Wednesday, October 21
11:00 am–12:30 pm

110 Traditional and Not-So-Traditional Malpractice Risks of In-house Counsel

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Faculty Biographies

Susan Friedman

Susan F. Friedman serves as a senior vice president, claims advocate and employed lawyers practice leader for the FINPRO New York Office. Ms. Friedman's primary responsibilities include consulting with clients with regard to complex claim issues involving copyright and trademark infringement, securities litigation, regulatory investigations, business disputes involving directors, officers or employees, marketing/media/advertising errors and omissions, lawyers professional liability, employment practices, ERISA/fiduciary liability, fidelity, and all related forms of professional liability.

Prior to joining Marsh, Inc., Ms. Friedman was claims counsel for American International Group and worked in the areas of directors and officers liability, ERISA/fiduciary liability, and employment practices liability. She began her legal career as an Associate Attorney in the litigation departments of general liability and lawyers' professional liability for Wilson Elser, LLP. Immediately preceding her professional experience in law and insurance, Ms. Friedman was employed in a variety of capacities in the media/entertainment industry.

She is a contributing writer to the Legal Times, The New York Law Journal and the International In-House Counsel Journal. Ms. Friedman is a member of the new Insurance Editorial Board of The International In-House Counsel Journal. In addition, she speaks publicly and writes on a variety of insurance topics germane to all financial product lines. She is also on the board of directors of AutismNetworks.com.

Ms. Friedman holds a BS from Cornell University. She graduated magna cum laude from The New York Law School where she served as an Editor for The New York Law School Law Review.

David Hensler

David Hensler is a partner at Hogan & Hartson in Washington, DC. Mr. Henser works on complex commercial litigation and has handled jury and non-jury trials for both plaintiffs and defendants in a wide variety of cases. His present practice involves securities fraud litigation, internal investigations, insurance coverage disputes, aviation and noise impact litigation, and many other types of general commercial litigation.

Mr. Hensler was an adjunct professor at Georgetown University Law Center where he taught a course on the use of economic analysis in litigation. He is also the co-author of several articles on asset valuation in the context of corporate takeovers and divestitures. Following graduation from law school, he joined the General Counsel's Office of the Securities and Exchange Commission where he handled securities fraud litigation.

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Mr. Hensler is a Fellow of the American College of Trial Lawyers (ACTL) and was Chair of the ACTL's State Committee for the District of Columbia. He was described as "the city's commercial litigator par excellence" in a Legal Times article titled "Identifying 20 Leading Litigators." Mr. Hensler was ranked No. 1 for General Commercial Litigation in Washington, DC in Chambers USA: America's Leading Lawyers for Business Litigation (2005).

Mr. Hensler received his JD from St. Louis University School of Law.

Kirk Raslowsky

Kirk J. Raslowsky, senior vice president and associate general counsel of Chubb & Son, a division of Federal Insurance Company, based in New Jersey.

Prior to becoming GC of CSI, Kirk was CSI's E & O product counsel. He has also served as product counsel to Financial Institutions. Before joining Chubb, he held a variety of technical and managerial positions at National Union Fire Insurance Company (AIG), including Financial Institutions Product Counsel and Complex Claim Director. Mr. Raslowsky began his legal career by serving as a judicial clerk in the Superior Court of New Jersey

He is a member of the New Jersey Bar Association and is a former Trustee of Somerset County Bar Foundation.

Mr. Raslowsky received a BA from Wake Forest University. He earned his JD from Seton Hall law school.

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TRADITIONAL AND NOT SO TRADITIONAL MALPRACTICE RISKS OF IN-HOUSE COUNSEL

I. NOT-SO-TRADITIONAL MALPRACTICE RISKS – OMISSIONS

A. Examples of "Omissions" as Malpractice

- Intellectual Property
- Human Resources
- Work for Multiple Entities or Non-Wholly-Owned Subsidiaries
- Record Preservation
- Failure to Correct Misstatements by Other Corporate Officers or Directors
- Failure to Advise Corporate Officers or Directors Concerning Their Legal or Fiduciary Duties

B. Examples of "Omissions" as Ethics Obligations

- Rite Aid
- World Health
- Google
- Electro Science
- Computer Associates
- Hollinger

II. NOT-SO-TRADITIONAL MALPRACTICE CLAIMANTS

A. Trustees in Bankruptcy or Receivers and Bankruptcy Examiners – e.g., Lehman, Enron, Madoff

B. Regulators (esp. following regulatory takeovers) – e.g., FDIC

C. Former Employees

D. Former Employers – e.g., Tyco

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E. ERISA Participants

F. Third-Parties – e.g., recipients of opinion letters

G. Shareholders – esp. derivative actions

III. TRADITIONAL AND NOT-SO-TRADITIONAL THREATS TO INDEMNIFICATION BY EMPLOYER

A. Bankruptcy or Receiverships

B. Regulatory Takeovers

C. Derivative Actions - e.g., Disney

D. Hostile Directors (esp. following a change in control) – e.g., Tyco

E. Alleged Statutory Violation – e.g., Chiquita, Salomon Brothers

F. Alleged Breach of Fiduciary Duty – e.g., use of privileged information

G. Conduct Allegedly Contrary to Employer's Best Interests

IV. NEW DEVELOPMENTS AFFECTING IN-HOUSE COUNSEL MALPRACTICE RISKS

A. Ramifications of the Financial Crisis

B. Gatekeeper v. Confidante – Congressional and Regulatory Investigations

C. Whistleblowers & Breaches of Confidentiality

D. Communication – Privilege Pitfalls

E. The Reach of Outside Third Parties

F. Blogs, Tweets, and Social Networking Websites

G. A New Era in the Employment Arena

H. Climate Change

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I. New Legislation and Compliance

V. PRACTICAL TIPS TO PROTECT YOURSELF

A. Observations by a Longtime Corporate Counsel

B. Observations by a Malpractice Defense Counsel

C. Suggestions on Additional Forms of Protection (e.g., insurance)

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ACC Conference: October 2009

"Traditional and Not-So-Traditional Malpractice Risks of In-House Counsel.

"Focus on the ***"O"*** in E&O"

Stephanie Rubino, Assistant Vice President & Assistant Counsel
and
Kirk J. Raslowsky, Senior Vice President & Associate General Counsel

I.
Introduction

"E&O" or "Errors & Omissions" are the companion liability exposures faced by legal counsel. Every lawyer should be acutely aware of the *"errors"* aspect of the exposure that looms daily, implicit in every word of legal advice imparted to clients. The *"errors"* danger is every attorney's worst nightmare: a complaint filed a day after the statute of limitations' expiration; the legal advice provided that was based upon overturned precedent, or approval of contract language containing provisions that are invoked unfavorably against the client are all examples of attorney "errors" that are commonly understood to invite certain claims of malpractice. It is the liability exposures inherent in such mistakes (i.e. the ***"E",*** as in *"errors*" aspect of E&O) that motivates attorneys to keep abreast of developments in current case law, legislation and legal trends in general. In short, attorneys understand the need to be diligent in striving to provide accurate and legally sound advice because "errors" can be drains upon not only financial and professional resources, but can translate into the ultimate cost to a practicing attorney: the loss of one's license to practice law.

However, equally as vital to the diligent avoidance of "errors" in dealings with clients (or others who may rely on an attorney's legal advice) is a lawyer's appreciation of the obligation to act affirmatively in certain instances when nobody has actually sought his or her counsel. It is this second half of the "E&O" pair of exposures; the **"O"** or **"Omissions**" aspect of "E&O" that presents a labyrinth of potential liabilities, in particular for the In-House Lawyer who faces unique responsibilities in the legal and ethical obligation owed to his ultimate client: the Organization that employs him.

This discussion provides a reminder of a sort of inverse corporate counsel Miranda rule: namely, that under certain situations, in-house lawyers have No Right to Remain Silent (or to Do Nothing). Often, what in-house lawyers don't say (or don't do), can and will be used against them in the form of legal liability and malpractice claims. This session will discuss cases where in-house counsel's inaction, silence or other "sins of omission" led to claims of malpractice that have often been upheld by courts.

II.
When "Omissions" = Malpractice Claims and Ethics Violations

What Standard of Care Is Owed to the Organization?

(i) **Attorneys-as-Corporate-Officers**: Duty of Loyalty/Duty of Care.

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The standard of care is also governed by the nature of the work performed (e.g. SEC rules and SOX provisions impose additional duties and reporting standards on attorneys who provide advice on securities and certain corporate matters);

(ii) **Attorneys as Non-Corporate Officers**: Standard of Professional Conduct, a/k/a "Ethics".
Absent a corporate officer title, all in-house counsel remain bound by the ethical standards inherent in the practice of law (see Model Rules of Professional Conduct which create affirmative duties to act under certain circumstances independent of any legal duty to do so).

A. **Examples of "Omissions" as Malpractice:**

- Intellectual Property work: Failure to properly investigate and register trademarks, service marks, etc.

  Example: General Counsel for a privately-held company participated in the decision to authorize the use of a trademark in certain marketing materials for his company but failed to complete the necessary investigation to determine ownership of the mark. A suit was then brought by parties alleging ownership of the trademark, personally naming the in-house counsel for contributory trademark infringement.

