999 Closing Program: In-House Ethics-What Would You Do?

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CORPORATE PROFESSIONAL RESPONSIBILITY

PRESENTATION GUIDE AND LEGAL AUTHORITIES

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SCENE ONE: BALANCING THE BALANCE SHEET

Presentation Guide

A. What is the "transaction review committee"? What are its duties?

- It appears to be a complex structured finance committee, which regulators urged corporations to create in the aftermath of the corporate accounting scandals of the late 1990s.
- This committee is designed to scrutinize particularly risky transactions.
- The proposed sale of loans appears to require this extra scrutiny, because it involves a commitment by the bank to pledge its own equity and poses significant legal and reputational risks.
- It is troubling that the detailed information that the transaction review committee will need to make an informed decision about the loan sale has not been gathered. Without a more detailed presentation, it is unlikely that the committee will be able to understand the bank's relationship with the loan purchasers, the business objectives of the sale, or the legal and reputational risks that the transaction poses. What, if anything, should Nelson do in this situation?

B. What suspicions does the proposed accounting treatment of the loan sale raise?

- The bank will make an equity commitment to guarantee the loans if the original borrowers default on payment.

  In light of the differences in how debt and equity commitments are accounted for, the use of an equity commitment suggests that higher scrutiny may be appropriate.
- In addition, the bank's seemingly low-value loans are being sold at a large profit. Is the transaction too good to be true?

  The bank should be concerned about whether something other than normal business considerations is driving the transaction.
- Should Bannister's claim that any losses would be realized only in the long-term affect the analysis?

C. What are Nelson's obligations under these circumstances?

- As a lawyer in the bank's legal department, Nelson's primary obligation is to the bank itself, not to Grant or to any other bank executive.

  Grant appears specifically to mistake the identity of his client in this scene when he says, in reference to corporate officers, that "we can't go to the board every time we disagree with our clients."

- Obviously, however, Nelson may be affected by other professional and personal loyalties, which he must try to balance with his primary obligation to the bank.

  Nelson may be afraid to push harder to get the details about this transaction because Grant has furthered his career and served as a mentor (or "second father").

  Nelson may also be afraid to push harder because the legal department could be held accountable for the original diligence on the loans.

D. How does Nelson's subordinate position to Grant affect his responsibilities?

- As general counsel, Grant will have the final say on many legal issues within the bank's legal department.

- Generally, if Grant makes a reasonable decision about an ambiguous question of professional responsibility, Nelson, as his subordinate, may properly act in accordance with that decision. On the other hand, the fact that Nelson takes orders from a superior does not, in itself, defend him from violations of applicable rules of lawyer conduct or of legal standards generally.

  To what extent should Nelson consider whether Grant's analysis of his suggestions constitutes an honest legal judgment or a more politically motivated dismissal of Nelson's concerns?

E. What kind of behavior should Grant be encouraging?

- Grant should encourage Nelson to challenge him and others in the corporation when Nelson identifies potential legal problems or risks.

- Encouraging such behavior is part of a corporate attorney's obligation to represent the bank zealously and to serve the best interests of the bank itself.

- Instead, Grant minimizes and dismisses Nelson's concerns.

F. Is it true that "as lawyers, all we can do is give advice"?

- It is true that lawyers should act as counselors to their clients. However, they should give candid advice and not passively acquiesce.

- Further, lawyers are authorized to go beyond the legal consequences of actions and advise on the economic, political and publicity-related consequences of their clients' actions.

- To what extent should Grant be relying on what has been reported to him as the conclusion of the bank's accountants? To what extent is this conclusion relevant to Grant's analysis?

G. Grant appears very deferential to the authority of the business line. Is he painting the right picture of corporate counsel's role within a firm?

- Grant has a duty to the corporation to provide the committee with his candid advice. The fact that an influential executive may disagree does not reduce or change Grant's obligation.

- This duty is particularly important here, because the bank is contemplating transactions that have been identified as requiring additional review. Grant is wrong to imply that this is not his concern.

- By not providing the committee with his view, Grant is undercutting the control function that the legal department is intended to provide.

SCENE ONE: BALANCING THE BALANCE SHEET

Legal Authorities

A. The Organization as Client: First Principles

- ABA Model Rule of Professional Conduct 1.13(a) dictates that "[a] lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents." (ABA Model Rules are available on the ABA website. The most recent Model Rules, from 2004, are cited here.)

- 17 C.F.R. § 205.3(a) under Section 307 of the Sarbanes-Oxley Act provides that an attorney appearing and practicing in the representation of an issuer before the SEC "owes his or her professional and ethical duties to the issuer as an organization." (Rules in 17 C.F.R. are referred to as "*SEC Rules*.")

B. Complex Structured Finance Transaction Review Committee

- Interagency Statement on Sound Practices Concerning Complex Structured Finance Activities

  In May 2004, the Department of the Treasury, the Office of Thrift Supervision, the Federal Reserve System, the Federal Deposit Insurance Corporation and the SEC issued a draft Interagency Statement on Sound Practices Concerning Complex Structured Finance Activities. The Interagency Statement provides guidance to financial institutions involved in "complex structured finance transactions." The definition of "complex structured finance transactions" includes those transactions that "may expose the financial institution to elevated levels of market, credit, operational, legal or reputational risks." 69 Fed. Reg. 28980, 28985 (May 19, 2004). Characteristics of a transaction that may trigger additional scrutiny include (1) the requirement of "an equity capital commitment from the financial institution," (2) a "questionable economic substance or business purpose" and (3) a structure "designed primarily to exploit accounting, regulatory or tax guidelines." *Id.* at 28988.

- Recommended Policies and Procedures for Review of Complex Structured Finance Transactions

  The draft Interagency Statement provides guidance on the policies and procedures that financial institutions should use when evaluating complex structured finance transactions:

  > Financial institutions offering complex structured finance transactions should maintain a comprehensive set of formal, firm-wide policies and procedures that provide for the identification, documentation, evaluation, and control of the full range of credit, market, operational, legal, and reputational risks that may be associated with these transactions. These policies should start with the financial institution's definition of what constitutes a complex structured finance transaction and be designed to ensure that the financial institution appropriately manages its complex structured finance activities on both an individual transaction and a relationship basis, with all customers (including corporate entities, government entities and individuals) and in all jurisdictions where the financial institution operates.

  Id. at 28986.

- Purpose of Review Procedures

  The Interagency Statement notes that these procedures should "ensure that staff approving each transaction fully understands the scope of the institution's relationship with the customer and has evaluated and documented the customer's business objectives for entering into the transaction, the economic substance of the transaction, and the potential legal and reputational risks to the financial institution." *Id.* at 28988.

C. Subordinate Lawyers within Law Firms and Associations

ABA Model Rule 5.2 provides that "[a] lawyer is bound by the Rules of Professional Conduct notwithstanding that the lawyer acted at the direction of another person," but a "subordinate lawyer does not violate the Rules of Professional Conduct if that lawyer acts in accordance with a supervisory lawyer's reasonable resolution of an arguable question of professional duty." *Accord* New York Disciplinary Rule 1-104.

D. Duty to Inquire into the Factual Elements of a Legal Issue

- The so-called "first rule of ethics" is competence. ABA Model Rule 1.1 provides that "[a] lawyer shall provide competent representation to a client. Competent representation requires the . . . thoroughness and preparation reasonably necessary for the representation."

  Comment 5 to ABA Model Rule 1.1 provides that "[c]ompetent handling of a particular matter includes inquiry into and analysis of the factual and legal elements of the problem." (Official comments to the ABA Model Rules are available on Lexis and Westlaw and in various deskbooks on legal ethics. The most recent official comments, from 2003, are cited here.)

- Counsel's passivity in the face of legally dubious corporate action could also be construed as a lack of "reasonable diligence" (ABA Model Rule 1.3) or breach of the duty to "explain a matter to the extent reasonably necessary to permit [a] client to make informed decisions" (ABA Model Rule 1.4(b)).

E. Lawyers as Candid Advisors

- ABA Model Rule 2.1 provides that "a lawyer shall exercise independent professional judgment and render candid advice. In rendering advice, a lawyer may refer not only to law but to other considerations such as moral, economic, social and political factors, that may be relevant to the client's situation."

