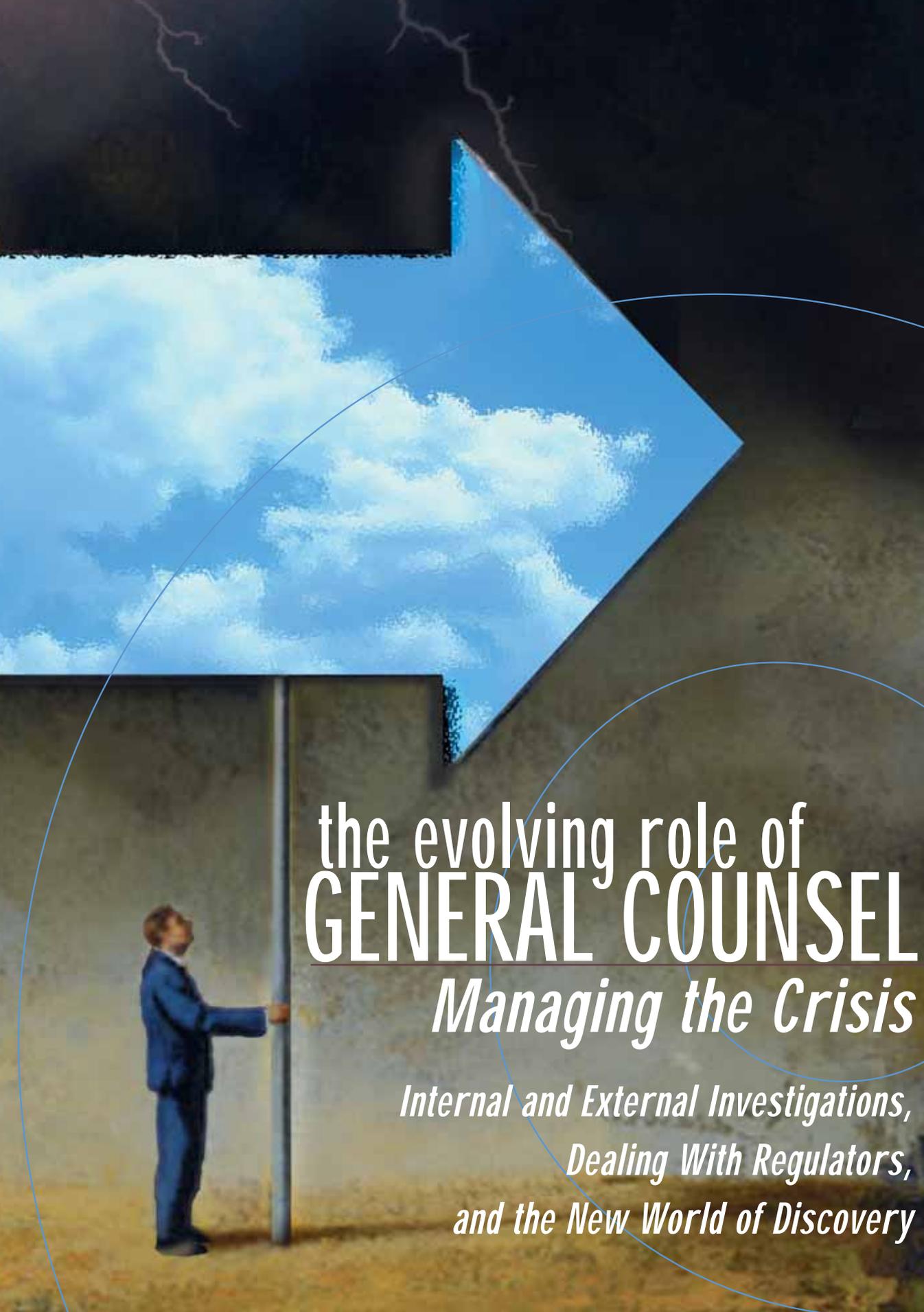


PRICEWATERHOUSECOOPERS 

presents



the evolving role of
GENERAL COUNSEL

Managing the Crisis

*Internal and External Investigations,
Dealing With Regulators,
and the New World of Discovery*

A Roundtable
Discussion

the
PANELISTS



Charles R. Hacker, Jr.
Partner
Dispute Analysis &
Investigations
PricewaterhouseCoopers LLP



Peter Lieb
Former Senior Vice President,
General Counsel
and Secretary
Symbol Technologies, Inc.



Mary Jo White
Partner and Chair,
Lawyer Litigation Group
Debevoise & Plimpton LLP



Steven L. Skalak
Partner
Global and US Corporate
Investigations Leader
PricewaterhouseCoopers LLP



Stephen M. Cutler
Partner and Co-Chair,
Securities Department
WilmerHale

TO THE READER:

Corporate governance has become a significant part of the general counsel role for all, and unfortunately for some, so too has managing corporate crisis. Dramatic changes in recent years in both the criminal and civil arenas has made the process of responding to a corporate wrongdoing an even more complex affair. Allegations of accounting improprieties or securities violations may give rise to investigations and actions by the SEC, the Department of Justice and the state Attorney Generals, as well as the plaintiffs' class action bar. Often, general counsel has to deal with all of these government and private matters simultaneously while also scrambling to ensure that audits and investigations are conducted quickly yet thoroughly.

Settlements, penalties and fines can be enormous, as are the public relations costs to the business. While the government has embraced remedies short of corporate death in deferred and non-prosecution agreements, personal liability is taking center stage. General counsel risk personal liability, in both civil and criminal forums, based on advice given to an offending company. Hopefully, the end result is a company purged of wrong-doers, reformed in culture, regulated with effective internal controls and communications, and willing to embrace the change necessary to ensure long term stability.

This was the focus of a recent roundtable discussion sponsored by PricewaterhouseCoopers, *The National* and *New York Law Journals* and the Directors Roundtable. In this lively discussion, panel members contributed perspectives from their respective areas of expertise and experience in dealing with corporate crisis. The panel included two former government attorneys — Mary Jo White, a former United States Attorney for the Southern District of New York, and Stephen Cutler, the former Director of the Securities and Exchange Commission Division of Enforcement — who led the wave of change of corporate governance and responsibility. (Both are now in private corporate practice.) At this event, Ms. White spoke about the proliferation of criminal investigations and prosecutions against companies and their employees and officers, and offered sound advice on how corporate attorneys can navigate this minefield. Mr. Cutler focused his remarks on a number of recent SEC cases brought against attorneys and the lessons to take away from those examples.

Providing further perspective from the private defense side, Peter Lieb described the significant challenges he faced as General Counsel of Symbol Technologies, Inc. in the aftermath of a widespread company fraud. He offered many insights on how to contain the damage from such cases and help the business to move forward. Adding another dimension to the discussion was Steve Skalak, Global and US Leader of the PricewaterhouseCoopers' Corporate Investigations practice, who commented on the role and expectations of auditors and how to manage this process.

This highly informative roundtable discussion, edited here for clarity and brevity, is included as a special supplement to *The National* and *New York Law Journals*. It is produced by the marketing department of ALM Media, Inc., independent of *The National Law Journal* and *New York Law Journal* editorial staff.

—Brian Corrigan, Esq.



MR. HACKER: In the past few years, reading about corporate malfeasance has become almost commonplace. Each day there seems to be a new SEC or government investigation that has in-house counsel scrambling to make sure that their company is preserving, not shredding documents, is competing, not colluding with business partners, and is providing fair disclosure to the public, as well as complying with a myriad of other regulations. Five to ten years ago, a general counsel did not have to worry about things like compliance with Sarbanes-Oxley, billion dollar class action settlements, and 100 million dollar SEC fines. They weren't concerned about the threat of being investigated by the SEC, DOJ and state attorney generals all at once while also fighting off plaintiff's attorneys, and even the possibility of personally being sued by the SEC or private litigants. The general counsel of the new millennium has to be prepared to deal with the convergence of all of these threats and more. We have seen a dramatic change in securities litigation and regulation enforcement, and today's general counsel needs to juggle more than ever before.