- Human Resources Management: Failure to conduct or properly investigate allegations of discrimination/harassment/retaliation can expose in-house counsel to claims of malpractice, misrepresentation, libel and expose the corporation to claims such as wrongful termination.

- Work for multiple entities or non wholly-owned subs: Failure to disclose conflicts of interest is an often overlooked area of malpractice by omission.

  Example: A stockbroker and her employer were accused of churning an account. In-house counsel represented both the individual broker and her employer in the ensuing arbitrations proceeding. When the arbitration panel found liability only on the part of the stockbroker (but not her employer), she was fired. The stockbroker later brought suit against the in-house attorney who had been assigned to represent her alleging failure to disclose conflict of interest.

- Discovery issues: Duty of in-house counsel to devise and oversee effective policies and procedures to ensure the preservation of electronic records. Failure to implement and/or failure to enforce effective records retention policy exposes counsel to "spoliation" of evidence claims;

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Case law: In Zublulaker v. UBS Warburg, 229 F.R.D. 422 (S.D.N.Y. 2004). A former employee brought suit for gender discrimination and requested certain discovery including copies of emails. The court's finding that the employer's attorneys (both outside and in-house counsel) failed to take appropriate precautions to preserve destroyed emails resulted in the Judge allowing an adverse inference against the employer. The outcome was a jury verdict in the amount of $29.3 million.

- **Misrepresentations**: Failure to correct others' statements: to Regulators; Under Oath in Deposition/Affidavits; Press Releases; M&A representations, etc.

Case law: The decision in Miller v. McDonald, 385 B.R. 576 (Bankr. D. Del. 2008), expanded the duties owed by corporate officers, including general counsel, and may expose GC who are also corporate officers to liability not only for their own wrongful conduct, but the failure to monitor, recognize and end the wrongful conduct of others. Despite the Miller court's concession that, because the GC was not a financial officer, his knowledge of the alleged "wasteful spending for personal benefit to other officers and directors" was not readily discernable, the court refused to dismiss the claim against him on the basis of the trustee's allegation that General Counsel "knew or should have known" of the incidents of corporate waste and "**failed to implement an adequate monitoring system that would have detected the alleged waste and other wrongdoing.** 385 B.R. at 590.. *Id.* at 593-94.

- **Advice to Management:** In-house counsel has liability not only for "incorrect or wrong" advice, but also for the advice not given.

Law review article: In *"(Not) Advising Corporate Officers about Fiduciary Duties"*, 42 Wake Forest L. Review 663, the author suggests that in-house counsel are arguably "uniquely positioned to specialize in preventative law" and may have a duty to advise the officers of corporation about their fiduciary duties to the corporation.

Claims Examples of "Omissions" as Ethics Violations:

Violations of a Company's Code of Business Conduct:

Many companies have a formal Code of Business Conduct which spells out the organization's expectations for its employees' business conduct, including setting forth its 'best practices' for fairly competing in the marketplace. Such codes serve as a guideline for employees to self-moderate their business activity and provide a blueprint for ethical decision-making. Most of these formal codes impose the obligation for employees to report any known or suspected violations to management, human resources or an appointed ethics officer if one has been designated by the organization.

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However, even in the absence of any such formal Code, an organization's in-house counsel have an inherent fiduciary obligation to their client (i.e. the corporation) beyond simply ensuring that their own actions comport with both the law and any formal Code of Business Conduct.

In fact, Rule 1.13 of the Model Rules of Professional Conduct[1] , "Organization as Client", provides general guidance that imposes an ethical responsibility on corporate counsel to "proceed as reasonably necessary" in the face of knowledge of a situation that may involve a violation of law and may result in "substantial injury" to the organization. While the RPC is imprecise, if instructive at all with respect to the attorney's required response, it is presumably purposefully vague to apply broadly to infinite scenarios. Nevertheless, the below excerpt from the Rule clearly telegraphs to in-house lawyers that they are under a professional ethical obligation to take affirmative action when they are in possession of certain knowledge that could have adverse legal consequences to the organization for whom they provide legal representation.

> "*If an lawyer for an organization knows that an officer, employee or other person associated with the organization is engaged in action, intends to act or refuses to act in a matter related to the representation that is a violation of a legal obligation to the organization, or a violation of law that reasonably might be imputed to the organization, and is likely to result in substantial injury to the organization, then the lawyer shall proceed as is reasonably necessary in the best interest of the organization. Unless the lawyer reasonably believes that it is not necessary in the best interest of the organization to do so, the lawyer shall refer the matter to higher authority in the organization, including, if warranted by the circumstances to the highest authority that can act on behalf of the organization as determined by applicable law."* R.P.C 1.13(b)

The range of appropriate responses once counsel is aware of a violation is varied and clearly will depend upon a case-by-case analysis. One response by an organization's counsel, however, which will almost *always* be inappropriate, is to say or do absolutely nothing.

Further, Sarbanes-Oxley, section 307 (see below) requires legal counsel who appear and practice before the SEC to "report up the ladder" knowledge of not only any violations of securities law but of any fiduciary duty breaches by corporate officers and agents.

Section 307 -- Rules of Professional Responsibility for Attorneys

> **Not later than 180 days after the date of enactment of this Act, the Commission shall issue rules, in the public interest and for the protection of investors, setting forth minimum standards of professional conduct for attorneys appearing and practicing before the Commission in any way in the representation of issuers, including a rule--**

[1] See Appendix for full text of Rule 1.13 "Organization as Client" of the Model Rules of Professional Conduct.

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1. **requiring an attorney to report evidence of a material violation of securities law or breach of fiduciary duty or similar violation by the company or any agent thereof, to the chief legal counsel or the chief executive officer of the company (or the equivalent thereof); and**

2. **if the counsel or officer does not appropriately respond to the evidence (adopting, as necessary, appropriate remedial measures or sanctions with respect to the violation), requiring the attorney to report the evidence to the audit committee of the board of directors of the issuer or to another committee of the board of directors comprised solely of directors not employed directly or indirectly by the issuer, or to the board of directors.**

The following are illustrative examples where an organization's in-house counsel was held liable for malpractice for doing nothing or for remaining silent when it had knowledge of relevant facts that were either not-disclosed, misrepresented or not fully disclosed in their proper context to the appropriate parties.

(1) **Rite Aid's** chief legal counsel Franklin Brown

The conviction of Rite Aid's former chief legal counsel is an excellent example of in-house counsel's failure to recognize that his *primary* responsibility was to the organization and not to any individual officer, director or employee. Brown was convicted for his role in Rite Aid's $1.6 billion restatement of earnings from 1997 to 1999 (which was at the time the largest accounting revision in US corporate history). Brown was the chief legal counsel to Rite Aid for over four decades, but misplaced his loyalty to his longtime friends who were also senior executives.

In its civil action, the SEC charged that Harrison Brown, Martin L. Grass, Rite Aid's former chief executive officer, and Frank M. Bergonzi, Rite Aid's former CFO, were responsible for one of the most egregious accounting frauds in history. The SEC alleged that Brown and the others engaged in an extensive accounting fraud scheme resulting in the significant inflation of Rite Aid's net income in every quarter from May 1997 to May 1999. The Commission also charged Brown and Grass with concealing certain related party transactions that enriched Grass at shareholder expense.

(2) **World Health's** GC Brian Licastro

The decision in Miller v. McDonald, *supra*, mentioned earlier in this outline, signaled an expansion of the duties owed by corporate officers, *including general counsel*, and may expose officers to liability not only for their own wrongful conduct, but the failure to monitor, recognize and stop the wrongful conduct of others.

Among the defendants in the suit brought by the bankruptcy trustee was Brian Licastro, World Health's vice president of operations and its general counsel. The bankruptcy trustee sought to recover against former officers and directors of the bankrupt company on claims including breach of fiduciary duty, waste of corporate

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assets, negligent misrepresentation and professional negligence, as well as claims for aiding and abetting breaches of fiduciary duty, waste and fraud. The complaint also alleged that the officers and directors filed false and misleading reports to the SEC and in press releases.

Considering the trustee's claim against Licastro for waste of corporate assets, the bankruptcy court acknowledged that the complaint did not allege that Licastro personally benefited from the alleged fraudulent expenditures and corporate waste, but found that general counsel may be exposed to liability for failing to monitor the conduct of others in the corporation. *Id.* at 593

(3)Electro Science's General Counsel John Isselmann:

ESI's General Counsel learned first-hand that if GC fails to fulfill its gatekeeper role, he (in addition to the corporate entity that employs him), will suffer the consequences. The SEC did not assert that Isselmann participated in a scheme to fraudulently boost the quarterly earnings at the Portland-based semi-conductor manufacturer. In fact, the SEC did not even claim that Isselmann knew of the fraud; only that the former GC failed to communicate material information and that, more importantly, he failed to contradict CEO/CFO when they misrepresented to board what GC had reviewed.

The settlement of these charges followed a 2004 speech by SEC's enforcement chief who announced SEC was considering actions against lawyers "who assisted their companies or clients in covering up evidence of fraud, or prepared or signed off on, misleading disclosures regarding the company's condition." The SEC observed that the Isselmann "failed in his gatekeeper role" as he was in possession of information that should have been passed on, both to the board and to the company's independent auditors. It was believed that had the information been provided to them, the financial fraud would have been prevented.