SCENE ONE: BALANCING THE BALANCE SHEET

Additional Reading

- James M. Altman, *Clarifying Your Client's Identity*, N.Y. L.J., Dec. 10, 1999.
- JOHN T. BOSTELMAN, THE SARBANES-OXLEY DESKBOOK (7th ed. 2005).
- Geoffrey C. Hazard, Jr., *Law Practice and the Limits of Moral Philosophy*, *in* ETHICS IN PRACTICE: LAWYERS' ROLES, RESPONSIBILITIES, AND REGULATION 75 (Deborah L. Rhode ed., 2000).
- DAVID LUBAN, LAWYERS AND JUSTICE: AN ETHICAL STUDY (1988).
- Stephen L. Pepper, *The Lawyer's Amoral Ethical Role: A Defense, a Problem, and Some Possibilities*, 1986 AM. BAR FOUNDATION RESEARCH J. 613 (1986).
- RONALD D. ROTUNDA & JOHN S. DZIENKOWSKI, LEGAL ETHICS: THE LAWYER'S DESKBOOK ON PROFESSIONAL RESPONSIBILITY (ed. 2005-06).

ACC Articles

- Steven N. Machtinger & Dana A. Welch, *In-House Ethical Conflicts: Recognizing And Responding To Them*, *ACC Docket* 22, no. 2 (February 2004): 22-36 *available at* http://www.acca.com/protected/pubs/docket/feb04/conflict.pdf
- James A. Nortz, *Business Ethics: Put Some Life Into Your Program, ACC Docket* 22, no. 2 (February 2004): 56-59 *available at* http://www.acca.com/protected/pubs/docket/feb04/life.pdf

ACC InfoPAKS:

- *Attorney-Client Privilege InfoPAK 2005* http://www.acca.com/infopaks/attclient.html
- *In-house Counsel Ethics InfoPAK 2005* http://www.acca.com/infopaks/ethics.html
- *In-house Counsel Standards Under Sarbanes-Oxley InfoPAK 2005* http://www.acca.com/infopaks/sarbanes.html

Benchmarking Resources

- *Leading Practices In Providing In-House Legal Support To The CFO & Finance Function* http://www.acca.com/protected/article/governance/lead_cfo.pdf

ACC Annual Meeting Program Materials

- Diane Klein, Matthew J. Revord, & Donna M. P. Wilson, *704 When Is a Lawyer Not a Lawyer?* http://www.acca.com/education2k2/am/cm/704.pdf

- Michael G. McCarty, Cisselon S. Nichols, & Laura Stein, *611 Attorney-Client Privilege & Attorney Work-Product Doctrines in an In-house Setting* http://www.acca.com/education03/am/cm/611.pdf

SCENE TWO: THE LONG ARM OF THE TRANSACTION

Presentation Guide

A. What concerns does the proposed loan sale raise?

- It appears that there may be a conflict between (1) the bank's interests and (2) Bannister and his family's personal interests.

- In particular, Bannister's explanation of the transaction raises a number of legal issues:

  - Bannister mentions that "family connections" are important to the bank's business in Russia and Eastern Europe, suggesting the possibility of unlawful conduct (*e.g.*, violation of the Foreign Corrupt Practices Act, which prohibits bribery and other corruption in overseas business dealings).

  - Depending on the extent of its business with these little-known foreign counterparties, the bank may also have investigative and recordkeeping duties under the "know your customer" rules required by the USA PATRIOT Act.

  - The loan guarantees to be issued to Bannister's family's companies may constitute an extension of credit by the bank, and therefore may be prohibited or be subject to significant restrictions under Federal Reserve Regulation O. For non-banks, a transaction such as this one may be subject to restrictions under Section 402 of the Sarbanes-Oxley Act.

  - SEC regulations also require the disclosure of loans to executive officers and their family members.

- Should the fact that Bannister's conflict was not disclosed in the relevant documents, and disclosed only after Grant pressed him on the issue, be enough to raise a concern?

  It appears that Bannister was prepared to present the transaction to the committee without discussing his conflict. In addition, the conflict and/or lack of its disclosure may violate the bank's code of conduct.

  If it turned out that Bannister did not personally negotiate the loan sales, how would that fact affect the extent or nature of the conflict?

B. Is it appropriate for Grant to characterize the inquiry as coming from Nelson?

Should Grant be more assertive and explain that Nelson's inquiry is also his own? Does his attitude toward Nelson's concerns minimize them and make Bannister more likely to dismiss them? If so, does this behavior reflect well on Grant's role within the bank?

C. Is Grant's glance at the woman exiting the elevator ethical?

- Case law relating to hostile work environments generally refers to severe or pervasive conduct.
- A senior lawyer's conduct, however, even if not severe or pervasive, can establish a "tone at the top" for an institution.

D. Does Grant know enough about the counterparties to the loan sale?

- Grant has no independent knowledge of the counterparties in question. Instead, his sense of their identity and their purpose is based solely on Bannister's representations. As noted, however, Bannister has a conflict with respect to the transaction.
- Grant owes a professional responsibility to the bank to form and provide his own independent legal judgment about the transaction.
- While Grant may not need to press Bannister to reconsider the prudence of the transaction from a business standpoint, he does need to push for adequate information to permit him to evaluate its legal risks.

  In addition, Grant may consider non-legal factors that may be relevant to the bank's situation.

E. What are Grant's legal and ethical obligations in this situation? How should he handle his duties to the corporation and to Bannister?

- Grant must remember that he owes his full allegiance to the bank, not to Bannister.
- Grant cannot be influenced by Bannister's personal desire to have Grant's support in the boardroom. He must fulfill his professional responsibility to give advice in the interest of the bank itself.

  This point is made prominently here, because it appears that Bannister's personal interests may be in conflict with those of the bank.

SCENE TWO: THE LONG ARM OF THE TRANSACTION

Legal Authorities

A. Duty to Avoid Influence by Personal Desires of an Organization's Constituents

- Although the ABA Model Code has been superseded by the ABA Model Rules, Ethical Consideration 5-18 of the Code provides further guidance about the duties of a lawyer representing an organization:

  > A lawyer employed or retained by a corporation . . . owes his allegiance to the entity and not to a stockholder, director, officer, employee, representative, or other person connected with the entity. In advising the entity, a lawyer should keep paramount its interest and his professional judgment should not be influenced by the personal desires of any person or organization [within the entity].

- SEC Rule 205.3(a) also addresses this issue:

  > That the attorney may work with and advise the issuer's officers, directors, or employees in the course of representing the issuer does not make such individuals the attorney's clients.

B. Duty to Take Measures to Avoid Violations

- ABA Model Rule 1.13(b) requires a lawyer for an organization to take measures if an officer of the organization intends to act in a way that violates a legal obligation to the organization and the act is likely to result in substantial injury to the organization:

  > 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.

- SEC rules issued under Section 307 of the Sarbanes-Oxley Act require reporting of material violations of applicable laws. These rules are discussed in detail in Scene Four.

C. Code of Conduct

- Both the NYSE and Nasdaq require listed companies to adopt codes of business conduct and ethics for directors, officers and employees. These codes must cover conflicts of interest and require any waiver for directors or executive officers to be approved by the board (or a board committee) and to be promptly disclosed. *See* Section 303A, sub. 10 of the NYSE Listed Company Manual; NASD Rule 4350(n).

- Item 406 of SEC Regulation S-K requires all registered companies to disclose whether the company has adopted a code of ethics for their "principal executive officer, principal financial officer, [and] principal accounting officer or controller, or persons performing similar functions." If the company has not adopted such a code of ethics, it must explain why it has not done so. SEC Rule 229.406(a). To satisfy the regulation, a company's code of ethics must promote "[h]onest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships." SEC Rule 229.406(b)(1). If an executive is exempted from following the code in a certain course of events, such a waiver must be disclosed publicly. *See* SEC Rule 229.406(d).

D. "Know Your Customer" Rules

Section 326 of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT) Act added a new provision to the Bank Secrecy Act requiring agencies to adopt rules "setting forth the minimum standards for financial institutions and their customers regarding the identity of the customer that shall apply in connection with the opening of an account at a financial institution." Pub. L. 107-56 § 326(a) (USA PATRIOT Act); 31 U.S.C. § 5318(*l*) (Bank Secrecy Act, as amended). These so-called "know your customer" rules require financial institutions to implement reasonable procedures to verify the identity of any person seeking to open an account, to maintain records of the information used to verify the person's identity and to determine whether the person appears on any lists of known or suspected terrorists or terrorist organizations provided to the financial institution by any government agency. *Id.* In April 2003, the Treasury, the Financial Crimes Enforcement Network and the SEC jointly adopted final regulations to implement such rules. 68 Fed. Reg. 25113.