Today's panel on the evolving role of the general counsel in managing crisis includes two distinguished professionals that helped generate the wave of change

in corporate governance and responsibility. Mary Jo White is the former United States Attorney for the Southern District of New York where she oversaw the successful prosecution of some of the most important national and international matters including complex white collar and international terrorism cases. Today she is the chair of the litigation department at Debevoise & Plimpton. Stephen Cutler is the former Director of the Securities and Exchange Commission Division of Enforcement and led the division through some of the most active years in SEC history, overseeing the agency's investigations of Enron, WorldCom, HealthSouth and others. He is currently a partner at WilmerHale.

While Mary Jo and Steve played key roles in creating the wave, our next panel member, Peter Lieb, unfortunately, got hit by it as a general counsel brought in to clean up a corporation during a crisis. Peter was the senior vice president, general counsel and secretary of Symbol Technologies from October of 2003 through February of 2006.

Our final panelist, Steve Skalak, has over 25 years of experience in auditing and forensic accounting investigations involving matters brought by the SEC, DOJ and civil litigants alleging violations of securities and exchange acts.

Before we hear from the panelists, let's take a look at a few recent trends and statistics from the 2005 PricewaterhouseCoopers' Securities Litigation study. Although shareholders class actions declined in 2005 from the previous year, settlements have increased dramatically, averaging approximately 72 million dollars each. This is approximately four times higher than it was in 2002. The settlement cost of the average shareholder class action alleging accounting error or fraud was even higher at 94 million dollars. This is over five times higher than 2002, and those averages exclude the largest settlements—WorldCom and Enron. For several years, Cendant was the only billion dollar class action settlement and no others were even close. Now there are six members of the billion-dollar club. In addition to the class action settlements, the SEC is imposing hefty penalties and fines with five of them exceeding 100 million dollars.

One last observation is that since 2002 over 30 enforcement actions have been initiated by the SEC against lawyers who are serving as corporation counsel or directors or officers. These cases reflect the SEC's strong desire to ensure that lawyers do not aid and abet violations of federal security laws. That alone ought to convince you that the role of

PETER LIEB,

was the Senior Vice President, General Counsel and Secretary for Symbol Technologies, Inc. from October 2003 through February 2006. In that position, Lieb negotiated settlements with the US Attorney's



Office for the Eastern District of New York, the Securities and Exchange Commission, and various classes alleging securities fraud by Symbol's former management. Earlier in his career, Mr. Lieb was a partner at Jones, Day, Reavis & Pogue and an Assistant U.S. Attorney for the Southern District of New York. Mr. Lieb started his legal career clerking for the Judge Amalya L. Kearse, and the Hon. Warren E. Burger, Chief Justice of the United States.

// The first thing you need to do in these situations with the government is cooperate. If you're going to cooperate, go all the way. In our case, the fraud was widespread and there was an obstruction and the government could have surely indicted us. They could also have offered a deferred prosecution agreement but instead they agreed to a non-prosecution agreement. And I think that the single biggest reason was that we did absolutely everything to help the government. That was critical. **//**

the corporate counsel has certainly changed.

I now introduce Peter Lieb who will talk about his experience as general counsel of Symbol Technologies.

MR. LIEB: Let me start off by telling you the situation at Symbol Technologies, a 1.8 billion dollar a year high tech company, when I arrived in October 2003 as the new general counsel. Symbol had just completed an internal investigation from which it was discovered that widespread fraud had been committed at various levels in the organization, but largely at the top. A former CEO was indicted and is now a fugitive in Sweden. Numerous other former senior managers were indicted; six or seven have pled guilty. There was a trial that just ended in February in a mistrial due to a hung jury and it is going to be retried next January.

When I arrived there was an awful lot to do. We had the grand jury investigation that was still ongoing, an SEC investigation that was ongoing, and numerous class actions that had been filed. A subsidiary of Symbol that we had acquired had committed securities fraud, and there were numerous class actions pending. As of October 2003, we had not filed our form 10K for the year 2002 so we were, obviously, late, which didn't sit well with the New York Stock Exchange. We had not settled with the former management. And lastly, we had a board of directors in place that had been the board when all this activity took place, although there was no evidence of participation on their part in the underlying fraud.

The fraud at Symbol was widespread. Most of the fraud wasn't terribly creative, just one of those quarters-end driven deals where at the end of the quarter the numbers weren't as good as management wanted. My guess is that at the beginning, there was simply aggressive accounting. At some point, though, it turned into outright improper accounting and fraud: playing with revenue recognition; bringing sales into the earlier quarter to make the revenue numbers; and, playing with reserves that had been set up for a rainy day to cover expenses.

It was nothing that hadn't been done before, with one exception, and that was a stock option scheme. The scheme allowed executives to get the second best price in the 30-day period from the exercise of the option instead of getting the price on the actual day of the exercise. Obviously, nothing in the plan documents permitted that.

Apart from all these problems, there was a culture of intimidation. Culture is incredibly important at corporations. If you have a culture of intimidation and you see something that's wrong, you are going to be reluctant to raise your hand. Putting aside the legal and accounting issues, it also impacts the business itself. An employee might recognize that certain business practices, even if ethical and legal, are not working to the benefit of the company, but if there is a culture of intimidation, he or she isn't likely to bring it to someone's attention.

Another problem is that Symbol operated as a silo organization. People in finance didn't talk to people in legal. So if somebody in finance detected an accounting problem but he didn't talk to the legal department, you can see how that could delay the fraud

from being uncovered and dealt with.

In 2003 when I arrived, we didn't document our financial controls. Today we document our controls as a result of Sarbanes-Oxley but that's not what we did in 2003. We didn't have many procedures and policies that made sense. Internal audit had no authority in the company.

So, what did we do? About six months later, we signed a non-prosecution agreement with both the United States Attorney's Office for the Eastern District of New York and the SEC. There are three possible outcomes in U.S. Attorney cases, and the non-prosecution agreement is the best outcome for a corporation in this situation. In that outcome, the U.S. Attorney does not file a criminal complaint, but you still enter into an agreement to do certain things in order to improve the company and maintain those improvements. At the same time, you have to settle separately with the SEC. Hopefully, the U.S. Attorney and the SEC will coordinate, and in Symbol's case they did, so the requirements in the two agreements are basically parallel.

More serious is a deferred prosecution agreement. That's essentially where the government files a criminal complaint against the company but says, "you don't have to file an answer." You enter an agreement with the government to do certain things, and provided that you comply with the agreement, after a period of time, the government agrees to dismiss the complaint.

The most serious of the three outcomes is indictment. Symbol could have been indicted; we had no defense.

Part of the agreement involves payment of money. We paid 37 million dollars to a restitution fund. About this time, the SEC had decided that this money would have to be a penalty. We would not get it reimbursed by insurance and couldn't deduct it. There was a 3 million dollar payment to the postal inspectors as part of the settlement with the government. On the same date we settled the class and agreed to a 96 million dollar settlement, again, with this money going to the shareholders who had been victimized by these events.

As part of the U.S. Attorney's Office and SEC agreements, we had to acknowledge what we did. That was probably one of the easiest things for our company to do because the new management team concluded that it was a good thing. We have 5500 employees, 99 percent of whom are honest, ethical people who may simply have been intimidated by the former management. It was important to acknowledge what had been done so that employees would realize that we're not going to BS about this; we are going to tell the truth, and we are going to get on improving the business and do it differently.

We had to agree to continue to cooperate with the U.S. Attorney's Office. If any of you are going through this, go in with your eyes open. The government usually ends up indicting people and they seek your help to do so. I am still paying the bills because there was a prosecution that resulted in a mistrial. Very often the government will ask for our help, and of course, if it's in the middle of a trial they need that help quickly. With outside attorneys helping, it ends up costing a lot.

We had to agree to a court-appointed examiner. The issue there is whether to secure the services of a monitor or an examiner. A monitor tends to be somebody who will spend a lot of time at your premises year-round whereas the examiner comes, maybe, once a quarter, if that, and then spends a lot of time with you at the end of each year. In a case like Symbol's, the examiner is a lawyer, and one of the things that the examiner has to do is to make sure that your controls are good. Well, they didn't teach me about controls in law school; I assume that they didn't teach any of you about controls in law school. So the examiner has to hire an accounting firm to assist him as his expert.

You should expect concerns by your management relating to whether the examiner's auditors agree with your current auditors. You also have to hold the hands of your current auditors who may be worried that they are going to be criticized. As the general counsel, I am responsible for the relationship with the examiner. You've got to manage that and make sure that goes smoothly because your auditors are very important and, obviously, your examiner is important.

