engage in any kind of risk assessment for the board and senior managers?
- What factors are considered in determining whether to prepare a written report (internal investigation or risk assessments)?
- Is privilege an issue? What is the role of lawyers (in-house) on fact-finding or investigative teams?
- Should companies prepare two internal investigation reports (one that might be provided to the government and a second for which privilege may be claimed)?
- Guidance or training on performing the investigation and writing the report?

- How are corporate “Miranda” warnings provided to employee interviewees (verbally, in writing, signed statement, etc.)? What should be included in the statement? How do you balance the fine line between making sure the employee understands his/her potential exposure, without giving them legal advice, and still encouraging them to provide the information critical to your investigation?
- Increasing concern over violations of employees’ rights in the investigation process: if talking to in-house and outside counsel is functionally the equivalent to talking to a government agent (note *Computer Associates* case) and if there’s a presumption that waiver will be sought/given, is telling an employee to cooperate in the investigation or be fired really the same thing as telling an employee they have no functional Fifth Amendment Rights?
- How do employees and managers respond within the company when they believe that lawyers are designated within the company as the folks who identify the people who’ll get thrown under the bus? Is there any way to counteract that?

7. Privilege in the Prosecutorial Context

- Federal agency enforcement actions identify lawyers as “gatekeepers” and require waiver as evidence of cooperation
- Privilege waiver cases are not making it to courts; waiver demands happen outside of the courtroom – pre-adjudication; the judiciary can’t protect the evidentiary privilege
- The entity owns the privilege - what is the process within the organization for granting waiver? Should the board be involved? Can the board realistically direct the management to do anything less than whatever the government asks for? Short vs. long-term interests
- Is the analysis different depending on the stage of the case (e.g., as a consideration for charging factors vs. witness interviews vs. after the economic fall-out of the allegations take their toll vs. during trial vs. at sentencing)?
- Limited, subject matter or selected waiver options: trying to hold the line against more costly/subsequent third party suits. Would a “codified” waiver right for the government (which protects privileged information from subsequent third party disclosure) a boon or a bane for companies? Is the privilege effectively dead at that point *vis-a-vis* the government? Will third parties be “stopped” by the waiver agreement with government? Which is more costly?
- Does the potential for waiver impact the decision to involve outside counsel?
- Is there a chilling effect on preventive law counseling and ability to perform effective internal investigations?
- Has your company successfully implemented strategies to demonstrate cooperation while also preserving privilege?

- Do clients care or even understand privilege? Does the presence or absence of privilege affect the way they behave? Is it a priority for client relationships? Does it really matter to anyone except the lawyers?

8. Criminalizing Business Errors

- Are you seeing any trends suggesting an increase in criminalizing business errors?
- In what regulatory arenas and contexts are these trends (if any) most prevalent (e.g., environmental, labor, tax, etc...)?
- What types of tactics are regulators employing in investigating and making prosecutorial referrals?
- Are in-house lawyers viewed as targets? How is this impacting relationships and function of lawyers (in-house and outside)?
- How is this impacting your role as CLO?
- How is this impacting indemnification policies, fee advancement, and requests for employee (including in-house lawyer) protections?

9. SEC Enforcement- as an example of government agency action towards public companies; CLOs as targets

- SEC is the “premier” regulatory agency in terms of enforcement actions: other agencies, such as DOL, IRS, EPA, and state regulators are watching SEC policies and tactics: it’s where they get their best ideas and are “emboldened” to regulate their communities in a similar fashion.
- In-house lawyers as “gatekeepers”- Cutler speech
- Different approach for in-house lawyers vs. outside counsel: enforcement against in-house counsel without independent finding of misconduct; no enforcement against outside counsel unless outside lawyer held civil or criminally liable or disciplined by the bar
- Some Notable Elements in SEC enforcement cases against in-house counsel:
 - > CLOs are nearly always the target
 - > Inside lawyers who rely on outside counsel are seldom targets
 - > Personal financial rewards are not necessary to prompt enforcement
 - > Underlying conduct: many cases involve disclosures/ omissions in disclosures
 - > Apparent imposition of a duty for generalist lawyers to seek expert legal and technical advice (generalist’s reliance on inside technical expert or seeing ‘red flag’ and failing to seek outside advice “is not well-received”)
 - > Corporate failure, holding several corporate offices, and/or failing to raise troublesome issues with the Board appear to be factors that can raise the risk for enforcement