E. Section 402 of the Sarbanes-Oxley Act and Federal Reserve Board Regulation O

- Limitations on Extensions of Credit by Non-Banks

  Section 402 of the Sarbanes-Oxley Act amended the Securities Exchange Act of 1934 to prohibit covered companies from making or arranging any extension of credit in the form of personal loans to or for their directors or executive officers. Pub. L. 107-204 § 402 (Sarbanes-Oxley Act); 15 U.S.C. § 78m(k) (Securities Exchange Act, as amended). Loans made or maintained by an FDIC-insured depository institution are exempt if the loans are subject to the insider lending restrictions of Federal Reserve Regulation O. 15 U.S.C. § 78m(k)(3).

- Limitations on Extensions of Credit by Banks

  The Federal Reserve's Regulation O governs the extension of credit by a bank to an executive officer, director or principal shareholder of the bank. It also applies to any extension of credit by a bank to another company controlled by such a person. 12 C.F.R. § 215.1(b). For the purpose of determining control of another company, shares owned or controlled by a member of a person's immediate family are considered to be held by the person. 12 C.F.R. § 215.2(m). Extensions of credit covered by Regulation O include the issuance of a standby letter of credit and other similar arrangements. 12 C.F.R. § 215.3(a)(3).

  No bank may extend credit to any executive officer, director or principal shareholder of the bank or to a company controlled by such a person unless the extension of credit (1) is "made on substantially the same terms (including interest rates and collateral) as . . . those prevailing at the time for comparable transactions by the bank" with outsiders, and (2) does "not involve more than the normal risk of repayments or present other unfavorable features." 12 C.F.R. § 215.4(a). In addition, significant extensions of credit to insiders must be approved by a bank's board of directors. 12 C.F.R. § 215.4(b).

F. Item 404 of SEC Regulation S-K

- Item 404 of SEC Regulation S-K requires the disclosure of any transaction exceeding $60,000 in which a registered company or any of its subsidiaries was or is a party, and in which any of the following persons has, had, or will have a direct or indirect material interest: (1) any director or executive officer of the company, (2) any nominee for election as a director, (3) any holder of more than 5% of voting securities and (4) any immediate family member of a person in any of the preceding categories. SEC Rule 229.404(a).

- For purposes of the foregoing paragraph, immediate family "shall include . . . spouse[s]; parents; children; siblings; mothers and fathers-in-law; sons and daughters-in-law; and brothers and sisters-in-law." *Id.* (instructions to paragraph).

G. Foreign Corrupt Practices Act of 1977

- As a result of SEC investigations in the mid-1970s, over 400 U.S. companies admitted making questionable or illegal payments in excess of $300 million to foreign government officials, politicians and political parties. The abuses ranged from bribery of senior foreign officials to secure some type of favorable action by a foreign government, to so-called "facilitating payments" made to ensure that government functionaries discharged certain ministerial or clerical duties (in other words, the common practice in some countries of giving small bribes to workers or law officers to get them to do their jobs). Congress enacted the FCPA to bring a halt to the bribery of foreign officials and to restore public confidence in the integrity of the American business system.

- The FCPA is discussed in more detail in Scene 4.

H. Creating a Hostile Work Environment

- Most antidiscrimination laws, such as Title VII, the Americans with Disabilities Act and the Age Discrimination in Employment Act, do not explicitly discuss harassment (speech or nonspeech). Rather, they simply bar discrimination in the "terms, conditions, or privileges of employment."

  However, courts have interpreted these words to prohibit forms of harassment under a theory of "hostile work environment" discrimination. Actionable hostile work environment discrimination is:

  - speech or conduct that is
  - "severe or pervasive" enough to
  - create a "hostile or abusive work environment"
  - based on race, religion, sex, national origin, age, disability, veteran status or, in some jurisdictions, sexual orientation, political affiliation, citizenship status, marital status or personal appearance,
  - that is actually subjectively perceived as such by an employee, and would be perceived as such by a reasonable person.

  See Harris v. *Forklift Systems, Inc.*, 510 U.S. 17 (1993) (setting the foregoing standard for hostile work environment discrimination).

- ABA Model Rule 8.4(d) provides that "[i]t is professional misconduct for a lawyer to . . . engage in conduct that is prejudicial to the administration of justice."

  Comment 3 to Rule 8.4 provides:

  > A lawyer who, in the course of representing a client, knowingly manifests by words or conduct, bias or prejudice based upon race, sex, religion, national origin, disability, age, sexual orientation or socioeconomic status, violates [Rule 8.4](d) when such actions are prejudicial to the administration of justice. Legitimate advocacy respecting the foregoing factors does not violate [Rule 8.4](d). A trial judge's finding that peremptory challenges were exercised on a discriminatory basis does not alone establish a violation of this rule.

- Lawyers with direct supervisory authority over other lawyers also have a responsibility to ensure that the other lawyers conform to the Rules of Professional Conduct. ABA Model Rule 5.1. Comment 2 to this rule notes that "the ethical atmosphere of a firm can influence the conduct of all its members."

SCENE TWO: THE LONG ARM OF THE TRANSACTION

Additional Reading

- H. Lowell Brown, *The Dilemma of Corporate Counsel Faced with Client Misconduct*, 44 BUFF. L. REV. 777 (1996).
- Kaveh Noorishad, Note, *The Sarbanes-Oxley Act and In-House Legal Counsel: Suggestions for Viable Compliance*, 28 GEORGETOWN J. LEGAL ETHICS 1041 (2005).
- Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, NYU Law and Economics Research Paper 04-032 (Sept. 25, 2004), *available at* http://ssrn.com/abstract=596101 (also forthcoming in YALE L.J.).

ACC Articles

- *Green Eye Shades For Lawyers: A Toolkit, ACC Docket* 23, no.3 (March 2005): 62-67 http://www.acca.com/protected/pubs/docket/mar05/toolkit.pdf
- *Lawyers as Whistleblowers: The Emerging Law of Retaliatory Discharge of In-house Counsel* http://www.acca.com/protected/article/governance/wrong_discharge.pdf

ACC InfoPAKS:

- *Homeland Security InfoPAK 2004* http://www.acca.com/infopaks/homeland.html
- *In-house Counsel Ethics InfoPAK 2005* http://www.acca.com/infopaks/ethics.html

ACC Annual Meeting Program Material

- Lisa E. Chang, Selena L. LaCroix, Don H. Liu, Lu Pham, & Betina W. Yip, *308 Whistle While You Work: Ethical, Fiduciary, & Other Dilemmas Facing Over-SOX'ed In-house Lawyers* http://www.acca.com/am/04/cm/308.pdf

ACC Benchmarking Resources

- *Leading Practices In Codes Of Business Conduct And Ethics* http://www.acca.com/protected/article/ethics/lead_ethics.pdf

SCENE THREE: DOCUMENT MANAGEMENT

Presentation Guide

A. How does the understaffing in Nelson's legal department affect his ethical responsibilities?

- A reduced or less qualified staff obviously impairs the ability of a lawyer to deliver timely, high-quality legal services. Thus, understaffing can compromise some of the core ethical duties of the lawyer:
  - *Diligence and Promptness*. Clients are entitled to reasonable diligence and promptness. It is a lawyer's responsibility to control her workload so that each matter is handled accordingly.
  - *Competence*. In addition, the "first rule of ethics" is competence, which requires thoroughness and adequate preparation.
  - *Adequate Supervision*. Lawyers in management roles also have an ethical responsibility to ensure that both lawyers and nonlawyers who report to them act ethically.

B. Is Nelson's delegation to Bobby appropriate? Has Nelson appropriately supervised Bobby's work?

- Given the significant responsibilities and risks that come with the subpoena and document request, when is it appropriate to delegate dealing with such tasks to nonlegal staff? In addition, when would Bobby's work cross the line into the practice of law?
- Has Nelson given Bobby appropriate and sufficient guidance as to the purpose of the email alert, the scope of documents to be retained and the persons who should receive the email?
- To what extent is Nelson responsible for Bobby's actions? Nelson recognizes that sometimes he has to remind Bobby over and over again. What should that tell him?

C. Are the bank's procedures for complying with the subpoena adequate?

- Nelson's response to the subpoena appears too casual. There does not appear to be a standard procedure for handling subpoenas.
- Under DOJ guidelines, the lack of any effective corporate compliance program to guide the bank's handling of subpoenas makes it more likely that the bank will be charged if misconduct is ultimately uncovered.

- Similarly, the lack of formal procedures reduces the likelihood that relevant documents will be retained by the bank in the first place. While this practice may or may not be good business, a charge of obstruction of justice could result from destroying or throwing away documents after a subpoena is served.

- Large banks may receive subpoenas for records nearly every day, so it may be understandable that Nelson is initially unmoved by this new subpoena. But it requires skilled legal judgment to tell subpoenas that are particularly sensitive from those that may be more routine and allowed to be widely disclosed. Has Nelson exercised such judgment? Does the bank's apparent lack of a standard procedure for handling subpoenas discourage him from taking a closer look at this one?

