Closing Program: When "Jeopardy" Is No Longer a Game Show: Safeguarding Against Personal, Professional, & Fiduciary Liability

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J. Alberto Gonzalez-Pita is the vice president-international legal, regulatory, and external affairs for BellSouth International. He is responsible for coordinating and providing all legal, regulatory, compliance, and external affairs services for BellSouth International in Latin America, Europe, and Asia/Pacific. He is also responsible for the corporate, securities, tax, and human resources groups in BellSouth Corporation's legal department.

Mr. Gonzalez-Pita was previously an executive partner in the international law firm of White & Case where he was chair of the firm's global privatization and Latin America practice groups. While in private practice, he represented the governments of Argentina, Panama, Venezuela, and Uruguay in a number of significant transactions, including privatizations of companies in the oil, gas, power, telecommunications, and steel industries. He also represented numerous private sector companies and financial institutions in a wide variety of domestic and international corporate, lending, and securities transactions.

Mr. Gonzalez-Pita is a member of ACC, the cochair of the corporate counsel committee of the International Bar Association, and cochair of The Conference Board's council of senior international attorneys. He also is a member of the Florida Bar Association, ABA, American Arbitration Association, and Maritime Law Association of the United States.

Nancy Higgins

Nancy Higgins is executive vice president of ethics and chief ethics officer for MCI, reporting to the CEO and the MCI board of directors. Ms. Higgins is responsible for the corporation's ethics and business conduct program and related compliance oversight activities.

Prior to joining MCI, Ms. Higgins was vice president, ethics and business conduct, for Lockheed Martin Corporation. Before joining Lockheed Martin Corporation, she headed the office of ethics and business conduct for Boeing Company where she led Boeing's company-wide ethics and compliance oversight program. Earlier, she served in Boeing's law department where she managed complex corporate litigation issues. Before joining Boeing, she practiced law at the Lane Powell firm in Seattle and at Skadden Arps in New York City.

Ms. Higgins is active in the leadership of the ABA. She is a member of the Conference Board Global Council on Business Conduct, and is a corporate fellow and member of the advisory board of the Ethics Resource Center Fellows Program. She also serves on the board of trustees of BAPA's Imagination Stage, a theatre arts center for young people that celebrates innovation, diversity, and inclusion.

Ms. Higgins earned her bachelor's from Western Washington State University in Bellingham, Washington, and holds a law degree from the University of Washington in Seattle. She has completed the Advance Management Program at INSEAD, an international business school in Fontainbleau, France.

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Rebecca M. Lamberth

Rebecca M. Lamberth is a partner in Alston & Bird's securities litigation group. In her securities practice, she has successfully defended clients under the Private Securities Litigation Reform Act and received the first summary judgment decision issued following passage of the PSLRA in In re Miller Industries Securities Litigation, 12 F. Supp. 2d 1323 (N.D. Ga. 2000).

In addition to securities litigation, Ms. Lamberth concentrates her practice on professional liability defense, D&O litigation, and complex commercial litigation. She has represented law firms sued by former clients or third parties, including trustees in bankruptcy. In the context of Neal Batson's service as Examiner in the Enron bankruptcy, Ms. Lamberth has just completed an extensive analysis of numerous lawyers involved in the representation of Enron. In addition to her work in the legal malpractice field, she has handled numerous multi-million dollar class actions, trials, and mediations throughout the country, defending both corporate and individual clients. Ms. Lamberth also counsels companies regarding securities disclosure and corporate governance issues.

Ms. Lamberth has served as an adjunct professor at Emory University School of Law in legal writing and has taught or lectured in various seminars on securities regulation and litigation, legal malpractice litigation, ethics, derivative litigation, trial techniques, and insurance-related matters. She has also published "In the Wake of the Reform Act, Allegations of Accounting Fraud Receive Increasing Focus in Securities Class Action Complaints," as well as an article analyzing the SEC's rulemaking, under Section 307 of the Sarbanes-Oxley, entitled "The SEC's New Standard Governing Attorney's Conduct 'Before the Commission' Adopts An Ambiguous and Perilous Scienter Standard."

She was awarded a BA from Vanderbilt University, where she was elected to Phi Beta Kappa, graduated summa cum laude, and received the Henry Swint writing award. She received her JD from The University of Virginia School of Law.

Simon M. Lorne

Simon M. Lorne is vice chairman and chief legal officer of Millennium Partners, L.P., a multi-strategy New York-based hedge fund, with primary responsibility for the development, enhancement, and oversight of the internal control environment as well as preparation for and attention to the evolving regulatory environment for hedge funds.

Prior to joining Millenium Partners, he was at Munger, Tolles & Olson LLP, located in Los Angeles. Mr. Lorne's practice focused on corporate transactions and corporate governance issues,

particularly special committee and audit committee reviews and examinations. Mr. Lorne was general counsel for the United States Security and Exchange Commission. This office advises the chairman and commissioners on all aspects of the chairman's activities, including adoption of corporate finance, mutual fund, securities exchange and broker-dealer rules and regulations, prosecution of enforcement cases, and relations with the Congress. Mr. Lorne was managing director, Salomon Brothers and Salomon Smith Barney in New York. Activities included serving as head of global internal audit (with reporting to the audit committee of the board), member of the investment banking screening committee, and organization of the global Citigroup compliance function.

He is the author of one multi-volume treatise, one handbook for corporate directors, and a number of articles in the popular and legal press. He is also a frequent speaker and lecturer, and has taught at the University of Pennsylvania and University of Southern California Law Schools. Since 1999, he has been codirector of Sanford Law School's Directors College, the nation's premiere program for the education of corporate directors.

Mr. Lorne received an AB, cum laude, from Occidental College in Los Angeles and a JD, magna cum laude, from the University of Michigan Law School at Ann Arbor.

Lucian T. Pera

Lucian T. Pera is a member of the law firm of Armstrong Allen, PLLC, resident in its Memphis, Tennessee office. His practice is composed primarily of civil trial work, including a wide variety of media, health care, personal injury, and general commercial litigation, as well as a growing practice in the area of lawyer ethics and professional responsibility.

From 1997 through 2002, he served as a member of the thirteen-person ABA Special Commission on the Evaluation of the Rules of Professional Conduct, which was charged with reviewing and proposing any needed changes to the current ABA Model Rules of Professional Conduct. He now serves as cochair of the ABA Business Law Section Committee on Professional Conduct, and he has served as chair of the Tennessee Bar Association Standing Committee on Ethics and Professional Responsibility since 2000. He was recently appointed as chair of the ethics committee of the Media Law Resource Center's defense counsel section.

He is the editor-in-chief of the award-winning *Tennessee Ethics Handbook* (now in its fifth edition) and one of two coauthors of a free national email newsletter on ethics, *Ethics and Lawyering Today.* He is chair of the editorial board of the *ABA/BNA Lawyers' Manual on Professional Responsibility* and a member of the American Law Institute.

Mr. Pera is a graduate of Princeton University and Vanderbilt University School of Law, and he served as a law clerk to Judge Harry W. Wellford of the U.S. Court of Appeals for the Sixth Circuit.

Clifford M. Sloan

Clifford M. Sloan is vice president, business development and general counsel of Washingtonpost.Newsweek Interactive, located in Arlington, Virginia, the Washington Post Company's internet and news media subsidiary. Washingtonpost.Newsweek Interactive publishes

Washingtonpost.com and Newsweek.com. Mr. Sloan oversees all business development and legal matters for the company.

Mr. Sloan has served in various government positions, including associate counsel to the President of the United States, assistant to the solicitor general at the U.S. Department of Justice, associate counsel in the Office of Independent Counsel during Iran-Contra, and law clerk to Supreme Court Justice John Paul Stevens and U.S. Court of Appeals Judge J. Skelly Wright.

Mr. Sloan also has taught the law of cyberspace as an adjunct professor at Georgetown University Law Center, George Washington University Law School, and American University's Washington College of Law.

Laura Stein

Laura Stein is senior vice president and general counsel of H. J. Heinz Company in Pittsburgh, a global premium branded food company with sales over $8 billion. She is responsible for Heinz's global legal, ethics, and compliance, corporate secretary, and enterprise risk management matters. A member of the Heinz management committee, reporting to the chairman, CEO, and president, she is involved in increasing shareholder value, setting strategic direction and policies, and overseeing global business operations. Ms. Stein works closely with Heinz's board on corporate governance. She is a member of the Heinz ethics and compliance, crisis management, investment management, disclosure, policy, and political action committees. Ms. Stein is a director of Heinz's Foundation, promoting family nutrition, diversity, and quality of life. Ms. Stein is president of Heinz's Global Organization for the Advancement of Leadership for Women, focusing on leadership and skill development, mentoring, and volunteerism.

Previously, Ms. Stein was assistant general counsel-regulatory affairs with The Clorox Company, serving as a member of the legal management committee, Glad management committee, worldwide leadership team, 2005 strategy team, and as liaison to the Latin American management committee. She was also a business lawyer with Morrison & Foerster in San Francisco, involved in mergers and acquisitions, securities and general corporate law, financial and international transactions, and nonprofit corporate law.

Ms. Stein is a director of Nash Finch Company, a publicly traded distributor and retailer with sales exceeding $4 billion, active as a member of ACC, and of Pittsburgh Ballet Theatre. She chairs the ABA commission on domestic violence, and was invited to the White House by the President for this work. She was previously vice chair of the board of East Bay Community Law Center, and a director of Global Education Partnership. She is on the advisory board of the ABA center for human rights and the client advisory panel of Lex Mundi. Ms. Stein was elected to the American Law Institute in 2001. She was named one of Pennsylvania's "50 Best Women in Business" by Pennsylvania's Governor in 2002 and has attended *Fortune Magazine's* Most Powerful Women in Business conferences. A published author and frequent public speaker, Ms. Stein is multilingual and has lived in Italy and China.

Ms. Stein graduated, Phi Beta Kappa, from Dartmouth College. She received her JD from Harvard Law School. She also has an MA from Dartmouth College.

Closing Ethics Program:
"When Jeopardy is More than a Gameshow:
Safeguarding Against Personal, Professional, and Fiduciary Liability"

Attached is a major new treatise analyzing in-house counsel liabilities for corporate wrongdoing in the Post-Enron environment. Also attached is a recent ACC Leading Practices Profile on "Indemnification and Insurance for In-House Lawyers: What Companies are Doing."

Both are available on the ACC website (linked to the Advocacy Homepage at http://www.acca.com/advocacy/index.php), if you would like access to electronic copies.

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In the interest of providing additional material for your consideration, please feel free to peruse at your leisure any of the following additional items which relate to our topic today, and which may be of help in researching these issues further:

• "The Ideal of the Lawyer-Statesman," by Ben Heineman, then-General Counsel of General Electric, *ACC Docket* (2004):
http://www.acca.com/protected/pubs/docket/may04/ideal.pdf

• Survey: Emerging Liability/Indemnification/Insurance Issues for In-House Counsel (Executive Summary)
http://www.acca.com/protected/Surveys/governance/indem_survey.pdf

• Counseling the Corporation Post-Sarbanes-Oxley: Ethics and Professionalism Issues for In-House and Outside Counsel, (Kathryn Fenton):
http://www.acca.com/protected/legres/corpresp/counselingcorporation.pdf

• "Emerging and Leading Practices in Sarbox 307/SEC Part 205 Up-the-Ladder Reporting and Attorney Professional Conduct Programs: What Companies and Law Firms are Doing," an ACC Leading Practices Profile (2003):
http://www.acca.com/protected/article/corpresp/lead_sarbox.pdf

• Services to develop in-house compliance training through WeComply, ACC's Alliance partner; for more information on our Alliance offering with WeComply, go to http://www.acca.com/practice/alliance.php#wecomply; to find out more about WeComply, go to http://www.wecomply.com.

• "The Effective Answer to Corporate Misconduct: Public Sector Encouragement of Private Sector Compliance Programs," by William Lytton and Winthrop Swenson, *ACC Docket*, November 2002:
http://www.acca.com/protected/pubs/docket/nd02/misconduct1.php

• ACC/NACD Survey on Corporate Director and Corporate Counsel Perspectives on Corporate Governance Issues:
http://www.acca.com/Surveys/resp_corpgov.pdf

EXAMPLES OF COMPANY INDEMNIFICATION PROVISIONS

Major Specialty Retailer: By-Law Indemnity
http://www.acca.com/protected/forms/governace/dol_rfp.pdf

Multinational Chemical Company: By-Law Indemnity
http://www.acca.com/protected/forms/governance/indem_chemical.pdf

Nonprofit Enterprise: Indemnification Policy
http://www.acca.com/protected/forms/governance/indem_nonprofit.pdf

Private Aerospace Company: By-Law Indemnity
http://www.acca.com/protected/forms/governance/indem_aerospace.pdf

Private Commercial Property & Casualty Insurance Company: By-Law Indemnity
http://www.acca.com/protected/forms/governance/indem_by-law.pdf

Private Manufacturing Company: Indemnification Policy
http://www.acca.com/protected/forms/governance/indem_manufactur.pdf

Additional By-Law Indemnification Policy:
http://www.acca.com/protected/forms/governance/indem_policy.pdf

• "*The Law of Inside Counsel*" by Saul, Ewing, Remick & Saul LLP (http://www.acca.com/protected/legres/program/newjersey/upl.html)

• "*Individual Liability for the Corporate Lawyer*" by Mark D. Nozette, Susan J. Lawshe, and John K. Villa (http://www.acca.com/education99/cm99/pdf/704.pdf)

• "*Naked As A Jaybird,*" by Eriq Gardner (Corporate Counsel, 9/1/03) (http://www.law.com/jsp/cc/pubarticleCC.jsp?id=1061306535093)

• "*Another GC Readies for Trial,*" by Jason Hoppin (Corporate Counsel, 12/1/03)

• "*Post-Enron Jurisprudence,*" by John Coffee (New York Law Journal, July 17, 2003) (http://www.law.columbia.edu/media_inquiries/news/july_2003/coffee_nyljjuly)

• "*Cover Me*" by Laurie J. Sablak (Corporate Counsel) (http://www.law.com/jsp/cc/pubarticleCC.jsp?id=1071719738502).

• "*Does Your D&O Policy Cover Your In-house Legal Staff,*" (Willis Executive Risks Alert, October 2003) (http://www.willis.com/news/publications/ER_alert.pdf)

• "*Corporate Counsel Guidelines-Section 6.13,*" by John K. Villa (http://www.acca.com/protected/legres/ccguidelines/sect613.html).

• "*Legal Malpractice Liability of Employed Attorneys,*" by Dennis L. Frostic, Thomas A. Brusstar, and Suzanne Mitrovic (ACCA Docket, Fall 93) http://www.acca.com/protected/pubs/docket/fall93/legalmal.html

• "*Loss Prevention: Should a Nonprofit Carry D&O?*" by Hays Companies at http://nadco.haysaffinity.com/loss_prevention_1.aspx.

• "*Directors and Officers Liability Insurance Overview,*" by David M. Gische and Vicki E. Fishman http://profs.lp.findlaw.com/insurance/insurance5.html

• White Paper: "*Some thoughts on D&O Insurance Strategies—Post Enron,*" by Charles R. Lotter Executive VP, General Counsel & Secretary of J.C. Penney Corporation, Inc. http://www.acca.com/protected /article/governance/dol_strategy.pdf

• "*Comments of Chubb Group of Insurance Companies Re: SEC File No. 33-8150.wp; Implementation of Standards of Professional Conduct for Attorneys*" (Dec. 17, 2002) (http://www.sec.gov/rules/proposed/s74502/smfitzpatrick1.htm)

• Report of the Examiner, Neal Batson, Alston & Bird, Enron Bankruptcy Case:
Full report: http://www.acca.com/public/article/corpresp/batsonreport.pdf
Appendix C - regarding specific roles of lawyers:
http://www.acca.com/public/article/corpresp/batsonappendixc.pdf

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INDEMNIFICATION AND INSURANCE COVERAGE FOR IN-HOUSE LAWYERS:
WHAT COMPANIES ARE DOING

Part of an Ongoing Series of
ACC's "Leading Practices Profiles" SM
http://www.acca.com/vl/practiceprofiles.php

January, 2004

Are company protections for in-house lawyers in sync with such lawyers' changing roles and responsibilities, as well as stakeholder's and regulator's expectations, and recent court cases' prescriptions? In-house lawyers are in the line of fire in a way they've never been before. And in addition to prosecutions by regulators or lawsuits brought on behalf of the company for professional breaches, the addition of fiduciary breaches (as a responsible officer or manager of the company) to the mix means that in-house lawyers are increasingly at risk for lawsuits brought by non-clients.[1] This profile and its attendant resources are written to help you assess your emerging role in preventing corporate failures, the risks you face (personally and professionally) in representing your client in that capacity, and protections available to you in the in-house employment setting.

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[1] See "*The Law of Inside Counsel*" by Saul, Ewing, Remick & Saul LLP (http://www.acca.com/protected/legres/program/newjersey/upl.html) (describing liability and insurance issues for in-house lawyers); see also "*Individual Liability for the Corporate Lawyer*" by Mark D. Nozette, Susan J. Lawshe, and John K. Villa (http://www.acca.com/education99/cm99/pdf/704.pdf) (containing excerpts from Chapter 6 of "*Corporate Counsel Guidelines*" by John K. Villa).

For articles describing increasing potential for suits naming in-hosue lawyers as defendants, see "*When You're the Target,*" by Anthony K. Greene (Chief Legal Executive, Spring 2003) (http://www.chieflegalexeuctive.com/sub_pages/publications/CLE/PDF/2002_SpringCLE_Spr03Greene_Final.pdf); see also "*Corporate Counsel: Attorneys Who represent companies Face Higher Possibility of Liability to Nonclients,*" by Joan C. Rogers (reproduced by Hinshaw & Culbertson from ABA/BNA's Lawyer's Manual on Professional Conduct, Vol. 9, No. 7 pp. 17-181 (March 26, 2003) (http://www.hinshawlaw.com/ArticlesPublciations/lmrm_corp_counsel_liability_non-clients.cfm).

Much attention has focused on top lawyers for public companies being named as defendants in high-profile shareholder litigation and becoming targets of suits involving broader allegations of corporate misconduct.[2] In addition, attorney conduct standards pursuant to Sarbanes-Oxley and recent case law setting a new standard of personal liability on a corporate CLO may introduce a whole new set of exposures.[3]

However, in-house lawyer liability is not limited to lawyers for public companies. Lawyers for private companies and non-profit enterprises are also vulnerable to liability claims. Less publicized, but still very real, is the potential for in-house lawyer liability to third parties in a variety of contexts, including fiduciary breaches, matters involving opinion letters and certifications, joint venture work, pro bono matters, work for non-wholly owned subsidiaries, and others.[4]

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2 See Enron Bankruptcy Examiner Neal Batson's Report on the liabilities and roles of in-house and outside counsel representing Enron: full report is at http://www.acca.com/public/article/corpresp/basonreport.pdf (this is a 6 MB file); for the appendix report focusing on lawyer roles, go to http://www.acca.com/public/article/corpresp/batsonappendixc.pdf (this is a 12.2 MB file). See also, *"Naked As A Jaybird,"* by Eriq Gardner (Corporate Counsel, 9/1/03) (http://www.law.com/jsp/cc/pubarticleCC.jsp?id=1061306535093) (discussing recent corporate scandals and lawsuits naming General Counsel as defendants, including lawsuits against top lawyers at Tyco International Ltd., Enron Corp., Arthur Anderson; Rite Aid Corp., and U.S. Wireless Corporation, and views on D&O Insurance coverage and other insurance impacts); see also *"Another GC Readies for Trial,"* by Jason Hoppin (Corporate Counsel, 12/1/03) (describing case against the ex-general counsel of HBO & Co.). For discussion on another recent case imposing personal liability exposure on a CLO, see *"Advocacy Alert: Latest Weapon of Plaintiffs' Bar, Personal Liability Exposure for CLOs: Effects and Implications of Pereira v. Cogan,"* (ACC Docket, January 2004) (http://www.acca.com/protected/pubs/docket/jan04/inbox.pdf); see also *"Post-Enron Jurisprudence,"* by John Coffee (New York Law Journal, July 17, 2003) (http://www.law.columbia.edu/media_inquiries/news/july_2003/coffee_nyljjuly) (describing the Periera case as one that "should particularly chill the hearts of inside general counsel").

3 See infra fn. 2 *"Naked As A Jaybird;"* see also *"Comments of Chubb Group of Insurance Companies Re: SEC File No. 33-8150.wp; Implementation of Standards of Professional Conduct for Attorneys"* (Dec. 17, 2002) (http://www.sec.gov/rules/proposed/s74502/smfitzpatrick1.htm) (includes descriptions of insurance protections for lawyers and possible impacts, including addition of exclusions and higher premiums, of Sarbox proposed attorney conduct rule). For articles on the recent Pereira case setting new legal standards, see infra ACC Advocacy Alert article and New York Law Journal article referenced in fn. 2.

4 See infra *"The Law of Inside Counsel"* at f.n.1; see also infra fn. 1 *"Individual Liability for the Corporate Lawyer"* at Section 6.05 (describing corporate counsel civil liability to third parties). For a description of third-party malpractice claims that might arise in connection with services performed by in-house lawyers for private companies (as well as public companies), see *"Cover Me"* by Laurie J. Sablak (Corporate Counsel) (http://www.law.com/jsp/cc/pubarticleCC.jsp?id=1071719738502). For a discussion of why legal malpractice may be an issue for in-house lawyers doing pro bono work, see *"The CorporateProBono.Org Guide to Legal Malpractice Insurance Options for Corporate Attorneys Involved in Pro Bono Work"* at http://www.cpbo.org/resources/archive/resource1274.html.

For articles discussing potential attorney liability to non-clients, see *"Practicing Law Through The Rear View Mirror, Attorney Liability to Non-Clients in the Untied States,"* by James R. Walsh and Elizabeth E. Davies (California Business Litigation Legal Research Library, October 2000) (http://www.calbuslit.com/rearview.pdf); see also *"How to Avoid Having Strangers for Clients,"* by Phillip Feldman (ExpertLaw.com May 2003 (http://www.expertlaw.com/library/attyarticles/third_parties.html).

And, the insurance landscape is changing. Companies are facing shorter policy terms, increased premiums, shrinking coverage, and expanding exclusions.[5] Renewal efforts have been described as more rigorous and involving more detailed inquiries about company financials and operations. In addition, prospective carriers are including questions about corporate governance and internal controls programs as part of their due diligence. New questions are also being raised about the scope of Directors & Officers Liability Insurance coverage: does it cover claims against attorney-officers for professional services or legal advice?[6] These issues will likely be greatly affected by the results of the first several major liability actions currently in the courts against in-house and outside counsel. It is possible that major damage, penalty and defense costs – the likes of which are without previous precedent in terms of in-house counsel liability -- will adversely impact both the cost and coverage exclusions of employed lawyer liability insurance and corporate D&O and indemnification policies in the future.

What are companies and organizations doing to provide coverage against potential liability for in-house lawyers who are doing their jobs? This Profile provides some general background information on indemnification and insurance considerations for in-house lawyers, and summarizes information on related program initiatives gathered from responses to a recent Association of Corporate Counsel survey titled: *Emerging Liability/Indemnification/Insurance for In-House Counsel.*[7] Almost 500 companies responded to this survey, providing both an interesting and informative backdrop for our analysis.

This Profile also takes a closer look at combination indemnification and insurance programs at eight featured companies whose names we agreed not to reveal. These companies include public, private, and non-profit enterprises ranging in size from small to Fortune 100. Law departments for featured companies also range in size: from a solo in-house lawyer to a law department with more than 75 lawyers. Featured in this Profile are programs for the following: **Fortune 100 Retail Company; Major Specialty Retailer; Multinational Chemical Company; Large Non-profit Enterprise; Private Aerospace Company; Private Commercial Property & Casualty Insurance Company;**

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5 See infra "*Naked As A Jaybird*" at fn. 2.

6 For an article sharing views on whether D&O Liability Insurance covers in-house legal staff, see "*Does Your D&O Policy Cover Your In-house Legal Staff,*" (Willis Executive Risks Alert, October 2003) (http://www.willis.com/news/publications/ER_alert.pdf) (describes questions on coverage for role as lawyer and asserts that an attorney-officer's executive job responsibility is to provide legal advice to the corporation and that there shouldn't be a distinction in roles). For additional commentary on this issue see infra "*Naked As a Jaybird*" at fn. 2 (describing reviews of D&O policies and interviews with underwriting officers at insurance companies regarding coverage for legal services under D&O policies); see also infra fn. 3 "*Cover Me*" (describing employed lawyers professional liability insurance and views on D&O coverage).

7 An Executive Summary of the survey results may be viewed via links to ACC's Virtual Library at http://www.acca.com/protected/Surveys/governance/indem_survey.pdf. For the raw survey results, email merklinger@acca.com or hackett@acca.com.

Private Manufacturing Company with less than 1000 Employees; and Public Technology Company.

Section I below summarizes background issues for your consideration. Section II overviews key themes and program insights gathered from discussions with representatives from the companies highlighted in this profile. Section III describes the programs of each of the eight companies in more detail. Section IV provides sample policies from profiled organizations as well as a list of resources identified by ACC or companies represented in this Profile that may be helpful to others as they evaluate their program efforts. We will continue to add new policies and examples we collect over time from additional companies.

I. BACKGROUND ISSUES—SOME GENERAL THOUGHTS ON INDEMNIFICATION AND INSURANCE PROGRAMS

Most companies have had some form of protection in place for many years. And, those companies would probably say that those protections would cover at least some actions of some in-house lawyers. Many of these protections are not formally communicated to in-house lawyers generally, but instead are on a shelf to be dusted off in the unfortunate event that cause for evaluating coverage under the indemnity or insurance policy arises. That may be too late.

Corporate scandals and bankruptcies, new regulations, emerging standards of liability, and huge damage awards are rapidly impacting the availability, cost, and scope of insurance and indemnification protections.[8] These external forces, together with the evolving roles of in-house lawyers, support taking action now to assess needs and risks and implement coverage programs to best address them.

RECENT ACC SURVEY ON EMERGING LIABILITY / INDEMNIFICATION / INSURANCE FOR IN-HOUSE LAWYERS

To help gather information on emerging liability issues and indemnification and insurance programs implemented by companies, the Association of Corporate Counsel contacted approximately 4,000 member companies in November 2003 to complete a short survey. 483 responses were received. An Executive Summary and the corresponding Survey results may be viewed via links to ACC's Virtual Library.[9]

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8 See "*General Counsel Symposium: Directors in the Spotlight: Heightened Scrutiny and developments in Insurance and Indemnification Arrangements,*" by Lois F. Herzeca, Robert E. Juceam, and William G. McGuinness of Fried, Frank, Harris, Shriver & Jacobson (Oct. 24, 2003) (http://www.ffhsj.com/Symposium_Material/GC_fall_03/spotlight_main.htm; click on titled article); see also "*Comments of Chubb Group of Insurance Companies Re: SEC File No. 33-8150.wp; Implementation of Standards of Professional Conduct for Attorneys*" (Dec. 17, 2002) (http://www.sec.gov/rules/proposed/s74502/smfitzpatrick1.htm) (includes descriptions of insurance protections for lawyers and possible impacts, including addition of exclusions and higher premiums, of Sarbox proposed attorney conduct rule).