Other Miscellaneous Areas Where In-House Counsel's Knowledge May Give Rise to a Duty to Act:

- Discrimination, Harassment and Retaliation complaints;
- Workplace Violence;
- Conflicts of Interest;
- Disclosure of Gifts and entertainment expenses
- Outside employment/Board memberships
- Political contributions and activities;
- Company records and accounts
- Expense accounts
- Customer privacy
- Employee privacy

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Appendix A

Model Rules of Professional Conduct

Client-Lawyer Relationship
Rule 1.13 Organization As Client

(a) A lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents.

(b) If a lawyer for an organization knows that an officer, employee or other person associated with the organization is engaged in action, intends to act or refuses to act in a matter related to the representation that is a violation of a legal obligation to the organization, or a violation of law that reasonably might be imputed to the organization, and that is likely to result in substantial injury to the organization, then the lawyer shall proceed as is reasonably necessary in the best interest of the organization. Unless the lawyer reasonably believes that it is not necessary in the best interest of the organization to do so, the lawyer shall refer the matter to higher authority in the organization, including, if warranted by the circumstances to the highest authority that can act on behalf of the organization as determined by applicable law.

(c) Except as provided in paragraph (d), if

(1) despite the lawyer's efforts in accordance with paragraph (b) the highest authority that can act on behalf of the organization insists upon or fails to address in a timely and appropriate manner an action, or a refusal to act, that is clearly a violation of law, and

(2) the lawyer reasonably believes that the violation is reasonably certain to result in substantial injury to the organization,

then the lawyer may reveal information relating to the representation whether or not Rule 1.6 permits such disclosure, but only if and to the extent the lawyer reasonably believes necessary to prevent substantial injury to the organization.

(d) Paragraph (c) shall not apply with respect to information relating to a lawyer's representation of an organization to investigate an alleged violation of law, or to defend the organization or an officer, employee or other constituent associated with the organization against a claim arising out of an alleged violation of law.

(e) A lawyer who reasonably believes that he or she has been discharged because of the lawyer's actions taken pursuant to paragraphs (b) or (c), or who withdraws under circumstances that require or permit the lawyer to take action under either of those paragraphs, shall proceed as the lawyer reasonably believes necessary to assure that the organization's highest authority is informed of the lawyer's discharge or withdrawal.

(f) In dealing with an organization's directors, officers, employees, members, shareholders or other constituents, a lawyer shall explain the identity of the client when the lawyer knows or reasonably should know that the organization's interests are adverse to those of the constituents with whom the lawyer is dealing.

(g) A lawyer representing an organization may also represent any of its directors, officers, employees, members, shareholders or other constituents, subject to the provisions of Rule 1.7. If the organization's consent to the dual representation is required by Rule 1.7, the consent shall be given by an appropriate official of the organization other than the individual who is to be represented, or by the shareholders.

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Will More GCs Be Targeted for Investigation in 2009?

Susan F. Friedman
New York Law Journal
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Dark clouds loomed over in-house counsel throughout 2008 as the list of their potential liabilities surged in mass and intensity. Although the whirlwind of activity surrounding the backdating of stock options seemingly subsided, albeit temporarily, via case dismissals and settlements,[FOOTNOTE 1] lightning bolts struck in the form of claims against in-house counsel involving bribery, fraud, conspiracy, insider trading, violations of securities laws, failures to disclose, e-discovery errors, defamation via electronic media, violations of attorney-client privilege in the whistleblower context, failure to monitor, regulatory and investigative issues inclusive of Sarbanes-Oxley[FOOTNOTE 2] and the Foreign Corrupt Practices Act[FOOTNOTE 3] (FCPA), and breaches of fiduciary duties. Punishments for these wrongful acts included termination, community service, disbarment, disgorgement, fines and penalties, and incarceration.

In view of this mix of existing and new exposures confronting in-house attorneys, this article highlights the current business and legal environment most germane to in-house practitioners, provides a random sample of atypical real-life claims, and discusses protections sought by those practicing in-house. To date a handful of general counsels have been targeted for investigations, named as defendants in legal actions, or both. It is likely, however, that we will see more legal and enforcement activity in 2009.

GATEKEEPER VERSUS CONFIDANT

Notwithstanding the haze surrounding the continuing debate of gatekeeper versus confidant, thunder rumbled for in-house counsel mid-year when the U.S. Bankruptcy Court for the District of Delaware in *Miller v. McDonald* (*In Re World Health Alternatives Inc., et al.*)[FOOTNOTE 4] solidified the in-house counsel role as corporate gatekeeper by holding that a general counsel's lack of knowledge and participation in fraudulent conduct does not absolve him of his oversight duties to monitor and report wrongdoing.[FOOTNOTE 5] Additionally, the court specifically noted §307 of the Sarbanes-Oxley Act.[FOOTNOTE 6] In allowing the bankruptcy trustee to proceed against the general counsel, the court seemingly made clear the evolving expectations for those in the role of general counsel.

Although the role of gatekeeper may have been more firmly established, the duty of in-house counsel as confidant appeared to remain in a fog. This was demonstrated by countersuits for violations of attorney-client privilege and breach of confidentiality against in-house counsel by their client-employers in response to whistleblower and wrongful termination actions. Insurers of in-house counsel report that these types of claims are on the rise. Notably, a majority of states permit in-house attorneys to file whistleblower actions, yet only a handful allow them to provide the necessary evidence to prove their wrongful termination cases.

Attorney-client privilege and disclosure issues recurred year-long as evidenced by revisions made to the Corporate Charging Guidelines of the U.S. Department of Justice[FOOTNOTE 7]; Federal Rule of Evidence 502 signed into law[FOOTNOTE 8]; public release of the Securities and Exchange Commission enforcement manual known as the "Red Book"[FOOTNOTE 9]; and the reconsideration by the Financial Accounting Standards Board of proposed rules for disclosure of loss contingencies, including litigation, on financial statements.[FOOTNOTE 10]

Given the volume of information stored electronically, privilege and disclosure have become particularly vital with respect to discovery rules. This has also presented challenges for in-house counsel in terms of responsiveness to discovery demands. Aside from a select few high-profile cases involving significant misrepresentations, infractions of the rules appear to be at a minimum.

THE CURRENT CRISIS

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The cyclones of existing exposures in no way prepared in-house counsel for the subprime meltdown and subsequent global economic crisis. Likened to a hurricane or tsunami, neither term adequately describes the world financial situation given its epic proportions and unrelenting fluidity. While most days appear bleak, rays of sun create a mirage on others.

Media reports estimate that by year-end over 630 lawsuits related to the subprime meltdown will have been filed in federal courts since the inception of this crisis. The FBI continues to conduct investigations, over 400 defendants have been charged by the U.S. Department of Justice, and the SEC has nearly 55 pending investigations, all in the subprime area. The total number of subprime securities lawsuits filed in 2008 will be close to 100. [FOOTNOTE 11] Approximately 35 auction rate securities lawsuits have been filed thus far. [FOOTNOTE 12] Aggrieved parties include borrowers, lenders, shareholders, institutional investors, employees, regulators, entities with commercial contracts, and originators of mortgages. Allegations include failure to disclose, unfair and deceptive trade practices, discrimination, fraud, insider trading, failure to monitor, misrepresentation, negligence, breaches of fiduciary duties, aiding and abetting, and violations of securities laws and laws relative to credit, banking, and the housing market.

Investigations by regulatory agencies and law enforcement multiply daily. Targets of these investigations and legal actions include virtually anyone remotely affiliated with this economic downturn. According to NERA Economic Consulting, investigations and litigation will likely continue for the foreseeable future. Legal commentators advise that although the Emergency Economic Stabilization Act of 2008[FOOTNOTE 13] was signed into law on Oct. 3, 2008, it's probable that the act will give rise to a new set of litigation issues in addition to more legislation and regulations, particularly since its purpose continues to be debated, notwithstanding ongoing bailout activity.

As with the stock options backdating crisis, hailstones have begun to hit in-house counsel. A growing number of general counsels are being identified in congressional hearings, and more in-house attorneys will likely be impacted by this crisis as the number of subprime-related lawsuits naming general counsels multiplies. While there existed in-house counsel who appreciated the risks and warned management accordingly, they appeared to be in the minority. A growing faction of experts posit that had in-house counsel been more vigilant with due diligence in assessing potential risks, regardless of their understanding of these complex financial instruments, the overall effects of this crisis could have been mitigated.

CLAIMS AGAINST IN-HOUSE COUNSEL

Insurers of in-house counsel report that subprime-related claims against in-house attorneys have been sparse, but claims overall have increased 60 percent to 100 percent over the past three-year period as the list of activities for which in-house counsel may be held accountable expands. Although the typical claims alleging missed statute of limitations, conflicts of interest, malicious prosecution/abuse of process, unauthorized practice of law, negligence in drafting, and failure to disclose, continue to be set forth, in 2008 certain atypical scenarios have repeatedly presented themselves and may ultimately become the norm. A sample of such claims is provided below. [FOOTNOTE 14] Inasmuch as these claims were actual cases handled by various insurers and brokers, certain facts have been modified to maintain anonymity.