We also had to agree to a formal training program. There were certain things that we had to do to educate people about basic accounting and fraud and our code of conduct. But we've actually put together a more robust training program to help change the culture and the attitudes of people.

Apart from the fact that this fraud was widespread, we had the added problem of an obstruction, which I suspect is not uncommon. So the investigation really went in two phases. In the first phase, everything was minimized and to some extent, the results were rigged. In the "come-to-Jesus" meeting with the SEC, the SEC likely possesses more information than the people conducting the meeting are aware of. They say, "hey, you're not helping; in fact, you're hurting yourself. We are going to do all sorts of things that will make it very difficult to run your company unless you get your act together." This results in the audit committee getting, obviously, very upset. Fortunately in our case, a terrific outside lawyer did a very thorough investigation and finally uncovered the facts.

With a fraud this widespread, all of our financial statements had to be thoroughly reviewed. We needed a Big Four accounting firm to assist our outside counsel in doing that. Once this investigation got on the right track, we had to have constant communication with the government as to the progress we were making. Initially, this communication was in part due to the fact that they didn't trust us. And then as they began to trust us, they wanted to know what we found because it helped them with their investigation. Just to give you an idea of the extent of this investigation, the fees were approxi-



mately 50 million dollars, which for a company our size, 1.8 billion dollars in sales, was quite significant. To put that in perspective, every 3 million dollars in expense costs our shareholders a penny in earnings. And so, 50 million bucks, it's about 17 cents in earnings that went to this investigation.

What are some of the things that we did after October 2003? Although the board itself was not involved in the wrongdoing, it was important for a variety of reasons to get a new board. We separated the role of the Chairman of the Board of Directors and the CEO. That's an interesting thing. We could have a whole panel discussion on that. But it's

obviously a good check and balance. If you have a good chairman and a good CEO who do not have big egos, they can have a good working relationship without the board becoming too actively involved in the CEO's responsibilities.

Virtually all of our board members are independent. Obviously, the more independent board members you have, the better the governance is going to be. And three of our board members have an enormous number of years in accounting, audit and control experience.

We had some board committees that didn't have charters. We had an audit committee whose charter was outdated and noncompliant. So we put together new charters. Our board, for a host of reasons, had a lot of meetings. A typical company will have six to eight board meetings a year, but in 2004, we had 23 board meetings.

We had completely new management culminating in a new CEO who was appointed ten weeks after I was hired. And, ultimately, we replaced our auditors. Obviously, we wanted to be transparent, not only internally, but also with the investing public. We were very honest and open in this critical period.

We changed our code of conduct. We put in place new governance guidelines, new insider trader guidelines. We put in a whistle-blower program. I think that most companies today have them, but we didn't at the time, and we established a fraud and abuse hotline that people could call directly and bypass management. They could go directly to the board with any issue.

Our internal audit department had obviously been ineffective. Now, the head of internal audit reports directly to the audit committee, and that ensures the integrity of what they are doing. We now have all sorts of training including fraud awareness training.

There are basically three things that we tried to do to transform the company. Focusing on people, process and systems covered the people end of things. We also hired a chief ethics and compliance officer whose full-time responsibility is to ensure the highest ethical conduct by people in the company. Process is very important. Sarbanes-Oxley is a big part of that, but there are other processes that are important to ensure that you have controls that operate the way that they should. You need good systems. Symbol was a company that primarily operated on an Excel spreadsheet. If there are lots of Excel spreadsheets on a lot of computers that are not tied together, you can see how it might be difficult to prevent or uncover fraudulent conduct, so you go to a system like SAP which centralizes the finance and accounting function.

The audit committee has a structured role with regular meetings with important stakeholders or people in management who can help to ensure that it is well-informed. The meetings are private so people are not reluctant to say what's really on their minds.

I've alluded to the need to change culture. I think the most important thing that you do in a situation like this is communicate widely and deeply and with mind-numbing consistency. I will give you an example. My former CEO, Bill Nuti, who is now the CEO at NCR, is one of the best CEO's in the

MARY JO WHITE,

Chair of the over 225-lawyer litigation group of Debevoise & Plimpton LLP, concentrates her practice on internal investigations and defense of companies and individuals accused of



involvement in white collar corporate crime or SEC and civil securities law violations, and on other major business litigation disputes and crises. For nearly nine years, Ms. White served as the first and only woman United States Attorney for the Southern District of New York, widely recognized as the premier U.S. Attorney's office in the country, where she successfully led investigations and prosecutions of large-scale white collar and complex securities and financial institution frauds and international terrorism cases from the 1993 bombing of the World Trade Center to the investigation of the September 11, 2001 destruction of the twin towers.

/// And the law is very much the prosecutor's friend, not the company's friend...I used to say that charging a company is like shooting at a fish in a barrel, because once you had one person, you could, if you so decided, indict the entire company. Obviously, indicting an entire company can have awesome consequences, even corporate death. Witness Arthur Andersen. ///

world, and he wants the absolute best results for the company and that's communicated to his company's employees. But employees also need to know that there are other values that are important to the company. So, just before the end of the quarter, Bill would send out an e-mail or a voice mail — he was quite effective with voice communications — saying, "Look, I want the absolute best quarter that we possibly can have. We owe it to our shareholders. But that said, having accurate financial statements is of greater importance to our company than one quarter's results. And so, if you see anything at all that may be wrong, well, then it probably is wrong. Don't do it, and report it." I was so proud of him for doing this, in part, because usually the lawyers beg the CEO to say this and nobody had to ask Bill to do it.

That "tone at the top" was critical because people knew that if the numbers weren't good for one quarter, that's fine, the next quarter we would make it up. Yes, if you didn't do a good job executing your sales plan, it could be a problem. But you had an even bigger problem if you played a game in order to make your numbers.

We had all-hands meetings, leadership forums, company-wide e-mails — and because people don't always read e-mails — voice mail communications. That's how we got out the communication.

I will tell you, there were a lot of problems. There were days that I didn't know whether the company was going to survive, and I worried about our situation a lot. But here is what I took from all of this. The first thing you need to do in these situations with the government is cooperate. If you're going to cooperate, go all the way. I mentioned to you the three levels of resolution with the government. In our case, the fraud was widespread and there was an obstruction and the government could have surely indicted us. They could also have offered a deferred prosecution agreement but instead they agreed to a non-prosecution agreement. And I think that the single biggest reason was that we did absolutely everything to help the government. That was critical.

The second thing that was critical was change. The change has got to be genuine and you have to be able to demonstrate it. As I mentioned earlier, you've got to communicate in order to change the culture. It can lead to a good legal result as our example demonstrates.

You need to get these situations behind you as quickly as you can. Obviously, you have to be thorough in your investigation and get it done properly. But get it behind you because the business can't live with this indefinitely. In our case, the fact that this one criminal trial resulted in a mistrial and the case will not be retried until January 2007 is a drag on our business. When the mistrial was announced our stock lost five or six percent in one day. Finally, you obviously have to run your business effectively because it doesn't do any good if at the end of the day, the business goes to pot and the shareholders suffer because you have a bad business.

MR. HACKER: Our next speaker will be Mary Jo White.

MS. WHITE: I want to talk about the criminal aspects

of major crisis, which is more and more a component of it. General counsel, company counsel, SEC practitioners and accountants never used to need to know much about the criminal enforcement of federal and state securities laws and other laws. They tended to be relevant for the defenders of the most egregious miscreants that none of us worked for or represented.

Well, that really has changed both for individuals and for companies. Prosecutors across the country have become very active, routinely joining forces with the SEC in parallel investigations and cases, and criminalizing actions that a few years ago no one would have thought of as a criminal matter. Many of the so-called earnings management cases that we have seen in the last few years fall into that category.

I think the proliferation of criminal investigations and prosecutions in this arena has been an accident waiting to happen. Why do I say that? Well, in part because the SEC's civil securities fraud powers are mirrored nearly identically in the federal criminal laws. The elements of the criminal and the civil offenses are nearly identical. Whether a case is brought civilly or criminally or both is largely a matter of prosecutorial discretion. Enron, WorldCom, Eliot Spitzer on the stage, the President's Corporate Crime Task Force in the Department of Justice, all add up to the birth of a true prosecutorial frenzy.