9 See infra fn. 7.

The recent Survey suggests that companies are doing many different things. Most companies said they have at least some form of indemnification or insurance protection (or combination) that would apply to at least some matters for some in-house lawyers. Some said that their companies do not have (or have not communicated) any indemnification or insurance programs that would cover them.

Indemnification practices include indemnifications required by some state laws, and indemnity provisions in company by-laws, indemnification policies, and individual indemnification agreements. Various forms of insurance protections were also identified, including Directors & Officers Liability Insurance, Errors & Omissions Insurance, and Employed Lawyers Professional Liability Insurance. Triggers, scope, and conditions of coverage also appear to be negotiable and vary broadly.

Distinctions in insurance coverage were noted: in some cases, only those in-house lawyers who are also officers of the company may be covered; in others, any in-house lawyers providing certain types of advice on SEC matters may be covered; in others, in-house lawyers specifically listed on endorsements may be covered. In addition, comments and concerns were raised about the scope of coverage for attorney-officers under Directors & Officers Liability Insurance: might services as a lawyer be excluded? Respondents also listed emerging liability issues of concern. Not surprisingly, many shared concerns regarding scope of their practice, new conduct expectations and exposures under Sarbanes-Oxley, and third party lawsuit exposures.

STEPS TO TAKE IN EVALUATING COVERAGE

Below are thoughts on five simple steps to take to facilitate evaluating coverage and matching fit. These steps and the associated discussion below are offered to help provide insights only and not as legal advice.

- **Step 1: Assess legal services provided by in-house lawyers:** An initial critical step in evaluating coverage is to assess legal services provided by in-house lawyers for the company. These may include services for the company and services for other entities undertaken at the request of the company.
- **Step 2: Evaluate areas of potential exposure:** Once roles are identified, a second important step is to evaluate areas of potential exposure and risk.
- **Step 3: Evaluate existing forms of protections:** This step requires an evaluation of existing forms of protections to determine if they provide acceptable risk management.
- **Step 4: Fill gaps:** Step four involves filling any gaps identified during the course of Step 3. Enlisting the help of an experienced insurance broker has been described as being very valuable in helping to assess insurance options that may help cover identified gaps where insurance is desired.
- **Step 5: Periodically review:** This step is part of the continuous improvement process to help ensure that as roles and risks change over time, coverage options are appropriately matched.

TYPES OF COVERAGE

Two key types of coverage are indemnification and insurance. A key advantage to having some form of insurance in addition to an indemnification is having an external

source of funding to help cover costs. This may be particularly important for in-house lawyers at companies that are start-up companies or that may not have the financial strength to back an indemnification commitment.[10] And if the underlying reason for your potential exposure involves a major financial debacle, it is likely that there will be trustees or others who will prioritize and adjudge the expenditure of scarce resources to defend those accused of wrongdoing.

However, the type and terms of insurance coverage that are most appropriate will depend on the nature of legal services provided and the terms of existing protections.[11]

- **Indemnification:** many Survey respondents said that indemnification protections were included in corporate by-laws. Additional forms of indemnification identified through discussions with companies featured in this Profile include: mandatory statutory indemnifications, individual indemnification agreements, and indemnification policies. Each indemnity will have its own language, and the express terms of the indemnity will define the scope of coverage. Here, evaluating definitions of covered persons, scope of the indemnity, scope of covered costs, provision on advancement of costs, statements about creating a contract right, and conditions and exclusions on coverage may be helpful starting points in assessing gaps.[12]

- **D&O Insurance:** generally written to cover directors and officers; may be expanded to cover additional individuals (such as expansions to cover employees or in-house lawyers generally, or in-house lawyers for certain types of SEC claims, or specifically listed individuals); typically exclude coverage for fines and penalties; may also contain language expressly excluding coverage for claims arising out of duties as attorneys or for professional services.[13]

- **Employed Lawyers Professional Liability Policies:** typically provide coverage for the purpose of providing legal services to the insured company; some policies may include coverage for defense costs incurred in defending disciplinary proceedings; coverage for fines, sanctions, and penalties is typically excluded;

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10 See "*Corporate Counsel Guidelines-Section 6.13,*" by John K. Villa (http://www.acca.com/protected/legres/ccguidelines/sect613.html).

11 Id. See also infra fn. 3 "*Cover Me.*" In addition, for an article on legal malpractice insurance for employed attorneys, see "*Legal Malpractice Liability of Employed Attorneys,*" by Dennis L. Frostic, Thomas A. Brusstar, and Suzanne Mitrovic (ACCA Docket, Fall 93) (http://www.acca.com/protected/pubs/docket/fall93/legalmal.html).

12 See infra fn. 8 "*General Counsel Symposium: Directors in the Spotlight: Heightened Scrutiny and developments in Insurance and Indemnification Arrangements.*"

13 For thoughts on D&O Insurance strategies, see article titled "*Some thoughts on D&O Insurance Strategies—Post Enron,*" by Charles R. Lotter Executive VP, General Counsel & Secretary of J.C. Penney Corporation, Inc. See also infra f.n. 8 "*General Counsel Symposium: Directors in the Spotlight: Heightened Scrutiny and developments in Insurance and Indemnification Arrangements;*" see article titled "*Loss Prevention: Should a Nonprofit Carry D&O?*" by Hays Companies at http://nadco.haysaffinity.com/loss_prevention_1.aspx. In addition, for an overview on D&O Insurance, see "*Directors and Officers Liability Insurance Overview,*" by David M. Gische and Vicki E. Fishman at http://profs.lp.findlaw.com/insurance/insurance5.html.

may also have broad SEC exclusions.[14] Among the factors to consider in evaluating the need for employed lawyers professional liability insurance are: ability of company to provide defense costs and indemnity; potential for shareholder litigation; potential for third party claims relating to nature of work; expectation regarding providing legal advice to joint ventures; expectation for providing opinion letters or certifications; provision of pro bono services, etc..[15]

II. SUMMARY OVERVIEW & THEMES FROM PROFILED COMPANIES

Each of the companies featured in this Profile described a combination of indemnification and insurance protections that would be available to provide coverage for at least some in-house lawyers. While many of the companies have indemnity protections in the company by-laws, the language, scope, and content of each provision varies. In addition, although all of the companies have D&O Liability Insurance policies, several companies have described expansions to the scope of coverage afforded by their policies.

PROGRAM MODELS
Below is a brief summary of some of the types of combinations identified by featured companies. Additional information on program elements, scope of coverage, and applicable conditions and exclusions may be found in the company program summaries in Section III of this Profile.

- **By-Law Indemnity / D&O Liability Insurance:** indemnity applies to officers, directors, and employees *to the extent required by* Delaware law (also goes beyond Delaware law and allows for indemnification even if not successful on the merits, with certain conditions including a condition that actions be taken in good faith); D&O Insurance applies to attorney-officers.
- **By-Law Indemnity / D&O Liability Insurance with added coverage:** indemnity applies to officers, directors, and employees *to the fullest extent authorized by General Corporation Law of State of Delaware* (also makes the indemnification a contract right and includes claims procedures); D&O Insurance applies to: (1) all in-house lawyers for certain types of SEC claims; (2) defined in-house lawyers who sign certifications related to Sarbanes-Oxley compliance; and (3) attorney-officers.
- **Indemnification Policy / D&O Liability Insurance:** indemnity applies to broad listing of individuals, including any employees; D&O Insurance applies to any employee working within the scope of employment or under management of an officer or director.
- **By-Law Indemnity / Indemnification Agreement / D&O Liability Insurance:** by-law indemnity applies to officers, and provides that Board of Directors may grant rights to indemnification and advancement of expenses to employees of the corporation or its subsidiaries who are non-officers; Indemnification Agreements

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[14] See infra fn. 8 "*Comments of Chubb Group of Insurance Companies Re: SEC File No. 33-8150.wp; Implementation of Standards of Professional Conduct for Attorney;*" see also infra fn. 3"*Cover Me;*" and fn. 1 "*The Law of Inside Counsel.*"

[15] See infra fn. 10; see also infra fn. 3 "*Cover Me.*" In addition, for an article on legal malpractice insurance for employed attorneys, see infra fn. 11"*Legal Malpractice Liability of Employed Attorney.*"

apply to attorney-officers; D&O Insurance applies to in-house lawyers who are also officers.

- **Indemnification Agreement / Employed Lawyers Professional Liability Insurance / D&O Liability Insurance:** indemnification agreement applies to any officer, director or employee by reason of being such; D&O Insurance applies to managers or employees; Employed Lawyers Professional Liability Insurance is for the sole in-house lawyer.
- **By-law Indemnity / D&O Liability Insurance / Errors & Omissions Insurance:** by-law indemnity applies to officers, directors and employees *to the fullest extent permitted by cited sections of the applicable State's insurance code;* D&O Insurance applies to General Counsel and attorney-officers; Errors & Omissions Insurance is currently available for in-house lawyers who litigate claims on behalf of insureds.
- **By-Law Indemnity / Indemnification Agreements/ D&O Liability Insurance:** by-law indemnity applies to officers, directors, and employees *to the extent permitted by General Corporations Law of Delaware;* Individual Indemnification Agreements are provided to board members and to some officers; D&O Liability Insurance applies to attorney-officers.
- **By-Law Indemnity / D&O Liability Insurance with added coverage:** by-law indemnity applies to directors, officers, employees, and agents (also says indemnity is a contract right and allows for advancement of expenses to the fullest extent allowable under Del. General Corporation Law); D&O Insurance includes added coverage for all in-house lawyers in certain situations.

THEMES

Some themes emerged from discussions with companies about their programs:

- **Indemnification:** all of the companies described some form of indemnification provided by their company. Six of the eight companies have an indemnification provision in the company's by-laws. Two companies described stand-alone indemnification policies or agreements that cover broad categories of individuals. Two companies described additional indemnification agreements for officers.
- **Scope of Indemnification:** some company indemnification provisions provide that the indemnity is to the extent permitted by or the fullest extent allowable under a cited State's law; some indemnification provisions provide that the indemnity is to the extent required by a cited state's law; other indemnity provisions create different obligations depending on whether the person seeking the indemnity is an officer or an employee.
- **Persons Covered by Indemnity Provision:** companies described a range of provisions. Each company representative shared that in-house lawyers would likely be covered by virtue of their status as employees. Some company provisions extend indemnification to covered persons (former, current or future); some extend indemnifications to the heirs, executors or administrators of covered persons.
- **Indemnification Coverage for services provided to other corporations or organizations at the request of the corporation:** some indemnification provisions expressly stated that the indemnity would apply to services for other entities if the covered individual was serving at the request of the corporation.

- **Good Faith Conditions on Indemnity:** several companies described provisions that granted an indemnity provided that the covered person was acting in good faith and in a manner reasonably believed to be in or not opposed to the best interest of the company.
- **Advancement of Expenses Under Indemnity:** many described their indemnification provisions as allowing for advancement of costs or expenses; some said that undertakings might be required for at least some employees as a condition of advancement of expenses.
- **Costs Covered by Indemnity:** many indemnification provisions list a broad range of costs that would be covered. Coverage for fines and penalties is expressly included in several provisions.
- **Indemnity as a Contract Right:** some of the by-law provisions expressly state that the indemnity provision in the by-laws shall be deemed to be a contract.
- **Process for Obtaining Indemnity Coverage:** some of the indemnification provisions and policies define a process for invoking indemnification protection.
- **Insurance Protections:** all of the companies described having D&O Liability Insurance; one company also had Employed Lawyers Professional Liability Insurance; one company had an Errors & Omissions Insurance Policy in addition to the D&O.
- **D&O Insurance Covered Persons:** some companies described adding coverage for persons in addition to directors and officers. One company added protections for all in-house lawyers for certain types of securities claims, and for certain named attorneys providing internal certifications relating to the required financial statement certification under Sarbanes-Oxley. Another company added coverage for all in-house lawyers. Some companies described D&O policies that cover any employee, or managers and employees.
- **No professional services exclusions in D&O:** none of the company representatives identified express policy exclusions for professional services. However, one company shared that recent communications with the company's carrier have caused the company to evaluate and review this issue.
- **Insurance Process More Rigorous:** several companies described recent experiences bidding and renewing D&O Insurance as more rigorous than before and involving due diligence efforts that included providing information to prospective carriers on corporate governance programs.
- **Insurance Premiums Increasing:** several companies stated that insurance premiums have increased, and that it may be more difficult/costly to retain existing terms of coverage.
- **Insurance Coverage for Fines/Penalties Excluded:** most of the companies stated that D&O coverage excluded fines or penalties.
- **Communications on Coverage:** most of the companies stated that there aren't formal programs or initiatives to communicate coverage to employees or in-house lawyers generally. Some companies stated that in-house lawyers have received communications about coverage as part of broader communications about Sarbanes-Oxley obligations.

III. PROGRAM SUMMARIES

Following are summaries from discussions with the eight companies about their programs.

Fortune 100 Retail Company

Organized under Delaware law, this Fortune 100 Retail Company has a combination of indemnification and insurance protections that would be available to in-house lawyers in the event that they are involved in a lawsuit or action relating to services performed for the company. More specifically, the company's By-Laws include an indemnification provision that states that the company will indemnify officers, directors, and employees for actions taken in good faith to the extent required by Delaware law. In addition, the company has a Directors & Officers (D&O) Insurance Policy that would be available to provide protections to in-house lawyers who are also officers of the company.

An Associate General Counsel for the company explains that the company recently went through an extensive effort to competitively bid its D&O Insurance Policy. The previous D&O Policy had been in place at a fixed price for five years. An RfP was prepared and an insurance broker was engaged to assist with the bidding process and validating market assumptions. The overall process was described as rigorous and involved due diligence requests for information on corporate governance and internal controls programs. The end result was that the company was able to maintain its existing insurance terms and obtain a one-year policy-- but at an increased cost.

Asked about emerging issues of concern regarding liability exposure for in-house lawyers, the company's Associate General Counsel explains her views on some statements by others regarding D&O insurance, and assertions regarding coverage for attorney-officers in their capacities as officers but not as in-house lawyers. More specifically, she emphasizes her view that "professional liability isn't a proper exclusion for a D & O Insurance Policy because officers who have professional expertise are officers primarily for such expertise. Our policy doesn't have an express professional services exclusion, and I doubt that such an exclusion would be inferred under insurance law precedents requiring any exclusions to be expressly stated."

Additional emerging issues identified by the company's Associate General Counsel include concerns about in-house lawyer liability for cases involving whistle-blowing lawyers with their own agendas. Another area of concern involves the notion that reasonable lawyers can disagree on interpretations of legal requirements, and the possibilities that in-house lawyers might find themselves subjects of suits or actions because of such reasonable disagreements.

INDEMNIFICATION IN BY-LAWS

As stated above, the company's By-Laws include an indemnification provision that extends an indemnity to all officers, directors and employees of the company for actions taken in good faith. The indemnity covers actual and reasonable expenses incurred in connection with civil or criminal claims, with some conditions. In addition, with the

same conditions, the indemnity would cover liability even if the employee ultimately loses the suit, provided that the employee's actions were taken in good faith.

The company's Associate General Counsel notes that indemnification to the extent included in the company's By-Laws is discretionary pursuant to Delaware corporate law, but is not required. She shares that the company has had an indemnification provision included in its By-Laws for over 10 years, and that the provision is re-examined on a periodic basis.

D&O INSURANCE POLICY

The company's D&O Insurance Policy is administered by its Risk Management Group. As stated above, the company's previous D&O Policy had been in place for five years (a three-year policy with a 2-year renewal) at a fixed cost. That policy is described by the company's Associate General Counsel as "a good policy from the standpoint of the insured."

Within the past year, the company competitively bid its D&O Insurance and listed requested coverage criteria in its RfP materials. In-house counsel played a key role in developing the RfP documentation and advising the Risk Management Group on the process. Asked about the length of time to develop the RfP documentation, the company's Associate General Counsel shares that it took around 30 days to draft and finalize. A sample copy of the Table of Contents for the RfP document may be accessed via link in the Resource List in Section IV of this Profile. The overall competitive bid process took around an additional 60 days, and included a 30-day due diligence period during which the company had an opportunity to share information on compliance, corporate governance, and internal controls.

Key features of the D&O Insurance include:

- **Broad definition of insureds:** the definition includes coverage for directors and officers of the company and its subsidiaries against all losses incurred in actions brought against them by reason of their office. In addition, directors and officers of the company serving on external non-profit organizations are also covered if the company has asked them to provide these services. The policy does not contain an express professional services exclusion.
- **Relatively narrow exclusions:** exclusions are generally limited to situations involving deliberate dishonesty. The policy also excludes damages relating to discharge of pollutants.
- **No deductibles for individual insureds**
- **Advancement of defense costs and right to select counsel**
- **Triggers:** events giving rise to claim may occur before or during the policy period
- **Choice of law and dispute resolution method addressed**

COMMUNICATIONS

Asked how the forms of coverage are communicated within the company, the Associate General Counsel explains that directors are periodically formally apprised of

protections afforded by the company's D&O Insurance policy at meetings of the Board of Directors. In addition, information on D&O coverage is provided to company officers at the time they become officers, and updated information is provided if significant changes to coverage occur.

Asked whether more questions are being raised by in-house lawyers about company protections in light of recently publicized high-profile litigation involving other companies, the Associate General Counsel shares that there haven't been many questions specifically asking about company liability protections. However, the company recently provided information to executives, middle management and in-house lawyers as part of its broader Sarbanes-Oxley training initiatives, and included information on available forms of coverage during those sessions. In-house lawyers played a key role in helping to develop the Sarbox training sessions. "Our company has a robust SEC group, and our Sarbox programs were developed in-house."

Major Specialty Retailer

In-house lawyers at this publicly-traded major specialty retailer number around 30, with all lawyers ultimately reporting into the company's Chief Administrative and Legal Officer. The company has two forms of protections available to in-house lawyers in the event that they are involved in a lawsuit or action relating to services provided for the company: Indemnification from the company; and Insurance coverage pursuant to a Directors & Officers (D&O) Insurance Policy.

The company's Chief Administrative and Legal Officer (CLO) shares that the indemnification policy was put in place by the company's Board of Directors in 1996, and that covered persons include but are not limited to in-house lawyers. In addition, the CLO explains that the company's D&O Policy was amended three years ago at no additional premium to expressly include coverage for all in-house lawyers (an expansion from traditional policy provisions that might only cover in-house lawyers who are also officers). That D&O Policy was recently renewed in December 2003, and although some of the coverage at some levels may apply to all in-house lawyers, many of the insurance coverage provisions primarily apply to in-house lawyers only if they are also officers of the company. . The CLO explains that the rationale for eliminating express coverage at some levels for all in-house lawyers generally is due to the broad scope of the indemnity that would run to all in-house lawyers.

INDEMNIFICATION POLICY

The company's By-laws include a provision titled "Indemnification of Directors, Officers, Employees and Agents." The provision states that the indemnity is a contract right. Under this policy, indemnified costs include expenses (including attorney's fees), judgments, fines and amounts paid in settlement, actually or reasonably incurred, and allow for advancement of defense costs to any officer or director to the full extent allowable by Section 145 of Delaware Corporation Law. The CLO states that costs in connection with fraudulent or illegal activity would be excluded from the indemnity. A copy of the By-Law provision may be accessed via link in the Resource List included in Section IV of this Profile.

Asked whether the company communicates the Indemnification Policy to its in-house lawyers, the company's CLO explains that information on this protection is communicated as part of an individual's overall orientation to the company.

DIRECTORS & OFFICERS INSURANCE

As stated above, about three years ago the company amended its D&O Policy to expressly include coverage for all in-house lawyers. The company's CLO shares that the amendment didn't require a large premium increase. In December 2003, the company renewed its D&O Policy and amended a number of its terms. The CLO explains that marketplace conditions drove the company to re-evaluate some of the terms and conditions included in the previous D&O Policy, and that the renewed policy includes a number of revised terms.

OTHER CONSIDERATIONS; EMERGING ISSUES

Asked whether the company considered the possibility of obtaining employed lawyers insurance, the CLO shared that the company hasn't procured Employed Lawyers Professional Liability Insurance since the indemnification policy would address costs that may be incurred by in-house lawyers. As for any concerns about emerging liability issues and in-house lawyer liability, the CLO describes his company as diligent, with a strong culture of integrity, and as having one of the highest corporate governance ratings of any fortune 500 company. He explains that, while he doesn't have any specific concerns about issues for his company, he believes that in a broader sense "in-house lawyers should be more concerned about implications of recent litigation, and about confidentiality issues and issues that may relate to noisy withdrawal proposals if they are adopted."

Multinational Chemical Company

This public company's indemnification and insurance protections for in-house lawyers include: an indemnity in the company's By-Laws; and insurance coverage pursuant to the company's Directors & Officers Insurance Policy. The company's By-Law indemnity provision is described by the company's Vice President General Counsel & Secretary (General Counsel) as "very broad, offering the fullest protections allowable under Delaware law." The Directors & Officers Insurance Policy also offers broader coverage than some traditional D&O Policies might provide. More specifically, the company's D&O Policy has been expanded to cover all in-house lawyers for certain types of securities claims. In addition, the Policy would cover certain defined in-house lawyers who sign internal certification statements relating to financial certifications under Sarbanes-Oxley.

The company recently renewed its D&O Policy. "The most recent renewal process was more rigorous than past annual renewals and included due diligence inquiries relating to corporate governance programs," explains the company's General Counsel. The company's D&O Policy is administered by its Risk Management Group, and efforts to

renew the Policy were led by that group in coordination with the company's General Counsel.

INDEMNIFICATION IN BY-LAWS

The company's by-laws include an agreement to indemnify any officer, director or employee of the company for activities undertaken in the course of their employment when sued for work in their capacity as a company employee. The company's General Counsel explains that the indemnity provision is very broad and has been in place for at least 5 years. In-house lawyers providing services for the company would be able to seek protections pursuant to this provision. A copy of the indemnity provision included in the company's by-laws may be accessed via link in the Resource List in Section IV of this Profile.

Asked what types of costs would be covered pursuant to this indemnity, the General Counsel shares that it would cover all "expense, liability and loss (including attorneys' fees, judgments, fines, ERISA excise taxes or penalties and amounts paid or to be paid in settlement) reasonably incurred or suffered." In addition, the General Counsel notes that defense costs could also be advanced. Coverage for actions, suits or proceedings relating to external services, such as pro bono services, performed at the request of the company or for the benefit of the company would also be covered. The indemnification provision in the By-Laws states that the right to indemnification pursuant to the By-laws shall be a contract right. The indemnity provision also establishes procedures for making claims, and enables a claimant to request that Independent Counsel be appointed to determine entitlement to indemnification.

DIRECTORS & OFFICERS INSURANCE POLICY

The company's D&O Policy consists of multiple "sides" that define various types of coverage. "Side A" coverage defines insurance protections directly available to covered individuals. Side B coverage allows the company to make claims against insurance for expenses in defending directors, officers, or employees. Side C coverage relates to securities issues. Side D coverage applies to fiduciary liabilities for employee benefit plans.

Are all in-house lawyers covered under the D&O Policy? All in-house lawyers who are also officers of the company would be considered covered persons under this policy. In addition, all in-house lawyers would be covered for certain types of securities claims. The policy also covers certain defined individuals that include in-house lawyers who sign internal certifications relating to the required financial statement certification under Sarbanes-Oxley. The company's General Counsel explains that the company is currently evaluating whether the scope of coverage may be expanded during the next renewal to include all in-house lawyers generally. Asked whether the policy excludes coverage for lawyers providing professional services to the company (e.g., providing services as lawyers), the General Counsel explained that the policy does not provide for such an exclusion.

What types of costs are covered? Covered costs include defense costs, settlements and judgments. Costs for fines and penalties or for punitive damages are not covered where they are not insurable by law. Asked whether successful adjudication on the merits is a pre-requisite for coverage, the response was "no; generally coverage applies unless there is a final adjudication as to conditions for which coverage is excluded."

The company's D&O Policy has been in place for a long time, and is currently renewable annually. The company's General Counsel shares that the most recent renewal process was more rigorous than in past years, and included inquiries from insurers about the company's corporate governance programs. In addition to increased interest in corporate governance, renewal costs also increased. And, the company's General Counsel shared that it may become harder and harder each year to renew on the same terms.

Large Non-Profit Enterprise

This large, non-profit enterprise (Enterprise) has an in-house law department of 9 lawyers reporting to its General Counsel. Asked about what forms of protection might be available to in-house lawyers if they are involved in a lawsuit or action relating to their services for the Enterprise, the General Counsel described two key forms of coverage: (1) an Indemnification Policy; and (2) a Directors & Officers Liability Insurance Policy.

Both the Indemnification Policy and the Directors & Officers Liability Insurance Policy (D&O Policy) apply to broad categories of individuals, including in-house lawyers. Both forms of coverage have been in place for many years (at least 22 years for the indemnification policy, and at least 15 for the D&O Policy), and are described as having evolved over time. Within the past three years, the General Counsel led an effort to evaluate the Indemnification Policy. This initiative resulted in some enhancements that are described as making broader protections available to covered individuals.

The Enterprise's Office of General Counsel oversees matters relating to the Indemnification Policy, and also works closely with the Enterprise's Office of Risk Management on evaluating matters that may trigger protections under these programs.

INDEMNIFICATION POLICY

As stated above, the Enterprise's Indemnification Policy has been in place for many years. Several years ago, the Enterprise re-evaluated and enhanced its policy. The effort was led by the Enterprise's General Counsel, and included consulting with outside lawyers specializing in insurance and indemnification matters, and benchmarking programs at other non-profit enterprises to develop the enhanced and updated version of the Policy that exists today.

Some key features of the Indemnification Policy are highlighted below. (A copy of the Enterprise's Indemnification Policy may be accessed via link in the Resource List in Section IV of this Profile.)