Misappropriation of Confidential Information. An associate general counsel of a consulting firm divulged information pertaining to a new product, not yet released for public consumption, on a social networking Web site. The in-house attorney praised the new product and advised readers that it would be a "big hit" once available. The consumer products company involved, a client of the consulting firm, learned of this activity. It claimed that this wrongful activity would have an extremely detrimental impact on its marketing plan insofar as release of this confidential information would be available to its competitors. Subsequently, an action was commenced against the associate general counsel and her employer for misappropriation of trade secrets, breach of confidentiality, and breach of contract. The matter settled for $1.6 million. The settlement included the voluntary resignation of the associate general counsel.

Securities Class Action -- Subprime. A securities class action was commenced in the U.S. District Court for the Southern District of New York naming the entity and various directors and officers,

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inclusive of the general counsel, as defendants. The entity was a financial services holding company with lending operations that included subprime residential real estate loans throughout the United States. The plaintiffs alleged breach of fiduciary duties and violations of the Securities Exchange Act of 1934.[FOOTNOTE 15]

The shareholder class asserted that the general counsel was engaged in a conspiracy that caused the company to issue improper, false, and misleading statements, including press releases and media reports, that wholly misrepresented the financial health and prospects of the business. The defense motion for dismissal was granted with the court noting that the plaintiffs did not satisfy the requisites necessary to sustain the action. An estimated $1.2 million was incurred in defense costs.

Note on Early Subprime Litigation. A number of the earliest cases filed relative to the subprime crisis were seemingly met with a polar chill when dismissed in the early stages for failures to allege facts sufficient to satisfy pleading requirements. It is premature to determine whether these cases will ultimately be litigated, yet notably, courts are scrutinizing these matters for specificity.

Breach of Confidentiality by Whistleblower. An associate general counsel of an energy/oil company commenced an action against his employer for retaliatory termination. The plaintiff claimed he was terminated for reporting financial information that he was required to report, although it exposed the employer-company to allegations that it had violated federal securities laws. Thereafter, the company commenced an action against its former associate general counsel alleging that any evidence or testimony offered to prove the retaliation case would violate attorney-client privilege and breach confidentiality.

The underlying retaliatory termination action was settled for $800,000, and the countersuit by the employer was discontinued.

Outside Third-Party Claim of Legal Malpractice. A cosmetics manufacturer was the defendant in several actions commenced by retailers and consumers alleging false advertising, misrepresentation, deceptive trade practices, and personal injury regarding lotions it distributed. The manufacturer tendered the defense to its insurer and was assigned a claims adjuster who monitored the litigation.

The litigation increased in complexity prompting the claims adjuster to seek advice from an in-house attorney employed by the insurer. The in-house attorney maintained a dialogue with the general counsel and defense counsel. A judgment was rendered against the manufacturer. Thereafter, the manufacturer commenced an action against the insurer's in-house attorney for negligence in rendering legal advice, conflict of interest, and misrepresentation. The matter settled for $3 million.

Bribery and Breach of Contract. A general contractor for a real estate developer entered into contracts with several subcontractors to build luxury homes. The general contractor was paid for the work performed and then offered an in-house attorney, employed by the real estate developer, a portion of the payment if he agreed to advise the subcontractors that due to financial difficulties the full amount owed to them could not be paid. The in-house attorney refused the bribe, but the general contractor did not pay the subcontractors.

The subcontractors commenced actions against the general contractor, the real estate developer and the in-house attorney claiming breach of contract, conspiracy, misrepresentation, fraudulent inducement, and conversion. Although the in-house attorney did not accept the bribe, he was terminated from employment. He was later dismissed from the case.

WEATHERING THE EXPOSURES

In-house counsel have sought protection from potential liabilities in various ways. Notwithstanding state laws and corporate bylaws providing for indemnification, the "written side-agreement" has gained in popularity. Here, the employer agrees in writing to defend and indemnify an in-house attorney in the event of a claim. Yet many in-house counsel question whether corporate

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indemnification is sufficient protection. Several attorneys who have accepted in-house positions over the past two years have made their acceptance contingent upon the existence of insurance.

Although directors' and officers' liability insurance (D&O insurance) generally provides coverage to in-house counsel who are also corporate officers, it often attempts to delineate between officer activities and duties of in-house counsel. As such, ample coverage against claims of legal malpractice may require significant modifications to these policies. Typically, insurers have been less inclined in this climate to provide accommodations, and boards of directors are generally in agreement, because they are not inclined to allow erosion of policy limits by legal malpractice claims.

Many in-house attorneys seek protections similar to their outside counsel counterparts. As a result, the interest in and purchase of stand-alone insurance policies for in-house counsel have escalated. These policies, known as employed lawyers professional liability insurance or employed lawyers policies, are engineered to address claims alleging negligent acts, errors or omissions in the performance of duties of in-house counsel and their legal staffs.

Beginning in late 2007 and throughout 2008, the significant rise in interest in employed lawyers policies prompted several insurers to offer certain policy enhancements. These may include:

• Non-rescindable coverage for non-indemnifiable loss, where the employer cannot or will not indemnify in-house counsel;

• An order of payments provision whereby payments for non-indemnifiable loss are made first and then reimbursement is made to the entity for claim costs it incurs;

• A sublimit of liability for securities actions with a proviso that where no D&O insurance exists the employed lawyers policy acts as primary insurance;

• Inclusion of shareholder derivative actions, criminal proceedings, and civil administrative or regulatory investigations within the scope of coverage;

• Availability of coverage for cross-claims and third-party claims for contribution or indemnification;

• Coverage for prior wrongful acts that materialize into claims during the policy period (known as full prior acts coverage);

• Coverage for claims of wrongful termination, harassment or discrimination by a director or officer;

• The need for final judicial or arbitration finding of fraud or personal profit to impose the fraud exclusion;

• Costs affiliated with extradition; and

• Generous deletion of portions of the insured versus insured exclusion which typically has provided defense cost coverage in the event of a claim by the employer, but now may expressly allow for defense cost coverage for claims initiated by trustees in bankruptcy, receivers, liquidators, successors, and assignees.

Certain enhancements remain under consideration and may be achieved on a case-by-case basis:

• Given the potential number of attorneys who may exit in-house practice, a longer extended reporting period may be preferable, because it provides coverage for claims made after the policy expiration date that involve wrongful acts that occurred during the policy period.

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• Inasmuch as the employer is the sole client of in-house counsel, a degree of coverage for settlements and judgments, where the employer is the claimant, would make employed lawyers policies more akin to insurance coverage purchased by their law firm counterparts; and

• The deletion of sublimits of liability for securities claims so that an entire policy limit of liability is available for securities actions would increase protection, particularly in this economic downturn.

FINAL ADVISORY

It is likely that a frigid climate will continue for in-house attorneys as they experience: increased government scrutiny, investigations, and regulations in a multitude of areas, inclusive of the world's financial meltdown; a plaintiffs' bar ready to tornado through corporations to expose them; pressure to monitor financial conditions and compliance efforts; challenges to attorney-client privilege and disclosure; efforts to impose liability on secondary actors revisited in view of the economic crisis; heightened responsibility for oversight and due diligence; efforts to eradicate anti-competitive trade practices, bribery, and ills within the scope of the FCPA; demands of electronic discovery; pitfalls associated with communicating via the Internet whether it be blogs, social networking Web sites or e-mail; and the uncertainty that a new administration to the White House brings.

As the precipitation of new and existing exposures perpetuates, in-house counsel are challenged to know all laws applicable to their industry; analyze and question decisions of management; investigate improprieties and seek remedies; firmly establish internal risk assessments and compliance programs; maintain unyielding morality as legal practitioners; be vigilant with regard to rules of ethics, inclusive of multijurisdictional practice[FOOTNOTE 16]; and perhaps most important, realize that inaction is potentially as hazardous as wrongful action.

The exposures of in-house counsel combined with an ambitious list of tasks to prevent liability continually compel in-house attorneys to review the protections afforded to them via indemnification and insurance. Those practicing in-house who understand their roles, risks and protections are more likely to succeed in avoiding white-out conditions as this blizzard of change persists.

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:::::FOOTNOTES:::::

FN1 Approximately 225 securities fraud class actions and shareholder derivative lawsuits were filed alleging backdating of stock options. Over 50 of these actions have been dismissed, and an equal number have settled. Although these actions continue to be filed, at present the pace has slowed. See generally http://www.sec.gov/Archives/edgar and http://securities.stanford.edu.

FN2 Corporate and Criminal Accountability Act of 2002, 18 USC §1514A et seq. (2002).

FN3 15 USC §§78m, 78dd-1, et seq. as amended 1998.

FN4 No. 06-10166, 2008 Bankr. LEXIS 1012 (Bankr. D. Del. April 9, 2008).

FN5 Id.

FN6 See note 2 supra.

