"Hot Button" Enforcement Issues for In-House Counsel
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LAWYER AS TARGET: Lessons Learned From Recent Prosecutions of Corporate Counsel

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The list of in-house and corporate counsel criminally prosecuted for complicity in fraud is growing long enough to give pause to even the most ethical lawyer. Even a civil enforcement action by the Securities and Exchange Commission can be career-ending. Short of that, demotions and terminations of counsel are common when a corporation in the hot seat attempts to demonstrate its *bona fides* to law enforcement by "cleaning house" of wrongdoers -- and of those perceived as enablers of wrongdoing. Can a lawyer protect herself while protecting her client?

Examining some of the recent prosecutions and enforcement actions[2] against counsel reveals a number of principles that may assist counsel in analyzing the best response to a "hot button" client request.

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[2] This does not purport to be a comprehensive review of every enforcement action against corporate counsel, but merely a discussion of some illustrative examples. For a table of cases that is far more comprehensive, upon which the author relied in part in selecting cases for this analysis, *see* Yuri Milkulka and John Horan, *General Counsel Under Attack: Criminal and Enforcement Proceedings, Investigations, and the Travails of In-House Counsel* (October 2007); available at http://www.abanet.org/litigation/committees/corporate/docs/2007_materials_underattack.pdf.

The Role of Counsel: "Advisor" Versus "Implementer"

The role of counsel serving an organizational client varies widely. Some corporate counsel straddle business and legal operations, with a concomitant ability to influence business decisions.[3] Some do pure legal work, but their perspectives are integrated into organizational planning. Others are "implementers" whose primary role is to make management's decisions into reality.

The social science literature sheds some light on the impact of organizational dynamics on lawyers' ethical judgments.[4] But most lawyers whose clients are organizations are familiar with the corporate executive who says "make this happen," without elucidating the rationale, the goal, or the business context. The government enforcement actions that often worry corporate counsel are those in which the lawyer-as-implementer merely drafts the contract (for example) for a deal that the government later labels fraudulent – calling the lawyer a co-conspirator. Sometimes the distinction between the lawyer who is "just doing her job" and the lawyer who is willfully facilitating a fraud is in the eye of the beholder.

Consider, for example, the case of Robert Graham, a former Assistant General Counsel at General Re Corporation, who drafted contracts for a transaction between General Re and AIG. The federal indictment in which he was charged alleged that the transaction was a sham designed to create the appearance that General Re was purchasing reinsurance from AIG, when in reality

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[3] And with concomitant headaches about protecting the attorney-client privilege.

[4] *See e.g.*, Arthur J. Lachman, *"Are They Just Bad Apples? Ethical Behavior in Organizational Settings": An Introduction*, *available at* http://www.abanet.org/cpr/pubs/lachman.pdf.

AIG assumed no risk.[5] Prosecutors said that Graham created a "paper trail" to hide the reality of the sham transaction from auditors; Graham contended that he created the paper that he believed he had to create to effectuate a legitimate deal.[6] The jury accepted the government's version. Graham was sentenced to a year-and-a-day in federal prison, and a $100,000 fine.[7]

Knowledge Is A Double-Edged Sword

Counsel may be forgiven for concluding, at least temporarily, that closing her eyes to the economic reality of a transaction is one path to avoiding an accusation of complicity in fraud. On occasion, counsel's ignorance of the underlying facts, underlying accounting issues, or even the underlying legal issues has been exculpatory. For example,

- Jay Lapine, general counsel at McKesson HBOC, was indicted for securities fraud for drafting "side letters" that allowed customers to withdraw from sales contracts (suggesting that revenue from the contracts should not be recognized).[8] A jury acquitted him, accepting his argument that he was not involved with revenue

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[5] Indictment, Docket Entry #1, United States v. Ferguson, et al., No. 1:06-cr-00033 (E.D.Va. Feb. 1, 2006).

[6] Amy Miller, *Former Top Lawyer Faces Life in Jail for Phony Deal*, CORPORATE COUNSEL, Mar. 28, 2008, *available at* http://www.law.com/jsp/cc/PubArticleCC.jsp?id=1206441807473.

[7] Colleen McCarthy, *Former Gen Re Exec Gets One-Year Sentence*, BUSINESS INSURANCE, Apr. 30, 2009, *available at* http://www.businessinsurance.com/article/20090304/NEWS/200015631.