D. Was Nelson's phone call to Bannister appropriate? What problems does it create?

- A critical threshold question that Nelson fails to answer is to whom disclosure of the subpoena is permitted. Quite often, the existence of a subpoena may not be disclosed to the executives whose files and records are sought. Other disclosure within a corporation also may be restricted, as well as disclosure outside of the corporation.

- Subpoenas must be read carefully by their addressees to determine such disclosure restrictions. Too often, corporate counsel and others do not exercise this level of initial caution. Is Nelson guilty of this behavior? How many people read the subpoena before it came to his office?

- Nelson's phone call to Bannister could create the impression that Nelson "tipped off" Bannister to the grand jury subpoena. The call, and Grant's specific authorization of it, could lead to the conclusion that the bank is trying to protect a culpable employee.

- Arguably, Nelson has failed to create an appropriate office atmosphere in which the significance of the subpoena and the importance of strict compliance were clearly communicated to those who were responsible for it, including, if applicable, Bannister and others.

  - Nelson does not identify the types of documents that should be retained.

  - Nelson does not caution Bannister when Bannister notes that all nonessential loan files are routinely tossed, or seek to determine the legality of this procedure.

  - Nelson acquiesces when Bannister insists on identifying responsive documents himself, rather than leaving that work to the legal staff. It is dangerous to allow an executive to review and produce his own files and records. An investigator could fault both the executive's and the bank's motives in not providing stricter, more formal oversight.

- If Bannister were to alter or destroy documents, it might be concluded that Nelson had assisted Bannister's obstruction of justice. If documents are destroyed, will Nelson's and Bannister's recollections of the call be the same? Will Bannister's assistant recall that the call was "urgent"?

- Under federal law, officers, directors and attorneys of financial institutions may be subject to criminal penalties for disclosures regarding grand jury subpoenas, including disclosures to persons named in the subpoenas and disclosures "with the intent to obstruct a judicial proceeding." Because such intent is sometimes liberally inferred by investigators and prosecutors, especially in the past several years, corporate counsel should take great care that their clients are not required to fall back on a defense based on lack of intent.

- If the foregoing restrictions on financial institutions are not applicable, a federal prosecutor can formally request non-disclosure of information about a grand jury subpoena by recipients. For a subpoena not so designated, however, a prosecutor might still informally ask that the subpoena remain confidential. Compliance with such a confidentiality request can be considered by prosecutors in evaluating the extent and authenticity of a company's cooperation.

- Great discretion is necessary to respond properly to subpoenas. Discussing a subpoena with the government body that issued it may help to clarify the level of disclosure that will be considered appropriate. Does Nelson or Grant stop to consider making such a call before talking to Bannister?

E. Has the bank adequately cooperated with the government subpoena and investigation? Has Grant's and Nelson's conduct affected the bank's cooperation?

- Several elements of Grant's and Nelson's behavior make it likely that a prosecutor will determine that the bank failed to cooperate under DOJ guidelines. Inadequate cooperation may negatively affect the resolution of an investigation.

  - Grant's emphasis on keeping things from "moving too quickly" raises concerns that the bank will collect and disclose documents in a manner that is neither timely nor complete. If this approach impairs the eventual production of documents, it may be considered an attempt to impede the government's investigation.

  - Nelson has not taken effective steps to ensure that the bank does not conceal, alter or destroy documents that are responsive to the subpoena. If responsive documents become unavailable after the service of a subpoena, the bank will be critically vulnerable to a charge of obstruction of justice.

This is particularly true because Nelson alerts interested bank executives the same day he receives the subpoena, but permits Bobby to wait until the next day to send out a document retention notice.

F. Should Grant and Nelson represent the bank in response to a subpoena investigating a transaction that they both were involved with?

- It appears that Grant, and probably Nelson, worked on and processed the loan sale transaction, notwithstanding any reservations they may have had about it. However, neither considers the ethical propriety of responding to the subpoena and potentially defending an incident in which he directly participated.
- Lawyers are prohibited from representing clients in matters in which they have personal interests. Other considerations, however, are also relevant:
  - What if Grant and Nelson are called as witnesses in the investigation?
  - Would a prosecutor or outside party question the results of any review or judgment call that Grant or Nelson made in connection with the investigation and the bank's response?
- In this circumstance, it may be prudent for either other in-house lawyers or outside counsel to represent the bank in this matter. Grant and Nelson should also consider retaining their own counsel insofar as the ongoing investigation may involve their own conduct.

SCENE THREE: DOCUMENT MANAGEMENT

Legal Authorities

A. Understaffing and Its Implications for Attorney Conduct

- Diligence

  ABA Model Rule 1.3 requires that "[a] lawyer shall act with reasonable diligence and promptness in representing a client." Comment 2 to Rule 1.3 specifically provides that "[a] lawyer's work load must be controlled so that each matter can be handled competently."

  Courts considering the matter have concluded that it is a lawyer's responsibility to control her workload and that she can be disciplined for delay and procrastination for failure to do so. *See, e.g.*, *In re Fraser*, 523 P.2d 921 (Wa. 1974), *overruled by In re Boelter*, 985 P.2d 328 (Wa. 1999) (overruled on other grounds involving attorney's fees).

- Competence

  ABA Model Rule 1.1 requires that "[a] lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation."

- Supervision of Other Lawyers

  ABA Model Rule 5.1(b) provides that "[a] lawyer having direct supervisory authority over another lawyer shall make reasonable efforts to ensure that the other lawyer conforms to the Rules of Professional Conduct." The measures required will depend on the nature of the lawyer's practice and the structure of her department. In some cases informal supervision is all that is required, and in other cases more elaborate procedures may be necessary. *See* Comment 3 to ABA Model Rule 5.1.

  Under certain circumstances, a lawyer may be held responsible for another lawyer's violation of the rules of professional conduct. *See* ABA Model Rule 5.1(c). In addition, professional misconduct by a lawyer under supervision could reveal a violation of the supervisory obligations imposed by ABA Model Rule 5.1(b).

B. Delegation to, and Supervision of, Nonlawyer Assistants

- Supervision of Nonlawyer Assistants

  With respect to nonlawyers "employed or retained by or associated with" a lawyer, the "lawyer having direct supervisory authority over the nonlawyer shall make reasonable efforts to ensure that the person's conduct is compatible with the professional obligations of the lawyer." ABA Model Rule 5.3(b). Comment 1 to ABA Model Rule 5.3 provides that "[a] lawyer must give [nonlawyer] assistants appropriate instruction and supervision concerning the ethical aspects of their employment" and that "[t]he measures employed in supervising nonlawyers should take account of the fact that they do not have legal training and are not subject to professional discipline."

  New York Disciplinary Rule 1-104(C) requires corporate legal departments adequately to supervise the work of nonlawyers in the department. It notes that "the degree of supervision required is that which is reasonable under the circumstances, taking into account factors such as the experience of the person whose work is being supervised, the amount of work involved in the particular matter, and the likelihood that ethical problems might arise in the course of working on the matter."

  Under certain circumstances, a lawyer can also be responsible for conduct of a nonlawyer that would be a violation of the rules of professional conduct if a lawyer engaged in such conduct. *See* ABA Model Rule 5.3(c); New York Disciplinary Rule 1-104(D).

- Limits on Delegation

  A lawyer shall not help any person to "practice law in a jurisdiction in violation of the regulation of the legal profession in that jurisdiction." ABA Model Rule 5.5(a).

  The definition of the practice of law is established by state law or applicable agency regulations. In addition, ABA Model Rule 5.5(a) does not prohibit a lawyer from employing the services of nonlawyers and delegating functions to them, "so long as the lawyer supervises the delegated work and retains responsibility for their work." Comment 2 to ABA Model Rule 5.5.

C. Cooperation with Federal Investigation of a Corporation

- Relevance of Cooperation to Federal Prosecution

  The Department of Justice has issued guidelines that instruct federal prosecutors when they decide whether, and to what extent, to seek criminal charges against a business organization. These guidelines were recently revised to increase "emphasis on and scrutiny of the authenticity of a corporation's cooperation." Memorandum from Larry D. Thompson to Heads of Department Components and United States Attorneys at 1 (Jan. 20, 2003), and attached Principles of Federal Prosecution of Business Organizations (the "*Thompson Memo*"). Generally, prosecutors are directed to reserve leniency for corporations that fully and adequately cooperate with government investigations in accordance with the guidelines.