FN7 See generally, Remarks Prepared for Delivery by Deputy Attorney General Mark R. Filip at Press Conference Announcing Revisions to Corporate Charging Guidelines, Aug. 28, 2008 at http://www.usdoj.gov/dag/speeches. The revisions include a provision that cooperation with the Department of Justice isn't dependent upon a corporation's waiver of the attorney-client or work product privilege.

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FN8 See http://federalevidence.com/taxonomy/term/215. The new rule guides attorney-client privilege, the work product doctrine, and limitations on waiver of the privilege.

FN9 This is a guide for SEC staff members in investigating potential violations of the securities laws and provides that all waiver requests pertaining to attorney-client or work product privileged information must be reviewed by supervisory staff.

FN10 Numerous practitioners and supporting organizations alerted the Financial Accounting Standards Board to the potential for jeopardizing attorney-client privilege if proposed changes to how companies disclose losses were not modified.

FN11 See generally, http://securities.stanford.edu.

FN12 Id.

FN13 Pub. L. 110-343, enacted Oct. 3, 2008.

FN14 All of the claims presented were resolved with financial contributions from employed lawyers professional liability insurance; the subprime and bribery claims also received contributions from directors' and officers' liability insurance policies.

FN15 Securities Exchange Act of 1934, 17 CFR §240 Rule 10b-5, as modified.

FN16 Most recently, the generally more restrictive New Jersey Supreme Court amended New Jersey Rule 1:27-2(a)(iii) (effective Sept. 1, 2008) by allowing in-house counsel the ability to represent employees, directors, and officers in claims involving the employer, provided that in-house counsel has a limited license to practice in the state.

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Developing in-house counsel's role in the fight against global corruption.

Mission Possible

BY SUSAN F. FRIEDMAN

Stories of foreign intrigue are no longer the exclusive realm of spy thrillers as in-house counsel increasingly find themselves entangled in the corporate battle against corruption—either inadvertently as unwitting participants in alleged "bad acts" or as gatekeepers who must assess risks and guide compliance initiatives. Although the most recent spate of problems may not have involved "moles" divulging their true identities at the Berlin Wall, chases through untamed oil fields, or the deployment of secret agents, they have included the use of slush funds with fabricated names, the routing of bribery payments through offshore accounts, clandestine and questionable payments, handwritten notes to avoid leaving a trail of electronic evidence, and documents marked "do not copy" or "store in a high-security vault."

Historically, as the global economy has experienced rising prices in the food and energy sectors, the level of corruption has increased in step with panic and avarice. For many individuals and corporations, the most significant form of corruption has been bribery, which may come in the way of cash, jewelry, all-expense-paid vacations, artwork, wines, or gift certificates. This form of corruption is in direct violation of the Foreign Corrupt Practices Act of 1977 (FCPA)[1] and its anti-bribery provisions.[2]

This article focuses on the anti-bribery provision of the FCPA, and data pertaining to corruption, targets, compliance, and protections, all with a view toward assisting in-house counsel in examining their potential exposure and role.

The Act

In 1976, post-Watergate, a Securities and Exchange Commission (SEC) investigation disclosed that "more than 400 U.S. companies admitted to having made questionable or illegal payments in excess of $300 million to foreign government officials, politicians, and political parties."[3] In response to this investigation and in an effort to curtail the bribery of foreign officials and restore the public's trust in the U.S. system of doing business, Congress enacted the FCPA in 1977.

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The anti-bribery provisions of the FCPA make it unlawful for a U.S. person, including issuers of securities regulated by the SEC and domestic concerns, as well as certain foreign issuers of securities, to make a corrupt payment to a foreign official for the purpose of obtaining or retaining business for or with, or directing business to, any person.[4] The FCPA applies to individuals, firms/corporations, officers, directors, employees, agents of firms/corporations and any stockholder acting on behalf of a firm/corporation.[5] The FCPA also applies to foreign firms and persons who take any act in furtherance of a corrupt payment while in the United States.[6] U.S. parent corporations are liable for the acts of foreign subsidiaries where they authorize, direct or control the activity in question.[7]

Notably, the FCPA applies to payments to any public official, regardless of rank. The payment can be money or anything of value, and it must be made with corrupt intent. It is also a violation of the anti-bribery provisions to make a payment to an intermediary or third party while knowing that all or a portion of the payment is designed to influence a foreign official.[8]

The anti-bribery provisions exclude payments to facilitate or expedite performance of "routine governmental action" such as granting permits or licenses; processing visas or work orders; or providing police protection, telephone service, power or water.[9] The FCPA also provides an affirmative defense where a payment made to a foreign government official is lawful under the written laws of the foreign official's country, or

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where a payment was a reasonable and bona fide expenditure directly related to the promotion, demonstration or explanation of products or services or to the performance of a particular contract between a company and a foreign government.[10]

Enforcement

The Department of Justice (DOJ) is responsible for all criminal enforcement of the FCPA and for civil enforcement of the anti-bribery provisions with respect to domestic concerns, foreign companies, and nationals, while the SEC is charged with civil enforcement with respect to issuers of securities.

In determining how payments should be characterized, the DOJ has established an FCPA Opinion Procedure which allows any U.S. company or national to submit proposed business conduct and receive an opinion as to whether the conduct described would be considered prohibited pursuant to the FCPA.[11] Inasmuch as provisions of the FCPA are broad and there is little case law interpreting them, the DOJ often recommends consulting with counsel when analyzing the statute.[12]

Criminal penalties for violating the anti-bribery provisions for corporations and other business entities include a fine of up to $2 million; directors, officers, employees, stockholders and agents are subject to a fine of up to $100,000 plus up to 5 years imprisonment. No corporate indemnification is permitted for fines against individuals.[13]

Civilly, the U.S. Attorney General or the SEC may bring an action for a fine of up to $10,000 per violation against companies and individuals.[14] In an SEC enforcement action the court may also impose an additional fine based on ill-gotten gains received. Further, persons or entities judicially determined to have violated the FCPA may be barred from doing business with the federal government.

Although there is no private right of action under the FCPA, the same conduct that violates the anti-bribery provisions may serve to initiate civil lawsuits alleging breaches of fiduciary duties, violations of the federal securities laws, fraud, and violations of the Racketeer Influenced and Corrupt Organizations Act (RICO).[15] As such, directors and officers of companies continue to be on high alert as related civil actions are filed against them. Thus, in-house counsel who are also officers may have an additional exposure in this regard. Note, however, that while FCPA fines and penalties are typically not eligible for coverage pursuant to a Directors & Officers (D&O) Liability Policy, defense costs for investigations as well as defense and indemnity payments for civil actions may be available.

Aside from the threat and costs of multijurisdictional investigations and litigation, in-house counsel are particularly concerned with the exorbitant dollar amounts disgorged, the considerable size of criminal fines,[16] payments to the SEC, monitoring arrangements with the DOJ if a plea deal is struck, the costs of internal investigations which can run from $2 million to $20 million, and damage to reputation/brand image.

Globally, U.S. regulators are working in conjunction with international prosecutors and investigators to further anti-corruption initiatives and equalize the economy so as not to provide unfair advantages to those who engage in corrupt activity. By example, the OECD (Organization for Economic Cooperation and Development) Anti-Bribery Convention on Combating Bribery of Foreign Public Officials in International Business Transactions includes 37 member countries focused on reducing corruption in developing countries. As the data bears out, vigorous enforcement of laws and implementation of initiatives on a global scale require teams of international crime fighters and other resources.

Data Dossier

Robert S. Mueller III, director of the Federal Bureau of Investigation (FBI), in his April 2008 speech before an American Bar Association Annual Conference stated, "[T]he FBI is uniquely situated to address corruption. We have the skills to conduct sophisticated negotiations. We are insulated from political pressure and we are able to go where the evidence leads us, without fear of reprisal or recrimination,"[17] and they have.

The FBI has four full-time agents dedicated to FCPA probes. At the beginning of 2008, the FBI had an estimated 77 pending FCPA investigations. That number does not include the multitude of internal company probes that have not been reported to the government. Additionally, the DOJ employs more than a dozen FCPA prosecutors who by year-end 2007 brought approximately 16 enforcement actions; an equal number was brought by the SEC.

In 2007, the SEC and DOJ imposed more than $135 million in fines, penalties, and disgorgement against corporations for violations of the anti-bribery provisions. The U.S. government's enforcement efforts, which involve parallel investigations and less reliance on self-reporting, have continued in 2008. Further, inasmuch as the DOJ has not hesitated to enforce the FCPA against foreign-owned companies it seems likely that more non-U.S. probes by the DOJ are on the way.

According to Daniel E. Karson, executive managing director of Kroll Associates, in comments made to the author, "[I]n 2007 and now in 2008, the FCPA has eclipsed Sarbanes-Oxley as the primary concern for corporate general counsels."[18] An analysis of FCPA enforcement trends by Kroll indicates that since 2000, the largest number of cases involve Asia, followed by Latin America, Africa, Europe, and the Middle East.[19] The Kroll analysis notes that emerging economies may present breeding grounds for bribery.