- **Scope of Individuals Covered:** The scope of the individuals covered under the policy is very broad. It includes broad categories of individuals (including any employee) serving the company in various capacities. In addition, it covers persons who serve in various capacities on external enterprises or entities as part of their official company duties. The Enterprise's General Counsel explains that the latter portion of the definition regarding external services was added as part of the recent enhancement effort to help clarify that individuals who perform services for external organizations as part of official company duties are covered by the indemnification policy.
- **Indemnification:** The scope of the indemnity is also described as broad, applying to "any covered person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative, arbitrative or investigative…." In addition, indemnified expenses include "expenses (including attorneys' fees), judgments, fines, penalties, and amounts paid in settlement actually and reasonably incurred by him or her in connection with such action, suit or proceeding…."
- **Conditions:** The indemnity is available if the covered person "acted in good faith and in a manner he or she reasonably believed to be in or not opposed to the best interests of the company, and, with respect to any criminal action or proceeding, had no reasonable cause to believe his or her conduct was unlawful." The General Counsel shares that the phrase "or not opposed to the best interests of the company" was added as part of the recent enhancement effort. In addition the indemnification section lists provisos stating that indemnification will not be made for actions involving intentional, willful or reckless misconduct or gross negligence in performing duties, unless and only if a court of competent jurisdiction determines that the covered person is fairly and reasonably entitled to the indemnity.
- **Additional indemnity if successful on the merits:** The policy also provides for indemnification, notwithstanding other provisions in the policy, if a covered person is successful on the merits or otherwise.
- **Procedure:** The policy includes a procedure for notifying the Office of General Counsel in order to benefit from the policy. The procedure requires that notifications be made within 5 business days of receipt of notice that the person is or is threatened to be made a party.
- **Advancement of Expenses:** The policy includes a provision on advancement of expenses.

DIRECTORS & OFFICERS LIABILITY INSURANCE POLICY

This form of coverage is principally administered by the Enterprise's Office of Risk Management. In the event of a claim or issue that may be made pursuant to this policy, the Enterprise's Acting Risk Manager explains that the Office of Risk Management would investigate claims under either the indemnification policy or the insurance policy and would coordinate with the Office of General Counsel to evaluate and administer appropriate coverage.

The Enterprise's Acting Risk Manager describes the scope of covered persons as "any employee who has been, now is or shall be working for the non-profit enterprise as long as the individual is/was/will be working within the scope of his or her employment or under the management of a Director or Officer of the Enterprise."

Asked whether the policy recites any exclusions for professional services, the Acting Risk Manager states that there are no such exclusions. Covered costs under the Enterprise's insurance policy would include defense costs and settlement costs. Costs for fines and penalties would also be covered.

COMMUNICATIONS ON COVERAGE

Asked how these policies are communicated, the General Counsel shares that they aren't formally and broadly communicated. However, both the General Counsel and the Acting Risk Manager explain that if an inquiry is made or an issue that may trigger the protection arises, the policies are communicated and, in the case of the indemnification policy, a copy of the policy is provided. As for in-house lawyers, the indemnification policy has been communicated to them since the Enterprise's Office of General Counsel administers the indemnification policy. In addition, the General Counsel shares that the law department has internal guidelines for administering the policy, and in-house lawyers have and work with these guidelines.

Private Aerospace Company

This private aerospace company has a small in-house law department of two lawyers, one of which is an officer of the company. Its liability protections for in-house lawyers are described as a combination of indemnification and insurance. The indemnity component stems from an indemnification provision in the company's By-Laws that extends to officers, directors and employees of the company. A Directors & Officers (D&O) Liability Insurance Policy provides coverage to officers of the company, which includes any in-house lawyers who are also officers.

The company's D&O Policy is renewable on an annual basis, and the premiums for comparable coverage increased last year by around 25%. In addition, the General Counsel says that the process for obtaining D&O coverage as "significantly more difficult" than in prior years. More specifically, the General Counsel explains that insurance underwriters are conducting rigorous due diligence and asking detailed questions that had never previously been asked.

INDEMNIFICATION

The By-Law indemnification provision is described as broad and having been in place for about 40 years. The indemnity states "[t]he corporation shall indemnify its officers, directors, employees and agents to the extent permitted by the General Corporation Law of Delaware." (A copy of the indemnification provision may also be accessed via link in the Resource List included in Section IV of this Profile.) Asked about the types of costs that would be covered, the General Counsel shares that the company has no policies or procedures that either give affected individuals notice of this indemnity

protection or provide any more detail about which costs will be indemnified. Board Directors and one or two officers have individual agreements with the company that may include more detailed indemnity protection. The General Counsel shares that there haven't been requests from employees for information about protections generally, and that there isn't an organized formal program for communicating the indemnification coverage.

DIRECTORS AND OFFICERS INSURANCE

The company's D&O Liability Policy applies to claims for wrongful acts of a director or officer of the corporation while acting in their respective capacities as duly elected or appointed directors and officers. "Wrongful act" is defined to include "any breach of duty, neglect, error misstatement, misleading statement or omission by the insureds alleged by any third party claimant solely by reason of their being directors and officers of the corporation." Losses paid by the policy include defense expenses as well as judgments and settlements. Fines or penalties are excluded. Additional policy exclusions are enumerated within the policy. The policy does not expressly exclude coverage for professional services.

QUESTIONS ASKED DURING INSURANCE RENEWAL

As stated above, the company's most recent renewal efforts included due diligence on the part of underwriters, asking more detailed questions than had been asked in prior annual renewal efforts. Questions included:

- Request for information regarding layoffs / facility closings, including reasons for the foregoing and information on anticipated layoffs or closings. Additional details relating to whether labor counsel was consulted and release agreements were signed were also requested.
- Questions regarding profitability and losses
- Questions regarding major customers and material changes experienced or anticipated
- Questions regarding account receivables and reserves
- Questions regarding process for plant divestitures or closures, including use of counsel and governmental inquiries

CONSIDERATIONS; EMERGING ISSUES

Asked whether the company has considered adding Employed Lawyers Professional Liability Insurance to the forms of coverage available to in-house lawyers, the General Counsel shares that it has not.

Private Commercial Property & Casualty Insurance Company

This private company has two groups of in-house lawyers that ultimately report into its General Counsel: three lawyers are assigned to the company's corporate legal department, and ten lawyers are assigned to another department and litigate claims on behalf of policy-holders. Five of the company's lawyers, including the company's General Counsel, are also officers of the company.

Asked about the types of indemnification or insurance coverage that would be available to in-house lawyers if involved in a lawsuit or action regarding services for the company, the company's General Counsel explained that the company has had a combination of indemnification and insurance in place for more than 20 years. The company's By-Laws provide for indemnifications to officers, directors and employees. Insurance programs include: Directors & Officers Insurance; and Errors & Omissions Insurance.

INDEMNIFICATION

The company's By-Laws provide an indemnity for current and former Directors, officers, employees and agents to the fullest extent permitted by the State's insurance code. In addition, the By-Laws provide that the corporation will indemnify, to the fullest extent permitted by the State's insurance code, any person who is serving or who has served at the corporation's request as a Director officer, employee or agent of another corporation. As employees, in-house lawyers would benefit from these protections.

The scope of indemnification coverage applies to defense costs incurred in defending "a civil, criminal or administrative or investigative action, suit or proceeding (including all appeals) or threat thereof." The By-Laws provide that defense costs may be advanced as authorized by the Board of Directors and to the fullest extent permitted pursuant to the state's insurance code. An example of the indemnification provision from the company's By-Laws may be accessed via link in the Resource List included in Section IV of this Profile.

FORMS OF INSURANCE

The company's General Counsel explains that the company has an Errors & Omissions ("E&O") insurance policy that would cover actions of the company's in-house lawyers who litigate claims on behalf of policyholders. Following recent communications with the company's Directors & Officers Insurance carrier, the company is also evaluating enhancing its existing E&O policy to add in-house lawyers from the company's corporate law group.

As stated above, the company's Directors & Officers Insurance Policy would apply to in-house lawyers who are also officers of the company. The insurance is described as covering the General Counsel's actions in the capacity of the company's General Counsel and as an officer. For other attorney-officers, while it is described as clear that their actions involving business and management responsibilities as officers would be covered, recent communications with the company's D&O insurance carrier have led to additional discussions about whether attorney-officers would be covered under the D&O Policy for providing legal services. In light of these discussions, the company is evaluating enhancing its Errors & Omissions policy to address any potential gaps.

COMMUNICATIONS

Although the company hasn't instituted a program to formally communicate these coverages to all employees, the General Counsel explains that information would be provided in response to any requests or inquiries by employees. An exception is that directors are provided with a copy of the D&O Insurance Policy. Asked whether she has noticed an increase in questions from in-house lawyers about coverage that might be available to them, the General Counsel explains that this has not been the case. She also adds that it is useful to find a good independent insurance agent to help negotiate provisions on a company's behalf.

Privately-held Manufacturing Company with 1,000 Employees

The General Counsel and sole in-house lawyer for this privately-held manufacturing company describes available liability coverage as a combination of indemnification and insurance. More specifically, coverage components include: Officer, Director and Employee Indemnification Agreement; Employed Lawyers Professional Liability Policy; and Directors & Officers (D&O) Liability Insurance Policy.

INDEMNIFICATION AGREEMENT

The General Counsel describes the company's indemnification policy for officers, directors, and employees as broad. The policy was developed in 2000, and key features are summarized below. A copy of the policy (identifying information redacted) may be accessed via link in the Resource List in Section IV of this Profile.

- **Indemnified party:** applies to "any former, present or future director, officer or employee of the company or the legal representative of [the same] …by reason of such person being or having been such director, officer or employee."
- **Types of Proceedings:** includes any civil, criminal, administrative, or arbitrative action (pending, threatened or completed) and any appeal or inquiry or investigation that could lead to the same.
- **Costs may be paid in advance:** may be paid in advance of final disposition if authorized by a majority of the board of directors not parties to the matter; provided that an undertaking is made to repay advanced costs unless it is ultimately determined that the party is entitled to the indemnity.
- **Types of costs:** defined broadly to include costs, disbursements, attorneys fees, amounts paid in satisfaction of settlements, judgments, fines and penalties.
- **Conditions:** person must have acted in good faith and in a matter reasonably believed to be in or not opposed to the best interests of the company (for criminal proceedings—had no reason to believe conduct was unlawful)
- **Exclusions:** for proceedings by or in the right of the company, no indemnity is available for person adjudged by any court to be liable for intentional or gross misconduct, except as and to the extent determined by the court.

D&O LIABILITY INSURANCE

The company's General Counsel is also an officer of the company. Asked whether the D&O Liability Insurance policy excludes coverage for services rendered in professional

capacity as General Counsel (rather than as an officer), the General Counsel states that it does not. The General Counsel explains that the company has had a D&O policy in place for quite some time and that there has recently been a large premium increase for this coverage, so the company is currently evaluating options with other carriers.

The policy defines insureds as managers or employees. The policy lists a number of exclusions, including those of an insured person serving as a director, officer, trustee, regent, governor or equivalent executive, or as an employee of any other entity even if such service is at the direction or request of the insured entity. An exception to this exclusion is for services to outside entities that are specifically listed as an endorsement, or for services for a not-for-profit corporation, or certain other 501(c)(3) entities or religious or charitable not-for-profit organizations, provided that the outside service is at the request of or with knowledge and consent of the company.

Costs covered under the D&O Policy include defense costs (reasonable and necessary legal fees and expenses), investigation costs, damages, settlements, judgments, and pre- and post-judgment interest. Also covered are punitive and exemplary damages where insurable by law. Salary and wages are not covered. Also excluded are taxes, fines, or penalties imposed by law and non-monetary relief.

EMPLOYED LAWYERS PROFESSIONAL LIABILITY INSURANCE

Another form of insurance coverage available to this General Counsel is Professional Liability Insurance. The General Counsel shares that the insurance has been in place for around 4 years, and that premiums have increased. Asked why the company has secured Employed Lawyers Professional Liability Insurance in addition to the D&O Liability Insurance and the Indemnification policy, the General Counsel explains that this coverage is a bit of "bootstrapping," but that it also would cover claims for professional services to officers or directors, for joint ventures, and for opinions to lenders. In addition, the General Counsel notes that the insurance provides an additional outside source of funding for liability claims.

The policy lists around 18 types of exclusions, including exclusions for securities-related violations under the '33 or '34 Acts. Claims for fines, sanctions, penalties, punitive damages, and for exemplary damages are also excluded.

Public Technology Company

The in-house law department for this public technology company includes around 75 lawyers. When asked about the forms of liability protections for in-house lawyers, the company's General Counsel identified three forms of protections that would be available to in-house lawyers who are also officers of the company, and an additional form of protection that would be available to any company employee or agent, including all of the company's in-house lawyers.

More specifically, lawyers who are also officers of the company would have the following types of liability protections: Directors & Officers (D&O) Insurance;

Indemnification Agreements; and Indemnification described in company By-Law provisions. In addition, the company's General Counsel explains that all in-house lawyers may seek indemnification pursuant to protections available to company employees or agents generally pursuant to Section 78.7502 of Nevada's General Corporation Law.

FORMS OF COVERAGE FOR LAWYERS WHO ARE CORPORATE OFFICERS

As stated above, in-house lawyers who are also officers of the company have the following forms of coverage available to them: D&O Insurance; individual indemnification agreements; and indemnification pursuant to the company's by-laws.

- **D&O Insurance:** The company has a D&O insurance policy for directors and officers of the corporation. In-house lawyers who are also officers of the company may seek protection pursuant to this policy. The policy does not specifically exclude coverage for professional services or for claims against corporate officers arising out of their duties as attorneys. The policy allows for advancement of defense costs, and covers judgments, settlements and defense costs and expenses such as reasonable attorneys' fees. Excluded are coverage for fines and penalties, or for matters involving improper personal gain or involving any fraudulent or criminal act committed with actual knowledge of its wrongful nature or with intent to cause damage.
- **Indemnification Agreements:** Directors and Officers of the company may also have individual indemnification agreements in place. In-house lawyers who are also officers of the company have coverage under such an indemnification agreement. The General Counsel explained that these agreements typically include coverage for all claims arising from any act, omission or neglect or breach of duty, while acting in the capacity as an officer of the company or an affiliate, to the extent not covered by insurance or other indemnity. These agreements also exclude coverage for claims arising from dishonesty, improper personal gain or profits from short-swing securities trading violations. Costs and expenses of defense are advanced, upon the officer's written undertaking to repay same if ultimately determined not entitled to indemnification; provided, however, that no such advance occurs if disinterested Directors, or independent legal counsel, finds that it is more likely than not that the officer will be found not entitled to indemnification.
- **By-laws:** The company's by-laws expressly provide that officers shall be indemnified to the fullest extent allowable by applicable law. The indemnity covers all loss, liabilities and expenses, including judgments, fines, penalties, attorneys' fees and settlement amounts, reasonably incurred in connection with any suit or proceeding arising from actions allegedly taken or omitted in the capacity of an officer, or in any other capacity while serving as an officer. Expenses are to be paid as incurred, upon the officer's written undertaking to repay same if found not entitled to indemnification. The by-laws also allow the Board of Directors to grant rights to indemnification and advancement of expenses to employees of the corporation or its subsidiaries who are non-officers, such as other in-house attorneys.

FORMS OF COVERAGE FOR IN-HOUSE LAWYERS GENERALLY

All in-house lawyers, whether or not also officers of the corporation, may benefit from mandatory indemnification protections available to all company employees or agents pursuant to Nevada's General Corporation Law (Nevada Revised Statutes Section 78.7502; following is a link to the referenced section of the Nevada statutes: http://www.leg.state.nv.us/NRS/NRS-078.html#NRS078Sec7502). More specifically, Section 78.7502 titled: "Discretionary and mandatory indemnification of officers, directors, employees and agents" provides for permissive and mandatory indemnification under certain circumstances. The General Counsel of this company explains that the although the company's by-laws do not extend mandatory indemnification generally to company employees or in-house lawyers, such indemnification may be available pursuant to the relevant subsection of 78.7502 describing mandatory indemnifications.

The mandatory indemnification provisions of Section 78.7502 (3) provide for indemnification of expenses, including attorneys' fees and fines, if successful on the merits or otherwise, in defense of any action, suit or proceeding described in subsections (1) or (2) (e.g., the discretionary indemnification subsections) of Section 78.7502. For indemnification to be available, the individual seeking the indemnification must have "acted in good faith and in a manner which he or she reasonably believed to be in or not opposed to the best interest of the corporation, and, with respect to any criminal action or proceeding, had no reasonable cause to believe his conduct was unlawful". In addition, in the case of employees who are also officers, the indemnity shall not be available in actions by the corporation or in shareholders' derivative actions, if the officer is found liable to the corporation or its shareholders, for any act or failure to act in his capacity of an officer (See NRS 78.7502 NRS 78.138, which provides that officers are not liable to the corporation or shareholders for damages as a result of any act or failure to act unless the act or failure to act constituted a breach of the fiduciary duties of an officer, and the breach of those duties involved fraud, misconduct, or a knowing violation of law.).

COMMUNICATIONS ON FORMS OF COVERAGE

Asked how matters that may give rise to possible coverage may be communicated to in-house lawyers, the company's General Counsel explained that an email was recently sent to lawyers addressing expectations pursuant to Sarbanes-Oxley. In addition, the General Counsel shared that this issue was addressed globally around four years ago when the company studied its existing forms of coverage and evaluated the need for additional forms of coverage and determined that no additional coverage was warranted.

EMERGING LIABILITY ISSUES/CONCERNS

Asked about concerns regarding liability for in-house lawyers, the company's General Counsel shared that the Pereira case is of particular concern (See Pereira v. Cogan, 2003 U.S. Dist. LEXIS 7818 (S.D.N.Y. May 12, 2003). Remarking further, the General Counsel shared that the Pereira case ventures into dangerous waters in finding a company's

General Counsel liable for matters involving improprieties by others which he may know nothing about.

LEADING PRACTICES

Asked which elements of the company's approach to establishing forms of protections the General Counsel would consider to be leading practices, the General Counsel explained that the indemnity protections guaranteed under Nevada law provide significant and meaningful protection for the in-house attorneys, and that the bylaws also permit the Board of Directors the flexibility to provide further indemnification.

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ACC thanks Renee Dankner, former senior counsel to Mobil Oil Corporation, for her work on this profile.

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IV. RESOURCE LIST

Please note that this listing does not constitute a recommendation or endorsement for any product, service or company. Please find below a list of resources identified by companies or by ACC as possible resources that may be helpful or of interest in evaluating or developing coverage programs for in-house lawyers.

ACC Alliance Partner – Chubb Specialty Insurance
ACC has chosen Chubb to offer members the purchase employed lawyers liability insurance designed specifically for in-house counsel. For more information and contacts, please go to http://www.acca.com/practice/alliance.php#chubb.

EXAMPLES OF COMPANY INDEMNIFICATION PROVISIONS

Major Specialty Retailer: By-Law Indemnity
http://www.acca.com/protected/forms/governace/dol_rfp.pdf

Multinational Chemical Company: By-Law Indemnity
http://www.acca.com/protected/forms/governance/indem_chemical.pdf

Nonprofit Enterprise: Indemnification Policy
http://www.acca.com/protected/forms/governance/indem_nonprofit.pdf

Private Aerospace Company: By-Law Indemnity
http://www.acca.com/protected/forms/governance/indem_aerospace.pdf

Private Commercial Property & Casualty Insurance Company: By-Law Indemnity
http://www.acca.com/protected/forms/governance/indem_by-law.pdf

ACC's Leading Practice Profiles: http://www.acca.com/vl/practiceprofiles.php

Private Manufacturing Company: Indemnification Policy
http://www.acca.com/protected/forms/governance/indem_manufactur.pdf

Additional By-Law Indemnification Policy:
http://www.acca.com/protected/forms/governance/indem_policy.pdf

ARTICLES; PUBLICATIONS

"*The Law of Inside Counsel*" by Saul, Ewing, Remick & Saul LLP
(http://www.acca.com/protected/legres/program/newjersey/upl.html)

"*Individual Liability for the Corporate Lawyer*" by Mark D. Nozette, Susan J. Lawshe, and John K. Villa
(http://www.acca.com/education99/cm99/pdf/704.pdf)

"*Naked As A Jaybird,*" by Eriq Gardner (Corporate Counsel, 9/1/03)
(http://www.law.com/jsp/cc/pubarticleCC.jsp?id=1061306535093)

"*Another GC Readies for Trial,*" by Jason Hoppin (Corporate Counsel, 12/1/03)

"*Advocacy Alert: Latest Weapon of Plaintiffs' Bar, Personal Liability Exposure for CLOs: Effects and Implications of Pereira v. Cogan,*" (ACC Docket, January 2004).
(http://www.acca.com/protected/pubs/docket/jan04/inbox.pdf)

"*Post-Enron Jurisprudence,*" by John Coffee (New York Law Journal, July 17, 2003)
(http://www.law.columbia.edu/media_inquiries/news/july_2003/coffee_nyljjuly)

"*Cover Me*" by Laurie J. Sablak (Corporate Counsel)
(http://www.law.com/jsp/cc/pubarticleCC.jsp?id=1071719738502).

"*Does Your D&O Policy Cover Your In-house Legal Staff,*" (Willis Executive Risks Alert, October 2003)
(http://www.willis.com/news/publications/ER_alert.pdf)

"*General Counsel Symposium: Directors in the Spotlight: Heightened Scrutiny and Developments in Insurance and Indemnification Arrangements,*" by Lois F. Herzeca, Robert E. Juceam, and William G. McGuinness of Fried, Frank, Harris, Shriver & Jacobson (Oct. 24, 2003)
(http://www.ffhsj.com/Symposium_Material/GC_fall_03/spotlight_main.htm; click on titled article)

"*Corporate Counsel Guidelines-Section 6.13,*" by John K. Villa
(http://www.acca.com/protected/legres/ccguidelines/sect613.html).

"*Legal Malpractice Liability of Employed Attorneys,*" by Dennis L. Frostic, Thomas A. Brusstar, and Suzanne Mitrovic (ACCA Docket, Fall 93)
http://www.acca.com/protected/pubs/docket/fall93/legalmal.html

"*Loss Prevention: Should a Nonprofit Carry D&O?*" by Hays Companies at
http://nadco.haysaffinity.com/loss_prevention_1.aspx.

"*Directors and Officers Liability Insurance Overview,*" by David M. Gische and Vicki E. Fishman
http://profs.lp.findlaw.com/insurance/insurance5.html

"*The CorporateProBono.Org Guide to Legal Malpractice Insurance Options for Corporate Attorneys Involved in Pro Bono Work*"
http://www.cpbo.org/resources/archive/resource1274.html.

MISCELLANEOUS

White Paper: "*Some thoughts on D&O Insurance Strategies—Post Enron,*" by Charles R. Lotter Executive VP, General Counsel & Secretary of J.C. Penney Corporation, Inc.
http://www.acca.com/protected /article/governance/dol_strategy.pdf

"*Comments of Chubb Group of Insurance Companies Re: SEC File No. 33-8150.wp; Implementation of Standards of Professional Conduct for Attorneys*" (Dec. 17, 2002)
(http://www.sec.gov/rules/proposed/s74502/smfitzpatrick1.htm)

Report of the Examiner, Neal Batson, Enron Bankruptcy Case:
Full report: http://www.acca.com/public/article/corpresp/batsonreport.pdf
(this file is 6 MB)
Appendix C regarding specific roles of lawyers:
http://www.acca.com/public/article/corpresp/batsonappendixc.pdf
(this file is 12.2 MB)

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Paradise Tarnished:
Today's Sources of Liability Exposure For Corporate Counsel

October 1, 2004

(ACC thanks Lucian T. Pera and Brian S. Faughnan for their work in preparing this article)[1]

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I. Introduction

In professional circles and according to the traditions of legal lore, the life of corporate counsel is the envy of the profession. The view from the outside looks rosy: no time sheets; just one client; no demands for higher billable hours or collections; a regular salary; stock options; corporate perqs; dinner with the family more than once a week. In reality, while the demands of in-house practice are different, they are just as great, and carry with them their own weights and unique responsibilities, often related to larger business concerns. Even so, most in-house counsel would not consider swapping their corporate positions to move back to private practice: they enjoy the challenges and opportunities presented by the corporate practice environment. But an increasing number of in-house lawyers are experiencing a strong upswing in professional uncertainty: corporate in-house practice and its challenges have changed significantly in the last few years.

Though very few companies were directly implicated, a thunderous series of corporate scandals rolled across the front pages over the last few years. The allegations and, in many cases, the truth of the scandalous behaviours behind them, deeply shocked and rocked the business world. Formerly respected household name brand companies became synonyms with corporate wrongdoing.

One of the first questions asked by shareholders, regulators, the media, and even outraged colleagues at soon to be bankrupt companies was, "Where were the lawyers?" Quick on the heels of these scandals, Congress leapt into action with the adoption of Sarbanes-Oxley, and the SEC and other regulators began to re-examine and tighten regulations and oversight of all sorts for the clients of corporate counsel. And the SEC was authorized to specifically adopt regulations to ensure that appropriate attorney conduct was squarely in the center of the scrutiny imposed.[2] All these, and other factors, affect and will continue to drive the practice of corporate counsel for the foreseeable future, in ways small and large.

One area of rising concern that will only increase in focus over the next few years: personally liability exposure of corporate counsel employed in companies accused of wrongdoing, for either acts and omissions in their work that may have impacted the failure du jour. It is easy to discount high profile prosecutions of general counsel who appear to have been caught doing something outrageously illegal. But a number of these cases, if we take off our 20/20 hindsight glasses, might not be so obvious.

Indeed, just the sheer number of in-house counsel prosecutions in the last few years is unheard of in a segment of the profession that historically has never been at the front of the prosecutors' radar. So what's happened? Are in-house counsel suddenly more likely to include amongst their ranks a larger number of criminals? Has the evolution of the in-house counsel's role placed them into positions where they are more likely to be corrupt? Or is the message to the in-house community one that might be read as something akin to, "We're watching you ever more closely and examining your actions or inactions with far greater scrutiny. Don't think that just because you're a lawyer that you're not responsible or that you're immune to prosecution."?[3]

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[2] Sarbanes-Oxley Section 307 authorized the SEC to develop a set of attorney conduct regulations, now codified at 17 CFR Part 205. Go to http://www.acca.com/legres/corpresponsibility/attorney.php for links to the rules, backgrounders, law department resources/benchmarks, and other information.

[3] See, e.g., the Comments of Stephen M. Cutler, head of the SEC's enforcement division, to an audience at UCLA's law school on September 20, 2004 ("The Themes of Sarbanes-Oxley as Reflected in the Commission's Enforcement Program," found at: http://www.sec.gov/news/speech/spch092004smc.htm):

While no startling new types of exposure or theories of liability have exploded on the legal landscape in recent prosecutions, and even though the existing data points may yet be too few to denote a trend, there are, in fact, a series of new, high-profile instances of corporate counsel being held accountable in previously uncommon ways – ways that have caused or will cause many corporate counsel to sit up, take notice, and consider the implications for their own situations. **And that is precisely the purpose of this article: to consider the implications of recent developments in corporate counsel exposure for both corporate counsel and their clients.**

One obvious starting point for any discussion of the emerging sources of liability exposure faced by corporate counsel is how, if at all, such sources have traditionally differed from those faced by attorneys in private practice. At the most basic level, the sources of liability exposure for attorneys in private and corporate practice are identical: (1) criminal liability and (2) civil liability. Further, the scope of civil liability exposure could be simply divided into two subcategories without distinguishing between corporate counsel and private practitioners: (1) potential civil liability to their clients[4] and (2) potential civil liability to third parties.