And the law is very much the prosecutor's friend, not the company's friend. A company is criminally culpable if even one of your employees, however low down in the organization, commits a crime in the course of his or her employment that benefits the company at least in part. Most of you know that the law approaches absolute liability, but it is breathtaking in its breadth. When I was on the "wrong" side of the aisle, I used to say that charging a company is like shooting at a fish in a barrel, because once you had one person, you could, if you so decided, indict the entire company. Obviously, indicting an entire company can have awesome consequences, even corporate death. Witness Arthur Andersen.

Federal prosecutors have guidelines for making these important, discretionary corporate charging decisions. Written guidelines were issued by the Department of Justice for the first time in 1999 under the name of the Holder Memo, named for Eric Holder who was then the Deputy Attorney General. They were then reissued on January 20th of 2003 over the signature of Larry Thompson who was then the Deputy Attorney General. It's known as the dreaded Thompson Memo in most quarters. Larry, as most of you know, is now the general counsel of PepsiCo. The Thompson Memo sets forth nine primary factors for prosecutors to score a company on. These factors are very similar to the SEC's factors set forth in the so-called Seaboard Release. The major factors that a prosecutor will weigh-in deciding whether to charge a company are how pervasive was the wrongdoing, were higher-ups involved, did management condone the fraud, did the company have an effective compliance program, did the company self-report the wrongdoing to the authorities, has the company sufficiently house-cleaned itself of the wrongdoers, has it sufficiently cooperated in the government's investigation. The New York Attorney General, by the way, doesn't

have his own set of guidelines but he and the assistant AGs use the Thompson Memo and cite it quite frequently.

Now, a biggie on all the lists is cooperation, as Peter talked about. A subset of cooperation is waiver of the attorney-client privilege, which is very problematic, especially, when it is requested by the prosecutor or the SEC. Despite their protestations to the contrary, for many prosecutors, the waiver of privilege has become a litmus test for cooperation. Even where the government lacks sufficient evidence at the time and there might not even be a crime, the message at the outset of an investigation is often, "waive the privilege, give us the information or the company faces a very serious risk of being indicted." So I encourage you to read the Thompson Memo, read the Seaboard Release, memorize them and take them to heart because they will affect what happens to your company.

MR. HACKER: Do they ever not seek the waiver of the privilege at this point in time?

MS. WHITE: They don't always seek it. It varies from office to office. They will dance around it a little bit. But we are now attuned to this, and we are afraid that if we don't come in and waive, we'll be scored down. You will hear the supervisors of the various offices say that they don't routinely ask for the waiver of the privilege. But those of us in the trenches know quite differently. In my view, the government attorneys shouldn't be asking for a waiver nearly as often as they are, especially when they don't truly need it to do their job.

For example, say that in the course of an internal investigation, outside counsel had talked to someone from the company who the government regards, let's say, rightly so, as the worst wrongdoer. Then that wrongdoer pleads the Fifth Amendment when the government wishes to question him. The government doesn't want to immunize that person because he is at the top of the bad food chain. And so they come to the company and say, "we want to know what he said to you." I think from the government's point of view, that's justified.

MR. CUTLER: Mary Jo, the Justice Department recently issued a memo that essentially requires all U.S. Attorney offices to develop their own policies or procedures for elevating these sorts of issues. Do you think that portends a change in how the department and U.S. Attorney's Offices around the country will approach requests and demands for waiver of privilege?

MS. WHITE: What Steve is referring to is a memo issued, I believe in October 2005, by Robert McCallum, the acting Associate Attorney General. The memo instructed the U.S. Attorneys to develop a written review process in each of their offices but didn't specify what has to happen before the line attorneys can ask for a waiver of the privilege. I take it as a positive sign. I hope that it will result in some moderation. But in the experience of many of us in the field, while it is good to get a supervisor in the chain before the line attorney asks for a waiver, it is

often the supervisor who is the biggest problem. So we'll see what happens. I do think that this memo does reflect some greater sensitivity.

MR. CUTLER: I know that senior people in the department and at the SEC, me included when I was there, essentially disclaim responsibility for seeking waivers on a blanket basis. Would your practice point be to try to elevate, wherever you could, a request for a waiver? I know within the SEC there is a policy that waivers should not be sought unless the request has been reviewed and approved at a senior level.

MS. WHITE: Absolutely, take it up the chain. Regarding the SEC, despite its policy of obtaining approval for requests for waiver, the staff attorneys nevertheless routinely ask for your interview memos from the start. So, I think that there is a disconnect on that issue between practice and policy.

MR. CUTLER: When I was at the SEC, I always distinguished between the after-the-fact internal inquiry and the advice given to the company at the time of the act under investigation. I don't think the government actually wants to put a chill on companies seeking legal and other advice concerning the propriety of engaging in a particular business practice.

MS. WHITE: I think that the first request you get - in virtually every case - is for your interview memos from the internal investigation. I don't think that it is justified to ask for even that in every case. But once that is asked for, if there is an issue of what the advice was back when the events occurred, it's not very long before the government requests information about that as well. But it is usually not the first request made.

MR. LIEB: How do you counsel a company about the fear of challenging line attorneys about a request for interview memos? People have got to be worried that if they threaten to take the matter to the line attorney's supervisor, they may anger the person making the charging decision.

MS. WHITE: That's a concern with almost every issue in the investigation. It does help that the SEC has a policy about this and it now helps that the U.S. Attorney's Office is going to have a similar policy. But you have to pick your battles because if you alienate the line assistant, that's about the worst thing you can do. On the other hand, because this issue has received so much attention, I think the line assistants are accustomed to having this question taken above their heads, usually, without a price to the company under investigation. But you should still do this very carefully.

MR. CUTLER: : When I started practicing in this area, I remember a partner telling me that defending against an SEC investigation was like litigating with both your adversary and your judge. That's the mindset that I bring to the practice. You do have to be incredibly careful. You do have to appeal decisions in such a way that you actually are a supplicant; you can't handle it the way you would private litigation. That was one of the biggest mistakes I saw when I was in government practice.



STEPHEN M. CUTLER,

is a partner at WilmerHale and co-chair of the firm's Securities Department. Previously, he served as Director of the Securities and Exchange Commission's Division of Enforcement, where he oversaw



the SEC's investigations of numerous financial reporting failures, including those at Enron, WorldCom, Adelphia, Tyco and HealthSouth. In addition, he led the Commission's actions involving NYSE specialists, research analyst conflicts and mutual fund market timing and revenue sharing. Mr. Cutler was a partner at Wilmer, Cutler & Pickering prior to his time at the SEC. He rejoined the firm in 2005. Mr. Cutler counsels companies on conflicts, compliance and corporate governance issues. He also conducts internal investigations and represents companies and individuals in government and self-regulatory organization investigations and proceedings. Mr. Cutler received a J.D. degree from Yale Law School, where he served as an editor of the Yale Law Journal. He received a B.A. degree, summa cum laude, from Yale University.

// The lesson of that case is, if the problem touches you, it's yours. Practically speaking, you can't argue that you didn't have a duty to bring the matter to somebody's attention. Once a matter crosses your desk, you've got to treat it as though you are the lawyer on it whether you want to be or not. //

It just doesn't work.

MS. WHITE: No question about that. You lose your credibility with the government by acting in ways that you would in civil litigation. For example, when preparing a witness for a civil deposition, you commonly advise, "don't volunteer anything." But that's not how you prepare a witness to talk to the government because the government is looking for the information. If they think you're holding back and acting as if you are a civil litigant, you're way behind the curve.

Let me move on to a couple of other topics. One of the new features of the corporate criminal landscape is the proliferation of deferred prosecution or similar agreements between companies and the U.S. Attorneys. You've been used to that in SEC matters for a long time, but now you're seeing household names across the lot being required to enter into these deferred prosecution agreements. Peter talked about this, but again to remind you of some of the common terms, you pay a lot of money typically and you admit your wrongdoing. There is none of this "don't admit or deny" like you see in SEC settlements. You allow the government in a deferred prosecution to file a charge but they don't pursue it. But it is a very ugly instrument, the charging instrument. You agree these days to a very detailed statement of facts drafted by the government. And, even if you don't think the statement is quite right, you agree not to contradict it, not only in the government proceedings but routinely, also in the civil litigations. So you are really quite hampered by that.