The 2007 Bribe Payers' Index compiled by Transparency International cited India, China, and Russia as having the highest corruption rates. Although Chinese officials maintain that anti-corruption is a top priority, noting the 500,000 bribery cases investigated over the past decade and the fact that an individual can be sentenced to death for a bribery conviction, it remains high on the risk list. Absent from all lists is Nigeria, which remains a focus of the DOJ with respect to the potential for bribery. Kroll has ranked potential exposure by industry sectors (from highest risk to lowest) as energy, technology/telecom, medical/pharmaceutical, food/agriculture, metals/mining, construction, and chemicals.[20]

According to the 2008 European Corporate Integrity Survey published by Integrity International, bribery was highest among the most critical concerns for European in-house counsel. Many overseas operatives have embraced the U.S. position and work in conjunction with the DOJ as demonstrated by an OECD 2007 report citing that more than 150 prosecutions or investigations involving bribery have been brought worldwide.

As companies continue to expand globally and encourage business and legal cultures that will not tolerate bribery, the FCPA and similar types of investigations, penalties and legal actions continue to rise. As such, in-house counsel remain vigilant in monitoring developments and targets.

The Target

Among the targets of FCPA current enforcement activity are individual officers and employees of companies. These individuals increasingly are being held criminally liable for their conduct. This represents a shift in the DOJ focus on charging corporations with criminal offenses. At present, the DOJ more commonly offers companies deferred prosecution agreements, as alternatives to criminal prosecution, in exchange for monetary penalties and continued cooperation with the government. Meanwhile, individual officers and employees continue to face employment termination and criminal prosecution.

In an analysis of target trends, it appears the U.S. government is particularly interested in pursuing multiple companies in a specific industry sector,

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such as oil, gas, energy, or construction and related industry groups, because historically the FBI has discovered a higher incidence of corruption in these sectors. Further, companies that conduct business in countries known to have heightened susceptibility to corruption are also targeted by the government. Additionally, the government has paid significant attention to companies with prior FCPA-related issues or repeat offenders. Finally, and as Mr. Karson highlights, it has become much more commonplace for the Department of Justice to target local business partners of U.S. entities in other countries such as consultants or agents. Third-party agents and consultants are often native to the countries in which they conduct business and are unaware of FCPA provisions. Traditionally, they have acted as intermediaries between political officials and foreign subsidiaries of U.S. companies, and if bribery is a customary local practice, they too have been involved in such activity as the intermediary; hence, the heightened focus on this group of individuals.

The stories of individual targets that have been apprehended may read like complex mysteries complete with alias names, motives, disguises, and clandestine activities, but U.S. and international anti-corruption experts have been able to decipher clues and follow the trails through multiple countries to disclose corrupt activity. To maintain anonymity, true names and corporate positions of individual targets are not often disclosed, but those involved in the bribery process have included chief executive officers, chief financial officers, legal chiefs, finance directors, client/account executives, third-party agents/intermediaries, and board members, as well as low and mid-level managers. Acts that have been the subject of such stories include wiring millions of dollars to Iranian officials in exchange for oil and gas rights; paying off Nigerian officials with suitcases of cash in exchange for oil; wooing government officials in an Asian country with lavish weekend getaways in return for defense and aerospace contracts; offering shares of stock in return for furthering business interests in another Asian country; and providing cash and gifts in certain European countries to win construction contracts.[21]

While less than a handful of in-house counsel have been implicated pursuant to the anti-bribery provisions, they often are the initial targets questioned during the course of an investigation. Although in-house counsel generally seek to cooperate with authorities, there may be ramifications for the attorney/client privilege, which varies internationally. Inquiries made of in-house counsel often focus on compliance and due diligence functions within the FCPA context.

Compliance

In his April 2008 speech, Robert Mueller, FBI director, also remarked, "…you are those to whom business leaders turn for counsel. You are often one of the first lines of defense. You are the gatekeepers—the ones who must say, 'this is the right thing to do….'"[22] In this regard, although a company's board of directors is ultimately responsible for the oversight and management of an FCPA compliance program, significant portions of these duties are delegated to in-house counsel. As such, it becomes incumbent upon in-house counsel to assist in conducting worldwide risk assessments to identify business units and regions where they believe their companies are most exposed to corruption; research and retain competent local counsel where necessary; work in cooperation with leadership of the company to establish clear, written policies, codes of conduct, training, procedures, and hotlines; and aid in creating a culture of anti-bribery compliance from the top down.

Effective compliance also typically requires: ongoing monitoring to ensure that all policies are regularly evaluated and are working to prevent or identify inappropriate activities; managing internal investigations; establishing appropriate disciplinary mechanisms for violations of company policy or the law; conducting due diligence inclusive of background checks and FCPA compliance on all foreign business partners, potential acquisitions/mergers, agents or anyone engaged in overseas commerce on behalf of the company[23]; being acutely aware of, and accounting for, societal and language differences in international compliance training; and documenting all compliance efforts.

Mr. Karson of Kroll also advises: "A particular area of concern and challenge for general counsels is due diligence on foreign agents and consultants…. Corporations need to know exactly who they hire and what services are to be performed as a majority of FCPA investigations target these individuals." It has been equally challenging for in-house counsel to impress the importance of FCPA compliance upon employees of non-U.S. subsidiaries and affiliates.

According to the U.S. Federal Sentencing Guidelines Chapter 8 Part B (2005), which provides guidance with respect to the establishment of compliance programs, penalty reductions for companies of up to 95 percent are available provided that an effective compliance and ethics program is created and implemented.[24] Failure to establish such programs may result in additional liability of in-house counsel charged with this responsibility.

Protection

In addition to robust FCPA compliance programs, due diligence and consulting with counsel, the DOJ and SEC consistently highlight that self-reporting is a vital protective measure for in-house counsel in their efforts to minimize legal exposure to the corporations they serve. In-house counsel may also seek to review their D&O liability insurance policies in the event that the directors, officers, or company they serve are confronted with an FCPA investig and/or related civil litigation as insurance coverage may be available depending upon the allegations and circumstances.

As for protecting themselves, Employed Lawyers Professional Liability Insurance is specifically designed to provide coverage for claims alleging negligent acts, errors or omissions in the performance of the duties of in-house counsel and their staffs. Although no insurance will provide coverage for intentional violations of statutes and their attendant fines and penalties, defense cost coverage is available in the investigation stage through litigation up and until there is a final adjudication. On the civil side, in terms of allegations of breaches of fiduciary duties, violations of the federal securities laws, fraud, misrepresentation, and negligence, this type of insurance may provide coverage for defense costs as well as monies for settlements or judgments.

In the end, for in-house counsel, although there may be no billionaire eccentric foreign villains with desires to take over the world, and no cerebral sophisticated secret agents dedicated to moral ideals, foreign intrigue persists via the FCPA and the global anti-corruption crime fighters.

1. 15 USC §§78m, 78dd-1, et seq. as amended, 1998.
2. Id. §§78dd-1(a), 78dd-2(a), et seq.
3. U.S. DOJ "Lay Person's Guide to FCPA," http://www.usdoj.gov.
4. See note 2 supra. The FCPA also requires companies whose securities are listed in the United States to make and keep books and records that accurately and fairly reflect the transactions of the corporation and to devise and maintain an adequate system of internal accounting controls. Id. at §§78dd-1(a), 78dd-2(a), 78dd-3(a), 78dd-1(f)(1).
5. See note 3 supra.
6. See note 3 supra. This addition was made by Congress in 1998.
7. See note 3 supra.
8. Id. Knowledge includes conscious disregard and deliberate ignorance.
9. 15 USC §§78dd-1(b), 78dd-2(b), 78dd-3(b). The statute lists examples of routine government action, but companies must also make certain that such payments do not violate the local laws of the country in which they are doing business.
10. Id. at §§78dd-1(c)(1), 78dd-2(c)(1), 78dd-3(c)(1), 78dd-1(c)(2)B, 78dd-2(c)(2)B, 78dd-3(c)(3)B. Generally, as anti-corruption legislation spreads globally, the first affirmative defense is often unavailable.
11. 28 CFR Part 80.
12. See note 3 supra.
13. See note 12 supra.
14. Id.
15. 18 USC §§1961-1968, 1970 as amended.
16. The largest FCPA penalty thus far was $44 million which included an $11 million criminal penalty and $33 million in disgorgement of profits. The average settlement cost for the three-year period ending 2007 was $13.5 million.
17. See http://www.fbi.gov/pressrel/speeches/mueller041708.htm, April 17, 2008.
18. See generally, Kroll Global Fraud Report Annual Edition 2007/2008 and June 2007 Corruption and the Foreign Corrupt Practices Act.
19. Id.
20. Id.
21. See generally, http://www.america.gov/st/washfile, U.S. Department of State 2008.
22. See note 17 supra.
23. The U.S. Department of Commerce Commercial Services Program has several programs to assist U.S. companies in conducting due diligence when selecting business partners or agents overseas. See generally, http://www.trade.gov/cs.
24. U.S. Sentencing Guidelines, §8B2.1 (2005).