Because of the often specialized nature of the services often performed by corporate counsel, however, it is also helpful to divide corporate counsel's sources of liability exposure in a slightly different manner so as not to overlook important nuances. For purposes of this article, the spectrum of potential sources of liability exposure for corporate counsel will thus be divided into four categories: (1) governmental liability, including both criminal and civil liability in proceedings initiated by governmental agencies, such as the U.S. Securities and Exchange Commission; (2) liability to shareholders, both current and former; (3) liability to the client-employer; and (4) liability to others.

"How about lawyers? Consistent with Sarbanes-Oxley's focus on the important role of lawyers as gatekeepers, we have stepped up our scrutiny of the role of lawyers in the corporate frauds we investigate. We have named lawyers as respondents or defendants in more than 30 of our enforcement actions in the past two years. ….

We have seen too many examples of lawyers who twisted themselves into pretzels to accommodate the wishes of company management, and failed in their responsibility to insist that the company comply with the law. ….

We have more to do in this area. Based on our current investigative docket, I think you can expect to see one or more actions against lawyers who, we believe, assisted their clients in engaging in illegal late trading or market timing arrangements that harmed mutual fund investors. We are also considering actions against lawyers, both in-house and outside counsel, who assisted their companies or clients in covering up evidence of fraud, or prepared, or signed off on, misleading disclosures regarding the company's condition. One area of particular focus for us is the role of lawyers in internal investigations of their clients or companies. We are concerned that, in some instances, lawyers may have conducted investigations in such a manner as to help hide ongoing fraud, or may have taken actions to actively obstruct such investigations."

[4] For corporate counsel, of course, the client more often that not is also their employer. See Association of Corporate Counsel, "In-House Legal Department Ethical and Professional Conduct Manual Chapter Two: Who's The Client?" available at http://www.acca.com/protected/legres/conductmanual/.

But there is also an additional overlay of exposure for many corporate counsel. Frequently, corporate counsel serve as officers (*e.g.*, vice president or secretary) or directors of their client-employer or of an affiliated company. Thus, to fully consider their potential exposure, these corporate counsel must consider two separate, but potentially overlapping, sources of liability: (a) liability flowing from actions they take as an attorney; and (b) liability flowing from actions they take as an officer or director of the company.[5] Further, recognizing these distinct roles played by corporate counsel is important not only for understanding the scope of such liability exposure, but also for a complete understanding of whether particular insurance coverages may be applicable to particular liability risks.

To consider the current environment of liability exposure for corporate counsel, this article will explore several noteworthy high-profile incidents over the last few years (1999-2003) in which corporate counsel have been individually named as defendants in multiple sets of legal proceedings,[6] often including criminal proceedings, as a means to examine: (1) how the traditional types of liability exposure for corporate counsel may be evolving; and (2) whether there exist legitimate grounds for corporate counsel to be concerned that their liability exposure is expanding.

In addition, this article will also discuss an increasingly important issue for today's corporate counsel -- methods of managing their potential liability exposure. Topics that will be addressed will include: (1) the effect that the changed corporate environment may have on the effectiveness of reliance solely upon indemnity provisions; and (2) the need for, and the availability of, different kinds of insurance coverage applicable to the types of claims that ethical, competent corporate counsel may be most concerned about, such as directors and officers' (D&O) insurance policies and malpractice insurance policies.

II. Overview of the Case Studies

We focus in this article on seven high-profile corporate scandals occurring from 1999 through 2003 which, as a result of the fall-out of the scandal, involved litigation, either civil or criminal, in which corporate counsel for the entity was named, usually in multiple proceedings, as an individual defendant. *(While often discussed, a great number of highly public scandal allegations did not give rise to indictments or suits against an in-house lawyer; the group of in-house counsel we examine in this article include only those who were formally indicted or sued as of the date of publication of this article: October 1, 2004. At the time of publication, we know of a few additional general counsel whose cases may make the update of this article, but since formal actions had not been filed, we had no ability to assess the theories of liability under which they may be prosecuted.)*

The time-line of the seven corporate scandals involved is as follows:

1999 – HBOC/McKesson Corp.
1999 – Trace International
2000 – Rite Aid, Inc.
2001 – Enron

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[5] Obviously, in any particular situation, the precise role in which corporate counsel acted may not be altogether clear.

[6] One of the corporate counsel included as a case study, Philip Smith, was only named as an individual defendant in one legal proceeding; however, the issues raised in that proceeding are so novel as to merit inclusion. *See infra* at 10-12. Another, Jonathan Orlick, also was only named as an individual defendant in one proceeding, but he has also sued his former employer, Gemstar, for defamation with regard to the characterization of his termination as "for cause." *See infra* at 34-37.

2002 – Qwest
2002 – Tyco, Inc.
2003 – Gemstar

As a result of the fall-out from those corporate scandals, the following corporate counsel found themselves in the cross-hairs, either of government lawyers or plaintiffs' counsel, and sometimes both:

Jay Lapine (**HBOC/McKesson Corp.**) was indicted and charged with criminal securities fraud. In addition, he was named as an individual defendant in a civil securities fraud lawsuit brought by the SEC and in securities litigation[7] pursued by private plaintiffs.

Philip Smith (**Trace International**) was named as an individual defendant in a civil lawsuit brought by Trace's bankruptcy trustee alleging, among other theories, breach of fiduciary duty. Smith was ultimately determined by the trial court to be liable in the amount of approximately $21 million.

Franklin Brown (**Rite-Aid**) was indicted and ultimately convicted of making false statements to the SEC, obstruction of justice, and witness tampering. Brown is currently awaiting sentencing and faces a maximum sentence of 65 years. Brown was also named as an individual defendant in a civil securities fraud lawsuit brought by the SEC and in securities litigation pursued by private plaintiffs.

James Derrick, Rex Rogers, Kristina Mordaunt, Scott Sefton, and Jordan Mintz (**Enron**) were each singled out in the final report by the examiner appointed by the bankruptcy court, commonly called the "Batson Report," as potentially having committed legal malpractice and breaches of fiduciary duty for which they could ultimately be found to have liability to Enron's bankruptcy estate. In addition, Derrick and Rogers were named as individual defendants in securities class action litigation and, as a result of the findings in the final Batson Report, were also added as individual defendants in a shareholder derivative action pending in Texas state court.

Drake Tempest (**Qwest**) was named as an individual defendant in securities litigation pursued by private plaintiffs. In addition, media reports continue to speculate that he may be the subject of ongoing investigations by the SEC and/or criminal prosecutors.[8]

Mark Belnick (**Tyco**) was indicted, but ultimately acquitted, on New York state criminal charges of falsifying business records and grand larceny. In addition, Belnick was named as an individual defendant in a civil securities fraud lawsuit filed by the SEC. Further, Belnick was also sued individually by Tyco, his former employer, for, among other things, breach of fiduciary duty and fraud.

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[7] Throughout this article, the term "securities litigation," when used to refer to actions brought by private plaintiffs, will include shareholder derivative lawsuits where applicable.

[8] Hudson, Kris, "Qwest case outcome may ripple," *Denver Post* (April 5, 2004), available at http://www.denverpost.com. However, in an August 2, 2004, news article reporting on federal judge's ruling upholding a subpoena served by the SEC on Tempest in connection with the SEC's ongoing investigation of Qwest, Tempest's attorney stated that "he does not expect Tempest to face criminal charges." *Associated Press*, "Ex-Qwest Executive Told to Appear in Court," (August 2, 2004), available at http://www.forbes.com/associatedpress/feeds/ap/2004/08/02/ap1487080.html.

Jonathan Orlick (Gemstar) has been named as an individual defendant in a securities fraud lawsuit filed by the SEC. In addition, Orlick has sued Gemstar for defamation in connection with Gemstar's contention that Orlick's termination was "for cause."

An analysis of the case studies discussed here in which high-profile corporate counsel have been named as individual defendants in criminal or civil proceedings from 1999-2003 reveals that, other than the clear appearance that criminal prosecutions, SEC proceedings, shareholder derivative claims, and securities fraud class action claims against corporate counsel are being pursued with increasing frequency, there does not appear to be anything significantly new about the sources of liability exposure for corporate counsel that are classified above as "governmental liability" and "liability to current and former shareholders," although certainly post-Sarbanes-Oxley, the duties of corporate counsel are now more explicitly regulated than ever before.

Nevertheless, a review of those same high-profile events (many of which remain ongoing) shows that there may ultimately be an expansion in the scope of exposure faced by corporate counsel with regard to potential liability to their client-employer and to third parties resulting from the final fallout of these particular corporate scandals.

III. Case Studies: Corporate Counsel in the Cross-Hairs

We turn now to our case studies of corporate counsel targeted for liability in connection with recent corporate scandals.

First, a word of caution about our sources and purposes: The information contained in this section detailing the events leading up to criminal or civil proceedings against corporate counsel, and describing the allegations made and causes of action pursued in those proceedings, is based on media reports and publicly-available documents, most of which has not been further verified by the authors. Wherever possible, we have tried to indicate in footnotes and otherwise the sources of our information.

Quite obviously, many of these accounts generated from ongoing proceedings are one-sided and do not present a complete picture of facts or defenses that may have been, or may yet be, offered by these corporate counsel in their own defense. Remember, the purpose of this article is merely to explore the first indications of any new or changed *potential* sources of liability exposure for corporate counsel, taking recent high-profile circumstances as a data set. This article is not intended to pass any judgment, or draw any conclusions, regarding the merits of any of the allegations in pending or contemplated proceedings against corporate counsel. Given the ongoing nature of most of the proceedings involved, it may well be years before any considered, final judgments may be possible based on their outcome.

A. Jay Lapine (HBOC/McKesson)

On January 12, 1999, HBO & Company ("HBOC") and McKesson Corporation ("McKesson") merged, with the new merged entity becoming known as McKesson HBOC. Prior to the merger, HBOC and McKesson were engaged in distinct aspects of the health care industry. HBOC was in the business of developing (and subsequently marketing and selling) computer software for use in the health care industry. McKesson's primary business focus was manufacturing and distributing pharmaceuticals, health care supplies, and drinking water.[9]

[9] Complaint ¶¶ 8-9, filed September 27, 2001, in *SEC v. Lapine*, Civil Action No. C-01-3650 (VRW) (N.D. Cal.).

In late April 1999, just three months after the merger, McKesson HBOC announced its discovery during its year-end audit that certain software sales transactions at HBOC had been recorded improperly and were being reversed.[10] The company's stock plunged as a result, and its market value dropped by more than $9 billion dollars in one day.[11] Subsequently, McKesson HBOC launched an extensive internal investigation and, ultimately, restated its financial statements for the prior three years.[12]

The primary component of the accounting problems identified post-merger by McKesson HBOC involved the use of "side letters" and "side agreements" in connection with software licensing contracts.[13] McKesson HBOC determined that, despite the fact that customers had the right to cancel contracts or return product if certain contingencies were not met, HBOC had been recognizing revenue from those contingent contracts prior to the satisfaction of such contingencies, which was in contravention of Generally Accepted Accounting Practices (GAAP).[14]

Moreover, McKesson HBOC's internal investigation revealed that, to accomplish this accounting manipulation, HBOC had been separating out the side letters from the corresponding contracts and not providing their outside auditors with those side letters. McKesson HBOC also identified another accounting manipulation — backdating certain contracts to record revenue in an earlier quarter and treating exchanges of cash and inventory as end-of-quarter "sales."

Upon completion of its investigation, McKesson HBOC turned over what has been termed a "virtual road map to the fraud"[15] to prosecutors and to the Securities and Exchange Commission (SEC).[16] Criminal proceedings against Albert Bergonzi, the former co-president of HBOC and the former President of the HBO division of McKesson HBOC and Jay Gilbertson, the former co-

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[10] April 28, 1999, Press Release, McKesson HBOC, available at http://www.mckesson.com/releases/1999/042899_191180013.htm.

[11] "SEC charges former HBO & Co. CEO McCall," *Atlanta Business Chronicle* (June 5, 2003), available at http://www.bizjournals.com/atlanta/stories/2003/06/02/daily42.html. McKesson HBOC went from a closing share price on April 27, 1999, of $65.75 to a closing price on April 28, 1999, of $34.50 per share. *See* http://bigcharts.marketwatch.com for historical stock quote information for McKesson HBOC (symbol:MCK).

[12] June 4, 2003, Press Release, Office of the United States Attorney for the Northern District of California, available at http://www.justice.gov/usao/can/press/html/2003_06_04_mckesson.html.

[13] *Id.*

[14] *Id.*

[15] Hoppin, Jason, "In a First for Feds, General Counsel Is Indicted for Fraud," *The Recorder* (June 6, 2003), available at http://www.law.com/jsp/article.jsp?id=1052440840504.

[16] Former McKesson HBOC Vice President and General Counsel Jay Lapine has sought access to McKesson HBOC's investigative report and findings, arguing that the disclosure of those materials to the SEC waived any work-product protection. The trial court has ruled that Lapine should have access to such and the matter is presently on appeal to the Ninth Circuit. *See generally* Brief of the Securites and Exchange Commission, *Amicus Curiae*, in Support of McKesson Corporation and Supporting Reversal, *U.S. v. McCall*, No. 03-10511 (9th Cir.), available at http://www.sec.gov/litigation/briefs/mckesson.htm.

president and CFO of HBOC followed quickly.[17] Gilbertson pled guilty and implicated Jay Lapine, the former Vice President and General Counsel of the HBOC division of McKesson HBOC.[18] Lapine had been with HBOC since 1994, serving as Associate General Counsel from 1994 to 1997 and then serving as HBOC's General Counsel from 1997 until the merger became effective.[19] Lapine was terminated by McKesson HBOC in June 1999, about five months after the merger and about two months after the announcement of the discovery of accounting problems.[20]

The criminal proceedings.[21] A federal criminal indictment filed against Lapine in the Northern District of California was unsealed on June 4, 2003.[22] According to the U.S. Justice Department, Lapine was the first ever corporate general counsel to be indicted for securities fraud.[23] It was in connection with the indictment of Lapine that Deputy U.S. Attorney General Larry Thompson was first quoted as saying: "Major corporate fraud cannot happen over an extended period of time without the complicity of accountants, lawyers and other professionals."[24]

The criminal indictment against Lapine charged him with: (1) conspiracy in violation of 18 U.S.C. § 371; (2) securities fraud in violation of 15 U.S.C. § 78j(b); (3) filing false documents with the SEC in violation of 15 U.S.C. § 78ff; and (4) circumventing accounting controls and falsifying books and records in violation of 15 U.S.C. § 78m(b).

The SEC lawsuit.[25] Lapine also had been named as a defendant in a securities fraud proceeding filed by the SEC on September 27, 2001.[26] The SEC action asserts claims against

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[17] *See* Superseding Indictment, *United States v. Bergonzi*, No. CR-00-0505 MJJ (N.D. Cal.).

[18] June 4, 2003, Press Release, Office of the United States Attorney for the Northern District of California, available at http://www.justice.gov/usao/can/press/html/2003_06_04_mckesson.html; "Former McKesson HBOC chief indicted," *Silicon Valley/San Jose Business Journal* (June 5, 2003), available at http://www.bizjournals.com/sanjose/stories/2003/06/02/daily41.html?jst=s_rs_hl.

[19] Complaint ¶ 7, filed September 27, 2001, in *SEC v. Lapine*, Civil Action No. C-01-3650 (VRW) (N.D. Cal.).

[20] *Id.*

[21] *United States v. Bergonzi*, CR 00-0505 MJJ (N.D. Cal.).

[22] October 14, 2003, Stipulation and Order Staying Civil Proceedings While Criminal Case Is Pending, *SEC v. Lapine*, Civil Action No. C-01-3650 MJJ (N.D. Cal.).

[23] Hoppin, Jason, "In a First for Feds, General Counsel Is Indicted for Fraud," *The Recorder* (June 6, 2003), available at http://www.law.com/jsp/article.jsp?id=1052440840504.

[24] *Id.*

[25] *S.E.C. v. Lapine*, Civil Action No. C-01-3650 (VRW) (N.D. Cal.).

[26] S.E.C. Litigation Release No. 17189 (October 15, 2001), available at http://www.sec.gov/litigation/litreleases/lr17189.htm. During a deposition that occurred in connection with the SEC proceedings, Lapine exercised his Fifth Amendment right against self-incrimination. *See* Memorandum of Points and Authorities in Support of Defendant Jay Lapine's Motion For Stay of Discovery at 4, filed Aug. 21, 2002, in *SEC v. Lapine*, No. C-01-3650-MJJ (N.D. Cal.). Lapine also exercised his Fifth Amendment right against self incrimination in his

Lapine for (1) violating Sections 10(b) and 13(b)(5) of the Exchange Act and Rules 10b5 and 13b2-1 (the antifraud, internal controls, and books and records provisions of the federal securities laws); (2) aiding and abetting violations by HBOC of Sections 13(a) and 13(b)(2)(A) of the Exchange Act and Rules 12b-20 and 13a-13 (the requirement for filing accurate periodic reports with the Commission).[27] The forms of relief sought by the SEC against Lapine include an injunction barring Lapine from ever serving in the future as an officer or director of a public company and disgorgement of bonus compensation and sale proceeds from stock sales.[28]

Lapine has stated in pleadings filed in connection with the SEC action against him that he "intends to agree to the proposed settlement of the SEC's claims against him, but requires additional time to resolve certain personal matters prior to formally entering into an agreement."[29]

Shareholders derivative suits and securities fraud class actions. Not surprisingly, as a result of McKesson HBOC's announcement of the problems with the integrity of its financials, a number of securities fraud class action suits and shareholder derivative lawsuits were filed against McKesson HBOC. Lapine is a named defendant in at least one shareholder derivative suit filed in Delaware state court,[30] as well as at least one securities fraud class action suit filed in California.[31] Lapine has been named as an individual defendant in these suits because of his trading activity.

The allegations of wrongdoing that have been leveled at Lapine include the following:

•that he was personally involved in backdating contractual documents related to a multi-million dollar software transaction with Data General Corporation so as to record the associated revenue in the previous financial period and meet analysts' expectations;

•that he was personally involved in the negotiations of two transactions in which "side letters" were negotiated in order to be able to prematurely record revenue associated with the transactions; and

•that he profited from such actions because he received significant bonuses that were tied to meeting earnings expectations and sold company stock at prices that were inflated as a result of acts of fraud.

B. Philip Smith (Trace International)

Answer to the SEC's complaint filed on October 7, 2002. *See* Answer to the Complaint (filed October 7, 2002), *SEC v. Lapine*, No. C-01-3650-MJJ (N.D. Cal.)

[27] Complaint ¶¶ 31-46 (filed September 27, 2001), *SEC v. Lapine*, Civil Action No. C-01-3650 (VRW) (N.D. Cal.).

[28] *Id.* at 10-11.

[29] Memorandum of Points and Authorities in Support of Defendant Jay Lapine's Motion For Stay of Discovery at 4 (filed August 21, 2002), *SEC v. Lapine*, No. C-01-3650-MJJ (N.D. Cal.).

[30] *Kelly v. McKesson HBOC, Inc.*, C.A. No. 17282-NC (Del. Chancery Ct., New Castle County).

[31] *Merrill Lynch Fundamental Growth Fund, Inc. v. McKesson HBOC, Inc. et al*, No. CGC 02 405792 (Cal. Superior Ct., San Francisco County).

On July 21, 1999, Trace International, a privately-held holding company with substantial investments in two publicly-traded companies, Foamex and UAG,[32] and another privately-held company, filed for bankruptcy protection under Chapter 11.[33] As is discussed more fully later in this article, the fact that these companies were not publicly-held is of great significance to corporate counsel evaluating their present potential liability exposure.[34]

After its Chapter 11 case was converted to a Chapter 7, the Chapter 7 bankruptcy trustee, John Pereira, filed a civil lawsuit seeking to recoup tens of millions of dollars back into Trace's bankruptcy estate. The lawsuit named as defendants the controlling shareholder of Trace, Marshall Cogan, and seven other former officers or directors of Trace, including Philip Smith, Trace's General Counsel, Vice President,[35] and Secretary.[36] The claims brought by the bankruptcy trustee against Smith were for (1) breach of fiduciary duty; and (2) unlawful payment of dividends and redemption of preferred stock.[37] The overarching theory behind the lawsuit was that Trace had been operated to pursue the best interests of Cogan, and not Trace, and that creditors of Trace had been damaged by the actions of Trace's officers and directors occurring while Trace was in the "zone of insolvency."

In his role as Trace's General Counsel, Smith hired and supervised outside counsel. Further, in his role as Trace's Secretary, "Smith maintained the corporate minute books and, when requested by the chairman, sent out notices of board meetings. He took the minutes of Board meetings and drafted unanimous consents."[38] In addition to being General Counsel, Vice President, and Secretary of Trace, Smith was also General Counsel and Secretary of Foamex and UAG, two public companies in which Trace had substantial investments.[39]

Despite the fact that there were no allegations that Smith received any personal benefit from any of the transactions that were challenged by the bankruptcy trustee, the trial court, addressing what it considered to be "novel issues of corporate governance,"[40] on May 12, 2003, found Smith to

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[32] Together, Trace's holdings in those three companies constituted 90-95% of its assets. *Pereira v. Cogan*, 294 B.R. 449, 470 (S.D.N.Y. 2003).

[33] *Pereira*, 294 B.R. at 463.

[34] *See infra* Section IV.D.

[35] Along with Smith, a number of other professionals at Trace held the title of Vice President, and the trial court noted that such title did not automatically confer or denote any decision-making authority. *Id.* at 522.

[36] Smith joined Trace as its General Counsel, Vice President, and Secretary in 1988, after spending 8 years in private practice at Akin, Gump, Strauss Hauer & Feld LLP. *Id.* at 468. Prior to his time at Akin Gump, Smith worked at the SEC.

[37] Second Amended Complaint ¶¶ 31-64, *Pereira v. Cogan*, No. 00-CIV-619 (RWS) (S.D.N.Y.).

[38] *Pereira*, 294 B.R. at 469.

[39] Interestingly, Smith received his salary from Foamex and UAG, and not Trace. The only compensation Smith received from Trace involved a company car and occasional bonuses. As an example, for the year 1999, Smith's total compensation from Trace only amounted to $60,000. *Id.*

be liable for damages to the bankruptcy estate in excess of $21 million.[41] Specifically, Smith was found to have liability in connection with improper loans made to Cogan and two other Trace insiders and the structuring of a transaction that was undertaken in order to satisfy Trace's obligation to redeem a specific amount of Trace preferred stock that had been issued to Dow Chemical Company.[42] The trial court did not find Smith liable with regard to any unlawful payments of dividends concluding that Smith appropriately discharged his obligations as General Counsel by providing legal advice regarding when dividends can be issued.[43] Smith appealed the trial court's decision to the Second Circuit on July 21, 2003, and that appeal remains pending.

The allegations of wrongdoing that have been leveled at Smith include the following:

•devising a scheme to avoid certain legal impediments that existed that prevented Trace from redeeming Trace shares from Dow Chemical Corp. that it was obligated to redeem by disguising the redemption as a purchase of the shares from Dow by Cogan in which Trace loaned the purchase price amount to Cogan and Cogan, in turn, pledged the Dow shares to Trace;

•failing to take actions to prevent Trace from improperly paying out dividends; and

•failing to understand and to properly advise the Board of Directors of its responsibility to approve of loans made to Cogan and other insiders;

C. Franklin Brown (Rite-Aid)

At the end of 1999, Rite-Aid's board of directors announced that its preliminary results for the second quarter of 2000 indicated a $67.9 million dollar loss. At the same time, Rite-Aid also announced its intention to restate its financials for prior years.[44]

Prior to its ultimate restatement, the board of directors undertook an eight-month internal investigation that commenced in October or November 1999.[45] Rite-Aid's ultimate July 2000 restatement of earnings was, at the time, the largest restatement of corporate income in U.S. history and served to eliminate all of its originally reported profits from 1996 through the first quarter of 2000.[46]

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[40] *Pereira v. Cogan*, 294 B.R. at 462. Among the novel issues involved was the imposition of legal liability upon officers and directors for acts and omissions occurring at a time when the company, although not actually insolvent, is within the "zone of insolvency." *See* Epstein, Michael, J., "Furthering Insolvency: How did we get here from there?" TRGUSA.com, available at http://www.trgusa.com/Furthering_insolvency_MJE.htm.

[41] The award against Smith was for $21,392,974.45, comprised of an award of $13,984,712.52 ($13,411,712.52 for loans to Cogan; $573,000 for loans to two other insiders; and $3,000,000 for the Dow redemption transaction) plus pre-judgment interest. Final Judgment (June 24, 2003), *Pereira v. Cogan*, No. 00-CIV-619 (RWS) (S.D.N.Y.).

[42] *Pereira*, 294 B.R. at 534-35, 537-38.

[43] *Id.* at 523.

[44] Indictment ¶ 43, *U.S. v. Grass*, No. 1:02-CR-146 (M.D. Pa.).

[45] *U.S. v. Grass*, 239 F. Supp. 2d 535, 536 (M.D. Pa. 2003).

The problems associated with the integrity of Rite-Aid's financials included a variety of accounting manipulations designed to positively affect Rite-Aid's stock price, including premature recording of revenue, improper extensions of asset depreciation time periods, and improperly recording revenue from payments made by insurance carriers for medicine that had been ordered by customers of Rite-Aid but never actually picked up by those customers.[47] Another major source of Rite-Aid's financial problems was that Rite-Aid had been inflating its revenues by manipulating its right to credits from its suppliers for damaged and outdated goods.[48]

At the time this massive restatement was announced by Rite-Aid, Franklin Brown was Rite-Aid's Chief Legal Counsel, Executive Vice President, and Vice Chairman of Rite-Aid's Board of Directors. Brown was one of the four top corporate officers of Rite-Aid, and his compensation was tied to the performance of Rite-Aid's stock. Brown resigned his employment with Rite-Aid on February 25, 2000, and resigned from its Board of Directors three months later.[49]

The criminal proceedings.[50] Brown was indicted by a federal grand jury in June 2002 and charged with: (1) conspiracy to defraud; (2) fraud in connection with the purchase or sale of securities; (3) thirteen counts of making false statements to the SEC; (4) ten counts of mail fraud; (5) six counts of wire fraud; (6) criminal forfeiture; (7) conspiracy to obstruct justice; (8) obstruction of grand jury proceedings; (9) obstruction of government agency proceedings; and (10) tampering with a witness.[51]

Brown was convicted after a jury trial in October 2003 of making false statements to the SEC, obstruction of justice, and tampering with a witness; Brown was, however, acquitted of wire fraud.[52] Brown was the first executive post-Enron to be convicted by a jury. Brown's sentencing has not yet taken place, but is presently scheduled for September 27, 2004.[53] He faces a maximum sentence of 65 years in prison and $2.5 million in fines.[54] Prior to Brown's conviction, the former CEO of Rite-Aid, Martin Grass, pled guilty in June 2002 to two counts of conspiracy and received an eight-year prison sentence.[55]

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[46] Indictment ¶ 47-48, *U.S. v. Grass*, No. 1:02-CR-146 (M.D. Pa.).