Other provisions include reporting to the government for a period of years on how you're enhancing your compliance programs, internal controls and often companies are required to agree to outside monitors and examiners. The terms can be similar to those in the SEC agreements but they can be worse, and the stigma is worse. Not as bad as an indictment or full fledged prosecution but Draconian nevertheless. And non-prosecution agreements — depending upon their specific terms — may not be much better.

MR. LIEB: As a practical matter, one of the biggest concerns is that if you do business with the government, having a criminal complaint filed against your company almost routinely results in a debarment investigation or a suspension order and you may lose that business.

MS. WHITE: In that case a company will try to seek in advance a waiver from such consequences. No question a non-prosecution agreement is better, the major benefit being, I think, less stigma. The charge isn't filed so you don't have those collateral consequences that Peter just described. But everything else is a matter of negotiation. "Contract of adhesion" comes to mind in talking about these agreements with the government. In the past you had prosecutors deciding not to do anything to a company that fully cooperated, housecleaned and so forth. Now, they are routinely asking for and getting these deferred prosecution agreements. I think that they are quite troubling.

MR. CUTLER: Mary Jo, you were the architect of the deferred prosecution agreement. I know we don't like to talk about that.

MS. WHITE: No, we don't. There is nothing like being cited to yourself.

MR. CUTLER: These have really proliferated, right? I can't imagine that when you gave birth to this you thought it would become routine. What do you think the limiting principle should be here?

MS. WHITE: Steve is referring to a situation in 1994 where some misguided U.S. Attorney entered into a deferred prosecution agreement with Prudential Securities. As it turned out, no individuals were charged. At the time, I thought it made sense primarily because it seemed that Prudential needed the bells and whistles going forward to enhance its compliance programs. But I certainly didn't expect to do it again myself; it was a unique situation.

I think deferred prosecutions are justified if a prosecutor, in good faith, has decided that he or she is otherwise going to indict the entity. In the case of every indictment, all of the collateral consequences to the company are bad, but you don't want to drive the company out of business, such as in the case of Arthur Andersen. Now, you may have a company that you think ought to go out of business because it continues to harm the public. But let's assume you think that it would be bad for the public interest for that company to go out of business, which is going to be the case most of the time. Then I think that a deferred prosecution can be justified because you really are holding back on the punishment, although there needs to be something that has some teeth to it in order to make sure the company understands the severity of the situation.

The other instance where I think it can be justified is where, even if the prosecutor is not on the brink of indicting, it is necessary to change the corporate culture of a company that has had a lot of problems over the years.

Read one of these agreements because they have become standard fare now. By the way, there's been a terrific attempt to collect all of these agreements, both non-prosecution and deferred, by the *Corporate Crime Reporter*. They came out with a report in December 2005 and they have a website (www.corporatecrimereporter.com). The Justice Corporate Crime Task Force also has a website.

Let me talk briefly now about parallel proceedings. That's when you have multiple adversaries facing you at once -- the class action bar, the SEC, the Department of Justice, Eliot Spitzer, the other AGs around the country, the Departments of Insurance, you name it. The law is quite encouraging of that kind of cooperation and there is an old Supreme Court case, *U.S. v. Kohler*, that essentially endorses parallel proceedings.

This year, however, there was a rather remarkable decision that came out of the District of Oregon, *United States v. Stringer*, 2006 WL 44193 (D. Or. Jan. 9, 2006) which is now on appeal to the 9th Circuit. The district court dismissed a securities

fraud indictment on the grounds that the working relationship between the SEC and the U.S. Attorney in the investigation violated the defendant's Fifth Amendment due process rights. The judge found that the government intentionally deceived the defendants by actively concealing that the U.S. Attorney's Office had targeted the defendants for likely criminal prosecution, and then deliberately stayed out of sight while the SEC proceeded to investigate with behind-the-scenes guidance and help from the U.S. Attorney's Office. Not knowing that they were under criminal investigation, the defendants cooperated with the SEC even though they had a Fifth Amendment right not to testify. Subsequently, the evidence they provided to the SEC was the primary evidence upon which they were indicted. The defendants asserted that had they been notified of the possibility of a criminal prosecution or the fact of a criminal investigation, they would have sought a stay of the SEC proceedings, produced no documents, refused to testify, and wouldn't have given the SEC a Wells submission that had various admissions in it. Agreeing with the defendants, the court found that the concealment of the criminal investigation was an abuse of the investigative process. It's a very rare example of a court calling foul in the government's use of parallel proceedings.

MR. SKALAK: It also sounds like they didn't have a very good criminal defense lawyer.

MS. WHITE: Well, the question was asked during one of the SEC's depositions as to whether there was an ongoing criminal investigation, and the answer was found to be deceptive. But your point is still well taken. Here's what the court said. "Dismissal of an indictment is warranted if the alleged government misconduct is so grossly shocking and so outrageous as to violate the universal sense of justice. The conduct in this case meets the standard. The U.S. Attorney's Office spent years hiding behind the civil investigation to obtain evidence and avoid criminal discovery rules and avoid constitutional protections." This result is probably confined to the particular facts here but the case is important to know about if you get into a situation where you think that you are being unfairly whipsawed by the parallel proceedings.

AUDIENCE MEMBER: Would you, as a matter of course, ask the SEC attorney if there is another government agency involved in this matter?

MS. WHITE: If I suspected that, yes, I would. But if I didn't suspect it, I would not because I wouldn't

want to give them any ideas to make it any worse than it is.

AUDIENCE MEMBER: Even the most junior of SEC attorneys knows how to pick up the phone and call a U.S. Attorney's Office, so I'm not sure the question itself would prompt the phone call. But it's hard to know whether the decision in *Stringer* turns on the failure of the SEC to inform the defendant about the criminal investigation in response to a direct question, or on the fact that it appeared that the SEC was acting at the behest of the Department of Justice.

MS. WHITE: The issue was probably more at the U.S. Attorney's end than the SEC's end. There was also a similar ruling a couple of years ago in the *Scrushy* case where evidence from an SEC deposition was suppressed because of the same kind of help behind-the-scenes from the U.S. Attorney's Office.



One last thing I'll mention is another possible budding trend on the Department of Justice side. Last year there was a series of indictments and guilty pleas in the Southern District involving the sale of food to U.S. Food Service by sixteen different vendors. U.S. Food Service allegedly inflated its earnings by reducing its cost of goods sold on the basis of fictitious promotional allowances purportedly given by the vendors. The vendors were indicted for aiding and abetting the scheme by giving the outside auditors of U.S. Food Services false confirms of these so-called

promotional allowances. The U.S. Attorney's Office was clearly sending a message here, by going after all of these third-party vendors, which they might not have done in prior years. This shows that, on the criminal side, the focus is now not only on the primary wrongdoers in a securities fraud but on the aiders and abettors as well, as the SEC has been doing for awhile. You saw the same kind of third-party charges, both criminal and civil, brought in Enron, for example, and I think you should expect to see more of that.

MR. HACKER: Mary Jo, you described the thought process behind the deferred prosecution agreement. Is there a similar thought process concerning the choice between monitor and examiner?

MS. WHITE: I think prosecutors should ask themselves what is needed in the particular case. Is the company under investigation one that really needs its business monitored day-to-day, or do you just want to be sure that the agreed upon enhancements have been implemented and are taking hold? I think the quasi-monitor role is being overused in these deferred prosecution agreements.

MR. HACKER: Those agreements usually provide that the government has to approve the monitor or examiner. What criteria does the government use for that approval?

MS. WHITE: They want someone they have confidence in and someone they feel will be independent of the company.

MR. HACKER: This seems to be a good segue to Steve Skalak.

MR. SKALAK: As you heard from Peter and Mary Jo, significant difficulties confront the company when there's an investigation going on. One of the important considerations in this circumstance is how are you going to get the audit completed and the company's financial statements filed. And, I think that many times the expectations of the auditors are overlooked.

Certainly, where a significant investigation is going on, general counsel is going to have a major role in assisting with a lot of activities related to the completion of the company's financial statement audit. And it is a difficult situation. Relationships are often strained, credibility of management could be challenged, there may be finger-pointing, and unhelpful things like that.