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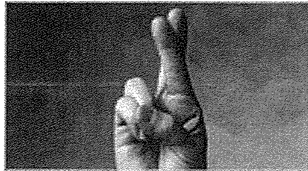

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In-House Counsel Face New Global Challenges

Susan F. Friedman
New York Law Journal
August 14, 2009

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As the world has been asked to "reduce, reuse and recycle," so too has the climate changed for in-house counsel. "In the past, there may have been one or two hot button issues, but today, there are a myriad of issues confronting in-house practitioners that run the gamut from attorney-client privilege and electronic social media to employment law and the environment," said Allison Hoffman, senior vice president and chief legal officer of Incisive Media-North America, the parent company of the *New York Law Journal*. "Everything that we do as in-house counsel has a liability component to it."

Although no new claim trends against in-house counsel have emerged in 2009, the atmosphere is polluted with an unemployment rate of 9.5 percent,[FOOTNOTE 1] liquidity crisis, congressional investigations, collapse of industry giants, massive frauds via Ponzi schemes, regulations to help the planet "go green," shrinking legal departments, pandemics, an explosion of online modes of communication, and new rules for a broad cross-section of industries.

Inasmuch as the Securities and Exchange Commission has turned its attention on the financial crisis, there has seemingly been less focus on in-house counsel with respect to the typical high-profile issues of insider trading and backdating stock options. Rather, newsworthy activities of in-house counsel have included resigning upon learning that the corporate client may be involved in a Ponzi scheme; reapplying for their own positions following a reduction in force; uncontrolled social networking and blogging; and preparing companies for pandemics and a green economy.

Following discussions with numerous in-house practitioners, this article presents topics frequently cited by the in-house bar as affecting the ways in which they practice law now and into the sustainable future. It concludes with highlights of insurance coverage protection available to in-house attorneys.

CONGRESSIONAL INVESTIGATIONS

Today's heat stress derives from a Congress whose oversight and investigatory panels take a "slash and burn" approach to uncover truths. In fact, a growing number of general counsel continue to be identified in congressional hearings. Congressional committees possess broad oversight and investigatory jurisdiction. Oftentimes, the investigative process is a precursor to legislative action to remedy wrongdoing. These investigations may adversely impact the reputations of a company, its officers, and products or services, as well as wreak havoc with shareholder confidence.

Inasmuch as Congress views in-house counsel as "gatekeepers," their inability to effectively manage this role represents significant exposure to themselves and the organizations they serve. "There is increased pressure on corporate counsel to act as regulators on management, but they must maintain their independence, because without independence, they cannot do their jobs," advises Paul Davis, vice president and general counsel of Tampa Bay Lightning and St. Pete Times Forum. "The primary concern here is that corporate counsel often view themselves as upper management, fearful that others in management may view them as adversarial if they maintain their independence, and this is particularly problematic in the context of investigations."

It is incumbent upon in-house counsel to understand the rules of congressional investigations, know the political figures involved, prepare their organizations, and recognize that cooperation needs to be balanced with attorney-client privilege. Although Congress does not have to recognize confidentiality privileges, congressional members may not seek to harm a company by needlessly revealing privileged information. See generally, *Watkins v. United States*, 354 U.S. 178 (1957); *Eastland v. United States Servicemen's Fund*, 421 U.S. 491 (1975); 2 U.S.C. 192 et seq.; 18 U.S.C. 1505; *In re Provident Life & Accident Co.*, No. CIV-1-90-219 (E.D. Tenn. June 13, 1990).

As such, the disclosure of privileged information may be negotiated prior to a congressional hearing or investigation.

COMMUNICATIONS AND PRIVILEGE

"A primary problem in large organizations are 'information traps' where the business professionals in a company do not communicate with the legal department about issues in which corporate counsel should be involved," observes Henry T. French Jr., general counsel for Global Litigation and compliance director of XL Global Services Inc. a member of the XL Capital Group. "Oftentimes business people work in corporate silos and in-house counsel need to know how to navigate those silos so that they can stay informed about the activities occurring in the corporation -- in-house lawyers should really have the ultimate backstage pass." Interestingly, Davis commented, "[B]usiness people may purposely not talk to the general counsel's office, because they don't want to be subject to restrictions that the legal department may place upon them. It's often not until the 'thunderclap' from out of the blue hits them with something unexpected that they get corporate counsel involved." Unfortunately, from a liability perspective, in-house counsel themselves are exposed to the extent that they are not advised of legal issues requiring their involvement.

Inasmuch as corporate counsel frequently perform business functions in addition to dispensing legal advice, their roles can be blurred, which places attorney-client privilege in jeopardy. "We need to educate non-lawyers about privilege, because dressing up business communications with privilege markers makes for sloppy communications which are not confidential," explains French. "Business people cannot use the legal department as a cloak; they need to understand who owns the attorney-client privilege and how it works."

Hoffman, of Incisive Media, adds, "[A]s a threshold matter, it is imperative that corporate counsel understand that they represent the company first and foremost -- and not any particular individual." Earlier this year, the issue of "who is the client" surfaced in a number of cases involving senior level corporate officers[FOOTNOTE 2] who claimed that they were represented by defense counsel for their respective corporations, and as such, the attorney-client privilege attached to the communications that they made to such counsel. These cases alerted the in-house bar that all employees must be cautioned that the corporation is their only client, and only the corporate entity has the power to assert or waive the attorney-client privilege.

In-house counsel may also be exposed to legal liability for the inadvertent waiver of attorney-client privilege whether it be within the context of discovery or disseminating information through other channels such as press releases or online communications. Inasmuch as e-mail and other electronic forms of communication are utilized in glacial proportions, they pose substantial liabilities for in-house counsel.

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ELECTRONIC MEDIA EXPLOSION

Perhaps more powerful than all alternative energy sources combined is the power of the World Wide Web. More than 60 million Americans read blogs and approximately 15 percent of Fortune 500 companies have blogs with links to corporate Twitter accounts.[FOOTNOTE 3] Facebook progressed to blogging, and catapulted to the new "sunspot," Twitter. To capitalize on the popularity of evolving social media, many companies now choose to disseminate information to shareholders, clients, and personnel via alternative modes of communication.

As the communication ozone layer reaches new heights, the potential liabilities include divulging proprietary information or trade secrets; defamation and violations of other privacy rights; infringement of intellectual property rights; false advertising; violations of e-commerce regulations; indirect liability for third-party acts; inadvertent release of attorney-client privileged information; data security breaches; and violating rules established by regulatory bodies that govern corporate communications. Perhaps most problematic for in-house counsel is that all information transmitted through blogs, Twitter, and social networking Web sites is discoverable.

Yet, organizations that do not embrace the new forms of communication risk losing market share, reputation, and revenue to their more technologically sophisticated competitors. As such, as gatekeepers, corporate counsel have seemingly been charged with the responsibility and liability of monitoring content, privacy issues, and other legal aspects for marketing in the new social mediums. Moreover, and despite that there are no laws that specifically regulate blogging nor any specific case law to offer guidance, in-house attorneys oftentimes are the drafters of corporate social networking and blogging/Twitter policies, hence making them targets if policies prove to be ineffective.

French explains: "Most companies haven't had to start to think about blogging or Twitter, but now, there is a clear need to have a robust all encompassing social networking policy -- to protect the outside world from comments of employees as well as to protect employees from each other as defamation and even cyber-bullying (harassment electronically) or other types of very public tirades are already finding their way into the corporate realm."

DOWNSIZING AND UPSIZING

Skyrocketing unemployment continues to have significant implications for in-house practitioners. Two theories seem to have emerged relative to corporate legal departments, both of which lead to an increase in potential liability for in-house counsel. There are organizations that unilaterally seek to terminate all non-revenue generating employees, and those in-house attorneys who remain must take on broader responsibilities. "The pitfall here is that legal department heads must make certain that they have enough staff to cover the workload effectively. Otherwise matters will fall through the cracks, and in-house attorneys may be exposed to claims for malpractice," says French. Alternatively, companies may seek to increase legal department staff, but reduce spending on outside counsel. An increased in-house workload translates into increased exposure.

In-house counsel specializing in labor and employment issues are experiencing a sharp increase in the demands of their positions as a result of reductions in force and heightened legislative activity. Corporate counsel have been enlisted to assist in planning reductions in force by evaluating and developing internal company policies, training senior level staff as to proper procedures for employment termination, analyzing severance pay and releases, counseling terminated employees regarding employment benefits, conducting litigation risk assessments, and monitoring corporate compliance with existing laws.

Notably, the number of lawsuits brought pursuant to the Workers Adjustment and Retraining Notification Act (WARN), [FOOTNOTE 4] which governs notice requirements for plant closings and mass layoffs, has reportedly tripled. Additionally, an enhanced WARN Act bill called the Federal Oversight, Reform and Enforcement of the WARN Act has recently been proposed.[FOOTNOTE 5] Further, many corporate counsel must be familiar with the Employee Retirement Income Security Act of 1974 as amended (ERISA) which governs employee benefits,[FOOTNOTE 6] as well as the Consolidated Omnibus Budget Reconciliation Act[FOOTNOTE 7] (COBRA), which provides terminated employees with the right to continue health insurance sponsored by their employers. COBRA has become particularly challenging due to new rules regarding government subsidization.

Further, a slew of new pro-employee legislation has been passed inclusive of the Lilly Ledbetter Fair Pay Act of 2009 [FOOTNOTE 8] and the ADA Amendments Act.[FOOTNOTE 9] Numerous labor/union bills are before Congress including the Employee Free Choice Act.[FOOTNOTE 10] In-house counsel will likely play a significant role in labor negotiations and compliance efforts, and as such, expose themselves to liability.