- Completeness of Disclosure

  An important factor to be weighed by a prosecutor in determining the adequacy of a corporation's cooperation is the completeness and timeliness of its disclosure to federal authorities. Thompson Memo § 4. Complete disclosure may also include a "waiver of attorney-client and work product protections, both with respect to its internal investigations and with respect to communications between specific officers, directors and employees and counsel." *Id.* The guidelines stress that such waivers "are often critical in enabling the government to evaluate the completeness of a corporation's voluntary disclosure and cooperation." *Id.*

- Appearance of Protection of Culpable Employees

  Prosecutors must also consider "whether the corporation appears to be protecting its culpable employees and agents." *Id.* In particular, the guidelines express a negative view of corporation support for employees in the form of advancing attorney's fees, retaining employees without sanctioning their misconduct or providing information to employees pursuant to a joint defense agreement. *Id.*

- Conduct Impeding an Investigation

  Prosecutors must consider "whether the corporation, while purporting to cooperate, has engaged in conduct that impedes the investigation," regardless of whether such conduct rises to the level of criminal obstruction of justice. Thompson Memo § 6. Such conduct may include inappropriate directions to employees or their counsel, presentations or submissions that contain misleading statements or omissions, incomplete or delayed production of records and failure promptly to disclose known illegal conduct. *Id.*

- Corporate Compliance Programs

  DOJ guidelines also direct prosecutors to evaluate the design and efficacy of corporate compliance programs when deciding whether or not to seek charges against a corporation. Particularly relevant to this evaluation is "whether the program is adequately designed for maximum effectiveness in preventing and detecting wrongdoing by employees and whether corporate management is enforcing the program [rather than] tacitly encouraging or pressuring employees to engage in misconduct to achieve business objectives." Thompson Memo § 7. Evaluation of such corporate compliance programs also includes the corporation's procedures and policies concerning cooperation with government investigation of potential wrongdoing.

- Cooperation in SEC Enforcement Actions

  The SEC also has emphasized the relevance of a corporation's cooperation in SEC enforcement actions. It has set forth criteria similar to those of the DOJ that it "will consider in determining whether, and how much, to credit self-policing, self-reporting, remediation and cooperation – from the extraordinary step of taking no enforcement action to bringing reduced charges, seeking lighter sanctions, or including mitigating language in documents we use to announce and resolve enforcement actions." SEC Exchange Act Release No. 44,969, at 2 (Oct. 23, 2001) (the "*Seaboard Release*").

D. Obstruction of Justice

- Criminal Penalties for Destruction of Documents

  Section 802 of the Sarbanes-Oxley Act provides for criminal penalties for persons who knowingly destroy or alter any document or record "with the intent to impede, obstruct, or influence [an] investigation" under the jurisdiction of the United States. Pub. L. 107-204 § 802(a) (amending 18 U.S.C. § 1519).

- Criminal Penalties for Causing Another Person to Withhold or Destroy Documents

  Under 18 U.S.C. § 1512(b), criminal penalties may be imposed on anyone who "knowingly uses intimidation, threatens, or corruptly persuades another person, or attempts to do so, or engages in misleading conduct toward another person, with intent to (1) influence, delay, or prevent the testimony of any person in an official proceeding; or (2) cause or induce any person to (A) withhold testimony, or withhold a record, document, or other object, from an official proceeding [or] (B) alter, destroy, mutilate, or conceal an object with intent to impair the object's integrity or availability for use in an official proceeding."

- "Corrupt Persuasion" and the Recent *Arthur Andersen* Case

  In 2004, the Fifth Circuit upheld a conviction of national accounting firm Arthur Andersen for obstructing an SEC investigation of Andersen's work for Enron Corporation in the years before its spectacular collapse. *United States* v. *Arthur Andersen*, 374 F.3d 281 (5th Cir. 2004). Andersen executives were alleged to have known that an SEC investigation was imminent, but to have continued to direct subordinates to destroy relevant documents up until they actually received subpoenas. This behavior was held to violate 18 U.S.C. § 1512(b)(2)(B) notwithstanding that there was no clear prohibition at the time with respect to destroying documents on one's own behalf before a subpoena was issued. *See* 374 F.3d at 292-300.

  On May 31, 2005, a unanimous Supreme Court overturned Arthur Andersen's conviction. 544 U.S. ___, 2005 WL 1262915 (May 31, 2005). The Court's inquiry was narrow, focusing only on the deficiencies in the instructions to the jury. The Court found that "[p]ersuading a person with intent to cause that person to withhold testimony or documents from a Government proceeding or Government official is not inherently malign." *Id.* at *4 (internal citations omitted). However, the jury had been instructed that it could find Andersen guilty even if Andersen "honestly and sincerely believed that its conduct was lawful." *Id.* at *6 (internal citations omitted). The Court concluded that "[o]nly persons conscious of wrongdoing can be said to knowingly corruptly persuade . . . . [which] the jury instructions at issue simply failed to convey." *Id.* at *5-6 (internal citations omitted). Corporate counsel should note, however, that this holding does not eliminate the crime of corrupt persuasion and that the Court did not reach the question of whether Andersen *was* conscious of wrongdoing.

E. Disclosure of Grand Jury Subpoenas

- Rule 6(e) of the Federal Rules of Criminal Procedure establishes rules for secrecy related to federal grand jury proceedings. Rule 6(e)(6) provides:

  > Records, orders and subpoenas relating to grand-jury proceedings must be kept under seal to the extent and as long as is necessary to prevent disclosure of a matter occurring before a grand jury.

  Rule 6(e) applies to government attorneys, grand jurors and other agents of the court. It generally does not apply to witnesses.

- Notwithstanding this limitation on the applicability of Rule 6(e), the Right to Financial Privacy Act prohibits disclosure of certain federal grand jury subpoenas for financial institution records. 12 U.S.C. § 3420(b). Applicable penalties are set out in companion provision 18 U.S.C. § 1510(b). The criminal penalties include fines and a maximum prison term of five years if an officer, director, partner, employee, agent or attorney of or for a financial institution notifies, directly or indirectly, any person regarding the existence or contents of a covered subpoena with the intent to obstruct a judicial proceeding. *Id.* §§ 1510(b)(3)(A), 1510(b)(1). In addition, fines and a maximum prison term of one year may be imposed if notification is made, directly or indirectly, to a customer of the financial institution whose records are sought, or to any other person named in the subpoena. *Id.* § 1510(b)(2). Because these penalties apply to *indirect* notifications, they highlight the need for a strict, formal policy for dealing with receipt of subpoenas.

- Additionally, prosecutors can request that non-disclosure provisions be added to other subpoenas. *See* Fed. R. Crim. P. Rule 6, Advisory Committee Notes, 1983 Amendments (available in 18 U.S.C.A.). Prosecutors also may informally request that the existence or contents of a subpoena remain confidential.

F. Subpoenas for Bank Records in Money Laundering Suits

- In many federal actions involving the seizure of money or other assets alleged to be the proceeds of unlawful activity, any party may subpoena books, records and any other documents of any financial institution. 18 U.S.C. § 986(a). For transactions in connection with which such federal actions may arise, see 18 U.S.C. §§ 1956 (financial transactions to promote or disguise the nature of unlawful activity), 1957 (financial transactions in criminally derived property), and 1960 (unlicensed money transmitting).

- The disclosure prohibitions of the Right to Financial Privacy Act, discussed in Section E above, apply to any subpoena issued under Section 986(a) in connection with a possible crime under Section 1956 or § 1957. 12 U.S.C. § 3420(b)(1)(A); 18 U.S.C. § 1510(b)(3)(B)(i).

- In these statutory provisions, "unlawful activity" is given an expansive definition that includes (1) offenses against foreign nations involving murder, kidnapping, extortion, fraud, bribery or embezzlement, (2) racketeering activity and (3) violations of a great number of other laws and sections of laws, as listed. *Id.* § 1956(c)(7).

G. Conflicts of Interest

- ABA Model Rule 1.7(a)(2) provides that "a lawyer shall not represent a client" when that representation might be "materially limited . . . by a personal interest of the lawyer." New York Disciplinary Rule 5-101 similarly explains that "[a] lawyer shall not accept or continue employment if the exercise of professional judgment on behalf of the client will be or reasonably may be affected by the lawyer's own financial, business, property, or personal interests."

SCENE THREE: DOCUMENT MANAGEMENT

Additional Reading

- Roger C. Cramton, *Enron and the Corporate Lawyer: A Primer on Legal and Ethical Issues*, 58 BUS. LAW. 143 (2002).

- David B. Fein, *First, Do No Harm*, LEGAL TIMES, Sept. 28, 1998.

- Bruce A. Green, *The Criminal Regulation of Lawyers*, 67 FORD. L. REV. 327 (1998).