[47] S.E.C. Litigation Release No. 17577 (June 21, 2002), available at http://www.sec.gov/litigation/litreleases/lr17577.htm.

[48] *Id.*

[49] Indictment ¶ 9, *U.S. v. Grass*, No. 1:02-CR-146 (M.D. Pa.).

[50] *U.S. v. Grass*, No. 1:02-CR-146 (M.D. Pa.).

[51] Indictment, *U.S. v. Grass*, No. 1:02-CR-146 (M.D. Pa.); *see* "Ex-Rite Aid execs indicted," (June 21, 2002), available at http://money.cnn.com/2002/06/21/news/companies/riteaid/.

[52] Taub, Stephen, "Jury Conviction for Former Rite Aid Exec," CFO.com (October 21, 2003), available at http://www.cfo.com/printarticle/0,5317,10939|C,00.html?f=options.

[53] "Another Sentencing Date Set For Rite Aid Exec," WHTM.com (August 19, 2004), available at http://www.whtm.com/news/stories/0804/166657.html.

[54] *Id.*

The SEC action. Brown was also named as a defendant in civil proceedings brought by the SEC alleging accounting fraud.[56] In its civil lawsuit, the SEC asserts claims against Brown for: (1) violating Section 17(a) of the Securities Act; (2) violating Section 10(b) of the Exchange Act and Rule 10b-5; (3) violating Section 13(b)(5) and Rules 13b2-1 and 13b2-2; (4) violating Section 14(a) of the Exchange Act and Rules 13a-11 and 14a-9(a) (controlling person liability); and (5) violating Section 20(a) of the Exchange Act and Rules 12b-20 and 13a-1 (controlling person liability).[57] The forms of relief sought by the SEC against Brown included permanent injunctive relief, civil monetary penalties, a bar against Brown acting as an officer or director of a public company in the future, and disgorgement of ill-gotten gains, including performance-based bonuses.[58]

Securities fraud litigation. Brown was named as an individual defendant, along with other corporate directors of Rite-Aid, in a number of securities litigation class actions. The allegations leveled against Brown, however, involved duties allegedly owed by Brown as a result solely of his status as Vice-Chairman of the Board of Directors and not as a result of his status as Chief Legal Counsel or Executive Vice-President.[59]

The allegations of wrongdoing that were leveled at Franklin Brown include the following:

- having knowledge of a wire transfer in which $2.6 million was wired from Rite-Aid to CCA Associates, Inc., whose only shareholders were Martin Grass and a member of his family and not taking steps to disclose the related-party nature of the transaction;

- engineering a payment of $11 million in order to settle a lawsuit that had been brought by a fired Senior Vice-President in response to a threat by that individual that he would go public with his knowledge of Rite-Aid's practice of upcharging its vendors for damaged and outdated goods credits;

- executing loan guarantees without the Board's knowledge or consent and creating Certificates of Excerpts from Minutes that falsely represented that the Board had authorized him to execute the loan guarantees;

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[55] "Former Rite Aid CEO Pleads Guilty To Conspiracy," WSOCTV.com (June 17, 2003), available at http://www.wsoctv.com/print/2274654/detail.html?use=print. It has been reported that Brown had been offered a chance to plead guilty to one count, but backed out of a plea agreement during the summer of 2003. *See* Taub, "Jury Conviction for Former Rite Aid Exec," *supra* note 40.

[56] *S.E.C. v. Bergonzi*, No. 1:CV-02-1084 (M.D. Pa.); *see* S.E.C. Litigation Release No. 17577 (June 21, 2002), available at http://www.sec.gov/litigation/litreleases/lr17577.htm.

[57] Complaint ¶¶ 69-94, 100-113, *SEC v. Bergonzi*, No. 1:CV-02-1084 (M.D. Pa.), available at http://www.sec.gov/litigation/complaints/complr17577.htm.

[58] Complaint, Prayer for Relief, *SEC v. Bergonzi*, No. 1:CV-02-1084 (M.D. Pa.), available at http://www.sec.gov/litigation/complaints/complr17577.htm.

[59] *See In re: Rite Aid Corporation Securities Litigation*, MDL-1360 (Master File No. 99-CV-1349 (SD) (E.D. Pa.); *Manzo v. Rite Aid Corporation*, No. 184511-NC (Del. Chancery Ct., New Castle County); *In re Rite Aid Corporation Derivative Litigation*, No. 174440-NC (Del. Chancery Ct., New Castle County). The *Manzo* lawsuit was dismissed on December 19, 2002. The other lawsuits appear to have been resolved either directly or indirectly via a class settlement upon terms that did not require Brown to make any settlement payment.

•participating in the creation of severance letters for certain employees containing lucrative severance payments that were back-dated to periods in which Grass was still Rite-Aid's CEO;

•falsifying, or causing others to falsify documents;

•paying a former employee of Rite-Aid $5,000 cash in exchange for agreeing to sign an affidavit that would provide necessary support for Rite-Aid's accounting entries;

•attempting to learn how to alter the internal clock on company computers in order to make the file generation date match the dates on back-dated letters;

•conspiring to inflate Rite-Aid's reported income; and

•misleading federal investigators and Rite-Aid's internal investigators.

D. James Derrick, Rex Rogers, Kristina Mordaunt, Scott Sefton, and Jordan Mintz (Enron)

The accounting scandal at Enron is now the stuff of legend. The media saturation that followed the revelation of Enron's problems and the coverage of the details of the particular types of accounting manipulations involved may be unprecedented. This article assumes that readers have a passing familiarity with the basic details of Enron's demise. However, as short refresher, the following is a pared-down timeline of some of the most noteworthy events involved:

•August 2000 – Enron shares are trading at their highest price ever of $90.

•December 2000 – Enron announces that Jeffrey Skilling will assume the position of CEO in February 2001, while Kenneth Lay, who had been Chairman and CEO, will remain Chairman.

•August 14, 2001 – Skilling resigns after only six months as CEO. Lay reassumes the CEO role.

•August 22, 2001 – Sherron Watkins, an Enron finance executive, has a private meeting with Lay and discusses her concerns that accounting fraud might ruin Enron. Watkins had previously provided Lay with an anonymous memo that said "I am incredibly nervous that we will implode in a wave of accounting scandals."

•October 16, 2001 – Enron reports a $638 million third-quarter loss and also discloses a $1.2 billion reduction of shareholder equity.

•October 24, 2001 – Andrew Fastow is removed from his position as CFO.

•November 8, 2001 – Enron restates its financials for the preceding 5 years to show losses of $586 million.

•November 28, 2001 – Enron's stock share price drops below $1.

•December 2, 2001 – Enron files bankruptcy.

•January 23, 2002 – Lay resigns as Enron's Chairman and CEO.[60]

An incredible amount of public scrutiny has been directed toward executives such as Kenneth Lay,[61] Andrew Fastow,[62] and Jeffrey Skilling.[63] However, the role played by Enron's in-house counsel has also been the subject of some significant media attention.[64]

Enron filed for bankruptcy in the Southern District of New York on December 2, 2001.[65] In the bankruptcy proceedings, the court, pursuant to 11 U.S.C. § 1104(c), authorized and directed the appointment of an examiner. On May 22, 2002, the United States Trustee appointed R. Neal Batson, an attorney with Alston & Bird, LLP in Atlanta, as the Enron examiner and the Batson appointment was approved by the bankruptcy court on May 24, 2002.[66] Batson's first three interim reports were released on September 21, 2002, January 21, 2003, and June 30, 2003, respectively. On November 4, 2003, Batson's fourth and final report was publicly released.[67]

The Final Report of Neal Batson, Court-Appointed Examiner (the "Batson Report") is the most complete, publicly-available analysis of the questionable accounting and business practices that

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[60] Associated Press, "Chronology of Enron Corp.," (July 15, 2004), available at http://www.newsday.com/business/nationworld/wire/sns-ap-enron-chronology,0,6766906.story?coll=sns-ap-business-headlines.

[61] Lay is the former Chairman and CEO of Enron. Lay resigned from Enron on January 23, 2002, and was indicted on federal criminal charges on July 7, 2004. *See* Crawford, Krysten, and Arena, Kelli, "Enron's Lay Indicted," (July 7, 2004), available at http://money.cnn.com/2004/07/07/news/newsmakers/lay/; "Lay resigns as Enron Chief," *CNN.com* (January 24, 2002), available at http://www.cnn.com/2002/US/01/23/enron.lay/.

[62] Fastow is the former CFO of Enron and was ousted from that position on October 24, 2001. Fastow was indicted on federal criminal charges on October 31, 2002, and pled guilty on January 14, 2004. *See* Rogers, Jen, "Fastow and his wife plead guilty," (Jan. 14, 2004), available at http://money.cnn.com/2004/01/14/news/companies/enron_fastows/; "Enron's ex-CFO seeks protection from lawsuits," *HoustonChronicle.com* (June 21, 2002), available at http://www.chron.com/cs/CDA/story.hts/front/1465229.

[63] Skilling resigned from his position as CEO of Enron in August 2001, after serving only 6 months in that role. He was indicted on federal criminal charges on February 19, 2004. "Skilling indicted for fraud," (Feb. 19, 2004), available at http://money.cnn.com/2004/02/19/news/companies/skilling/.

[64] France, Mike, "What About Enron's Lawyers?" *BusinessWeek Online* (December 23, 2002), available at http://businessweek.com/magazine/content/02_51/b3813093.htm; France, Mike, "The Case of Enron's Top Lawyer," *BusinessWeek Online* (Dec. 19, 2002), available at http://businessweek.com/bwdaily/dnflash/dec2002/nf20021219_2395.htm;

[65] *In re Enron Corp.*, No. 01-16034 (AJG) (S.D.N.Y.)

[66] Final Report of Neal Batson, Court-Appointed Examiner, November 4, 2003, p.1 ("Batson Report") (available at http://www.enron.com/corp/por/examinerfinal.html. The full report is also available at http://www.acca.com/public/article/corpresp/batsonreport.pdf.

[67] The fourth and final report, including Appendices A-G spans 1,115 pages. In total, the collection of all four reports from Batson spans 4,440 pages.

ultimately led to Enron's descent into bankruptcy. Anyone interested in gaining an understanding of the nature and details of those accounting and business practices should look to the Batson Report and not this article. In an attempt at the briefest of summaries regarding the nature of the wrongdoing at Enron, the primary accounting issues at Enron involved failure to properly disclose the existence and scope of related party transactions, its use of special purpose entities (SPEs) to manipulate its financial picture, and Enron's proclivity for entering into transactions that had no legitimate business purpose in order to bolster its balance sheet.

Appendix C to the Batson Report is entitled "Role of Enron's Attorneys."[68] Appendix C focuses upon Enron's outside counsel,[69] as well as certain of its in-house counsel, and the roles they played in certain SPE transactions, Enron's disclosures about those transactions, and the internal investigation launched by Enron in response to allegations of wrongdoing that were made in a letter sent to Kenneth Lay by Sherron Watkins, an Enron employee and former accountant.[70] That portion of the Batson Report advised that Batson had concluded that Enron had potentially viable claims for malpractice and breach of fiduciary duty against five of its in-house counsel: James Derrick, Rex Rogers, Kristina Mordaunt, Scott Sefton, and Jordan Mintz.

All this said, do be aware that the Batson Report is not intended as a complete evaluation of the liability of Enron's former lawyers, which would take into account factual and legal defenses that these lawyers might have. The report was commissioned to assist Enron's bankruptcy trustees in evaluating whether to pursue claims against these lawyers. In other words, it identifies claims that Enron may possess for which a conclusion could be reached that factual issues exist that would require a jury determination, *i.e.*, claims that would survive summary judgment. Specifically, the standard applied in the Batson Report for determining that a claim was potentially viable is expressed as follows:

> Where the Examiner reaches the conclusion that there is *sufficient evidence for a fact-finder to conclude* that a claim exists, the Examiner has determined that in a legal proceeding regarding such matter, the proposition would be submitted to the fact-finder for decision. In most cases, the fact-finder would be a jury, although in equitable subordination actions the bankruptcy court serves as the fact-finder. The decision of the fact-finder would be made after evaluating the documentary evidence, the testimony and credibility of witnesses and the reasonable inferences that may be drawn from this evidence.[71]

The Batson Report also made clear, with regard to malpractice claims against any professional, where normally a qualified expert opinion would be necessary that the standard of care was not satisfied, that "[w]here the Examiner reaches the conclusion *that there is sufficient evidence for a fact-finder to conclude* that these types of negligence claims exist, the Examiner has determined that the plaintiff would be able to produce a qualified expert to express such an opinion."[72]

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[68] Appendix C to the Batson Report is available for download in two parts at http://www.enron.com/corp/por/examinerfinal.html and can also be found at http://www.acca.com/public/article/corpresp/batsonappendix.pdf.

[69] Specifically, the law firms of Vinson & Elkins, L.L.P. and Andrews Kurth LLP. Batson Report, Appendix C at 21-26.

[70] Batson Report, Appendix C at 26-176.

[71] Batson Report at 13-14 (emphasis in original).

[72] Batson Report at 14 n. 26 (emphasis in original).

The Batson Report outlined three types of causes of action that may be viable: (1) legal malpractice premised upon a failure to comply with Texas Rule 1.12[73] (Texas' corollary to ABA Model Rule 1.13)[74]; (2) legal malpractice based on negligence; and (3) aiding and abetting the Enron officers' breaches of fiduciary duty. The Rule 1.12 and aiding and abetting claims would require *actual knowledge* of the wrongdoing on the part of counsel. The Batson Report concludes that only circumstantial evidence of this exists.

As for aiding and abetting, the attorney needs to have actual knowledge, needs to have given substantial assistance (routine services will not constitute substantial assistance), and the resulting injury needs to be direct or reasonably foreseeable result of the conduct. The Batson Report notes that, although this standard would apply to in-house counsel as well, because of the fiduciary duties owed by an in-house counsel who is also an officer of the company,[75] their conduct is better viewed through the breach of fiduciary duty prism than aiding and abetting concepts.[76]

The Batson Report identified the following in-house counsel at Enron as individuals against whom claims believed to be viable enough to withstand summary judgment could be made:[77]

James Derrick

Derrick, a former partner at Vinson & Elkins LLP and former judicial clerk on the United States Court of Appeals for the Fifth Circuit, is the former General Counsel of Enron.[78] According to the Batson Report, Derrick "viewed his principal role as administrator of the law department,

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[73] "Texas Rule 1.12 addresses the attorney's role when the attorney represents an organization (such as a corporation) and learns that a representative of the organization has committed or intends to commit a violation of law which might reasonably be imputed to the organization (such as the dissemination misleading financial information)." Batson Report, Appendix C at 3. "Thus, an attorney for Enron who knew that (i) an officer was engaging in wrongful conduct, (ii) substantial injury to Enron was likely to occur as a result of that conduct, and (iii) the violation was within the attorney's scope of representation, but failed to take appropriate affirmative steps to cause reconsideration of the matter -- including referral of the matter to a higher authority in the company, including, if appropriate, the Enron Board -- would not have acted as an attorney of reasonable prudence would have acted in a similar situation." Batson Report, Appendix C at 4.

[74] The text of Texas Rule 1.12 and comments is available at: http://www.txethics.org/reference_rules.asp?view=conduct&num=1.12.

[75] Rex Rogers, Scott Sefton, and Jordan Mintz, in addition to being in-house counsel, also each were corporate officers holding the title of Vice President.

[76] Batson Report, Appendix C at 5.

[77] Subsequent to the completion of the Batson Report, the bankruptcy court in New York gave permission to plaintiffs' counsel representing Enron's creditors in a civil fraud and negligence suit pending in Texas to name in-house counsel at Enron as defendants in that suit. "Judge says Enron creditors may sue law firms, auditor," *Houston Business Journal* (Dec. 2, 2003), available at http://www.bizjournals.com/houston/stories/2003/12/01/daily13.html?jst=s_rs_hl.

[78] Prepared Witness Testimony of James V. Derrick, Jr., Esq. before the House Committee on Energy and Commerce's Subcommittee on Oversight and Investigation (March 14, 2002), available at http://energycommerce.house.gov/107/hearings/03142002Hearing511/Derrick,Jr.855.htm.

relying upon the general counsel of each business unit to manage the attorneys and transactions within that business unit."[79] Derrick became Enron's General Counsel in 1991.

Enron's in-house legal department was comprised of approximately 250 attorneys and was highly decentralized. Each of Enron's business units had its own legal department that was supervised by a general counsel for that business unit.[80] Within each business unit's legal department, the attorneys were given various titles such as "Senior Counsel," "Assistant General Counsel," and "Vice President."[81] Each general counsel for the business units had dual reporting obligations with an obligation to report to the head of the particular business unit and to Derrick.[82]

Derrick's oversight of the activities of other Enron in-house counsel included weekly meetings in his office involving the general counsel of Enron's major business units and monthly meetings in his office that also involved the general counsel of Enron's entities located overseas.[83] Derrick played a significant role in litigation involving Enron, but apparently did not get involved in business transactions generally unless something specific was brought to his attention.[84] Derrick often attended meetings of Enron's Board of Directors, but primarily attended such meetings for the purpose of making presentations to the Board about litigation matters and rarely gave legal advice to the Board.[85]

Derrick also was responsible for retaining Vinson & Elkins to head up Enron's investigation launched in response to Enron employee Sherron Watkins' letter to Enron Chief Executive Officer Kenneth Lay expressing serious concerns with Enron's business and accounting practices.[86]

The potential allegations of wrongdoing against Derrick identified in the Batson Report include the following:

•failing to educate himself as to the underlying facts and governing law with regard to the LJM1/Rhythms Hedging Transaction prior to advising the Enron Board of Directors regarding the basis on which it could approve that related party transaction;

•failing to have any substantive involvement in any Enron business transactions unless a particular issue was brought to his attention;

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[79] Batson Report, Appendix C at 11.

[80] Batson Report, Appendix C at 15.

[81] Batson Report, Appendix C at 17 n. 25.

[82] Batson Report, Appendix C at 17.

[83] Batson Report, Appendix C at 18.

[84] Batson Report, Appendix C at 11.

[85] Batson Report, Appendix C at 11. In fact, Derrick personally made a presentation to Enron's Board about whether Enron's Code of Conduct would prohibit Fastow from having an ownership interest in one of Enron's SPEs -- known as LJM1. *Id.*

[86] Batson Report, Appendix C at 159-166.

•rarely advising the Board of Directors and failing to advise them even when significant issues came to his attention;

•failing to confirm that other lawyers to whom he had delegated responsibility were adequately performing their duties;

•failing to inform himself adequately about the content of Enron employee Sherron Watkins' letter to Lay that expresses concerns about Enron's business and accounting transactions; and

•failing to inform himself adequately about Enron outside counsel Vinson & Elkins' involvement in the transactions criticized by Sherron Watkins' letter prior to tasking Vinson & Elkins with investigating the allegations.[87]

Potential causes of action. The Batson Report identifies and concludes that Enron might have viable causes of action against Derrick for legal malpractice based on negligence, but concluded that claims for aiding and abetting a breach of fiduciary duty by Enron officers, or legal malpractice premised upon a failure to comply with Texas Rule 1.12 (the Texas equivalent of ABA Model Rule 1.13), would not be viable claims against Derrick.[88]

Securities litigation. Derrick is an individually-named defendant in a securities fraud class action suit filed in federal court in Texas by former Enron shareholders.[89] Derrick has also been added as a named individual defendant to a shareholders derivative lawsuit pending in state court in Montgomery County, Texas.[90]

Rex Rogers

At the time that the Enron scandal broke, Rogers held the title of Vice President and Associate General Counsel.[91] He was the Enron in-house attorney with primary responsibility for Enron's securities disclosures. All SEC filings and SEC-related matters went through him.[92] Rogers supervised approximately eight attorneys and was near the top of Enron's organizational chart.[93]

Rogers provided legal advice as the lead attorney with respect to Enron's SEC filings, including such items as proxy statements and annual and quarterly reports.[94]

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87 Batson Report, Appendix C at 190-191.

88 Batson Report, Appendix C at 11-12, 190-191

89 *In re Enron Corp. Securities Litigation*, No. H-01-3624 (*Wilt v. Fastow*, No. H-02-0576) (S.D Tex.).

90 *Official Committee of Unsecured Creditors of Enron Corp. v. Fastow et al.*, Case No. 02-10-06531 (Dist. Ct. for 9th Judicial Dist., Montgomery County, Texas).

91 Batson Report, Appendix C at 15 n.17.

92 Batson Report, Appendix C at 17.

93 Batson Report, Appendix C at 17 n. 27.

94 Batson Report, Appendix C at 82 n.310

Rogers also was somewhat involved in the Watkins investigation, meeting with Enron employee Sherron Watkins after she circulated her letter to Lay.[95]

The potential allegations of wrongdoing against Rogers identified in the Batson Report include the following:

•failing to fulfill his responsibility to Enron with regard to advising it as to how it must disclose SPE transactions;

•failing to inform the Enron Board of the Raptors restructuring in early 2001 which involved the issuance of stock;

•failing to make certain that the 2001 proxy statement disclosed Fastow's compensation from the LJM2 transactions; and

•substantially assisting Enron's officers in intentionally withholding information from the Board.[96]

Potential causes of action. The Batson Report identifies and concludes that Enron might have viable causes of action against Rogers for legal malpractice based on negligence, legal malpractice based on failure to take remedial action in violation of Texas Rule of Professional Conduct 1.12, and breach of fiduciary duty.[97]

Securities litigation. Rogers is an individually-named defendant in a securities fraud class action suit filed in federal court in Texas by former Enron shareholders.[98] Rogers has also been added as a named individual defendant to a shareholders derivative lawsuit pending in state court in Montgomery County, Texas.[99]

Kristina Mordaunt

Mordaunt was the in-house attorney with Enron who was responsible for certain SPE transactions occurring in 1997, known as the Chewco transactions. At that time, Mordaunt was the Assistant General Counsel of Enron Capital and Trade.[100]

Mordaunt served as a senior in-house counsel on a number of SPE transactions within Enron Global Finance, after Enron Global Finance and its corresponding legal department had been created in the third quarter of 1999.[101]

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[95] Batson Report, Appendix C at 159.

[96] Batson Report, Appendix C at 191-193.

[97] Batson Report, Appendix C at 191-193.

[98] *In re Enron Corp. Securities Litigation*, No. H-01-3624 (*Wilt v. Fastow*, No. H-02-0576) (S.D Tex.).

[99] *Official Committee of Unsecured Creditors of Enron Corp. v. Fastow et al.*, Case No. 02-10-06531 (Dist. Ct. for 9th Judicial Dist., Montgomery County, Texas).

[100] Batson Report, Appendix C at 110.

With regard to another scrutinized SPE transaction, the LJM1 Formation and the LJM1/Rhythms Hedging Transaction, it appears that Mordaunt may have been directing the legal work on Enron's behalf, but the full scope of her role is murky in light of the fact that "Mordaunt has exercised her Fifth Amendment Privilege" with respect to the topic.[102] Neither Mordaunt, nor any other Enron attorneys who were actually involved with the LJM1/Rhythms Hedging Transaction, were present at the time this transaction was presented to the Board of Directors for approval in June 1999.[103] Instead, as noted above, Derrick, who had not actually worked on the transaction, made the Board presentation.

Mordaunt also came under fire in connection with an investment she made into one of Enron's SPE's – Southampton. Mordaunt invested less than $6,000 in Southampton, one of Enron's SPEs, without receiving the necessary approval, and received a return on her investment in excess of $1 million.[104]

The potential allegations of wrongdoing against Mordaunt identified in the Batson Report include the following:

- failing to adequately analyze the conflict of interest created by an Enron officer also serving as general partner of Chewco;

- failing to inform Enron's Board of the related party nature of the Chewco transaction despite knowing that the Board believed that Chewco was not affiliated with Enron;

- actively participating in the LJM1/Rhythms Hedging Transaction which was intended solely to manipulate Enron's financial statements; and

- placing her personal interests ahead of her client's and entering into a prohibited transaction with her client in connection with her $1 million profit on her unapproved investment in Southampton when she knew that LJM1 was a related party.[105]

Potential causes of action. The Batson Report identifies and concludes that Enron might have viable causes of action against Mordaunt for legal malpractice based on negligence or a breach of her own fiduciary duty, legal malpractice based on failure to take remedial action in violation of Texas Rule of Professional Conduct 1.12 and for aiding and abetting a breach of fiduciary duty.[106] In addition, the Batson Report also concluded that Enron might have viable causes of action against

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[101] Batson Report, Appendix C at 18.

[102] Batson Report, Appendix C at 116.

[103] Batson Report, Appendix C at 119.

[104] Batson Report, Appendix C at 13.

[105] Batson Report, Appendix C at 193-194.

[106] Batson Report, Appendix C at 12-13, 193-194.

Mordaunt for legal malpractice involving violation of Texas Rule of Professional Conduct 1.06(b),[107] and legal malpractice involving violation of Texas Rule of Professional Conduct 1.08.[108]

Scott Sefton

Sefton joined the legal department of Enron Gas Services in 1994. From January 1995 to September 1999, he was the acting chief legal counsel at Enron Global Finance in London. He was named Vice President and General Counsel of Enron Global Finance and returned to Houston in September 1999. In that final position at Enron, he reported directly to Fastow and to Enron's Deputy General Counsel.[109]

As Enron Global Finance's General Counsel, Sefton had what the Batson Report describes as an "overview" of the Enron Global Finance transactions.[110] Sefton became aware of conflict of interest issues posed by certain of Enron's SPEs, including Project Nahanni, and certain related party transactions, but did not advise Enron's Board of those issues.[111] Sefton was also one of the two in-house attorneys at EGF principally involved in another of the controversial Enron SPEs known as "The Raptors."[112]

Sefton resigned from Enron in October 2000 after he was informed that he was being replaced as EGF's General Counsel.[113]

The potential allegations of wrongdoing against Sefton identified in the Batson Report include the following:

- knowingly facilitated, as lead counsel, the Project Nahanni transaction which had no business purpose other than to impact Enron's financial statements;

- failing to advise the Enron Board, or even Derrick, of the conflict of interest issues related to the LJM1 and LJM2 transactions; and

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[107] "Texas Rule 1.06(b) provides that an attorney shall not represent a party if the representation of that party becomes adversely limited by the attorney's own interest." Batson Report, Appendix C at 194.

[108] Batson Report, Appendix C at 194. "Texas Rule 1.08 forbids an attorney from entering into a business transaction with a client unless, in general, the terms of the arrangement are fair to the client, the terms are understood by the client, the client has an opportunity to seek advice of counsel and the client gives written consent as to the attorney's participation." *Id.*

[109] Batson Report, Appendix C at 19.