[8] Superseding Indictment, Docket Entry #160, United States v. Bergonzi et al., No. 3:00-cr-00505-WHA-4 (N.D.Cal. June 3, 2003).

recognition.[9] Significantly, he testified that he tried to investigate how the sales contracts were being booked, but was rebuffed.[10]

- The former general counsel of Peregrine Systems, Eric Paul Deller, was acquitted of securities fraud and wire fraud when the jury apparently accepted his argument that he had not understood the accounting implications of the transactions that he was closing.[11] In contrast, his predecessor as general counsel, Richard Nelson, pled guilty – he was a JD/CPA to whom the ignorance-of-accounting defense was unavailable.[12]

- Daniel Adkins, former in-house attorney at Xpress Pharmacy, an internet pharmacy, was acquitted of the illegal distribution of prescription drugs.[13] His attorneys had argued that he acted in "good faith" and "did not know the details" of his client's operations.[14]

- A jury acquitted McAfee general counsel Kent Roberts of securities fraud in an options backdating case.[15] Jurors focused on what he knew at the time that he

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[9] *See id.*, Jury Verdict, Docket Entry #632 (jury verdict); *see also* Dan Levine, *Guilty Verdict for McKesson Chairman, but GC Acquitted*, LAW.COM, Nov. 20, 2009, http://www.law.com/jsp/article.jsp?id=1202435683122.

[10] Dan Levine, *Trial Begins Anew for McKesson Execs - - but with a Defense Witness from the Other Side*, LAW.COM, Oct. 29, 2009, http://www.law.com/jsp/article.jsp?id=1202435009762.

[11] Judgment of Dismissal, Docket Entry #1408, United States v. Gardner, et al., No. 3:04-cr-02605-W-13 (S.D.Cal. Mar. 27, 2009).

[12] *Former General Counsel and Acting Chief Executive Officer at Peregrine Systems, Inc., Pleads Guilty to Bank Fraud*, News Release (Dept. of Justice, Office of U.S. Att'y S.D.Cal.), Jan. 8, 2009, *available at* http://www.justice.gov/usao/cas/press/cas90108-Nelson.pdf.

[13] Jury Verdict, Docket Entry #354, United States v. Smith et al., No. 0:05-cr-00282-MJD-JJG-1 (D. Minn. Nov. 22, 2006).

[14] Shawn Hogendorf, *Smith Found Guilty in Xpress Pharmacy Direct Case*, PRIOR LAKE AMERICAN, Nov. 22, 2006, *available at* http://www.plamerican.com/news/courts/smith-found-guilty-xpress-pharmacy-direct-case-575.

[15] Jury Verdict, Docket Entry #140, United States v. Roberts, No. 3:07-cr-00100-MHP-1 (N.D.Cal. Oct. 3, 2008).

changed the date – which did not raise red flags about illegality[16] -- and not what he later learned.[17]

A Duty To Inquire?

Shielding oneself from unpleasant news is no way to practice law, of course. A lawyer's duty to her client is always paramount, and an effective lawyer is an informed lawyer.[18] Happily, counsel's duties to her client and her personal interest are unlikely to conflict when the question is whether counsel should take action when she suspects wrongdoing. *See, e.g.*, 15 U.S.C. § 7245 (Sarbanes-Oxley provision mandating the creation of rules requiring "up-the-ladder" reporting). A more difficult question is counsel's general "duty to inquire" when she has no suspicion – but little information – about a transaction. May counsel face personal jeopardy for missing a potential issue?

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16 Backdating an options contract is not illegal *per se*; illegality may arise out of nondisclosures or improper accounting. Presumably the jury in the Roberts case believed that Roberts did not possess information about the "downstream" disclosures and accounting that would flow from the backdating.

Two contrasting cases are (1) the conviction of the general counsel of Monster Worldwide for securities fraud, where he allegedly participated in the planning of the backdating scheme, *see infra* notes 28-29; and (2) the SEC charges against an in-house lawyer for Broadcom who prepared false meeting minutes intended to conceal two instances of backdating (including one instance of backdating his own options), *SEC Charges Four Current and Former Broadcom Officers for Backdating Options*, Immediate Release 2008-87, SEC. & EXCH. COMM'N, May 14, 2008, *available at* http://www.sec.gov/news/press/2008/2008-87.htm. The Broadcom lawyer was also identified as an unindicted co-conspirator in the indictment against other Broadcom personnel.

17 Dan Levine, *No Charges Stick to Former McAfee General Counsel in DOJ Case*, LAW.COM, Oct. 6, 2008, http://www.law.com/jsp/article.jsp?id=1202425039971.

18 The focus of this analysis is counsel's personal exposure to liability for wrongdoing within the corporate client – not the best way to limit the corporate client's exposure, which is a topic thoroughly covered elsewhere.