Internationally, guidance is sought from in-house counsel regarding pandemics for reasons of workplace safety,

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employee privacy rights and employment law issues. In fact, the EEOC issued a technical guidance document geared toward pandemics,[FOOTNOTE 11] which evidences its concern that employers may engage in conduct prohibited by the Americans with Disabilities Act in order to minimize risks of workplace infection.

Although passage of new laws and regulations to protect employees persists, in-house counsel must be cognizant that the administration's commitment to saving jobs may be compromised by other initiatives, such as global warming, which could give rise to job loss via plant closings and the shutdown of renewable energy companies.

GLOBAL WARMING

If greenhouse gas emissions, melting polar ice sheets, rising sea levels, traumatic weather events, loss of wildlife, and retreating glaciers don't make the "top concern" list of in-house counsel, the threat of claims by litigants, regulators and shareholders may.

What began with SEC disclosure obligations requiring publicly traded companies to report any material effects that compliance with environmental laws may have on their financial and competitive positions[FOOTNOTE 12] has escalated into the Obama administration's call for a "green economic revolution" and a reinvigorated Environmental Protection Agency (EPA) poised to establish a new regulatory scheme.

Pursuant to the responsibility conferred upon it by the U.S. Supreme Court in *Massachusetts v. EPA*,[FOOTNOTE 13] the EPA recently issued a proposed "endangerment finding" stating that greenhouse gases, including carbon dioxide, endanger public health and welfare as defined by Section 202(a) of the Clean Air Act.[FOOTNOTE 14] The EPA also issued a proposed rule requiring mandatory reporting of greenhouse gases from large sources in the United States.[FOOTNOTE 15] If accepted, this proposed rule may cause an increase in litigation against entities seemingly responsible for adverse environmental impacts from greenhouse gas emissions.

Earlier this year, the American Clean Energy and Security Act of 2009 (ACES), also known as the Waxman-Markey Bill,[FOOTNOTE 16] was introduced. The bill includes a proposed "cap and trade" program, which sets mandatory limits on carbon emissions and requires businesses to purchase permits to pollute. The bill has not yet passed through the Senate, and Congress is still debating how to distribute the pollution permits. In addition to carbon emissions, in-house counsel must also be aware of rules involving water pollution and airborne toxins. In view of current and proposed regulations, in-house attorneys are compelled to consult with engineers and environmental specialists to determine the magnitude of their companies' pollution.

State attorneys general, pension funds, environmental groups and investors now relentlessly demand information, transparency and accountability. Currently, litigation and investigations revolve around disclosure rules and compliance by the SEC and state attorneys general. We have also seen an escalating number of shareholder resolutions and increased mutual fund support of those resolutions as well as demands by asset managers, shareholder activists and institutional investors all seeking more stringent disclosure rules for climate-related liabilities. There have also been lawsuits against various entities alleging that their operations contribute to global warming; this demonstrates that reputational risk is of significance as companies may suffer damage to their brands if they are idle while their competitors take action to mitigate their contributions to global warming.

The federal goal of reducing emissions by 80 percent by 2050 signals that legislation and regulation impacting virtually every industry sector will be developed at an aggressive pace. As such, it is likely that in-house attorneys will interface with multiple disciplines within their organizations to establish protocols, and provide regulatory guidance, legal advice and strategies. They must manage fiduciary responsibilities, establish internal systems to measure risks and liability, and minimize future litigation as well as supervise communications with shareholders, employees, and regulators. In-house counsel who are not educated as to the issues expose themselves and the corporations they serve to liability.

INSURANCE FROM THE ELEMENTS

While "going green" is the wave of the future, turning green from fear of mounting exposures shouldn't be. Realizing that the evolving times have a significant impact on in-house practitioners, approximately 20 percent of Fortune 1000 companies purchase insurance coverage for their in-house counsel, commonly known as employed lawyers professional liability insurance ("employed lawyers insurance"). This insurance is specifically designed to provide coverage for any negligent act, error or omission committed with respect to the provision of legal services by in-house counsel and their staffs.

As the customer base for employed lawyers insurance has grown, the number of insurers offering this coverage more than doubled in 2009. Generally, most policy forms provide coverage for: investigations, ethical violations, disciplinary

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or licensing proceedings, violations of SOX and securities laws,[FOOTNOTE 17] administrative and regulatory proceedings, criminal actions, claims brought by the corporate employer (defense costs only), counseling regarding employment practices, providing advice to ERISA fiduciaries, copyright and trademark infringement, violations of privacy rights, and defamation.

Given the competition, certain insurers have provided customized or new enhancements which include:

- Two-year policy periods;
- Choice of counsel;
- Six-year extended reporting period to report claims made after the policy expiration date for wrongful acts that occurred during the policy period;
- The option for individuals to purchase tail coverage following employment termination or retirement;
- Defense cost coverage for: claims alleging misappropriation of trade secrets, violations of COBRA, unpaid wages/overtime pay, and claims by bankruptcy trustees/liquidators;
- Deletion of all sublimits so that all claims eligible for coverage are entitled to the policy's full limit of liability;
- First dollar coverage, in exchange for subrogation rights, where the corporate employer wrongfully refuses to indemnify in-house counsel;
- Not applying the pollution exclusion to non-indemnifiable loss where the company cannot or will not indemnify in-house counsel;
- Waiver of 50 percent of the policy's deductible/retention if a claim is settled with the consent of the individual insured at a mediation;
- An extended reporting period at no additional cost for in-house counsel who become totally and permanently disabled;
- Coverage for counseling regarding antitrust issues;
- Considering temporary attorneys as insureds;
- Making legal work provided to non-profit organizations eligible for coverage;
- Coverage for counseling human resource representatives regarding workers' compensation, social security and disability benefits; and
- Making non-compensated personal legal services to directors, officers and employees eligible for coverage.

THE FINAL FOOTPRINT

The volatility of the global economy presents risks as well as opportunities for in-house counsel. Their ability to communicate, initiate and mitigate will greatly impact the footprints that they leave. A comprehensive assessment of their roles, responsibilities, and exposures is vital to placing them in a better position to protect themselves and the corporations they serve before the climate changes again.

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:::::FOOTNOTES::::

FN1 U.S. Bureau of Labor Statistics as of June 2009. See www.bls.gov.

FN2 See e.g., *United States v. Nicholas*, Docket No. 338, Case No. 8:08-00139 (C.D. Cal. April 1, 2009) and Texas Lawyer Blog, "Pendergest-Holt Switches Courts, Adds Former GC as Defendant," April 16, 2009 at http://texaslawyer.typepad.com.

FN3 See http://www.socialtext.net/bizblogs and Pew Internet & American Life Project Surveys at www.pewinternet.org.

FN4 29 U.S.C. §§2101 et. seq. (1988).

FN5 H.R. 3042/S. 1374, (2009).

FN6 29 U.S.C. §§1001 et. seq. (1974) as amended.

FN7 Id. at Part 6 of Title I. See also 29 C.F.R. 2590, Pub. L. 99-272, 100 Stat. 82 (1985).

FN8 42 U.S.C. §§12111 et. seq., 29 U.S.C. §§621, 626, et. seq. (2009); see also S.181 at www.govtrack/us/congress/billtext.

FN9 42 U.S.C. §§12101 et. seq. (2008).

FN10 H.R. 800/S. 1041 (2007).

FN11 See http://www.eeoc.gov/facts/h1n1.

FN12 Regulation S-K Items 101 and 103, 17 C.F.R. Sec. 229 (2007).

FN13 549 U.S. 497 (2007). Here, the Court held, among other things, that greenhouse gases were air pollutants within the meaning of Section 202(a) of the Clean Air Act.

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FN14 42 U.S.C. 7401-7671 (1970) as amended by the Clean Air Act Amendments Pub. L. 101-549 (1990); see, www.regulations.gov under Docket ID No. EPA HQ-OAR 2009-0171: Proposed Endangerment and Cause or Contribute Findings for Greenhouse Gases Under the Clean Air Act (PDF) or www.epa.gov/climatechange/endangerment.html.

FN15 See www.regulations.gov under Docket ID No. EPA-HQ-OAR-2008-0508.

FN16 H.R. 2454/S.2191 (2009).

FN17 Employed lawyers insurance policies are excess to directors and officers liability insurance for claims involving the violation of securities laws to the extent that allegations are not for legal malpractice in which case, employed lawyers insurance is primary coverage.

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ACC Extras

Supplemental resources available on www.acc.com

Insurance Coverage For Lawsuits: Allocate Responsibility And Avoid Malpractice Claims.
ACC Docket. May 2003
http://www.acc.com/legalresources/resource.cfm?show=150378

In-House Malpractice Insurance - Should you Consider It?
Webcast Transcript. July 2005
http://www.acc.com/legalresources/resource.cfm?show=16424

Liability Concerns for In-House Counsel and Available Insurance Protection.
Quick Reference. September 2008
http://www.acc.com/legalresources/resource.cfm?show=199661

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