10. Private Right of Action to Enforce Compliance

- Are you seeing any trends suggesting an increase in private rights of action to enforce compliance (such as cases employing *qui tam* theories)?
- In what jurisdictions / regulatory arenas / contexts are these trends (if any) most prevalent (e.g., environmental, labor, FCPA, tax, etc...)? Are these cases more likely to be brought within or outside of the United States?
- What types of tactics are plaintiffs using in asserting these types of claims?
- What types of standing issues have been encountered? Are there successful strategies to address these?

Links to Resources:

(http://www.usdoj.gov/dag/speech/2006/mcnulty_memo.pdf)

(http://www.ussc.gov/2004guid/8b2_1.htm)

(<http://acc.com/resource/v5708>)

(<http://acc.com/resource/v5715>)

(<http://acc.com/resource/v6033>)

(<http://www.sec.gov/news/speech/spch042805gpp.htm>)

(<http://www.acca.com/protected/article/ethics/secrimproceed.pdf>)

B. Individual Liability-- The Reality: Corporate Counsel in the Crosshairs

1. ABA Model Rule 1.13 and law department “reporting-up” policies

- Although Sarbanes-Oxley 307 may not apply, are private company law departments implementing formal up-the-ladder reporting policies and practices? (It is already the individual lawyer’s professional responsibility to do so under Model Rule 1.13, which has an equivalent in every state’s professional rules.)
- What is the scope of reportable matters?
- Are certifications of individual lawyers required?
- What type of ethics/compliance reporting training is provided to in-house lawyers?
- Implications and methods for communicating up-the-ladder policy and program requirements to clients
- Role of in-house lawyer: Do the standards have a chilling effect on client willingness to seek preventive legal guidance?
- Interface with outside counsel: Do they sign onto your policy? Do you receive copies of their policies? Are there requirements for them to notify designated individuals within the law department simultaneously with performing their own internal review of whether a reportable issue has been identified? Does the fact that they also represent public companies lead them

to adopt processes/procedures that inherently affect the way they represent all clients, including private companies?

- Are in-house lawyers asking about corporate protections available to them in light of their increasing exposure?

2. **Director/Officer Liability- Case Law Developments**

- How have recent cases such as *Abbott Laboratories*, *McCall*, and *Pereira* impacted practices at the Board level? Is the Board asking for more frequent briefings on compliance-related matters? Have you conducted educational sessions relating to Director duties and case implications?
- Are you seeing trends suggesting an increase in requests from the Board and Officers for legal guidance on compliance matters?
- Have these decisions impacted dialogue with D&O carriers? What types (if any) of changes have you made to D&O policies as a result of these cases?
- What do these types of cases suggest regarding CLOs as possible targets for shareholder suits on theories involving allegations of omissions or failures in reporting certain types of matters to the Audit Committee/Board?

3. **In-House Lawyer Liability and Lawyers as Witnesses—contexts and consequences**

- Interviews of in-house lawyers by outside counsel engaged by the Board or a Board Committee
- Interviews of in-house lawyers by public regulators and law enforcement; access to in-house lawyers as part of the organization's cooperation
- Interviews of in-house lawyers in jurisdictions where privilege is not recognized
- Civil litigation depositions and other forms of discovery: case law trends allow depositions of opposing non-litigation counsel if the deposition will not elicit privileged information regarding litigation strategy in the pending case (*Shelton*, *Pamida*, *Philip Morris*)
- Grand Jury or Trial Subpoenas issued to in-house lawyers: issues relating to privileged information
- Client assertions of advice-of-counsel defense
- Testimony of in-house lawyers as part of federal sentencing "credit"
- Consequences of having in-house lawyers provide testimony can be significant, including waiver of attorney-client privilege and attorney work product doctrines, disqualification of lawyer as in-house counsel on the matter, and more
- Benefits of having in-house lawyers provide testimony can be significant, including opportunity to receive more favorable treatment for organization in charging decisions, receipt of cooperation "credit" in organizational sentencing, quicker resolution