So what can you expect from the auditors? Certainly, you can expect caution. They have good reason for being cautious. They have responsibilities arising under Section 10A of the Exchange Act and they have professional standards made more

STEVEN SKALAK,

CPA, is the Global and US Leader of the PricewaterhouseCoopers' Corporate Investigations practice. He has participated in a variety of corporate investigations relating to allegations of SEC violations, frequently involving possible accounting or auditing improprieties. In these matters, Steve has represented Audit Committees, Directors, Officers, Auditors, and Companies in class action litigation with shareholders and SEC enforcement actions. He has participated in a variety of major fraud investigations such as Diawa Bank, Sumitomo Corporation, Frankel, and Princeton Economics in which rogue executives defrauded their employers or investors. Mr. Skalak frequently serves as an arbitrator resolving commercial disputes.



// However, the fact that the internal investigation is not completed and that the board is not satisfied that a full internal investigation has been done, which drives their decisions about remediation and what they are going to do, is very problematic. You're not likely to make very much headway with the argument that, "well, there are only a few bits of the investigation to be completed internally, let's go ahead and finish the audit," as it can be the last fact discovered that changes the conclusion. //

stringent recently by the PCAOB, their new regulator. Auditors have faced substantial monetary penalties from the SEC, and class action settlements can be very significant.

I think it was Chuck that mentioned that 30 cases had been brought against attorneys recently. But since the enactment of the Private Securities Litigation Reform Act in 1995, there have been 290 class actions naming auditors, 95 of which are still active. The cumulative settlement in those is about 1.6 billion dollars, with an average of 25 million dollars each. So it's easy to see why the auditor is going to be cautious.

Another aspect of the interplay between counsel and the auditors often turns on the question of how the facts are going to be investigated. Auditors are confronted today with the PCAOB standard, AS3, on audit documentation. That standard essentially provides that any audit procedure which isn't documented will be considered to have been omitted from the audit. And if it's been omitted, the auditor is obligated to consider whether their report is correct and can continue to be relied on. As a consequence, the auditor is going to expect a full and transparent report of the findings of any internal investigation. An essential aspect of the audit process is seeking the appointment of an independent, expert investigator, typically counsel skilled in determining the credibility of the facts and the intent behind the actions that have led to a misstatement of the financial statement. The auditor needs to be able to distinguish under the accounting standards between mere error and fraud. So obtaining expert investigation by skilled counsel is critical.

Now, of course, that purpose is defeated with the assertion of privilege. We can re-open the debate about privilege and what it means vis-à-vis the auditors, but I think most auditors would take the view that the best practice in this regard is to have an understanding up-front that the findings of the investigation will not be privileged and will be shared with the audit team.

MS. WHITE: In the course of doing these 10A investigations in the last year, I have found that the auditors are asking more and more not just for the report of the findings, including whatever privileged material is relevant to that, but also for the interview memos, the extent that they exist. There is, obviously, sensitivity about that. Is that something that's considered necessary?

MR. SKALAK: I think that different auditors will have different views on this. But I think that most auditors, in seeking the facts, do not attempt to invade the region of privilege and legal advice.

In terms of whether an actual sharing of the notes is necessary, certainly where those materials are shared with the SEC, the auditor's appetite to see them as well will be greatly increased because they will have the attitude, "Well, if the regulators can see them and make judgments based on that information, why can't I?" In situations where the notes are kept confidential, there are practical means of working around the actual sharing of the notes,

for example by oral communication or summaries created for the purpose of the audit.

MR. LIEB: How do the auditors assure the company that the materials it seeks will be used for the sole purpose of determining the facts? Often these auditors are the same ones that had reviewed financial statements in the first place, and in light of the potential liability of auditors that you mentioned, might another purpose be to see what the evidence could be against the auditor himself?

MR. SKALAK: I am not sure I can answer that question as I don't have any personal experience with the restriction on the use of information exchanged in the conduct of the audit. However, as a general matter, I would observe that the facts have to be transparently exchanged. The facts may implicate the past audits in that they clearly disclose that the initial audit was deficient. The facts may also demonstrate that the audit was well done, properly designed and, that perhaps, the auditors were victim of some deceit on the part of management. What is important is that under the professional standards, the factual information has to be provided. Auditors are obligated to maintain their objectivity. So it may be a topic of discussion, if necessary, if you think, for example, the scope of suggested expansion of the investigation is not well designed. But I think in the end, the sharing of the facts and completion of financial statements has to be the first priority.

This problem of sharing the information is arising with greater frequency. We did a PricewaterhouseCoopers' Global Economic Crime Survey in 2005, and out of 3600 companies surveyed, 1200 of the respondents had been victims of an economic crime of some type. In virtually all cases — I think it was 81 percent worldwide and 90 percent in the United States — the company chose to conduct an internal investigation. So this question of what can be shared with the auditors and how that is going to take place is going to increasingly be raised.

Now, besides caution, I think that you can expect a couple of other things from the auditors. I think you can expect that the auditors will pay a lot of attention to the scope of the investigation. That's especially important because if the illegality is an isolated incident of misjudgment, or if it's some form of wrongdoing isolated to a particular operation or location within the company, it is the adequacy of the scope that is going to sustain the idea that this was not a widespread problem. I think you will find that the attention given to the scope of the investigation is greater and more important in those circumstances where there isn't a widespread problem. In the case of a widespread problem, it's easy to determine that the scope of the investigation needs to be broad and all encompassing.

MS. WHITE: I think that it is very important, as the counsel doing the 10A, to agree up-front with the auditors as to what the scope is so that you don't end up thinking you are done and then have the auditor raise other issues.

MR. SKALAK: Right, Mary Jo, but what you've raised is, in fact, very problematic under the auditing standards and the thought process that it puts on auditors. One of the auditor's expectations is that they are going to apply their knowledge and expertise to reevaluate the scope of the investigation as findings develop. In fact, the auditor is required to do so under Statement of Auditing Standard number 99, which says that the auditor must throughout the audit process, as well as at the end, evaluate the accumulated weight of the evidence determined. This means that you may very well get to the end of the 10A investigation and the auditor will state that another avenue needs to be pursued.

MS. WHITE: It's not a static scope. But I still think that it is very important at the beginning to say, "This is what we're doing and we want to be sure the auditors know what you're doing and that you, as the auditor, don't have in mind other things that are needed to be done at the outset." Clearly, the plan is dynamic as the evidence accumulates.

MR. SKALAK: I think that's clearly the best practice because it is frequently a source of tension that the scope apparently was fixed.

The other thing that is a source of tension is the idea of, whose scope is it? Many times the auditors get into this discussion of, "well you guys set the scope, we told you up-front what it was now you're asking for some other thing to be done." I have a couple of observations about that. One, that tension directly arises from the iterative nature of doing a good investigation. Two, I think that the auditors do look to the expert investigator to make the ultimate scope decision and to discuss it with management or the audit committee, whoever is supervising the investigation, so that when it's done, the investigators can say to the auditors, "look, we believe we performed a reasonable investigation and pursued all reasonable avenues of inquiry."

I think that the same sort of control of the thought process is necessary with respect to two other considerations that auditors will always have in these situations. One is, what is the impact of the findings of the company's system of controls, has a control deficiency been discovered, is it a material weakness, does it require disclosure? This necessitates a thought process by management.

The same is true of remediation. Obviously, under Section 10A, the auditors have a responsibility to learn what management's proposed remediation is and evaluate its appropriateness. But for management to ask auditors what they think is appropriate puts the auditors in a very awkward position, because it is their expectation that they should be evaluating the decisions of the investigation team and management. So I think the better formula is to test a preliminary conclusion in discussion with the auditors based on the findings of the investigation. This preserves for the auditor the ability to evaluate and assess the reasonableness of what is being proposed, which is the role assigned to them both under the Auditing Standards and under 10A.

The other issue that I think you can expect to arise is whether the auditors continue to rely on the

representations of management in completing the audit. Representations are received during an audit both informally through discussions with company employees and formally through letters of representations from senior management about the completeness and accuracy of the records and a whole host of other topics dealing with estimates and judgments that go into the financial statements. Often it is difficult to reach a conclusion about continued reliance where perhaps the evidence hasn't fully resolved the question of intent or

knowledge on the part of the member of management giving the representation. In the case of such uncertainty, the auditor may be reluctant to continue to rely on that individual's representation and may desire to obtain representations from another member of management.