[110] Batson Report, Appendix C at 19. "Sefton had to be informed of all transactions underway at Enron Global Finance to manage the workload of the attorneys in his department. 'Deal flow sheets' (a report listing all pending transactions and the attorneys assigned to each project that was prepared and circulated to attorneys in EGF Legal) and a 'mission critical' list provided Sefton with a summary of such transactions." *Id.*

[111] Batson Report, Appendix C at 72.

[112] Batson Report, Appendix C at 14.

[113] Batson Report, Appendix C at 20.

•participating in two of the four LJM2/Raptors Hedging Transactions which had no business purpose other than to impact Enron's financial statements.[114]

Potential causes of action. The Batson Report identifies and concludes that Enron might have viable causes of action against Sefton for legal malpractice based on negligence, legal malpractice based on failure to take remedial action in violation of Texas Rule of Professional Conduct 1.12, and breach of fiduciary duty.[115]

Jordan Mintz

Mintz succeeded Sefton as General Counsel to Enron Global Finance, but also held the title of Vice-President.[116] Mintz remained in the position of General Counsel for EGF until December 2002.[117] As had Sefton, Mintz "received sufficient information to have an overview of the transactions undertaken by Enron Global Finance, including the 'mission critical' list of pending deals."[118]

Mintz also served as lead in-house counsel for Enron with regard to the $2.6 million dollars payment to the Chewco SPE.[119] Despite having a strong belief that Enron was not required to make such a payment, Mintz complied with instructions regarding the making of that $2.6 million payment to Chewco without ever advising Derrick or any other officer of his opinion.[120]

In addition, Mintz personally was involved in a Board presentation in which certain information regarding the investment activity of one of Enron's SPEs was purposefully held back from Enron's Board.[121] Mintz also was aware that Fastow desired to keep information from the Board regarding the level of compensation he was receiving from one of Enron's SPEs. Mintz also was the recipient of an internal legal memorandum written by Stuart Zisman that expressed a concern about "financial statement manipulation" at Enron, and was himself the author of a memorandum that identified a number of concerns with the way certain related-party transactions were being approved by Enron.[122]

The potential allegations of wrongdoing against Mintz identified in the Batson Report include the following:

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114 Batson Report, Appendix C at 194-197.

115 *Id.*

116 Batson Report, Appendix C at 20 & n.42. Mintz had originally joined Enron in 1996 as Vice President of Tax for Enron Capital and Trade. *Id.* at 20, n.42

117 Batson Report, Appendix C at 20, n.42.

118 Batson Report, Appendix C at 20.

119 Batson Report, Appendix C at 131.

120 Batson Report, Appendix C at 134.

121 Batson Report, Appendix C at 129.

122 Batson Report, Appendix C at 132.

•knowingly assisting an Enron officer, Fastow, in violating his fiduciary duty of loyalty to Enron by not disclosing to the Board or to Derrick that Fastow did not want the Board to know the extent of his LJM compensation;

•participating in a presentation to Enron's Board that failed to include pertinent information regarding LJM2's investment activity with Enron during 2000, specifically that Enron had repurchased certain assets from LJM2;

•failed to adequately perform his role as counsel with regard to determining whether Fastow's interest in the LJM transactions needed to be disclosed;

•failing to disclose to Derrick, senior Enron officers, or the Board his misgivings regarding the LJM2 transactions; and

•failed to take any actions to prevent Enron from paying $2.6 million to Chewco despite believing that Enron was not legally obligated to make said payment.[123]

Potential causes of action. The Batson Report identifies and concludes that Enron might have viable causes of action against Mintz for legal malpractice based on negligence, legal malpractice based on failure to take remedial action in violation of Texas Rule of Professional Conduct 1.12, and breach of fiduciary duty.[124]

E. Drake Tempest (Qwest Communications)

Pervasive problems with Qwest Communications' accounting treatment of a variety of types of transactions came to light after Qwest was involved in a reverse acquisition with U.S. West. After completing its own internal investigation and undergoing a re-audit, Qwest expunged $2.5 billion of revenue based on what it deemed improper accounting from its 2000-2002 books.[125]

During the time periods in question, Drake Tempest, who started with Qwest in October 1998, was the General Counsel, Executive Vice President, and Chief Administrative Officer.[126] In September 2002, during congressional hearings regarding Qwest and Global Crossing, Tempest's role in setting financial goals at Qwest and accomplishing deals was a subject of much focus.[127] Committee Chairman Rep. Billy Tauzin (R-La.) read an anonymous e-mail during the hearing that alleged that Qwest's CEO, Joseph Nacchio, and Tempest set "impossible" financial goals for Qwest

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123 Batson Report, Appendix C at 197-201.

124 *Id.*

125 Backover, Andrew, "Qwest resists SEC request for report," *USA Today* (May 28, 2003), available at http://www.usatoday.com/money/industries/telecom/2003-05-27-qwest-probe_x.htm.

126 Qwest Press Release, "Qwest Announces Top Executive Team for Merger with US West," (March 3, 2000), available at http://www.qwest.com/about/media/pressroom/1,1720,250_archive,00.html. Previously, Tempest had, at one point, held the title of Corporate Secretary of Qwest. *See* http://www.qwest.com/about/investor/financial/reports/1998/board.html.

127 Hudson, Kris, "Previous regime's players scrutinized," *Denver Post* (Sept. 25, 2002), available at http://www.denverpost.com.

and that, as a result, Qwest managers bent the rules in order to achieve the financial goals that had been set.[128]

Tempest has publicly denied that Qwest intentionally published "misleading financial statements by electing an accounting treatment for optical-capacity sales that other companies do not use."[129]

In 2002, the SEC launched a formal probe of Qwest. Initially, the focus of that probe was Qwest's accounting treatment of asset swaps engaged in with other telecommunications companies. The SEC's investigation subsequently expanded, however, to include a comprehensive review of a number of accounting issues at Qwest from 2000 to 2002.[130] In April 2004, it was reported that settlement talks between the SEC and Qwest had broken down over the amount of the fine that the SEC was seeking from Qwest.[131] On September 10, 2004, however, reports began to surface in the media that Qwest had agreed to pay a quarter of billion dollars to settle with the SEC.[132]

In December 2003, the SEC reportedly notified at least eight current and former Qwest executives that they were being investigated in relation to Qwest's swap transactions.[133] It is unclear whether Tempest is among those being investigated by the SEC. It has been reported that "several small companies that supply telecom gear to Qwest disclosed in recent months that federal investigators have contacted them about their dealings with Qwest. Of interest is whether Qwest executives forced suppliers to grant them stock." Former General Counsel Tempest is among the executives at Qwest who accepted stock from Qwest's suppliers.[134]

In mid-April 2004, the criminal prosecutions of four mid-level Qwest executives on trial in federal court in Denver did not result in a single guilty verdict.[135] Two of the four executives were completely acquitted of all charges. One of the executives was acquitted on some of the charges while the jury deadlocked on the remaining charges. The jury deadlocked as to all of the charges

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128 *Id.*

129 Letter to the Editor of Drake Tempest, *Denver Post* (Sept. 10, 2001).

130 Backover, Andrew, "Federal investigation of Qwest's books widens," *USA Today* (May 30, 2003), available at http://www.usatoday.com/money/industries/telecom/2003-05-29-quest-usat_x.htm.

131 Hudson, Kris, "Qwest Reaches Impasse with SEC over Accounting Probe Fines," (April 15, 2004), available at http://www.miami.com/mld/miamiherald/business/national/8442006.htm.

132 *See* "Qwest settling SEC charges," *Denver Business Journal* (September 10, 2004), available at http://denver.bizjournals.com/denver/stories/2004/09/06/daily34.html.

133 Hudson, Kris, "Qwest case outcome may ripple," *Denver Post* (April 5, 2004), available at http://www.denverpost.com.

134 *Id.*

135 Cook, Dave, "Qwest Prosecutors End Up Empty-Handed," (April 19, 2004), available at http://www.cfo.com/article/1,5309,13338||A|93|,00.html.

against the fourth executive.[136] To date, there have been no reports as to whether or not the government will pursue any retrial with regard to the deadlocked charges.

From November 1999 to April 2001, Tempest allegedly sold 466,600 shares of Qwest stock resulting in proceeds in the amount of $20,876,780.[137] Tempest has been named as a defendant both in securities fraud class action litigation against Qwest and in a shareholders' derivative class action on Qwest's behalf against a number of Qwest's former officers and directors.[138] With regard to the securities fraud class action litigation, the plaintiffs' claims against Tempest, which involve primarily allegations of insider trading and responsibility for certain statements and omissions in Qwest's public filings under the "group published" doctrine, have withstood a motion to dismiss.[139]

Securities fraud class action.[140] The claims asserted against Tempest in the securities fraud class proceedings are for: (1) violating Section 10(b) of the Exchange Act and Rule 10b-5; (2) violating Section 20A of the Exchange Act; and (3) Section 11 of the Securities Act.

Shareholder derivative suit.[141] The claims asserted against Tempest in the shareholders derivative suit involve: (1) intentional breach of fiduciary duty; (2) negligent breach of fiduciary duty; (3) gross negligence; (4) corporate usurpation; (5) waste of corporate assets; (6) abuse of control; (7) unjust enrichment; (8) gross mismanagement; (9) violation of Section 14A of the Exchange Act; (10) breach of contract; and (11) contribution and indemnification.

The allegations of wrongdoing that were leveled at Tempest in the securities fraud class action and shareholders' derivative suits include the following:

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136 Vuong, Andy and McGhee, Tom, "Qwest trial ends in no convictions," *Denver Post* (April 18, 2004), available at http://www.denverpost.com.

137 Fourth Consolidated Securities Complaint ¶ 255, *In re Qwest Communications Int'l, Inc., Securities Litig.*, Civil Action No. 01-RB-1451 (PAC) (consolidated with Civil Action Nos. 01-RB-1472, 01-RB-1527, 01-RB-1616, 01-RB-1799, 01-RB-1930, 01-RB-2083, 02-RB-0333, 02-RB-0374, 02-RB-0507, and 02-RB-0658) (D. Colo.).

138 *See In re Qwest Communications Int'l, Inc., Securities Litig.*, Civil Action No. 01-RB-1451 (securities fraud class action) and *Troch v. Anschutz et al.*, Civil Action No. 01-RB-2083 (PAC) which have been consolidated with each other and with Civil Action Nos. 01-RB-1472, 01-RB-1527, 01-RB-1616, 01-RB-1799, 01-RB-1930, 02-RB-0333, 02-RB-0374, 02-RB-0507, and 02-RB-0658) (D.Colo.).

139 "The false statements alleged in the Complaint all were made in registration statements, prospectuses, SEC forms, or in statements to the press concerning Qwest's financial performance. All of these statements are subject to a presumption of collective action by corporate directors and officers under the group publication doctrine." *In re Qwest Comms. Int'l, Inc. Securities Litig.*, Civil Case No. 01-RB-1451 (CBS) (Consolidated with Civil Action Nos. 01-RB-1472, 01-RB-1527, 01-RB-1616, 01-RB-1799, 01-RB-1930, 01-RB-2083, 02-RB-333, 02-RB-374, 02-D-507, 02-RB-658, 02-RB-755, 02-RB-798), 2004 U.S. Dist. LEXIS 584, at *36 (D. Colo., January 13, 2004).

140 *In re Qwest Communications Int'l, Inc., Securities Litig.*, Civil Action No. 01-RB-1451 (Consolidated with Civil Action Nos. 01-RB-1472, 01-RB-1527, 01-RB-1616, 01-RB-1799, 01-RB-1930, 01-RB-2083, 02-RB-0333, 02-RB-0374, 02-RB-0507, and 02-RB-0658) (D. Colo.).

141 *Troch v. Anschutz et al.*, Civil Action No. 01-RB-2083 (PAC) (Consolidated with Civil Action Nos. 01-RB-1451, 01-RB-1472, 01-RB-1527, 01-RB-1616, 01-RB-1799, 01-RB-1930, 02-RB-0333, 02-RB-0374, 02-RB-0507, and 02-RB-0658) (D. Colo.).

•signing multiple Registration Statements which incorporate inaccurate and misleading financial information;

•failed to make a reasonable investigation into whether the statements contained in certain Registration Statements and prospectuses were true and did not omit material facts;

•failing to ensure that Quest did not engage in fraudulent and illegal activity;

•misusing his position to profit through the receipt of friends and family shares of stock from vendors seeking to do business with Qwest in violation of federal and state law;

•engaging in insider trading; and

•failing to act independently to fulfill the fiduciary duties owed to Qwest and its shareholders by approving improper stock grants to other members of Qwest's Board.

F. Mark Belnick (Tyco)

At the beginning of 2002, questions arose about the integrity of Tyco's financial statements and their accounting treatment, and the SEC began an investigation into the activities of certain Tyco executives, including its CEO, Dennis Kozlowski, and its CFO, Mark Swartz. In response, Tyco's stock declined from its opening price of $58.80 per share on January 2, 2002, to a closing price on January 31, 2002, of $35.15 per share.[142] On May 3, 2002, Tyco received a subpoena in connection with a criminal tax investigation of Kozlowski. Tyco's Chief Corporate Counsel Mark Belnick, in response to that subpoena, retained separate criminal counsel for Kozlowski and for Tyco, but apparently did not advise Tyco's Board of Directors regarding the subpoena being received.[143]

Prior to joining Tyco, Belnick was an attorney with Paul, Weiss, Rifkind, Wharton & Garrison in New York City from 1971 into 1998 (with the exception of a one-week stint in 1994 as Cornell's general counsel).[144] Belnick is often described as a close friend and protégé of the late Arthur Liman.[145] While in private practice, Belnick had served as a co-counsel, along with Liman, to the United States Senate Committee investigating the Iran-Contra affair.[146] Belnick joined Tyco as its Chief Corporate Counsel in 1998.

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[142] *See* http://bigcharts.marketwatch.com for historical stock quote information for Tyco Int'l (symbol: TYC).

[143] Rozen, Miriam, "Losing It All," *Corporate Counsel* (Jan. 21, 2003), available at http://www.law.com/jsp/cc/pubarticleCC.jsp?id=1045686304997.

[144] *Id.*

[145] Lin, Anthony, "Ex-Tyco GC Belnick Acquitted of All Charges," *New York Law Journal* (July 16, 2004).

[146] *Id.*

On June 3, 2002, Kozlowski resigned as CEO of Tyco. The next day he was indicted on criminal tax evasion charges. On June 10, 2002, Tyco terminated Belnick's employment.[147] On June 17, 2002, Tyco filed a civil lawsuit in the United States District Court for the Southern District of New York against Belnick seeking to recoup $30 million in allegedly undisclosed compensation, bonuses, and interest-free loans paid to Belnick.[148]

Tyco lawsuit.[149] Tyco's lawsuit against Belnick asserts the following causes of action: (1) breach of fiduciary duty; (2) inducing breach of fiduciary duty by Kozlowski; (3) conspiracy to breach fiduciary duty; (4) accounting; (5) constructive trust; and (6) fraud.[150] Tyco seeks the following forms of relief as against Belnick: (1) an award of damages; (2) forfeiture; (3) restitution; (4) an accounting; and (5) a declaratory judgment that Belnick's Retention Agreement is void.[151]

On October 21, 2002, Belnick filed a demand for arbitration with the American Arbitration Association, and a motion to compel arbitration, based upon an arbitration provision contained in what Belnick contends is his employment agreement with Tyco.[152] Tyco's lawsuit against Belnick was subsequently transferred to multi-district litigation in the United States District Court for the District of New Hampshire.

Criminal proceedings.[153] On September 12, 2002, Belnick was indicted by New York state authorities on six counts of falsifying business records; the indictment was later amended on February 3, 2003, to add three more counts, including one count of grand larceny.[154] The larceny charge related to Belnick's acceptance of a $12 million bonus that prosecutors allege he knew at the time he received it had not been authorized by the Board. Belnick's criminal trial in New York state court began in May 2004. On July 15, 2004, during the fifth day of the jury's deliberations, Belnick was acquitted of all criminal charges.[155]

SEC lawsuit.[156] In addition to the unsuccessful criminal proceedings against him and the lawsuit filed by Tyco, the SEC filed civil proceedings against Belnick on September 12, 2002, related

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147 Rozen, "Losing It All," http://www.law.com/jsp/cc/pubarticleCC.jsp?id=1045686304997.

148 Complaint (filed June 17, 2002), *Tyco Int'l Ltd. v. Belnick*, No. 02-CV-4644 (S.D.N.Y.).

149 Amended Complaint filed September 25, 2002, *Tyco Int'l Ltd. v. Belnick*, No. 02-CV-4644 (SWK) (S.D.N.Y.).

150 *Id.* ¶¶ 96-138.

151 *Id.* at 41-42

152 *See* October 28, 2002, letter from David W. Shapiro to Judge Shirley Wohl Kram.

153 *People v. Belnick*, No. 5258/02 (N.Y. Supreme Court).

154 *People v. Belnick*, No. 5258/02 (N.Y. Supreme Court); *see* "Tyco Counsel Charged with three further counts," (Feb. 4, 2003), available at http://www.srimedia.com/artman/publish/article_376.shtml.

155 Associated Press, "Belnick acquitted of grand larceny, securities fraud, falsifying records," *MSNBC.com*, (July 15, 2004), available at http://www.msnbc.com/id/5444957.

156 *S.E.C. v. Kozlowski*, No. 02-CV-7312 (S.D.N.Y.).

to insider trading and the failure to publicly disclose aspects of his compensation.[157] The SEC has asserted the following claims against Belnick: (1) violation of Section 17(a) of the Securities Act; (2) violation of Section 10(b) of the Exchange Act and Rule 10b-5; (3) violation of Section 13(a) of the Exchange Act, Rule 12b-20, and Rule 13a-1; (4) violation of Section 14(a) of the Exchange Act and Rule 14a-9; (5) violation of Section 13(b)(2)(A) of the Exchange Act and Rule 13b2-1; and (6) violation of Section 13(b)(5) of the Exchange Act and Rule 13b2-2.[158]

The SEC seeks the following forms of relief against Belnick: (1) disgorgement of all loan amounts he received from, and did not properly repay to, Tyco; (2) disgorgement of imputed interest on all low-interest or interest-free loans from Tyco that he should have publicly disclosed; (3) disgorgement of a dollar amount equal to the financial losses Belnick avoided through his allegedly manipulative stock sales; (4) disgorgement of all rent payments he received from Tyco for his home office located in his Utah residence; (5) an award of prejudgment interest as to all disgorged sums; (6) imposition of civil monetary penalties; (7) a bar preventing Belnick from serving in the future as an officer or director of a public company; and (8) a permanent injunction against Belnick committing future violations of federal law.[159]

The allegations of wrongdoing that have been leveled against Belnick include the following:

•failing to prevent the making of, and once made failing to disclose, low-interest and interest-free loans to Kozlowski and Swartz by Tyco;

•accepting low-interest and interest-free loans himself which had not been properly authorized by Tyco's Board and which had allegedly not even been disclosed to Tyco's Board;

•failing to disclose certain of his personal sales of Tyco stock;

•failing to cooperate with and/or attempting to interfere with Tyco's internal investigation into wrongdoing at Tyco;

•failing to repay to Tyco amounts that Belnick allegedly has admitted he owes to Tyco;

•instructing, through counsel, that Tyco delete information from Belnick's work computer, and personally deleting electronic information, in violation of Tyco policies that Belnick himself, as general counsel, created;

•failing to make certain that Tyco's Board was properly informed of all information that it reasonably needed to know, including instances of self-dealing, conflict-of-interest transactions, and serious legal or ethical issues;

•failing to disclose to Tyco's auditors the existence of a second version of each of his compensation agreements with Kozlowski;

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[157] S.E.C. Litigation Release No. 17722 (Sept. 12, 2002), available at http://www.sec.gov/litigation/litreleases/lr17722.htm.

[158] Complaint ¶¶ 62-74 (filed Sept. 12, 2002), *SEC v. Kozlowski*, No. 02-CV-7312 (S.D.N.Y.).

[159] Complaint at 20-22, *SEC v. Kozlowski*, No. 02-CV-7312 (S.D.N.Y.).

•accepting unauthorized loans from Tyco pursuant to a loan program for which he knew he did not qualify;

•engaging in self-dealing with regard to his 2002 employment agreement;

•misleading Tyco's Board with regard to the status and details of Belnick's 2002 Retention Agreement;

•approving SEC filings by Tyco that were not truthful, complete, or accurate;

•failing to disclose to Tyco's Board that an unauthorized $20 million "finder's fee" payment had been made by Kozlowski to Frank Walsh in connection with Tyco's acquisition of CIT and failing to advise the Board that it had the legal right to recover that unauthorized payment; and

•failing to timely advise Tyco's Board of the criminal investigation against Kozlowski.

G. Jonathan Orlick (Gemstar)

On March 18, 2002, Gemstar, a seemingly successful entity that was known for its interactive television program guide, announced the resignation of its co-president Peter Boylan, effective April 1, 2002. Simultaneous with the announcement of Boylan's resignation, Gemstar announced that Jonathan Orlick was being promoted from Senior Vice President and Deputy General Counsel to Executive Vice-President and General Counsel.[160] Approximately at the same time, Gemstar warned Wall Street that its licensing and technology revenues would drop by 50% during 2002, despite the company having previously reported solid earnings for the first quarter.[161]

In January 2003, Orlick, who is also a former member of Gemstar's Board of Directors, was replaced as Executive Vice President and General Counsel and appointed to a newly-created position at Gemstar, President of Intellectual Property.[162] In March, 2003, Gemstar announced that it would be restating its financials in an ultimate amount of approximately $200 million dollars.[163]

In June 2003, the SEC filed a securities fraud lawsuit against former Gemstar CEO Henry Yuen and former Gemstar CFO Elsie Yeung.[164] The securities fraud alleged to have occurred at

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[160] "Gemstar-TV Guide Announces Management Changes, Licensing Deal with JVC," *Digital Media Wire* (March 18, 2002), available at http://www.digitalmediawire.com/archives_031802.html.

[161] Donohue, Steve, "Boylan Resigns From Roiling Gemstar," *Multichannel News* (March 25, 2002), available at http://print.google.com/print/doc?articleid=hmmnQOOSuIK.

[162] "Publishing Industry Soundbytes," *The Write News* (Jan. 10, 2003), available at http://www.writenews.com/2003/011003_soundbytes.htm.

[163] Gemstar-TV Guide Press Release, "Gemstar-TV Guide International Announces Further Anticipated Restatements Related to Previously Disclosed Review," (March 10, 2003), available at http://www.gemstartvguide.com/pressroom/display_pr.asp?prId=149.

[164] Patrick, Aaron, "Ex-Gemstar head charged with fraud," *The Age* (June 29, 2003), available at http://www.theage.com.au/articles/2003/06/28/1056683948989.html.

Gemstar involves the manipulation of financial results by improperly reporting licensing and advertising revenue for its interactive television program guide from agreements that had either expired, were disputed, or did not exist; improperly reporting advertising revenue for its interactive television program guide for related transactions, including "round-trip" transactions as if they were unrelated transactions; improperly classifying revenues derived from its other business sectors as if those revenues were related to advertising for its interactive program guide; improperly reporting advertising revenue received from *TV Guide* for its interactive television program guide when Gemstar had not actually run the advertising; and improperly recognizing revenue during a twelve-month period from an eight-year licensing contract with AOL.[165]

On June 5, 2003, Orlick was fired by Gemstar "for cause."[166] On July 9, 2003, Orlick filed a defamation lawsuit against Gemstar claiming that the "for cause" designation was defamatory in that Orlick had not been convicted of any felony and had not been sued for fraud or embezzlement.[167] In addition to naming Gemstar as a defendant, Orlick's suit named Gemstar's CEO and Rupert Murdoch, CEO of NewsCorp, which owns 42% of Gemstar.[168] Orlick's defamation lawsuit seeks both damages and a retraction of the company's statements that the termination was for cause. Apparently, Orlick also has contended that he was terminated only after he tried to retrieve documents from his office that Gemstar had failed to provide to the SEC.[169] In February 2004, Gemstar submitted for approval a proposed settlement of securities fraud class claims against it in which it would pay to settlement class members $67.5 million in cash and stock.[170] In connection with the announcement of the proposed settlement of that class action, Gemstar advised that it would pursue its own claims against former management.[171] It is unclear whether Gemstar is contemplating a lawsuit against Orlick.

On January 5, 2004, Orlick was added as a named defendant by the SEC in its securities fraud lawsuit previously filed against Yuen and Yeung.[172] The SEC has asserted claims against Orlick for the following: (1) violations of Section 10(b) of the Exchange Act and Rule 10b-5; (2) violations of Section 13(b)(2)(A) of the Exchange Act and Rule 13b2-1; (3) violations of Section

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[165] S.E.C. Litigation Release No. 18199 (June 20, 2003) available at http://www.sec.gov/litigation/litreleases/lr18199.htm.

[166] "Former Gemstar counsel sues for defamation," (July 9, 2003), available at http://losangeles.bizjournals.com/losangeles/stories/2003/07/07/daily30.html.

[167] *Id.*

[168] *Id.*

[169] Patrick, "Ex-Gemstar head charged with fraud," at http://www.theage.com/au/articles/2003/06/28/1056683948989.html.

[170] Veiga, Alex, "Gemstar-TV Guide settles shareholder suits for $67.5 million in cash, stock," *CANOE Money* (Feb. 12, 2004), available at http://money.canoe.ca/News/Sectors/Media/2004/02/12/345577-ap.html. Orlick was not a named defendant in that securities fraud class action lawsuit.

[171] *Id.*

[172] S.E.C., "SEC Sues Three Additional Former Senior Executives of Gemstar-TV Guide for Their Part in Financial Fraud," (Jan. 5, 2004), available at http://www.sec.gov/news/press/2004-1.htm; "SEC sues 3 more ex-Gemstar executives," *MSNBC.com* (Jan. 6, 2004), available at http://msnbc.msn.com/id/3887659/.

13(b)(5) of the Exchange Act and Rule 13b2-2; (4) aiding and abetting violations of Section 13(a) of the Exchange Act, Rule 13a-1, and Rule 13a-13; and (5) aiding and abetting violations of Rule 12b-20.[173]

The SEC seeks the following forms of relief against Orlick: (1) civil monetary penalties; (2) disgorgement of ill-gotten gains, including his salaries, bonuses, and the proceeds he received from sales of Gemstar stock; (3) a bar against Orlick serving in the future as an officer or director of a public company; and (4) a permanent injunction against Orlick engaging in any other violations of federal law. Although the SEC has not pursued similar relief against Orlick, it is worth noting that the SEC previously employed Section 1103 of the Sarbanes-Oxley Act of 2002 to obtain a court order placing into escrow and under court supervision "approximately $37.64 million in cash payments that Gemstar had previously agreed to pay Yuen and Leung."[174]

The allegations of wrongdoing that have been leveled at Orlick by the SEC include the following:

- participating in Gemstar's fraudulent disclosure and recording of interactive television program guide licensing and advertising revenue;
- knowingly failing to disclose that Gemstar was improperly recognizing and reporting material amounts of revenue;
- making false representations to Gemstar's auditors regarding the status of negotiations between Gemstar and Scientific Atlanta;
- falsifying Gemstar's books and records; and
- aiding and abetting reporting and record-keeping violations committed by others at Gemstar.