4. Practical Considerations of In-House Lawyer as Witness

- Strategies for taking care not to blur legal and business functions for in-house lawyers: is this a realistic exercise for any in-house counsel who knows her job? Are we sending a message to in-house lawyers that is 'wise to pull back from business engagement, when that's what we ultimately think their most important contribution is?
- Training for in-house lawyers and clients on proper use of and protections offered by attorney-client privilege and attorney work product doctrine
- Implications of non-waiver and limited waiver agreements; exposure to third party claims and suits
- Responsibility for determining whether the in-house lawyer may testify- who decides? Should company representatives obtain independent legal advice on risks and benefits of testimony by in-house counsel?
- Implications of having an in-house lawyer execute affidavits and impacts on potential for becoming a fact witness
- Staffing of team for conducting internal investigations- consider including more than one lawyer, and/or a business person or outside counsel
- Issues surrounding retaining and paying for outside counsel to represent in-house lawyers performing roles as witnesses

5. Impact on CLOs- criminal cases

- Focus of criminal cases is almost entirely against CLOs
- About a dozen cases
- USDOJ Corporate Fraud Task Force and state AG equivalents
- Nearly all prosecutions were against in-house lawyers who also were subject to SEC administrative sanctions—what does this say about whether the focus of prosecutions is firmly in the public company sector? What impact does this have on private company CLOs and strategies?
- Some common threads noted in materials: big losses increase risk of prosecution; perjury and obstruction of justice as crimes charged; mere knowledge of transaction later deemed to be financial fraud does not appear to be sufficient to charge; almost absence of actions when inside lawyers have relied upon outside legal advice; no prosecutions where alleged fraud is complex and propriety debatable

Links to Resources:

(<http://www.acca.com/resource/v6328>)

(http://www.abanet.org/cpr/mrpc/rule_1_13.html)

(<http://www.dol.gov/sol/media/briefs/pereirabrief.htm>)

(<http://acc.com/resource/v6367>)

(<http://acc.com/resource/v6367>)

C. Indemnification & Insurance Issues

1. Directors & Officers Liability Insurance Coverage

- Scope of coverage: which in-house lawyers are covered? Does the insurance cover claims against attorney-officers for legal advice or is that advice considered to be professional services for which coverage is excluded?
- Trends in negotiating coverage: what types of information are underwriters seeking in discussions to cover in-house lawyers? What types of exclusions? How are premiums being impacted?
- Challenges in trimming exclusions: what are your experiences in negotiating and trying to carve back exclusions relating to in-house lawyers?
- Success stories/practical considerations in negotiating coverage?

2. Employed Lawyers Professional Liability Policies

- What are the benefits and limitations of having this form of coverage?
- Experiences negotiating these policies? Trends in negotiating coverage?
- Are in-house lawyers asking for this coverage?

3. Indemnification

- Within corporate by-laws
- Mandatory statutory indemnifications in some states
- Indemnification policies that apply broadly
- Individual Indemnification Agreements
- ACC amicus brief in *US v. Lake and Wittig*: asserting need for and public interest in preserving right to advancement of legal fees and expenses under pre-existing, generally applicable, statutorily authorized corporate policies
- Scope of coverage and issues relating to advancement of costs- view that full cooperation with the government requires refusal to pay legal costs for individuals who are unwilling to speak with prosecutors; enforcement officials or prosecutors increasingly likely to ask/demand that company not advance or indemnify targets of investigation—company and specifically counsel to company caught in the middle
- Prosecutorial trends, and trends in requests for indemnification of in-house lawyers

D. Private vs Public Issues

- With respect to trends and tactics on the private company front, what do private company CLOs see as being different for private companies versus what you see happening with regard to liability for public companies and their lawyers?
- What do these differences (if any) suggest?

- Are there liability issues unique to private companies?
- What resources would be most helpful to address liability issues that may be of greatest interest or concern to private companies?

Links to Resources:

(<http://www.acca.com/resource/v6300>)