Another issue is whether the auditor will conclude that the investigation should go beyond the particular matter under investigation. Auditors are obligated to consider whether there are implications for everything else covered by the audit. And that



**CHARLES R. HACKER,
JR., CPA,
CFE**

is a Partner in the PwC Investigations & Forensic Services practice located in New York City. He provides auditing and accounting investigative expertise to attor-



neys in litigation and has extensive experience in conducting and supervising fraud engagements. He has worked on matters concerning quantification of damages, lost profit claims, internal control reviews, diversion of corporate assets, employee misconduct, embezzlement, financial statement fraud, health care fraud, and contractual disputes. Mr. Hacker has assisted and participated in settlement negotiations or made presentations of investigation findings to the Department of Justice, Federal Bureau of Investigation, Office of Inspector General, Securities and Exchange Commission, and the Internal Revenue Service.

/// We have seen a dramatic change in securities litigation and regulation enforcement, and today's general counsel needs to juggle more than ever before...[recent] cases reflect the SEC's strong desire to ensure that lawyers do not aid and abet violations of federal securities law. That alone ought to convince you that the role of corporate counsel has certainly changed. ///

may trigger additional audit procedures which may take additional time and that, obviously, have to be factored in to the timetable for completion of the investigation and the audit. My point here is that you should not expect that completing the investigation is the same as completing the audit. And if the investigation is ongoing, the auditors will not likely issue their report right away since this would be in contradiction to their professional standards.

MS. WHITE: Steve, how does that work when the 10A investigation is finished but the government investigations are not over, as is typical. In a crisis, the company's priority is to get the financial statements out so it can go on with its business. How do the auditors approach that?

MR. LIEB: And often the government will not complete its investigation until they see the restated results so they know what the full scope of the problem is.

MR. SKALAK: The ongoing nature of a government investigation can be a problem but that is essentially dealt with in the audit thought process like any other contingency. However, the fact that the internal investigation is not completed and that the board is not satisfied that a full internal investigation has been done, which drives their decisions about remediation and what they are going to do, is very problematic. You're not likely to make very much headway with the argument that, "well, there are only a few bits of the investigation to be completed internally, let's go ahead and finish the audit," as it can be the last fact discovered that changes the conclusion. So I think that there's a distinct difference between the internal investigation and ongoing legal matters either by regulators or private litigants. That's an overview of what I think you can expect from the auditors in these situations.

MR. HACKER: Steve Cutler, do you have some comments about the SEC?

MR. CUTLER: Let me make just a couple of practice points regarding what you've just heard and then I will spend a few minutes on lawyers.

The first practice point I wanted to make about internal investigations is that the kinds of documents that you will create and maintain as counsel in an internal investigation have changed. When I first started doing these, when I'd hand a draft memo of an interview to one of my colleagues, he or she would invariably tell me to add a lot more mental impressions and legal analysis so that we could claim privilege or protection over this document. I don't think that's any longer the case because now the expectation is that when you do an internal investigation, you are going to have to produce it, if not to the government immediately, then to the auditors and then ultimately to the government. Today I would create interview memos that are purely factual and keep my mental impressions, legal analysis and conclusions in a separate place. If the government and auditors are

true to their word that what they really want are the facts as opposed to legal analysis — which, presumably, they can do as well — then you have a shot at protecting that stuff. If you put it all together, I think it's all gone.

A corollary is that the auditors will expect to see the factual analysis. The SEC is probably partly responsible for that because of a case it brought within the last two years against an auditor who had rendered an opinion without first receiving the results of an internal investigation. Ultimately, once auditors have it, the government is going to get it. There's been, I think, one or two opinions to the contrary, that suggest that there is some sort of common interest between the auditors and audit client. But I think that the government will take every opportunity to blow right through that assertion of a common interest privilege, particularly given concerns about auditor independence and the government's need to assess what stands behind an audit. So I think you should assume that once you do give material to an auditor, it's as good as producing it to the government. And in this day and age, it's as good as giving it to third parties as well.

I also wanted to comment on the issue of cooperation. The Commission put out a statement on corporate penalties in January which emphasized two primary factors in determining whether it would assess a monetary penalty against a corporation. The primary factors are: 1) whether the company realized a benefit from the misconduct, and 2) whether the imposition of a penalty would impose a burden on the victims of the misconduct. After these two primary factors are addressed, there is a laundry list of seven other secondary factors that the Commission will consider. Cooperation is one of those seven secondary factors. Thus, it's a fair question to ask whether cooperation will be much less of a touchstone for the Commission in determining how to address corporate misconduct in the future. It is hard to tell in the abstract and it depends on whether, if the first two primary factors suggest that a penalty is inappropriate, the seven secondary factors will not be considered at all.

I want to now talk a little bit about the Commission's cases against lawyers. In my mind, there are five notable cases over the last two years that I think any lawyer who practices in the corporate and securities area ought to be aware of.

The first is *Ira Weiss*. It's important, in part, because it is a decision of the full Commission. It was a litigated case so you've actually got a Commission opinion. The case involved a lawyer who rendered an opinion that certain municipal bonds weren't taxable. There was a question, at the time of their issuance, whether the bonds were actually taxable arbitrage bonds because the bond proceeds instead of being put into municipal projects, were going to be put into higher yielding instruments. And the IRS has a complicated, three-part test for determining whether, in such circumstances, bonds are taxable or not.

If you read the opinion, you get the sense that Weiss did very little to satisfy himself that the



municipal issuer had a clear intent at the time the bonds were issued to use the money for municipal projects within a certain timeframe, which is what's required by the IRS. And you also have the sense that along the way, he didn't do a very good job of apprising his client of the complicated test that the IRS uses. Weiss used a short-hand with the client that was somewhat deceiving. He told his client that if the issuer's intent was ultimately to use the money for municipal projects, it wouldn't matter if in fact the money wasn't used for those projects. But this was a mistranslation of the IRS test.

The SEC issued a cease and desist order against Weiss for negligence under the 33 Act, and got disgorgement of his attorney's fees of \$9,509.63. So what are the lessons of this case? First, the Commission will proceed administratively against lawyers. Twenty years ago, the Commission wouldn't have done that. Back then, the Commission only would have proceeded against lawyers in an Article 3 court.

Second, the Commission may be willing to proceed against lawyers who are merely negligent. Now, it is not clear whether the Commission would have brought this case had it known it was going to end up with a negligence-based result. Initially Division of Enforcement sought a cease-and-desist order for

scienter-based fraud, but the Commission rejected the fraud charge and only found that Weiss had acted negligently. So there's a question as to whether lawyers ought to be thinking that even negligent conduct can be the subject of an SEC action.

Third, you've got to have a sound basis for rendering advice. Weiss appears to have done very little diligence to determine whether his client could actually meet the IRS's three-part test.

Fourth, tell the client what the relevant legal standards are. I recognize that this is a hard thing to do. Sometimes business people don't want to hear all the legal mumbo jumbo. But I think one of the clear messages of this case is that the lawyer did a very poor job of communicating with the client about the IRS test that was at issue.

The second case I want to discuss was brought against David Drummond, the general counsel of Google. Between 2002 and 2004 — prior to going public — Google had issued to its employees and consultants 80 million dollars worth of stock options. It did so without registering the sale of those options or, as required under Rule 701, providing to the option recipients the financial information that was required under the rule's exemption to the registration requirement. Drummond had repeatedly failed to apprise his

client of the legal issues involved and effectively made his own decision that the risks were worth taking. Here, again, the lesson is, you've got to tell the client what the legal standards are.

The other lesson to draw from this case is that it is always wise to consult. I grew up as a lawyer at the feet of a couple of the deans of the securities enforcement defense bar, and I was always impressed that they would talk to each other about important issues they confronted in their own cases. Naturally, they wouldn't always agree with one another, but they would never make an important decision without that consultation. If you read the *Drummond* decision, you get the sense that while Drummond consulted with outside counsel early on in the process, he didn't do it again as the company was continuing along this path. So I think it is important to have colleagues to consult with.

Third is a case against John Isselmann, Jr., who was the general counsel of Electro Scientific. Electro Scientific had written off some pension liabilities that were on the company's books for employees in Asia. Through the audit process, the general counsel had received a memo that said that the pension liabilities were real liabilities and the company didn't have the right to unilaterally decide that it didn't owe that money. But Isselmann failed

to mention this to the audit committee or auditors, despite his presence at their meetings.