- Michael B. Himmel & Christopher S. Porrino, *When a Criminal Investigation Hits, It's No Longer Business as Usual*, N.J. L.J., Oct. 9, 1995.

- Paul J. Lambert, *Allegations of Misdeeds Call for Caution: When a Company Is under Criminal Investigation, Counsel Must React Swiftly but Also Need to Avoid Ethical Violations*, NAT'L L.J., Nov. 1, 1999.

ACC Articles

- Jay A. Brozost & Lawrence S. Goldman, *Grand Jury Investigations: A Guide for In-house Counsel ACC Docket* 21, no. 7 (July/August 2003): 58-72 http://www.acca.com/protected/pubs/docket/ja03/grandjury.pdf

- Mark J. Fucile, Peter R. Jarvis & Michael Roster, *Timing Is Everything: When Document Retention Policies And Related In-House Counsel Advice Intersect With Government Investigations And Litigation, ACC Docket* 20, no. 5 (May 2002): 18-31 http://www.acca.com/protected/pubs/docket/mj02/timing1.php

- Margaret Self & Derek M. Meisner, *Under The Magnifying Glass: Seven Steps To Living Through An SEC Investigation, ACC Docket* 23, no. 4 (April 2005): 22-31 http://www.acca.com/protected/pubs/docket/apr05/glass.pdf

- John K. Villa, *What Can You Tell Your Employees When the Feds Arrive to Question Them? ACC Docket* 20, no.1 (January 2002): 90-92 http://www.acca.com/protected/pubs/docket/jf02/ethics1.php

ACC InfoPAKS:

- *Records Retention InfoPAK 2005* http://www.acca.com/infopaks/recretent.html

- *Responding to Government Investigations InfoPAK 2004* http://www.acca.com/infopaks/govtinvest.html

ACC Benchmarking Resources

- *Leading Practices in Crisis Management and the role of in-house lawyers: What Companies Are Doing*
  http://www.acca.com/protected/article/crisismanage/lead_crisis.pdf
- *Leading Practices In Information Management And Records Retention Programs*
  http://www.acca.com/protected/article/records/lead_infomgnt.pdf

SCENE FOUR: DO YOU HAVE A MINUTE?

Presentation Guide

A. Does Nelson have a current attorney-client relationship with Jenny? Is Jenny's "confession" privileged?

- The attorney-client relationship will depend on Jenny's purpose in communicating with Nelson and her reasonable expectations.
  - Broadly speaking, privilege attaches to communications to an attorney made in an attorney-client relationship for the purpose of obtaining legal advice.
  - Depending on Jenny and Nelson's relationship and her understanding of his role within the bank, Jenny's communication may be privileged.
  - The facts that Nelson has helped Jenny in the past with legal issues and that she is establishing a relationship of trust would be considered in determining whether an attorney-client relationship exists.
- Does the fact that Nelson discusses with Jenny the need to "get you a lawyer" mean that her communications to him are not privileged? Would it matter if Nelson had stopped Jenny from continuing?
- Nelson may be in possession of information that he may not be permitted to disclose, even though he would need to do so in order best to represent the bank.

B. How should Nelson have handled his conversation with Jenny?

- Jenny's confession poses one of the most difficult ethical issues faced by corporate counsel: what to do when an employee of the corporation seeks legal advice but may have interests that are adverse to the corporation.
- In many cases, corporate counsel should stress that she represents the corporation and not the employee, notwithstanding the fact that the corporation has an interest in encouraging employees to speak with corporate counsel if they have issues or concerns.
- It is equally important to remind the employee that what he or she says is not necessarily confidential and that by default any privilege that does exist belongs to the corporation, not to the employee.
- How should corporate counsel balance (1) the risk of giving warnings when not required and therefore discouraging disclosure with (2) the risk of improperly establishing an attorney-client relationship with an employee?

- Even if Nelson did not immediately recognize the conversation with Jenny as a request for legal advice, is there a point when he should have stopped her? Was it appropriate for Nelson to continue to ask questions during the conversation? Should Nelson have been on guard in light of the fact that he knew Jenny was working with Bannister and on the loans?

- Furthermore, Nelson advised Jenny to be reticent and suggested that she not be too quick to volunteer information to investigators. Is this advice proper to give to someone who is not an attorney's client and whose interest in disclosing information to investigative authorities may turn out to be adverse to the attorney's client?

C. What kind of information about possible wrongdoing has Nelson received?

- Based on Jenny's statements, there is a strong possibility that Bannister, Jenny and the bank have violated the Foreign Corrupt Practices Act, which prohibits a company and its employees from bribing officials in overseas business affairs.

- For banks, making a false statement in the books or records of the bank may also be a crime.

- Jenny also asserts that other executive officials, including Grant, the general counsel, were involved in, or at the least knew about, this conduct.

D. What should Nelson do with Jenny's information? Does he have to do anything?

- Under the Sarbanes-Oxley Act, Nelson must report this information "up the ladder" to Grant.

  - This responsibility is triggered if Nelson has received, through Jenny, "credible evidence" of a "material violation" at the bank.

  - If Nelson reports directly to Grant and does not get an appropriate response from Grant, Nelson must report further up the ladder to the bank's board or board audit committee. If Nelson did not report directly to Grant, he would be permitted, but not required, to report further up the ladder.

- What if Nelson concludes that the information he received from Jenny is subject to attorney-client privilege? Can he still report up the ladder?

- For financial institutions, certain violations of law also give rise to an obligation to file a suspicious activity report. This obligation, however, is the bank's, not Nelson's.

E. Can Nelson continue to represent the bank in light of what he has heard? Must he quit his job?

- One of the most difficult dilemmas for corporate counsel is how, consistent with applicable rules of ethics, to continue to represent a client that she suspects is violating the law.

- In light of Jenny's revelations, Nelson must assess whether he can, and whether he wishes to, continue to work as a lawyer at the bank.

- The only applicable circumstance in which Nelson would be compelled to resign is if his continued employment would result in the violation of a disciplinary rule.

  - This does not appear to be the case, because no one has insisted that Nelson engage in unethical conduct going forward.

  - If, in the future, Nelson's superiors at the bank did insist that he violate an ethical rule – for example, by asking him to draft fraudulent documents – and he could not persuade them otherwise, then he would be obligated to resign.

- Nelson has the option of resigning if the bank has used Nelson's services in the past to perpetrate violations of law, even if his resignation would harm the bank. Under New York rules, Nelson would have the further option of resigning if his continued employment were likely, but not substantially certain, to result in the violation of a disciplinary rule.

- Even if Nelson resigns, his professional responsibility under the Sarbanes-Oxley Act continues.

SCENE FOUR: DO YOU HAVE A MINUTE?

Legal Authorities

A. Attorney-Client Privilege and Confidentiality of Client Information

- General Standard for Privilege of Confidential Communications

  The attorney-client privilege attaches to information when, in the context of an attorney-client relationship, that information is a confidential communication made to an attorney for the purpose of obtaining legal advice or services. *See, e.g.*, *New York* v. *Mitchell*, 58 N.Y.2d 368, 373 (1983); N.Y. C.P.L.R. § 4503(a); Restatement (Third) of the Law Governing Lawyers § 68 (2000). In determining whether a communication was made for the purpose of obtaining legal advice or services within the context of an attorney-client relationship, the "primary consideration is the reasonable expectations of the person in the position of putative client." Restatement (Third) of the Law Governing Lawyers § 72 cmt. c (2000).

  Generally, an attorney-client relationship will exist and privilege will attach if a client "consults to gain advantage from the lawyer's legal skills and training . . . even if the client may expect to gain other benefits as well, such as business advice or the comfort of friendship." *Id.* Other considerations in evaluating whether a communication is made for legal purposes include "the extent to which the [lawyer] performs legal or nonlegal work, the nature of the communication in question and whether or not the [lawyer] has previously provided legal assistance relating to the same matter." *Id.*

- Attorney-Client Privilege in the Corporate Setting

  Communications by employees to corporate counsel are generally protected by an attorney-client privilege, but by default that privilege belongs to the corporation as "client," not to the employees as individuals. *See Upjohn* v. *United States*, 449 U.S. 383 (1981). Courts have used many different tests to determine when the privilege may instead belong to employees as individuals. *See United States* v. *International Brotherhood of Teamsters*, 119 F.3d 210, 215 (2d Cir. 1997) (outlining the varying standards of the Third Circuit, Massachusetts, Michigan and New York; rejecting under all of them an employee's contention that he was represented by his employer entity's attorney). Most of these tests require some signal by an employee to corporate counsel that she is seeking advice only in a personal capacity, but this requirement is sure to be highly ambiguous as a matter of fact.