Some cases do suggest that law enforcement would impose upon counsel a general "duty to inquire" further when faced with a client saying, to the lawyer-as-implementer, "make it happen." For example:

- The SEC charged David Watt, the general counsel of ICN Pharmaceuticals, with participating in the drafting of a false and misleading press release about the significance of a "not approvable" letter from the FDA.[19] The SEC commented, interestingly, that Watt, "who lacked technical and regulatory expertise concerning FDA procedures and policies, did not consult regulatory counsel concerning the significance of the not approvable letter, or review the press release with regulatory counsel."[20] The SEC concluded not that Watt knew that the press release was false, but that he "should have known."[21] Watt settled the case.

- Stanley Silverstein, the general counsel of Warnaco, settled with the SEC over allegations that he approved a statement in the company's annual report attributing a $145 million restatement to start-up costs when it should have been attributed to defects in inventory accounting.[22] Interestingly, PriceWaterhouse Coopers had audited Warnaco' financial statement and did not object to the characterization.[23] The fact that the SEC nonetheless brought an enforcement action against the general counsel may suggest a rather extreme duty to inquire, even in the face of approval by an auditor.

- Senior counsel Kevin Hunsaker of Hewlett Packard relied on the assurances of his outside investigators that the investigative technique of "pretexting" was lawful.[24] He asserted the Fifth Amendment before the House of Representatives Committee on

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19 *In re* Watt, Order Instituting Proceedings, Exchange Act Release No. 46,899, Nov. 25, 2002.

20 *Id.*

21 *Id.*

22 *In re* Silverstein, Order Instituting Public Administrative and Cease-and-Desist Proceedings, Exchange Act Release No. 49,676, May 11, 2004.

23 *Id.*

24 Matt Richtel, *Charges Dismissed in Hewlett-Packard Spying Case*, N.Y. TIMES, Mar. 15, 2007, *available at* http://www.nytimes.com/2007/03/15/technology/15dunn.html.

> Energy and Commerce, and was criminally charged in California state court.[25] The charges were dismissed pending completion of community service.[26] General Counsel Ann Baskins, to whom he reported and to whom he gave assurances of legality, was not prosecuted (although she also took the Fifth before the same House Committee).[27] Perhaps law enforcement concluded that Hunsaker was not entitled to rely on the assurances of his outside investigators, but Baskins was entitled to rely on the assurances of a junior lawyer in her department.

An interesting – and real – dilemma for corporate counsel, particularly for junior counsel or those new to an organization, is the extent to which they are entitled to rely upon longstanding corporate practice. The Monster Worldwide general counsel apparently participated in the planning related to the backdating scheme; he was criminally charged with conduct that began in 1996, when the backdating itself started in 1997.[28] Could an assistant general counsel who joined the company in 1999 properly rely on longstanding practice to eschew further inquiry into the legality of backdating? No junior lawyers were indicted in that case.[29] Michael Belnick, former general counsel of Tyco International, successfully argued to a jury that he relied on longstanding corporate practice when he accepted and failed to disclose interest-free loans and a

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[25] Joel Rosenblatt & Karen Gullo, *Ex-Hewlett-Packard Chair Dunn Charged in Leak Case (Update9)*, BLOOMBERG.COM, Oct. 4, 2006, http://www.bloomberg.com/apps/news?pid=20601103&sid=aWPqoUipt1oE#.

[26] Richtel, *supra* note 24.

[27] *See* Margaret Kane, *HP's Top Lawyer Leaves, Won't Testify*, CNET NEWS, Sept. 28. 2006, http://news.cnet.com/HPs-top-lawyer-leaves,-wont-testify/2100-1014_3-6120551.html. *See also* Richtel, *supra* note 24.

[28] Information, Docket Entry #3, United States v. Olesnyckyj, No. 1:07-cr-00120-JSR-1 (S.D.N.Y. Feb. 15, 2007); see also footnote 16, *supra*.

[29] *Id.*

bonus from the company; he was acquitted after trial.[30] Whether counsel who fails to inquire is satisfying his obligations to his client is a separate question.

Of course counsel who undertakes an inquiry must be certain to follow through on what he learns – or be in a worse spot personally than before. For example:

- John E. Isselman was general counsel at Electro Scientific. Company executives eliminated retirement benefits for certain employees in order to improve the company's bottom line. Isselman knew that the company provided a statement to its auditor saying that it had no legal obligation to provide retirement benefits. He later learned that that statement was incorrect, but he (1) never corrected the information submitted to the auditor, and (2) did not make corresponding changes to the company's 10-Q, which he reviewed, before it was filed.[31] The SEC accused Mr. Isselman of securities fraud. He settled without admitting or denying the SEC's allegations.[32]

- Christi Suzbach, general counsel for Tenet Healthcare, certified that Tenet was in material compliance with federal law and an existing Corporate Integrity Agreement, after she sought and received outside counsel's opinion that physician-compensation arrangements at one Tenet-owned hospital violated the Starks Act.[33] The Department

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[30] Jonathan D. Glater, *Jury Finds Ex-Tyco Lawyer Not Guilty of all Charges*, N.Y. TIMES, July 16, 2004, *available at* http://www.nytimes.com/2004/07/16/business/jury-finds-ex-tyco-lawyer-not-guilty-of-all-charges.html.