The lesson of that case is, if the problem touches you, it's yours. Practically speaking, you can't argue that you didn't have a duty to bring the matter to somebody's attention. Once a matter crosses your desk, you've got to treat it as though you are the lawyer on it whether you want to be or not.

Fourth is a case against the former general counsel of Millennium. That's a hedge fund here in New York that was allegedly engaged in market-timing practices. The general counsel set up the legal entities that Millennium used to hide its identity from mutual funds that were trying to kick out market timers and, therefore, to avoid market-timing restrictions. He received a six-month bar from appearing before the SEC as an attorney, and a three-year bar from serving as an officer or director of a mutual fund or an investment advisor to a mutual fund.

The lesson here is, know where the advice that you are giving and the acts you are performing fit into the larger picture. Too many times over the last five years, we've seen lawyers involved in corporate transactions, the purpose of which may have not been known to the lawyer, but which were going to get the company in trouble. You've got to understand the purpose for a particular transaction on which you are giving advice.

Finally, is the FFP Marketing case against its general counsel, Craig Scott, in connection with the

company's filing of a 12b-25 form. That's the form that you file when you're late on your financials and you want an extension, which I think most of us would think of as boilerplate. Here, the SEC found that the form used was misleading as to the reasons for the company's late filing. The general counsel and the corporation were also sued on the ground that they failed to disclose an internal investigation related to the late filing. What I take away from this case is that disclosure of any kind is the area of greatest vulnerability and exposure for lawyers. That disclosure doesn't have to be in a 10K, a proxy, or IPO documents; it could be in a press release or any other statement made to the public. Don't think because it's not a 10K or a proxy that you don't have those same disclosure concerns. You certainly do.

MR. HACKER: Steve, do you have any thoughts on what the SEC is going to be looking at in the future?

MR. CUTLER: The two areas I suspect will receive more SEC attention are hedge funds and the pink sheets/ boiler rooms/bulletin board world. At least

one commissioner has said that the Commission should focus more attention on that latter area because the SEC has spent too much time focusing on the Fortune 500.

MR. HACKER: At this point are there any questions from the audience?

AUDIENCE MEMBER: Mr. Lieb, regarding the fees paid to outside examiners and monitors who are deposited upon the company by the U.S. Attorney, are there specific terms and is their billing reviewable by the inspector general for the Department of Justice?

MR. LIEB: It depends on what you negotiate. In our particular instance, we negotiated a flat fee which had an out if there was some development that required a lot of additional investigation by the examiner.

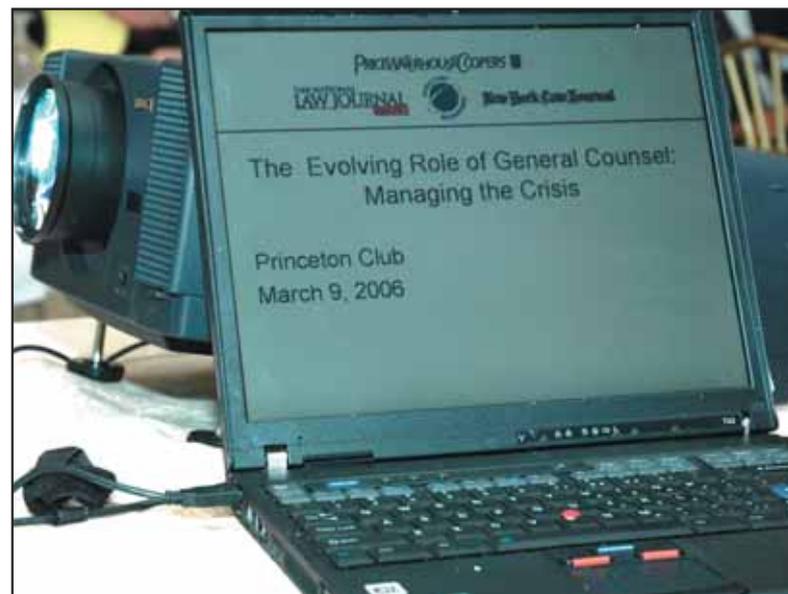
MS. WHITE: I think if you've got a court appointed examiner you should make the bill subject to court approval as opposed to a total blank check.

MR. LIEB: There may be a difference between an examiner and a monitor. With a monitor, if there is going to be a lot of investigatory and ongoing work, the monitor may not agree to a cap, and costs can get out of control. An examiner generally is a once-a-year sort of thing with an occasional phone call in the middle of the year. A flat fee may work in that case.

MR. HACKER: I had one question that was e-mailed that I would like to pose to the panel. What is the panel's opinion regarding individual directors keeping their own notes for a board meeting; should these be collected and maintained by the secretary or should they be shredded at the end of each meeting?

MR. CUTLER: Don't take notes.

MS. WHITE: Don't take notes, and don't leave the room with them. We will leave it at that. ■



About Pricewaterhousecoopers



PricewaterhouseCoopers (www.pwc.com) provides industry-focused assurance, tax and advisory services to build public trust and enhance value for its clients and their stakeholders. More than 130,000 people in 148 countries work collaboratively using Connected Thinking to develop fresh perspectives and practical advice.

The PwC Corporate Investigations practice is one of the largest and most experienced investigative groups in the world. Its international network of professionals in over 40 countries provides them with a unilateral advantage in investigating problems that extend across borders or that afflict multinational organizations. They possess a comprehensive understanding of both local and regional legal, financial and regulatory systems. Their methodology is honed from their involvement in hundreds of cases worldwide where they provide corruption and bribery services, securities litigation services and investigations & forensic accounting services.

“PricewaterhouseCoopers” refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

About Symbol Technologies



Symbol Technologies, Inc., The Enterprise Mobility Company™, is a recognized worldwide leader in enterprise mobility, delivering products and solutions that capture, move and manage information in real time to and from the point of business activity. Symbol enterprise mobility solutions integrate advanced data capture products, radio frequency identification technology, mobile computing platforms, wireless infrastructure, mobility software and world-class services programs under the Symbol Enterprise Mobility Services brand. Symbol enterprise mobility products and solutions are proven to increase workforce productivity, reduce operating costs, drive operational efficiencies and realize competitive advantages for the world's leading companies.

About Debevoise & Plimpton LLP



Debevoise & Plimpton LLP, a leading international law firm, has 650 lawyers, and offices in New York, Washington, D.C., Paris, London, Frankfurt, Hong Kong, Shanghai and Moscow. For the second consecutive year, in 2005 The American Lawyer named Debevoise the top A-List firm in the United States.

Debevoise focuses on excellence in legal services in sophisticated corporate, litigation, tax, and trusts and estates matters. The firm has extensive experience, representing clients in M&A, capital markets, corporate restructurings, financings, projects, privatizations, tax aspects of corporate transactions, executive compensation, employee benefits, asset management of high net-worth individuals and corporate fiduciary matters.

Mary Jo White, who served as the U.S. Attorney for the Southern District of New York from 1993 to 2002, chairs the litigation group. Our litigators handle complex cases involving securities, white collar crime, investigations, administrative proceedings, the First Amendment, intellectual property, products liability, international disputes and arbitration, antitrust and contract disputes.

About Wilmer Cutler Pickering Hale and Dorr LLP



WilmerHale is nationally and internationally recognized for its preeminent practices in antitrust and competition; bankruptcy; civil and criminal trial and appellate litigation (including government litigation and strategy and international litigation); corporate (including public offerings, public company counseling, start-up companies, venture capital, mergers and acquisitions, and licensing); financial services; intellectual property counseling and litigation; international arbitration; life sciences; securities regulation, enforcement and litigation; tax; telecommunications; and trade. The depth and scope of these practices provides WilmerHale with a cutting-edge blend of capabilities that enables its lawyers to handle deals and cases of any size and complexity. With a staunch commitment to public service, WilmerHale is renowned as a national leader in pro bono representation. The firm is more than 1,100 lawyers strong, with offices in Baltimore, Beijing, Berlin, Boston, Brussels, London, Munich, New York, Northern Virginia, Oxford, Palo Alto, Waltham and Washington, DC. For more information, please visit wilmerhale.com.



About The Directors Roundtable

The Directors Roundtable is a civic group which organizes the preeminent worldwide programming for directors and their advisors, including general counsel.

PRICEWATERHOUSECOOPERS 

New York Law Journal



THE NATIONAL
LAW JOURNAL