  Furthermore, even though an employee may not in fact have an attorney-client relationship as determined by one of the above judicial standards, the corporate counsel involved may have fallen short of the ethical rules that should guide her conduct. New York Ethical Canon 4-1 explains that a lawyer must preserve all confidences "of one who has employed or sought to employ the lawyer."

- Prohibition on Disclosure of Client Confidences

  A lawyer shall not reveal confidential client information unless the client gives informed consent or the disclosure is otherwise permitted or required (*e.g.*, when disclosure is necessary to prevent a crime). ABA Model Rule 1.6; New York Disciplinary Rule 4-101.

B. Conflicts of Interest

- Between Multiple Parties in General

  ABA Model Rule 1.7(a) proscribes a lawyer's representing more than one client when "the representation of one client will be directly adverse to another client" or "there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client."

  New York Disciplinary Rule 5-105(B) dictates that "[a] lawyer shall not continue multiple employment if the exercise of independent professional judgment in behalf of a client will be or is likely to be adversely affected by the lawyer's representation of another client, or if it would be likely to involve the lawyer in representing differing interests."

  Additionally, although a lawyer may discontinue representation of one of two adverse parties, the lawyer will then owe an obligation to the former client "not thereafter [to] represent another person in the same or a substantially related matter in which that person's interests are materially adverse to the interests of the former client unless the former client gives informed consent." ABA Model Rule 1.9(a); *accord* New York Disciplinary Rule 5-108(A).

- Between Organization and Constituent

  ABA Model Rule of Professional Conduct 1.13(a) dictates that "[a] lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents."

  SEC Rule 205.3(a) under Section 307 of the Sarbanes-Oxley Act provides that an attorney appearing and practicing in the representation of an issuer "owes his or her professional and ethical duties to the issuer as an organization."

  Comment 7 to ABA Model Rule 1.13 outlines the duties of a lawyer when the interest of his or her organizational client is adverse to one of its constituents. In these cases a lawyer "should advise any constituent . . . that the lawyer cannot represent such constituent, and that such person may wish to obtain independent representation." A lawyer must also take care that the constituent understands that the lawyer cannot represent him or her and that discussions between the lawyer and the constituent may not be privileged.

New York Disciplinary Rule 5-109(A) provides that "[w]hen a lawyer employed or retained by an organization is dealing with the organization's directors, officers, employees, members, shareholders or other constituents, and it appears that the organization's interests may differ from those of the constituents with whom the lawyer is dealing, the lawyer shall explain that the lawyer is the lawyer for the organization and not for any of the constituents."

- Client Confidences in Conflicted Representations

  ABA Model Rule 1.9(c) provides that "[a] lawyer who has formerly represented a client . . . shall not thereafter: (1) use information relating to the representation to the disadvantage of the former client . . . or (2) reveal information relating to the representation," except in the limited circumstances described above in reference to current clients.

C. Advising a Non-Client against Giving Information to Authorities

- Voluntary Disclosure of Information

  According to ABA Model Rule 3.4(f), a lawyer generally shall not "request a person other than a client to refrain from voluntarily giving relevant information to another party." However, an explicit exception is available when the person is "an employee or other agent of a client," and the lawyer "reasonably believes that the person's interests will not be adversely affected by refraining from giving such information." ABA Model Rule 3.4(f)(1)-(2).

- Assertion of Fifth Amendment Privilege

  Whether a lawyer may advise a non-client that she can or should assert her right against self-incrimination under the Fifth Amendment is unsettled. An older ABA opinion concluded that merely informing someone of the existence of that right is not improper. *See* ABA Comm. on Prof. Ethics, Informal Op. 575 (1962).

  Case law, however, is divided. *See State* v. *Fosse*, 424 N.W.2d 725 (Wis. App. 1988) (defense lawyer barred from advising prosecution witnesses of Fifth Amendment protections); *People* v. *Wolf*, 162 Ill.App.3d 57 (Ill. App. 1987) (defense lawyer not barred from advising potential government witness of Fifth Amendment protections); *see also In re Blatt*, 324 A.2d 15 (N.J. 1974) (sanctioning lawyer who advised potential witnesses to remain silent before federal grand jury investigation).

D. Reporting "Up the Ladder" under the Sarbanes-Oxley Act

- Framework of the Reporting Requirement under the Sarbanes-Oxley Act

  SEC standards of attorney conduct adopted under Section 307 of the Sarbanes-Oxley Act apply to in-house and outside counsel handling securities matters for SEC reporting companies. SEC Rule 205.3(b)(1) requires attorneys to report to the reporting company's chief legal officer any "evidence" of a "material violation" of certain U.S. securities and corporate laws. An attorney must report further up the ladder to the audit committee of the board, another independent committee of the board or the full board if the attorney does not receive an "appropriate response" from the chief legal officer. SEC Rule 205.3(b)(3).

- Events Triggering a Requirement to Report

  The reporting requirements are triggered whenever a lawyer representing an issuer becomes aware of "evidence" that a "material violation" has occurred, is ongoing, or is about to occur on the part of the issuer or one of its directors, officers or employees. Evidence must be credible such that it would be "unreasonable, under the circumstances, for a prudent and competent attorney not to conclude" that the occurrence of a violation is "reasonably likely." SEC Rule 205.2(e). A "material violation" is a material violation of federal or state securities law, a material breach of state or federal common law or statutory fiduciary duty or any similar violation. SEC Rule 205.2(i).

- Initial Reporting Procedures

  As noted, an attorney who receives evidence of a material violation must report that evidence to the issuer's chief legal officer. The attorney's reporting obligations are ended if she receives an "appropriate response" from the chief legal officer. SEC Rule 205.3(b)(8). An appropriate response is one that leads the attorney reasonably to believe that (1) no material violation has occurred, is occurring or is about to occur, (2) the issuer has adopted appropriate remedial measures or (3) the issuer, with the consent of the issuer's board of directors or a board committee, has retained an attorney to review the reported evidence and has either (a) implemented remedial measures or (b) been advised that the retained attorney may assert a colorable defense on behalf of the issuer in any proceeding related to the reported evidence. SEC Rule 205.2(b).

- Further Reporting Procedures

  If the reporting attorney does not receive an appropriate response from the issuer's chief legal officer, she must report the evidence either to the audit committee of the board, another independent committee of the board or to the full board. SEC Rule 205.3(b)(3).

- Qualified Legal Compliance Committee

  If an issuer has a qualified legal compliance committee, an attorney may report directly to that committee. If this procedure is followed, the attorney has no further obligation to determine if the response to the report was appropriate. SEC Rule 205.3(c)(1).

- Differing Reporting Requirements for Subordinate Attorneys

  An attorney under the supervision of another attorney other than the issuer's chief legal officer, such as a junior member of a corporate legal team, is required to report evidence of a material violation only to his or her supervising attorney. SEC Rule 205.5(c). This obligation to report exists even if the attorney believes that the reporting would be futile. The subordinate attorney is permitted, but not required, to engage in further up-the-ladder reporting if she believes that the supervising attorney has failed to comply with the attorney reporting rules. SEC Rule 205.5(d).

- Preemption of State Professional Responsibility Rules

  "An attorney who complies in good faith with the provisions of this part shall not be subject to discipline or otherwise liable under inconsistent standards imposed by any state or other United States jurisdiction where the attorney is admitted or practices." SEC Rule 205.6(c).

  This rule comports with ABA Model Rule 1.6(b), which provides that "[a] lawyer may reveal information relating to the representation of a client . . . to comply with other law."

- Permitted Disclosure to the SEC

  An attorney for an issuer is permitted, but not required, to reveal confidential information to the SEC without the issuer's consent to the extent that the attorney reasonably believes is necessary to (1) prevent the issuer from committing a material violation that is likely to cause substantial financial injury to the issuer or to investors, (2) prevent the issuer from committing perjury or prevent the perpetration of fraud on the SEC or (3) rectify the consequences of a material violation by the issuer if the attorney's services were used in furtherance of the violation. SEC Rule 205.3(d)(2).