Contrast the experience of Clinton Odell Weidner II, former president and general counsel of Capital City Bank, who obtained a loan by approving the extension of an executive's credit line so that the executive could loan him $1.5M to invest in real estate. He was charged, convicted, and sentenced to 78 months in federal prison. See United States v. Weidner, No. 5:02-cr-40140-JAR-1 (D. Kan. Nov, 7, 2002 – Mar. 15, 2004).

[31] *SEC Charges Former Executives of Electro Scientific Industries, Inc. with Financial Reporting Fraud*, Litigation Release No. 18,896, SEC. & EXCH. COMM'N, Sept. 24, 2004, *available at* http://www.sec.gov/litigation/litreleases/lr18896.htm.

[32] *Id.*

[33] Alison Frankel, *Whoops! Should have Filed Sooner! DOJ Lets Ex-Tenet GC off the Hook*, *THE AMERICAN LAWYER*, Apr. 23, 2010, *available at* http://www.law.com/jsp/cc/PubArticleCC.jsp?id=1202448487083.

of Justice brought a civil enforcement action against her under the False Claims Act.[34] The case never reached the merits because it was dismissed on statute of limitations grounds.[35]

- The Department of Justice reportedly considered indicting – but did not ultimately indict – the general counsel of Chiquita Banana, when the company continued making payments to a Colombian terrorist organization after its outside counsel, and Secretary of Homeland Security Michael Chertoff, advised it to discontinue the payments.[36]

Criminal Liability for Bad Legal Advice?

In a sense, many of the cases discussed above could be characterized as punishment for bad legal advice: a bad judgment about materiality, or the effect of a letter from regulators, or the legality of an investigative technique. But one recent case has struck fear in many hearts by raising the question of whether lawyers may face criminal liability for zealous, creative advocacy: the prosecution of outside counsel in the KPMG tax shelter case. Will counsel face prosecution for taking aggressive positions, adverse to the federal government, on complex and cutting-edge legal issues?

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34 Complaint, Docket Entry #1, United States v. Sulzbach, No. 0:07-cv-61329-KAM (S.D. Fla. Sept. 18, 2007).

35 *Id.*, Final Judgment, Docket Entry #144 (Apr. 16, 2010).

36 Carol D. Leonnig, *In Terrorism-Law Case, Chiquita Points to U.S.*, WASH POST, Aug. 2, 2007, *available at* http://www.washingtonpost.com/wp-dyn/content/article/2007/08/01/AR2007080102601.html. Chiquita disputed that Secretary Chertoff actually instructed the company to stop the payments, claiming instead that he promised to look into the matter further after the company self-disclosed the problem to him. The company took the position that it continued the payments only while awaiting further advice from the Department of Homeland Security.

Raymond J. Ruble was a tax partner in the prominent law firm Sidley Austin. He was indicted, convicted, and sentenced to seventy-eight months in federal prison for his role in the tax shelter scheme.[37] Representatives of KPMG sold the shelters to wealthy taxpayers who paid an "all-in fee," calculated as a percentage on the desired tax loss. The "all-in fee" covered fees to KPMG, to Ruble's firm, and to others, as well as a small sham investment.[38] In return for his fee, Ruble supplied opinion letters that would protect the taxpayers from stiff penalties if the IRS later disallowed the losses. As alleged in the Indictment, however, the letters were false in many particulars – but more importantly, they were *form* letters, each virtually identical to the others and to KPMG's own opinion letters. For each of these form letters, Ruble earned approximately $50,000.[39]

These facts are significant to the present analysis because they suggest that Ruble was not in fact indicted for his advice as counsel; if anything, he was indicted for pretending to provide counsel when he did not. Indeed, the Indictment specifically alleged that Ruble acted as a "joint develop[er] and market[er]" of the shelters, rather than the "independent . . . advisor" that he purported to be.[40] If there is a lesson in the KPMG case for corporate counsel, it may be that the closer that counsel hews to her traditional role as advisor, the better off she – and her client – are likely to be.

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37 United States v. Stein, et al., 01:05-crim-888-LAK (S.D.N.Y., filed Aug. 24. 2005).
38 Superseding Indictment in United States v. Stein, attached as Exhibit "A," at ¶ 26.
39 *Id.* at ¶ 35.
40 *Id.* at ¶ 40(e).