IV. Possible Effects of Recent High-Profile Cases on Sources of Exposure for Corporate Counsel

It seems clear from the above discussion of certain criminal and civil litigation brought against corporate counsel, as well as from several other high-profile cases,[175] that corporate counsel

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[173] S.E.C. Litigation Release No. 18530 (Jan. 6, 2004), available at http://www.sec.gov/litigation/litreleases/lr8530.htm.

[174] *Id.*

[175] David Rosenblatt, the former General Counsel and Senior Vice President of Homestore, and Nancy Temple, a former in-house attorney for Arthur Andersen, also found themselves named as individual defendants in class action securities fraud lawsuits, but unlike Drake Tempest of Qwest, they were able to secure trial court rulings dismissing those claims against them under the PSLRA (Private Securities Litigation Reform Act of 1995). *See In re Homestore.com, Inc. Securities Litig.*, 252 F. Supp. 2d 1018 (C.D. Cal. 2003); *In re Enron Corp. Securities, Derivative & ERISA Litigation*, 2003 WL 230688 (S.D. Tex. 2003).

Also, David Klarman, the former general counsel of US Wireless, was indicted in connection with allegations involving embezzlement and ultimately pled guilty in December 2003 to mail fraud and money laundering. "High-tech exec pleads guilty to mail fraud, money laundering," *Silicon*

are being named as individual defendants in securities fraud class actions, shareholder derivative lawsuits, criminal proceedings, and SEC investigations and proceedings with increasing frequency. However, setting aside this undeniable increase in frequency of instances in which corporate counsel are caught in the cross-hairs of government or plaintiff's lawyers, it is not altogether clear whether there are any other emerging trends affecting sources of liability exposure for corporate counsel that can be identified as a result of an analysis of these high-profile cases.

A. Impact on Scope of Governmental Liability Exposure?

Perhaps the most important lesson to be learned from these cases is that prosecutors and the SEC now appear to be more willing to pursue criminal and securities fraud charges against corporate counsel than ever before.

Competent, ethical corporate counsel have always known that theft, back-dating documents or otherwise falsifying records, lying to auditors, and tampering with witnesses are all illegal and that corporate counsel who commit such acts risk criminal prosecution. Further, although prior to Lapine's indictment it appears never to have actually happened,[176] corporate counsel also have known that acts of securities fraud could not only result in potential liability to the SEC, but also potential criminal prosecution. But there's certainly a difference between knowing that the possibility exists and knowing that prosecutors have brought such prosecutions and will likely do so again.

1. Criminal proceedings: New developments?

The criminal prosecution of Belnick by New York state prosecutors presented the potential for a drastic expansion of the scope of corporate counsel's liability exposure. As described above, prosecutors charged Belnick with falsifying business records and larceny. It was the larceny charge, however, that had a potentially devastating impact on liability exposure for corporate counsel.

The theory behind the larceny charge lodged against Belnick was that his receipt of an allegedly multi-million dollar bonus from Tyco amounted to a criminal act. As part of his defense, Belnick argued that he believed that the bonus paid to him had been authorized and that he had no reason to take any independent action to determine whether the Board of Directors had authorized such payments. Depending upon the basis for determination, a conviction of Belnick on the larceny charge could have resulted in a staggering increase in corporate counsel's liability exposure: corporate counsel would be faced with the dilemma of independently confirming an executive officer's authority to award compensation, on pain of criminal liability exposure. The idea that it is an affirmative duty of the general counsel to independently confirm executives' authority to take other kinds of actions might follow. The resulting risk of criminal liability for not making the right judgment call and questioning virtually every major decision of your boss is something that should cause general counsel a great deal of discomfort. Since it was a surprise to many in the legal community that Belnick was acquitted by the jury, and since prosecutors were enraged by the verdict, it is entirely possible that similar allegations will be vigorously sought and prosecuted in the future, perhaps with greater "success."

According to media reports, the jury instruction that was given by the judge in the Belnick case made clear that the jurors, when determining the merits of the larceny charge, "could consider

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Valley/San Jose Business Journal (Jan. 27, 2004), available at http://www.bizjournals.com/sanjose/stories/2004/01/26/daily32.html?t=printable.

[176] Hoppin, Jason, "In a First for Feds, General Counsel Is Indicted for Fraud," *The Recorder* (June 6, 2003).

whether Belnick had a good-faith reasonable belief that he had a right to accept the bonus offered by Kozlowski."[177] A jury instruction of that nature certainly helps to ameliorate concerns over the potential breadth of the prosecution's larceny theory. A different instruction could have lead to a much different result.

Fortunately for Belnick, he was acquitted on all counts in the New York criminal proceedings. (As noted, he still faces additional civil suits disputing the appropriateness of his actions, which have yet to come to trial.) Belnick's criminal case acquittal, however, does not necessarily mean that the legal theory offered by the prosecutors for the larceny charge was not, or would not be on other facts, a viable prosecution theory. And, of course, prosecutors read the newspaper accounts of novel theories offered by their colleagues, as much or more than corporate counsel do.

2. SEC proceedings: New developments?

With regard to SEC civil proceedings, it appears from the cases described above that, other than the increased frequency of same, the types of claims being pursued by the SEC and the forms of relief sought remain fairly steady. The provisions that corporate counsel are most likely to find themselves facing, if they are in the unfortunate position of having SEC proceedings initiated against them, include Sections 10(b), 13(a), 13(b)(2)(A), 13(b)(5), 14(a), and 20(a) of the Exchange Act, Sections 11 and 17(a) of the Securities Act, and Rules 10b-5, 12b-20, 13a-1, 13a-11, 13a-13, 13b2-1, 13b2-2, and 14a-9.

3. Sarbanes-Oxley: What impact?

Most corporate counsel are already familiar, to at least some extent, with the corporate governance changes imposed by Congress upon public companies in the Sarbanes-Oxley Act of 2002 and the attorney conduct standards now in place as a result of the SEC's enactment of the final regulations called for under Section 307 of Sarbanes-Oxley ("the Part 205 regulations").[178] In a nutshell, the Part 205 regulations impose a new layer of federal regulation upon corporate counsel that is more specific and more demanding than any professional conduct rules currently in existence at the state level.[179] These regulations focus on the public company attorney's duty to report allegations of wrongdoing up-the-ladder of command within the company, all the way to the board, if necessary. (Please note that Part 205's regulation of attorney conduct was not effective when the cases examined in this article arose, and thus, we are unable to draw any inferences about how such prosecutions will proceed in the future.)

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[177] Maull, Samuel, "Ex-Tyco Counsel Acquitted Amid Plea Talks," (AP Wire, July 16, 2004).

[178] The SEC's Part 205 regulations became effective after a long process of public comment and debate in August of 2003. *See* SEC Implementation of Standards of Professional Conduct for Attorneys, 17 C.F.R. § 205 (2003). *See generally,* ACC's SEC Attorney Conduct Rules' homepage at http://www.acca.com/legres/corpresponsibility/attorney.php; *see also,* "Emerging and Leading Practices in Sarbox 307 Up-the-Ladder Reporting …," available at http://www.acca.com/protected/article/corpresp/lead_sarbox.pdf; *see also* Broc Romanek & Kenneth B. Winer, *The New Sarbanes-Oxley Attorney Responsibility Standards*, ACCA Docket (May 2003), available to ACCA members at http://www.acca.com/protected/pubs/docket/mj03/standard2.php.

[179] However, the lay of the land at the state level is by no means static, The obligations imposed on lawyers by state ethics rules with regard to "reporting up" and "reporting out" for all clients are undergoing significant reform throughout the nation. For the status of these effects, see the ABA's website at http://www.abanet.org/cpr/jclr/jclr_home.html.

Obviously, in light of the fact that Sarbanes-Oxley was enacted in response to the wave of high-profile incidents that included some of the very corporate scandals described above, corporate counsel can and should expect that future SEC proceedings brought against corporate counsel will seek to rely upon some new regulatory and legal weapons granted to government regulators.

Sarbanes-Oxley, however, does not just impose obligations upon corporate counsel. It also provides new remedies to the SEC to be used in pursuing alleged wrongdoing. One example, Section 1103 of Sarbanes-Oxley, grants the SEC the ability to obtain a court order placing into escrow and under court supervision monetary amounts that a company has agreed to pay in the future to the defendant in such proceedings and would appear to be a very powerful new provision in certain circumstances.

4. Erosion of privilege and its consequences

For several years, government regulators and prosecutors alike have been demanding that companies voluntarily turn over reports of investigations of internal misconduct and other related materials that would otherwise be protected by the attorney-client privilege or the work product doctrine.[180] Although the government has often been willing to formally agree with the company involved to maintain the confidentiality of the materials being produced and to include a "non-waiver" provision in the formal agreement, courts have not been uniformly willing to honor government agencies' commitments of confidentiality by accepting this "selective waiver" of privilege or work-product protection as a legal argument for avoid disclosure of those materials to other third parties.[181]

This trend toward the forcing of companies to choose between potentially waiving any right to attorney-client privilege or work-product protection with regard to the rest of the world or incurring the full wrath of the federal government will likely increase, particularly if proposed amendments to sentencing guidelines recently approved by the U.S. Sentencing Commission go into effect.[182] Those proposed amendments suggest that "cooperation" for the purposes of qualifying for

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[180] Federal prosecutors, for example, have been instructed by U.S. Department of Justice leadership to consider during its investigation when determining whether to bring charges and in negotiating any plea agreement whether a company has been willing to waive privilege and work-product protections. Memorandum from Deputy U.S. Att'y Gen. Larry D. Thompson, *Principles of Federal Prosecution of Business Organizations* (Jan. 20, 2003), available at http://www.usdoj.gov/dag/cftf/corporate_guidelines.htm. This policy was originally articulated by Deputy Attorney General Eric Holder in 1999, in a predecessor memorandum entitled, *Bringing Criminal Charges Against Corporations,* or, as it's come to be known, "The Holder memorandum," available at http://www.usdoj.gov/criminal/fraud/policy/Chargingcorps.html

[181] Compare *Tenn. Laborers Health & Welfare Fund v. Columbia/HCA Healthcare Corp. (In re Columbia/HCA Healthcare Corp. Billing Practices Litig.)*, 293 F.3d 289 (6th Cir. 2002) (rejecting the concept of selective waiver) with *Diversified Industries, Inc. v. Meredith*, 572 F.2d 596 (8th Cir. 1978) (allowing selective waiver) and *Teachers Insurance & Annuity Association of America v. Shamrock Broadcasting Co.*, 521 F. Supp. 638 (S.D.N.Y. 1981) (allowing selective waiver in certain situations). *See also*, *U.S. v. Bergonzi,* (September 2004, No. 03-10511, in the Ninth Circuit Court of Appeals), in which McKesson Corporation is trying to convince the court to recognize the company's right to exclude information it shared with the SEC in resolving an allegation against it from being released to subsequent third parties.

mitigation in sentencing should include waiver of attorney-client privilege and work product protection for relevant information. These amendments have been sent to Congress for their approval by Fall 2004.[183]

B. Impact on Scope of Liability to Current and Former Shareholders

Corporate counsel have always been potential targets in the inevitable wave of securities fraud class action suits that follows many earnings restatements and other marked fluctuations of stock prices of publicly-traded companies if they have engaged in extensive stock trading during the time frame of the putative class period. This particular type of liability exposure appears to stem more, however, from their position as an officer or director of the company than from their role as corporate counsel.

For corporate counsel, until recently, the case law with regard to potential liability in securities fraud class actions appeared very favorable, as there could be no "aiding and abetting liability" and corporate counsel could only be liable as a primary violator.[184] The fact that the claims against Tempest survived a motion to dismiss is a cause for some concern. That concern is mitigated, however, by that fact that, even though the claims against Tempest, which relied heavily upon the concept of "group-published information,"[185] were allowed to survive a motion to dismiss under the Private Securities Litigation Reform Act ("PSLRA"), other jurisdictions have reached the conclusion that the "group-published information" doctrine was abrogated by the PSLRA.[186]

Other than the Qwest securities litigation and the survival of the claims against Tempest based solely on the "group-published" information concept, none of the securities fraud class action

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[182] "Sentencing Commission Approves Changes to Guidelines Pertaining to Organizations," Current Reports, ABA/BNA Lawyers' Manual on Professional Conduct, 20 Law. Man. Prof. Cond. 207 (Apr. 21, 2004); Sentencing Guidelines for United States Court, 69 Fed. Reg. 28,993 (May 19, 2004) (a copy of the proposed amendments to the Sentencing Guidelines is available on the Sentencing Commission's website at http://www.ussc.gov/GUIDELIN.HTM); Statement of the Association of Corporate Counsel to the Proposed Changes to Sentencing Guidelines for Corporate Defendants – Chapter 8 (March 17, 2004), available at http://www.acca.com/public/comments/governance/sentence.pdf.

[183] There is increased uncertainty in the land of the federal sentencing guidelines in light of the United States Supreme Court's recent ruling striking down the State of Washington's sentencing guidelines as unconstitutional. *Blakely v. Washington,* 124 S. Ct. 2531 (2004). Footnote nine of the Court's opinion, authored by Justice Scalia, states, "The Federal Guidelines are not before us, and we express no opinion on them." *Id.* at n.9. That language has created substantial debate over whether the federal sentencing guidelines will ultimately survive the inevitable constitutional challenges. *See* Christensen, Dan, "Federal Judge in Miami Rules Sentencing Guidelines Unconstitutional," *Miami Daily Business Review*, (July 21, 2004), available at http://www.law.com/jsp/article.jsp?id=1090180148215. For a collection of materials on developments post-*Blakely*, *see* http://www.nacdl.org/public.nsf/newsissues/blakely?opendocument.

[184] *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994).

[185] *See supra* note 137.

[186] *See, e.g.*, *P. Schoenfeld Asset Mgmt. LLC v. Cendant Corp.*, 142 F. Supp. 2d 589, 619 (D.N.J. 2001); *Alison v. Brooktree Corp.*, 999 F. Supp. 1342, 1350-51 (S.D. Cal. 1999); *Marra v. Tel Save Holdings, Inc.*, No. 98-3145, 1999 WL 317103, at *5 (E.D. Pa., May 19, 1999); *Coates v. Heartland Wireless Comms., Inc.*, 26 F. Supp. 2d 910, 916 (N.D. Tex. 1998).

lawsuits discussed above in which corporate counsel have been named as individual defendants truly alters the landscape with regard to liability exposure for corporate counsel.

Nevertheless, it stands to reason that, in light of the enactment of Sarbanes-Oxley, plaintiffs in securities class actions and plaintiffs in shareholder derivative lawsuits will continue to look to corporate counsel as potential individual defendants and to seek to impose liability upon corporate counsel separate and apart from whether they engaged in extensive trading activity. Given the duties and responsibilities imposed upon corporate counsel with regard to taking remedial actions, under Sarbanes-Oxley, for example, in an effort to try and prevent corporate wrongdoing, it does not take much imagination to identify the types of causes of action that securities fraud class action plaintiffs and shareholder derivative lawsuit plaintiffs will pursue when they believe that corporate counsel had sufficient information regarding wrongdoing and failed to take the appropriate remedial actions to try and prevent or limit the impact of such wrongdoing upon the corporation and public investors. The most obvious provisions for growth include corporate counsel's "reporting up" obligations and allegations that if corporate counsel had properly "reported up" as required that the public would not have been damaged.

Furthermore, in an environment where a company's very survival may increasingly depend upon such complete "cooperation" with criminal investigators or SEC regulators that the company essentially retains no attorney-client privilege, after-the-fact scrutiny by plaintiffs' counsel and others will certainly only increase, thus increasing the sources, and potential, for exposure for those who serve as corporate counsel.

Another provision concerning "whistleblowing" may also actually serve as additional fodder for plaintiffs' attorneys seeking to hold corporate counsel responsible in a securities or shareholders suit. Under Section 806 of Sarbanes-Oxley, a federal cause of action has been created for any corporate employee (including corporate counsel) who provides information or assists in an investigation relating to a company's violation of federal securities or anti-fraud laws.[187] Further, Section 1107 of Sarbanes-Oxley makes the act of retaliation against a "whistleblower" a federal crime punishable by a sentence of up to ten years in prison.[188] Thus, the combination of Sections 806 and 1107 could likely be argued by plaintiffs' counsel in a securities or shareholders suit to have provided sufficient protection such that a corporate counsel who is alleged to have known of wrongdoing, but failed to act on such knowledge, might be argued to have no room to argue an inability to raise legitimate issues in later litigation where she is named as a defendant.

It is not clear how allegations of securities fraud that may rely upon corporate counsel's obligations under Sarbanes-Oxley will fare in light of the pleading requirements set forth by the PSLRA. Thus, even if ultimately the United States Supreme Court determines that the "group-published information" doctrine is no longer viable in light of the PSLRA, there is no reason to believe that corporate counsel will not continue to find themselves being named as individual defendants by plaintiffs in securities fraud class actions and fending off allegations regarding the levels of knowledge they possessed about alleged corporate wrongdoing and what, if any, actions they took to comply with their reporting obligations under Sarbanes-Oxley.

Further, it appears that, given the nature of shareholder derivative actions and how the focus of such lawsuits is different from securities fraud class actions, such actions provide an even more fertile field for the pursuit of claims against corporate counsel (and, significantly, without regard to

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[187] Sarbanes-Oxley Act of 2002 § 806, 18 U.S.C. § 1514A (2004).

[188] 18 U.S.C. § 1513(e).

whether they also happen to be officers or directors of the company) relying upon allegations regarding failure to comply with the obligations imposed on corporate counsel by Sarbanes-Oxley.

C. Impact on Scope of Liability to Client/Employer

Potentially, the most significant development in liability exposure arising from the high-profile cases discussed above is the lawsuit pursued by Tyco against its former general counsel, Mark Belnick. Setting aside the issues that such litigation raises with regard to the effect on the attorney-client privilege[189] and Belnick's ability to use confidential client information to defend himself against the claims made by Tyco, the causes of action pursued by Tyco and the rhetoric they have used in so doing are unusual and worthy of analysis.

From the outset of the story that Tyco tells in its lawsuit against Belnick, Tyco leaves no doubt with regard to the level of obligations it claims are owed to it by its Chief Corporate Counsel:

> •"As one of Tyco's three executive officers, Belnick owed the Company fiduciary duties of honesty, good faith, care, and loyalty."[190]
>
> •"More than any other person, Belnick was obligated to ensure that the Company and its personnel fulfilled their legal and ethical duties, and to ensure that any conflict of interest, self-dealing, or other potentially serious legal or ethical problem was promptly brought to the attention of the Company's Board of Directors."[191]
>
> •"As a knowledgeable professional, Belnick was aware of the very large liability and damage to which the Company would be potentially exposed if it failed to fulfill its disclosure obligations."[192]
>
> •"The Chief Corporate Counsel must be the principal protector of the Board and the Company against the kind of misconduct engaged in by the Company's former Chief Executive Officer."[193]

Despite the direction in which such positions would appear to head, Tyco's Amended Complaint does not ultimately assert any cause of action against Belnick for legal malpractice. Instead, Tyco alleges that Belnick breached his fiduciary duty, induced Kozlowski to breach his fiduciary duty, entered into a conspiracy to breach fiduciary duty, and committed fraud against

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[189] Perhaps not surprisingly, Belnick's replacement as General Counsel of Tyco, William Lytton, has recently been quoted as saying: "For all practical purposes, the attorney-client privilege no longer exists, whether for inside counsel or outside counsel. You have to anticipate that whatever advice you give, at some future point you may have to give that information up to someone who can make your life very difficult if you do not give it up." *ABA/BNA Lawyers' Manual on Professional Conduct*, "Impact on Corporate Attorney-Client Privilege May Not Be All Bad, Some IBA Panelists Say," 20 Law. Man. Prof. Conduct 125.

[190] Amended Complaint ¶ 1 (filed Sep. 25, 2002), *Tyco Int'l, Ltd. v. Belnick*, No. 02-CV-4644 (SWK) (S.D.N.Y.).

[191] *Id.*

[192] *Id.* ¶ 3.

[193] *Id.* ¶ 5.

Tyco.[194] The breach of fiduciary duty cause of action appears to rely both on the fiduciary duty that Belnick, as an attorney, owed to Tyco as his client *and* the fiduciary duty that Belnick, as an officer of the corporation, owed to Tyco. It also appears to raise allegations that should serve as a further basis for corporations and corporate counsel alike to question whether or not it always makes sense for corporate counsel to also be asked to serve in another role as an officer or director of the corporation.

Specifically, Tyco makes certain allegations that almost appear to be "breaches of fiduciary duty squared." Tyco's allegations appear to insist that Belnick in his role as corporate counsel breaches his fiduciary duty to the corporation arising from the attorney-client relationship by not blowing the whistle on his own alleged wrongdoing performed in his role as an officer of the corporation.[195] Possibly, Tyco could make a similar argument against any officer or director of the corporation who fails to be totally candid with the corporation, without regard to whether that officer or director also serves as a lawyer for the corporation. These allegations by Tyco may, however, be more likely directed at supporting its claim against Belnick for inducing the breach of fiduciary duty by others and its claim against Belnick for conspiring with Kozlowski to commit a breach of fiduciary duty.[196]

Interestingly, according to media reports, prior to the acquittal of Belnick by a criminal jury in New York, Belnick had been offered a plea deal that would not only have resolved the criminal charges pending against him, but also Tyco's civil lawsuit.[197] In fact, those reports attribute Belnick's rejection of the offered plea deal because of "terms demanded by Tyco's lawyers."[198]

At one level, the Tyco lawsuit against Belnick may be a little more than an anomaly that arises simply from a set of peculiar circumstances. The fact that other corporations, such as, for example, McKesson HBOC and Rite-Aid have not pursued civil lawsuits against their former corporate counsel despite the fact that both Lapine and Brown were also subjected to criminal charges, may suggest that the Tyco lawsuit is a one-of-a-kind event. The Tyco suit may also simply be a product of underlying animosity between Belnick and Joshua Berman of Tyco, which, according to media reports, simmered throughout Belnick's tenure at Tyco.[199] However, the Belnick lawsuit could nevertheless turn out to be a watershed event and, in light of the clearly expressed obligations that corporate counsel has, under Sarbanes-Oxley, to take action to try and

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[194] *Id.* at ¶¶ 96-114, 131-138.

[195] *See, e.g.*, Amended Complaint ¶ 4. At one level, such an allegation seems closely akin to the notion that under the old ABA Model Code of Professional Responsibility (DR 1-103(A)) an attorney had an obligation of self-reporting to disciplinary authorities and that, as a result, any disciplinary infraction would actually amount to two infractions unless the attorney turned himself in to the disciplinary authorities.

[196] Amended Complaint ¶¶ 102-114.

[197] Lin, Anthony, "Ex-Tyco GC Belnick Acquitted of All Charges," *New York Law Journal* (July 16, 2004).

[198] *Id.*

[199] Rozen, Miriam, "Losing It All," *Corporate Counsel* (January 21, 2003), available at http://www.law.com/jsp/cc/pubarticleCC.jsp?id=1045686304997; Lin, Anthony, "Tyco Dispute Grows More Bitter," *New York Law Journal* (June 19, 2002), available at http://www.law.com.

prevent corporate wrongdoing, such lawsuits may become much more common in the event of future corporate scandals.

The findings in the Batson Report with regard to the potential claims that Enron may have against its in-house counsel provide another example of the possibility that, in the future, companies (or their bankruptcy trustees) will be forced to confront the question of whether they should pursue claims against corporate counsel if, or when, some form of corporate wrongdoing results in significant injury to the corporate entity. In addition to breach of fiduciary duty claims, the Batson Report confronts directly claims not asserted by Tyco in its lawsuit against Belnick — claims for legal malpractice. The Batson Report, however, not only identifies malpractice claims based on negligence, but also specifically based on failure to comply with an obligation under the Texas analog to ABA Model Rule 1.13 to take remedial actions in an effort to prevent corporate wrongdoing, which is similar in large degree to the types of obligations imposed by the federal legislature through Sarbanes-Oxley. It will be intriguing to see whether Enron (through its bankruptcy trustee) follows Tyco's lead and actually follows through with a lawsuit against some or all of the in-house counsel identified in the Batson Report.

Traditionally, the negative implications for the attorney-client privilege of suing one's own attorney have acted as a powerful force weighing against a company ultimately deciding to file a civil suit against its former corporate counsel. Because it has been universally recognized that the attorney-client privilege cannot be used as both a "sword" and a "shield," in making a decision to sue its former corporate counsel, a company must evaluate the ramifications flowing from the fact that the former corporate counsel will be permitted to disclose privileged communications or materials to the extent necessary to defend against the charges against her.

One development that would appear to increase the likelihood that companies will, over time, become more willing to bring suit directly against their own corporate counsel is the erosion to the value of the attorney-client privilege to companies being effected by the increasing insistence by government lawyers that companies waive any claim to attorney-client privilege lest they not be treated as cooperating fully with any governmental investigation.[200] Thus, because companies that find themselves in the midst of a governmental investigation are increasingly being placed into a position where they have to agree to waive the attorney-client privilege in order to be seen as cooperating with the investigation, such companies may have much less of a disincentive to pursuing a suit against their former corporate counsel with regard to any issues that are a part of the governmental investigation.

D. Impact on Scope of Liability to Third Parties

If the Tyco lawsuit against Belnick is the most significant development in the high-profile case studies described above, then the lawsuit by Trace's bankruptcy trustee against Trace's former General Counsel Philip Smith comes in a close second.

Unlike Tyco, Trace is a private company and, as such, the ramifications caused by the imposition of liability and award of damages in excess of $20 million against Smith could even be more far-reaching than Tyco's decision to sue its corporate counsel. In a post-Sarbanes-Oxley world, corporate counsel should not be complacent about their potential exposure based solely on the fact

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[200] See earlier footnote on the Holder and Thompson Memoranda setting policy for federal prosecutors that suggests that they should not negotiate or offer settlement options to non-cooperative targets (defined as those who don't waive privilege). Add to this the Federal Sentencing Guidelines' proscription, in both the original and amended version, that assigns negative "points" to companies that are not cooperative, defined to mean those who, amongst other things, don't waive privilege rights. (http://www.ussc.gov/GUIDELIN.HTM)

that they work for a private or a non-profit employer – the scrutiny that has come to public companies through Sarbanes-Oxley is already focusing in on the private company and not-for-profit sector.[201]

Further, the nature of the claim set forth by the bankruptcy trustee in the Trace proceedings was not only that Smith and others had acted in ways that were harmful to Trace, but that they had acted in ways that were harmful to Trace's creditors. Thus, the lawsuit against Smith in his role as corporate counsel not only creates a precedent to be used against corporate counsel for private or public companies, but also could be used as precedent to extend the scope of duties that a corporate counsel owes to third parties.