E. Suspicious Activity Reports

All federal regulators of financial institutions have issued regulations requiring reporting of suspicious activity by the financial institutions that they regulate. These regulations require that a financial institution report any transaction involving any known or suspected criminal violation or pattern of violations, that is committed against or facilitated by the financial institution, and in which the financial institution has a substantial basis for identifying one of its directors, officers, employees, agents or other affiliated parties as having committed or aided in the commission of a criminal act. *See, e.g.*, 12 C.F.R. § 208.62(c) (Federal Reserve Regulation H for member banks). The regulations also require a financial institution to report certain transactions conducted or attempted by or through the financial institution. *Id.*

F. Foreign Corrupt Practices Act of 1977 (Continued)

- Prohibition of Participation in Foreign Corrupt Practices

  The FCPA prohibits U.S. companies from bribing foreign officials to obtain advantages in the conduct of their overseas business. In particular, the anti-bribery provisions of the FCPA make it unlawful for a U.S. issuer or other domestic concern, or any person acting on its behalf (including directors, officers, employees, and others), to make a payment with the intention of inducing the recipient to use his official position to direct business to the payer, or to obtain any other advantage for the payer. Forbidden "payments" include actual payments, offerings and promises to pay money or anything of value. The recipient may be a foreign official, a foreign political party or party official or even a candidate for foreign political office. 15 U.S.C. §§ 78dd-1(a), 78dd-2(a).

- FCPA Sanctions

  Sanctions for violation of the FCPA include substantial criminal and civil liability, as well as administrative sanctions affecting a violator's ability to do business with the federal government or to engage in certain activities regulated by the SEC, the CFTC and other administrative bodies. *See* 15 U.S.C. §§ 78dd-2(g), 78ff.

- Recordkeeping and Internal Controls under the FCPA

  The FCPA requires companies whose securities are listed in the United States to meet certain accounting provisions. Listed companies must keep records that accurately and fairly reflect the transactions of the corporation and devise and maintain an adequate system of internal accounting controls. 15 U.S.C. § 78m(b)(2).

- FCPA Compliance

  To minimize liability, companies active in foreign markets must implement adequate compliance and ethics programs. Companies with such programs in place may see civil and criminal sanctions for any wrongdoing decreased by as much as 95%. *See* Federal Sentencing Guidelines (2004), ch. 8 ("Sentencing of Organizations"), §§ 8B2.1 (on effective compliance and ethics programs), 8C2.6 (on modification of sentences based on a "culpability score").

  In addition to a compliance and ethics program, factors key to obtaining such favorable treatment are prompt reporting to the authorities once a violation has been detected, and non-involvement of high-level personnel in wrongful conduct. *Id.* §§ 8C2.5(b), (f), (g) (lowering of culpability scores due to non-involvement of high-level personnel, adequate compliance and ethics program and self-reporting of violations, respectively).

G. False Statements in Bank Books and Records

Under 18 U.S.C. § 1005:

- "Whoever makes any false entry in any book, report, or statement"
- of "any Federal Reserve bank, member bank, depository institution, holding company, national bank, insured bank, branch or agency of a foreign bank, or organization operating under section 25 or section 25(a) of the Federal Reserve Act"
- "with intent to injure or defraud such bank" or "to deceive any officer of such bank"
- "[s]hall be fined not more than $1,000,000 or imprisoned not more than 30 years, or both."

H. Withdrawal from Representation

- General Prohibition on Withdrawal from Representation

  A lawyer may not withdraw from representing a client unless withdrawal can be accomplished without material adverse effect on the interests of the client, except in certain compelling circumstances. ABA Model Rule 1.16(b); New York Disciplinary Rule 2-110(C).

- Instances in Which a Lawyer Must Withdraw from Representation

  A lawyer representing a client must withdraw, even if it cannot be accomplished without material adverse effect on the interests of the client, if it is substantially certain that continued representation will result in violation of a disciplinary rule. ABA Model Rule 1.16(a)(1); New York Disciplinary Rule 2-110(B)(2).

- Instances in Which a Lawyer *May* Withdraw from Representation

  A lawyer is permitted to withdraw from representing a client, even if it cannot be accomplished without material adverse effect on the interests of the client, if (among other possibilities) the client (1) persists in a course of action involving the lawyer's services that the lawyer reasonably believes is criminal or fraudulent, (2) insists that the lawyer pursue a course of conduct that is prohibited by rules of professional conduct, (3) insists that the lawyer engage in conduct that is fundamentally disagreeable to the lawyer or (4) has used the lawyer's services to perpetrate a crime or fraud. ABA Model Rule 1.16(b); New York Disciplinary Rule 2-110(C). The New York rule is more specific than the ABA rule in explaining that a lawyer *may* withdraw if her continued employment is *likely*, but not substantially certain, to result in the violation of a disciplinary rule.

SCENE FOUR: Do You Have a Minute?

Additional Reading

- William H. Simon, *The Confidentiality Fetish: The Problem with Attorney-Client Privilege*, ATLANTIC MONTHLY, Dec. 2004, at 113.
- William M. Sullivan & Kevin M. King, *Know Whether the Benefits of Voluntary Disclosure Outweigh the Risks*, N.Y. L.J., July 7, 2003.
- Steven N. Machtinger & Dana A. Welch, *In-House Ethical Conflicts: Recognizing And Responding To Them*, *ACC Docket* 22, no. 2 (February 2004): 22-36 *available at* http://www.acca.com/protected/pubs/docket/feb04/conflict.pdf
- John K. Villa, *Ethics & Privilege: Hidden Storms for Those in Safe Harbors: The SEC's Professional Conduct Rules and the Federal Preemption Doctrine, ACC Docket* 22, no.2 (February 2004): 81-85 *available at* http://www.acca.com/protected/pubs/docket/feb04/ethics.pdf

ACC InfoPAKS:

- *Attorney-Client Privilege InfoPAK 2005* http://www.acca.com/infopaks/attclient.html
- *In-house Counsel Ethics InfoPAK 2005*
- http://www.acca.com/infopaks/ethics.html
- *In-house Counsel Standards Under Sarbanes-Oxley InfoPAK 2005* http://www.acca.com/infopaks/sarbanes.html

ACC Annual Meeting Program Material

- Michael G. McCarty, Cisselon S. Nichols & Laura Stein, *611 Attorney-Client Privilege & Attorney Work-Product Doctrines in an In-house Setting* http://www.acca.com/education03/am/cm/611.pdf

Corporate Professional Responsibility DVD
Virtual Library Resources

Scene 1 Balancing the Balance Sheet

Attorney-Client Privilege InfoPak http://www.acca.com/infopaks/attclient.html
In-house Counsel Standards Under Sarbanes-Oxley
http://www.acca.com/infopaks/sarbanes.html
In-House Ethical Conflicts: Recognizing And Responding To Them
http://www.acca.com/protected/pubs/docket/feb04/conflict.pdf
If The Other Hat Fits-Wear It: A Guide To Effective Business Partnering
http://www.acca.com/protected/pubs/docket/oct04/partner.pdf
When Is a Lawyer Not a Lawyer?
http://www.acca.com/education2k2/am/cm/704.pdf
611 Attorney-Client Privilege & Attorney Work-Product Doctrines in an In-house Setting http://www.acca.com/education03/am/cm/611.pdf

Scene 2 The Long Arm of the Transaction

In-house Counsel Ethics http://www.acca.com/infopaks/ethics.html
Homeland Security http://www.acca.com/infopaks/homeland.html
ACCA's Statement on In-house Counsel's Appropriate Role in Ensuring Corporate Responsibility
http://www.acca.com/public/accapolicy/corpresponspolicy.pdf
Sample Policy: Foreign Corrupt Practices Law
http://www.acca.com/protected/pubs/docket/nd97/foreign-sb1.html
Respect for coworkers and other: Policy Against Discrimination and Harassment
http://www.acca.com/protected/forms/harassment/respect.pdf
710 Conflicts of Interest in the Corporate Environment
http://www.acca.com/am/04/cm/710.pdf

Scene 3 Document Management

Sample Document Retention Policy
http://www.acca.com/protected/forms/records/retention_fae.pdf
How to Respond to a Government Investigation: Protecting Applicable Privileges
http://www.acca.com/protected/reference/government/privileges.pdf
Responding to Government Investigations
http://www.acca.com/infopaks/govtinvest.html
Subpoena Checklist
http://www.acca.com/protected/reference/internali/subpoenacheck.pdf
Records Retention
http://www.acca.com/infopaks/recretent.html

Leading Practices in Crisis Management and the role of in-house lawyers: What companies are doing
http://www.acca.com/protected/article/crisismanage/lead_crisis.pdf

Scene 4 Do You Have a Minute
Attorney-Client Privilege InfoPak http://www.acca.com/infopaks/attclient.html
In-house Counsel Ethics http://www.acca.com/infopaks/ethics.html
Ethics & Privilege:Investigative Attorneys and the Reporting Obligations under the SEC's Professional Conduct Rules
http://www.acca.com/protected/pubs/docket/apr04/ethics.pdf
In-house Counsel Standards Under Sarbanes-Oxley
http://www.acca.com/infopaks/sarbanes.html