The acts and omissions for which Smith was found by the court to have liability all appear to have stemmed solely from his responsibilities as a lawyer for the company, General Counsel, and not because of his status as Secretary or Vice-President of Trace.

The court absolved Smith of any responsibility for the payment of unlawful dividends because it found Smith had adequately discharged his duties to advise regarding the law as to the issuance of dividends.[202] With regard to Smith's liability for unauthorized loans to Cogan and other insiders, the court seems clearly to have concluded (without calling it such) that Smith committed a form of malpractice. The court emphasized that Smith not only did not advise the Board of Directors of Trace of its obligation to approve loans made to Cogan and other insiders, but that he did not believe that the Board of Directors actually had that obligation.[203] The court stated that Smith had admitted to not having read the relevant Delaware statute.[204] The clear tone of the court's ruling in that regard is that Smith failed to fulfill his duty to the company with regard to giving them sound legal advice.[205] However, the court fails to acknowledge or address whether such

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[201] *See* ACC's library of resources on the application of Sarbanes-Oxley principles and standards on private companies and non-profits at http://www.acca.com/vl/search.php?anytext=private+companies&subject=&documenttype=&country=. With a number of states considering or enacting what are essentially mini-Sarbox legislation (applicable to *all* companies in the state), and with insurance, financial, and investment institutions all demanding that their faith in their clients be verified by a showing of best-practice governance, and with prosecutors, the media and other stakeholders assuming that all companies should be held to the same standards of sound leadership and compliance, private companies and non-profits find themselves scrambling to enact reforms that will evidence their commitment to accountability and transparence, in order to compete in a world where public company competition is setting the standards.

[202] *Pereira*, 294 B.R. at 523.

[203] *Id.* at 523-24.

[204] *Id.* at 524.

[205] "Smith, as General Counsel, was supposed to advise the Board as to its obligations and responsibilities. Smith admits never giving the Board advice on the duties of corporate officers. He never discussed with the Board its duty to manage the corporation, the need to establish compliance and monitoring programs or an audit committee, the obligation to make decisions on redemption of the corporation's securities, the obligation to supervise and evaluate Cogan as CEO and to inform themselves as to transactions between Cogan and Trace. Smith did not believe that the directors had

ignorance of the law had any relevance at all given that Smith had never been asked by the Board of Directors to ever provide any legal advice regarding any requirements for approval of such loans.

With regard to its ruling that Smith was liable for negligence in transactions in which Trace redeemed its preferred Trace shares from Dow Chemical Company through Cogan, the court's ruling is less clear with regard to how liability against Smith can be justified based on his status as General Counsel. The only apparent basis for liability against Smith is that the Dow redemption was a redemption occurring at a time when Trace was insolvent.[206] However, it is difficult to fathom how liability can flow to Smith when the court made no finding that Smith either knew, or even should have known, that Trace was insolvent at the time. The court merely concluded that Smith's "active involvement" in the Dow transaction "suggested that it was within his discretionary authority and that he had the ability to prevent the redemption."[207]

The court's ruling is also chilling from the perspective of corporate counsel because it is unclear how Trace, who unlike any creditors was actually Smith's client, was damaged as a result of the "creative solution" that was devised by Smith in that ultimately whether Trace would owe $3 million to Dow or owe $3 million to Cogan, Trace was still going to have to pay someone $3 million. In fact, as the court appears to acknowledge, the whole reason that Smith devised the approach that was used was that Trace would actually have had to pay out $5 million if it had not loaned the $3 million to Cogan to redeem the shares. Thus, ultimately, under the questionable liability standard imposed by the trial court, Smith created personal liability for himself to the tune of $3 million by constructing a transaction that may actually have saved his client $2 million in cash. Further, Smith was not enriched in any way as a result of the transaction, it is at least arguable that none of Trace's creditors were injured, and the transaction appeared to have served to benefit Trace's shareholders.

If nothing else about the *Pereira* decision is clear, it is clear that it is incredibly difficult to reconcile with the traditional notion that an attorney is the agent of his client and not vice versa. The *Pereira* decision finds fault with Smith's conduct because the trial court believed that Smith was obligated to advise the Board of Directors regarding what it should and should not do and specifically failed to properly advise the Board of the "need to establish compliance and monitoring procedures or an audit committee;"[208] however, the court made no finding that Smith's client had asked him to provide any such service and certainly did not provide any guidance on how a General Counsel should go about providing such advice to the board of directors when he has not been asked for any advice on the subject matter. It is difficult to fathom under traditional agency principles one would expect to be applied to an attorney-client relationship how Smith could have been found liable for a failure to render such advice unless he had been charged by the board of directors with providing them advice regarding what sort of standards should be enacted.

The *Pereira* decision likely will significantly alter the landscape of liability exposure unless its impact is effectively limited. As has been noted by a prominent Columbia Law School professor, the ruling against Smith "should particularly chill the hearts of inside general counsel."[209] The best case

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the legal duty to determine if loans should or should not be made to Cogan or other insiders, and he admittedly never read the Delaware statute that made such duty a Board responsibility." *Id.* at 500.

206 *Pereira*, 294 B.R. at 534.

207 *Id.* at 522.

208 *Pereira*, 294 B.R. at 523.

scenario for corporate counsel would involve a reversal or significant alteration of the trial court's ruling on appeal. The worst case scenario is that *Pereira* could mark the beginning of a new legal trend of holding corporate counsel liable for failing to adequately exercise oversight responsibilities over company transactions, even with regard to transactions of which corporate counsel is completely unaware. Given the high-stakes involved in the outcome of *Pereira* on appeal, a number of general counsel and entities have filed an *amicus curiae* brief in appeal before the Second Circuit urging reversal of the *Pereira* ruling and arguing that the trial court's ruling "established an affirmative duty for corporate legal officers to control and supervise the board of directors, ensuring that directors ferret out, expose and prevent transactions that may damage the corporation and others."[210]

V. More Corporate Counsel In The Cross-Hairs: 2004 and Beyond . . .

Clearly, the ultimate outcome of the proceedings mentioned in the case studies above will have a significant impact on the liability landscape for corporate counsel and there will obviously be more such situations that will arise in the days to come. Odds are that the future cases will not be simply dismissed in the wake of Mark Belnick's acquittal, nor as bleak as may be feared as a result of the *Pereira* ruling. And the most recent example of corporate counsel facing governmental liability appears to bear out the conclusion that the sky has not fallen.

On June 3, 2004, the U.S. Attorney's office announced that Leonard Goldner,[211] former General Counsel and Executive Vice President of Symbol Technologies,[212] had been indicted by federal prosecutors.[213] At that same time, the SEC publicly announced that it had charged Goldner with securities fraud.[214] The SEC filed an 82-page complaint detailing the alleged dealings of Goldner and 10 other executives at Symbol. Interestingly, however, the allegations of wrongdoing leveled against Goldner did not relate to the primary fraudulent practices allegedly engaged in by the other Symbol executives, but rather appear to involve completely unrelated events. In fact, at no point does the SEC complaint allege that Goldner was aware of, or should bear any responsibility

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[209] Coffee, John C., Jr., "Post-Enron Jurisprudence," N.Y.L.J. (July 17, 2003), p.5 at 15 col. 2, available at http://www.law.columbia.edu/media_inquiries/news/july_2003/coffee_nyljjuly.

[210] Brief *Amicus Curiae* of Corporate Law Department Section of the Los Angeles County Bar Association et al. in Support of Appellant-Cross Appellee Philip Smith for Reversal at 3, *Pereira v. Cogan*, Nos. 03-5053, 03-5055, 03-5057, 03-5063, 03-5067 (2d Cir.).

[211] Goldner, after representing Symbol for nearly a decade as an outside counsel, joined Symbol as its general counsel in September 1990. According to a national survey, Goldner was the ninth-highest paid general counsel in the nation as of 2000. Bobelian, Michael, "Eight Charged in Fraud Case, Including Former GC," *New York Law Journal* (June 7, 2004), available http://www.law.com.

[212] Symbol, a publicly-traded company, primarily engages in the design, manufacture, marketing, and servicing of bar code scanners and similar devices.

[213] June 3, 2004, Press Release of Robert Nardoza, United States Attorney's Office for the Eastern District of New York, available at http://www.usdoj.gov/usao/nyc/pr/2004jun3.htm.

[214] S.E.C. Litigation Release No. 18734 (June 3, 2004), available at http://www.sec.gov/litigation/litreleases/lr18734.htm.

for, the financial and accounting manipulations allegedly engaged in by other high-ranking officers of Symbol.[215]

Instead, the SEC, and the U.S. Department of Justice alike, have gone after Goldner for an alleged scheme through which Goldner manipulated stock option exercise dates for certain executives including himself, in violation of the terms of Symbol's written stock option plans, including fraudulently backdating official documents regarding the exercise of such options. The SEC has alleged that Goldner violated Sections 10(b), 13(b)(2) and 13(b)(5) of the Exchange Act and Rules 10b-5 and 13b2-1; Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1 and 13a-13; Section 17(a) of the Securities Act; Section 16(a) of the Exchange Act and Rule 16a-3; and Section 14(a) of the Exchange Act and Rules 14a-3 and 14a-9.[216]

The criminal indictment against Goldner, like the SEC complaint, is based upon Goldner's alleged manipulation of Symbol's stock option plan to benefit himself and other selected company executives.[217] The indictment accuses Goldner of falsifying dates on official documents regarding the date that certain options were exercised, using dates that would be more favorable with regard to the amount of tax owed on the transactions.[218] According to prosecutors, these actions amounted to tax evasion and also defrauded Symbol of tax deductions the company could have taken if the appropriate dates had been identified on the official documents.[219] Despite the fact that Goldner was General Counsel, the indictment does not contain any allegations of securities fraud, but does allege conspiracy to commit mail and wire fraud, tax evasion, and conspiracy to impair, impede, and obstruct the Internal Revenue Service.[220]

The federal investigation into alleged accounting manipulations and wrongdoing at Symbol began in April 2001 as a result of the sending of an anonymous letter to the SEC.[221] Symbol also commenced its own internal investigation at about the same time. In connection with its dealings with federal investigators, Symbol has waived the attorney-client privilege.[222]

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[215] These alleged practices which are the focus of the overwhelming majority of the substance of the SEC's complaint included: (1) "fraudulent 'topside' entries" intended "to conform the unadjusted quarterly results to management's projections"; (2) creating "cookie jar" reserves by artificially reducing operating expenses through fabricating and misusing restructuring charges and other non-recurring charges; (3) "channel stuffing" schemes and other schemes for improperly recognizing revenue; and (4) concealing the adverse side effects of their other fraudulent schemes by manipulating levels of inventory and data regarding accounts receivable. *Id.*

[216] Complaint ¶¶ 156-183, 192-201 (filed June 3, 2004), *SEC v. Symbol Techs., Inc.*, (E.D.N.Y.), available at http://www.sec.gov/litigation/complaints/comp18734.pdf.

[217] June 3, 2004, Press Release *supra* note 209.

[218] *Id.*

[219] *Id.*

[220] *Id.*; *see* "Ex-Symbol Counsel Pleads not Guilty to Fraud Charge," (June 8, 2004), available at http://www.nysscpa.org/home/2004/604/2week/article34.htm.

[221] June 3, 2004 Press Release *supra* note 209.

[222] Lohr, Steve, "Ex-Executives of Symbol Technologies Charged With Fraud," *The New York Times* (June 4, 2004).

Interestingly, Sarbanes-Oxley plays a role in the Goldner proceedings, but not perhaps in the way some observers would have expected. The SEC complaint against Goldner states as follows: "Goldner continued the 'look-back' practice until the Sarbanes-Oxley Act of 2002 was enacted into law on July 30, 2002. The legislation's two-day deadline for filing Forms 4 and the prohibition on company loans to officers and directors rendered the practice unfeasible. Under prior law, Forms 4 could be filed as late as the tenth day of the month following the month in which the transaction occurred."[223]

VI. What Corporate Counsel Can Do To Manage Their Liability Exposure

Historically, corporate counsel have not paid the same level of attention toward securing and evaluating the appropriate level of personal protection for their liability exposure in connection with their legal practice as have their counterparts in private practice. Senior-level corporate counsel, who often serve as officers or directors of their corporate employer, have sometimes relied upon indemnification agreements with their corporate employer or directors' and officers' (D&O) liability insurance coverage, if available to them. For junior-level corporate counsel, however, indemnity coverage has historically been thought to be their only option for personal protection from out-of-pocket liability. In the current environment, corporate counsel (senior-level and junior-level alike) can no longer afford to simply assume that traditional indemnity arrangements or D&O coverage provide sufficiently adequate protection.

A. Whither Indemnification?

Indemnification is a straightforward concept. A number of traditional sources for indemnification are commonplace, including indemnity agreements and statutory provisions concerning indemnification obligations. Under either framework, the company is required (either by agreement or by statute) to indemnify its corporate counsel for certain liabilities that corporate counsel may incur in connection with performing her duties for the company. Obviously, indemnification offers no protection for corporate counsel from claims made by the client-employer. What is not as obvious, however, is that the protection afforded by indemnification may also be insufficient for other reasons. Corporate indemnification, in situations where corporate counsel's liability stems from a corporate scandal that itself has the potential to be an entity-threatening event, may not provide a reliable source of relief.

Further, as a result of the increasing pressure placed by prosecutors on companies and the increasing need by companies under investigation to be perceived as cooperating fully with any outside investigation, corporate counsel must begin to seriously question whether reliance solely upon rights of indemnity will be sufficient. As more and more pressure is brought to bear on companies being investigated, and greater and greater requirements are imposed upon those companies in order to be treated as having "cooperated" with any investigations, it can be expected that companies will be pressured to withhold indemnification from those to whom indemnification might otherwise be made available. The SEC has already begun to question the appropriateness of indemnification provided to targeted executives in cases under their investigation, suggesting that it is an inappropriate use of company resources.

The ever-expanding list of requirements being imposed by prosecutors upon the companies they investigate in order to qualify for being considered to be fully cooperating now appears to include refusing to pay the legal costs of employees unless those employees who are willing to talk to

[223] Complaint ¶ 133, *SEC v. Symbol Techs., Inc.* (E.D.N.Y.) available at http://www.sec.gov/litigation/complaints/comp18734.pdf.

prosecutors. A real world example of this concept can be found in the ongoing federal investigation of KPMG.[224] KPMG reportedly has told thirty-two of its employees and partners who have been informed by prosecutors that they are the subjects of a grand jury investigation that it will advance up to $400,000 for their legal costs, but only if those partners and employees agree to talk to prosecutors.[225] Attorneys for nineteen of those partners and employees have been reported as having stated that KPMG has imposed this restriction on the advancement of funds because it believes it has to do so in order to be seen by investigators as fully cooperating.[226]

In this environment, corporate counsel should be wary of assuming that the prospect of indemnification by their employer is sufficient protection alone against their liability risks.

B. Insurance Coverage Options

Other than reliance upon indemnification, out-of-pocket liability protection can be found from liability insurance. The most common types of insurance available are D&O insurance and employed lawyers professional liability insurance.

Directors & Officers Liability Insurance

D&O insurance is usually limited to providing coverage for undertakings by corporate counsel in her role as an officer or director and not when acting as a lawyer, *i.e.*, not when providing professional services or legal advice to the company. However, it can often be written so as to expand the scope of coverage to include other in-house lawyers generally or some limited subset of in-house lawyers, such as in-house lawyers involved in certain types of SEC claims. This type of coverage will also usually contain an exclusion with regard to the payment of fines and penalties.

Many in-house lawyers who believe that their company's D&O policies cover their business actions may find that their insurers will argue that *any* services provided by a lawyer are professional services for which the D&O policy excludes coverage. "'[P]rofessional liability' exposures have traditionally been viewed as outside the normal duties of a director or officer for purposes of D&O insurance."[227] Another layer of difficulty stems from the likelihood that the insurer providing D&O insurance may argue that when a lawyer also happens to be an officer or director, *any* services provided by the lawyer to the company are in the nature of professional services and are excluded from coverage under a D&O policy.[228]

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[224] Cohen, Laurie P., "Prosecutors' Tough New Tactics Turn Firms Against Employees," *Wall Street Journal*, A1 (June 4, 2004).

[225] *Id.*

[226] *Id.*

[227] Chubb Group of Insurance Companies letter of December 17, 2002, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, available at http://www.sec.gov/rules/proposed/s74502/smfitzpatrick1.htm.

[228] For those seeking more extensive information about the topic of D&O liability insurance, *see* Gische, David M., and Fishman, Vickie E., "Directors and Officers Liability Insurance Overview," available at http://profs.lp.findlaw.com/insurance/insurance5.html; and "Does Your D&O Policy Cover Your In-House Legal Staff" (Willis Executive Risks Alert, October 2003), available at http://www.willis.com/news/publications/ER_alert.pdf.

For those more specifically seeking how to confront the D&O insurance issue in a post-Enron environment, *see* White Paper: "Some Thoughts on D&O Insurance Strategies-Post-Enron,"

Employed Lawyers Professional Liability Insurance

Employed lawyers policies are primarily designed as a product to cover claims made against corporate counsel by third parties and are "designed to pick up where a traditional directors and officers liability insurance policy leaves off, providing more specialized coverage for the attorneys."[229] Such policies are usually limited to coverage for professional services rendered and might not extend to acts performed by corporate counsel in connection with business or other fiduciary responsibilities, *i.e.*, as an officer or director. Usually, coverage for the payment of fines, sanctions, or penalties is expressly excluded.[230]

Errors and Omissions Insurance

This type of insurance coverage likely would be the only type of coverage on which corporate counsel could expect to rely if faced with an adverse claim pursued by her employer, such as a claim for legal malpractice.[231]

C. General Counsel's Dilemma

In addition to the personal issues that every corporate counsel faces with regard to questions of indemnification and insurance coverage, corporate counsel who also happen to be General Counsel potentially face the obligation of advising the corporation regarding what types of coverage to provide its corporate counsel.

There is, of course, a natural conflict that is often created between the interests of senior-level corporate counsel and junior-level corporate counsel. As discussed above, junior-level corporate counsel are likely not going to qualify for coverage under normal D&O liability policies. Thus, a company's decision not to provide employed lawyers professional liability insurance coverage will likely leave many such junior-level corporate counsel unprotected (unless those corporate counsel obtain coverage on their own). The failure to offer such coverage to junior-level corporate counsel may serve to make those lawyers more skittish with regard to their obligations, such as "reporting out" or "reporting up," or could create a natural inclination on the part of such corporate counsel to *always* err on the side of reporting any allegations of which they become aware.

Senior-level corporate counsel will often qualify for D&O liability coverage. Thus, senior-level corporate counsel may not feel as great a need for employed lawyers coverage to be made available. However, the key question to be resolved in determining whether the perceived conflict is really a true conflict is whether the particular D&O policy being offered will cover claims against an attorney-officer or attorney-director that involve the provision of professional services or legal advice

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by Charles R. Lotter, Executive VP, General Counsel & Secretary of J.C. Penney Corporation, Inc., available at http://www.acca.com/protected/article/governance/dol_strategy.pdf.

229 Sablak, Laurie J., "Cover Me," *Corporate Counsel* (April 12, 2004), available at http://www.law.com/jsp/cc/pubarticleCC.jsp?id=1071719738502.

230 For greater detail regarding Employed Lawyers policies, *see* Gardner, Eriq, "Naked as a Jaybird," *Corporate Counsel* (Sept. 1, 2003), available at http://www.law.com/jsp/cc/pubarticleCC.jsp?id=1061306535093.

231 *See* Frostic, Dennis L., Brusstar, Thomas A., and Mitrovic, Suzanne, "Legal Malpractice Liability of Employed Attorneys," (ACCA Docket, Fall 1993), available at http://www.acca.com/protected/pubs/docket/fall93/legalmal.html.

to the company. If not, then a decision to offer employed lawyers coverage can be seen as being simultaneously in the best interest of both senior-level and junior-level corporate counsel.

Some of the basic factors for consideration when determining whether a need exists to obtain employed lawyers professional liability insurance include: (1) the extent to which the company can afford to indemnify corporate counsel or to pay for or provide for defense costs for their corporate counsel; (2) internal expectations with regard to the responsibilities of corporate counsel, such as whether they are expected to sign off on opinion letters, certify corporate information, provide legal advice to persons other than their employer, or provide pro bono services; and (3) the potential for liability exposure (*i.e.*, shareholder suits, securities lawsuits, and other third-party claims) that exists in connection with the type of work performed by the particular corporate counsel, or particular segment of corporate counsel.

In the present environment in which corporate counsel are already becoming more likely and inviting targets for inclusion in lawsuits by plaintiffs' counsel, however, an additional issue must be borne in mind. It may be that a company that provides substantial insurance coverage to its corporate counsel, such as a combination of D&O insurance and employed lawyers insurance, could create a perverse incentive to plaintiffs' counsel that could serve to attract claims against corporate counsel by others.[232]

VII. Conclusion

Although the ultimate effect of the last few years of corporate scandal and reform upon the potential liability of corporate counsel remains somewhat unclear and fundamentally unsettled, it is clear that these events have raised the bar and the stakes personally for corporate counsel in many ways. What is clear is that corporate counsel will more often be the focus of government enforcement efforts, including criminal prosecutions and SEC proceedings, as well as shareholder derivative claims, securities fraud class actions, and maybe even malpractice suits by their own clients.

Thus, until the true scope of this changed landscape comes into clear focus, it is incumbent upon corporate counsel to remain vigilant and continually aware of the risks they face from the traditional sources of liability exposure, potential new risks and variations on those traditional sources of liability exposure that may come about if, for example, Tyco's lawsuit against Mr. Belnick meets with judicial success or if the *Pereira* ruling is not rebuked on appeal and the available options for obtaining indemnity and insurance coverage to help manage their own personal liability exposure.

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[232] For a very helpful look at what several companies are doing in this area, *see* "Indemnification and Insurance Coverage for In-House Lawyers: What Companies are Doing," available to ACC members at http://www.acca.com/vl/practiceprofiles.php.

POTENTIAL COVERAGE FOR CLAIMS AGAINST IN-HOUSE COUNSEL

I. Potential Sources of Coverage for In-House Counsel

- Review the indemnification provisions in the company's by-laws or other agreements to determine the potential protection afforded to in-house counsel.

- Review the company's directors' and officers' liability ("D&O") policy and/or professional liability policy to determine if they encompass Claims against in-house counsel.

- Determine if a separate employed lawyers liability policy has been purchased, or should be explored.

II. Potential Protections for In-House Counsel under a Company's D&O Policy

- Review the terms and conditions of the Company's D&O policy, including (but not limited to) the following:

    - Definition of "Wrongful Act"

        - D&O policies generally cover "Loss" arising from "Claims" made against directors and officers for alleged "Wrongful Acts." Some policies define a "Wrongful Act" as alleged breaches of duty, neglect, errors, misstatements, misleading statements or omissions by the Insured in his or her capacity as a director or officer of a corporation or matters claimed against such director or officer *solely* by reason of his or her status as such.

            - Check the definitions in the D&O policy. The word "solely" in the definition of a "Wrongful Act" may lead a carrier to assert, depending on the allegations, that there is no coverage where a director or officer is sued in a dual capacity, i.e. as both a director or officer and outside or in-house counsel. For this reason, Insureds should negotiate to have the word "solely" deleted from the definition of "Wrongful Act," if possible.

            - Insureds may also negotiate an endorsement to the policy which provides specific coverage for "Wrongful Acts" made by general counsel in their capacity as such. For example, some carriers may be willing to offer an enhancement providing "errors and omissions" coverage for all in-house counsel.

- Definition of "Insureds" and/or "Insured Persons"
  - Many D&O policies define "Insureds" and/or "Insured Persons" to be only the directors and officers elected or appointed to such positions in accordance with a company's by-laws and/or certificate of incorporation.
    - If in-house counsel are not otherwise covered by the definition, Insureds may seek to revise the definition of "Insureds" and/or "Insured Persons" to include specific persons who may not legally be officers or directors, such as general counsel and their in-house colleagues.
- Professional Liability Exclusion
  - Many D&O policies contain a Professional Liability Exclusion, which may preclude coverage for Claims arising out of the performance or failure to perform professional services or any act, error or omission relating thereto.
    - If the Exclusion cannot be deleted, it should be narrowed. The language of the Exclusion should be clearly limited to "professional negligence," so that a claim involving the general counsel's business decisions in situations such as settlement are not excluded.
    - In addition, the Exclusion should be limited to liability arising out of work performed for a third party for a fee. The intent is to narrow the Claims that may be excluded.

III. Employed Lawyers Insurance

- If there is potential exposure to in-house counsel and if there is a question as to whether the company's bylaws and/or current policies provide adequate coverage, a company may wish to explore an employed lawyers policy.
- A company should carefully review and negotiate the terms and conditions of an employed lawyers policy just as it would a D&O policy. Consider all the terms and conditions of the proposed policy, including (but not limited to) the following:
  - Does the insurer defend the Claim and provide counsel or is the Insured obligated to defend and seek reimbursement? If the insurer defends, does the Insured or the carrier choose defense counsel? Is use of Panel Counsel required?
  - If the carrier has a duty to defend, does a retention apply to Defense Costs? Is there a retention for non-indemnifiable as well as indemnifiable Claims?
  - How does the policy interact with a D&O policy? Does the employed lawyers policy apply only as excess coverage to a D&O policy?

- How is a "Claim" defined? Does it encompass actions emanating from Section 307 of the Sarbanes-Oxley Act? Are investigations included as "Claims"?

- How are "Legal Services" (or the equivalent term in the policy) defined? Does the definition include pro bono or other services to third parties performed at the request of the Company?

- What constitutes "Loss"? Are fines, penalties or punitive and exemplary damages covered? Are expenses incurred to comply with injunctive relief covered?

- What is the definition of a "Securities Claim"? What is the definition of an "Employment Claim"? Are there sublimits of liability for different types of Claims?

- What is the scope of the definition of "Wrongful Act"?

- What are the exclusions in the policy? Review the "misconduct exclusions," i.e. exclusions for fraud/criminal conduct and the gaining of an illegal profit, in the policy. Do the misconduct exclusions apply only after a final judgment or adjudication that the misconduct occurred or can they be applied based on a lower standard? Are Defense Costs covered even if there is ultimately a criminal conviction or judgment of dishonesty?

- Are the exclusions "severable," so that the misconduct of one Insured does not preclude coverage for "innocent" Insureds?

- What information is considered to be part of the application for the policy? Does the policy contain a severability provision with respect to the application, so that a misrepresentation or omission by one Insured is not imputed to others? How broad is the severability language? Can the policy be made non-rescindable?

** The information for this outline was obtained from the following source:
Carolyn H. Rosenberg et al., *"Protecting Directors, Officers, and General Counsel in the 'New World' of Insurance,"* American Bar Association General Counsel Forum (2004).

