Recent Government Scrutiny of In-house Counsel

By David Fein and Robert Hoff

Introduction

When the financial news covers in-house counsel lately, the stories are increasingly about government enforcement actions against those lawyers. Following Enron, other corporate scandals, and the enactment of Sarbanes-Oxley earlier this decade, the Securities and Exchange Commission ("SEC") and the Department of Justice ("DOJ") heightened their scrutiny of lawyers as "gatekeepers" for the public companies they represent. In a speech two years ago, then SEC Enforcement Director Stephen Cutler announced increased enforcement attention on attorneys, whom he referred to as "sentries of the marketplace" whose job it was to "ensur[e] that our markets are clean."[1]

An unprecedented number of SEC and DOJ actions have been brought against attorneys in the last five years. Based on a variety of securities law and other violations, the SEC or DOJ charged in-house counsel at Google, KPMG, Gen Re, Computer Associates, Warnaco, GemStar-TV Guide and Symbol Technologies, among others.

The trend shows no signs of abating as many in-house counsel at public companies have found themselves caught up in the latest corporate scandals. This article will explore two such matters—the SEC's and DOJ's industry-wide stock options backdating investigation and the Hewlett-Packard board leak controversy—and will describe the role of in-house counsel in these controversies.

The Stock Options Backdating Investigation

The SEC's and DOJ's far-reaching investigations of improper backdating of stock options has ensnared over 130 public companies and resulted in the resignation or dismissal of dozens of high-ranking officers and directors. Among those who have resigned or been dismissed are the general counsel of Boston Communications Group, CNET, Comverse Technology, HCC Insurance, IBasis, KB Home, KLA-Tencor, McAfee, Mercury Interactive, Monster.com, and UnitedHealth.[2]

William Sorin, the former general counsel of Comverse Technology, pled guilty on November 2, 2006, to federal charges of conspiracy to commit mail fraud, securities fraud and wire fraud. Referring to the company's former CEO, Kobi Alexander (now a fugitive in Namibia), Mr. Sorin told a federal judge: "I knew what [Mr. Alexander] was doing was wrong and did not challenge his conduct or share my knowledge with the board of directors and auditors of the company." Mr. Sorin said he was complicit in the scheme out of "the respect I had felt for Mr. Alexander" and "my belief in his importance to the success of the company." Mr. Sorin added, "I failed as a lawyer and disserved our shareholders."[3]

Mr. Sorin's admission that he knew the CEO's conduct was wrong at the time, but did not challenge it or expose it to the company's board or auditors, raises a significant question: what should in-house counsel do when she suspects that a senior executive or board member is engaged in wrongdoing? From the SEC's perspective, the answer is clear. The lawyer – as gatekeeper – must act affirmatively to confirm or deny her suspicions and report and put a stop to any illegal conduct that has occurred. As Steve Cutler said, the SEC has "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."[4]

The requirement that in-house counsel report illegal activity is not just embodied in SEC speeches. Sarbanes-Oxley and the SEC regulations promulgated thereunder articulate the "up-the-ladder" reporting requirements for attorneys. While the intricacies of the requirements are beyond the scope of this article, they generally require an attorney who becomes aware of evidence of a material violation of the securities laws by a public company, or by any officer, director, employee, or agent of the company, to report the evidence to the company's chief legal officer, the company's chief legal officer and its chief executive officer, or the audit committee of the company's board of directors, another independent committee of the board or the full board.

In a recent article, one of Enron's former in-house attorneys said business managers at Enron pressured them to wave through deals, with little resistance from the general counsel. "The worst thing you could do at Enron was to be viewed as an obstructionist," he said.[5] Another former Enron lawyer observed that the value attorneys add "boils down to the questions they ask. Lawyers have to push beyond superficial explanations or a simple reliance on the work of others.... Though they can't review every business decision, they should carefully examine important ones. And they shouldn't be 'cowed by their clients.'"[6]

Former SEC General Counsel Giovanni Prezioso said that the SEC expects the chief legal officer of a public company to play an essential leadership role in assuring the appropriate tone and culture to support rigorous compliance with the laws. Of course, the chief legal officer is often in a better position than a junior lawyer to push back on management, and can be a bridge to the board on questionable or risky matters.[7] Ultimately, any in-house lawyer who has knowledge of or plays any role in a transaction is vulnerable to an enforcement action if the transaction later faces government scrutiny. As a result, for self-survival, as well as the benefit of their client, it is incumbent upon lawyers today to raise and pursue concerns they have in matters on which they are working.

In the stock options investigations, only one case—Comverse—has thus far resulted in charges against a company's general counsel. Mr. Sorin signed annual and quarterly reports that were allegedly misstated because they said "all options have been granted at exercise prices equal to fair market value on the date of grant."[8] Contrary to that statement, Mr. Sorin helped backdate the company's stock option grants to the CEO, other executives, other employees and himself (resulting in a personal profit of $1 million).

Mr. Sorin also allegedly lied to a Comverse in-house lawyer and the compa-

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ny's outside auditors once the alleged fraud came to light in 2006.[9] Presumably, he escaped an obstruction of justice charge because the government could not show that he intended or knew his statements would be provided to the government. In some recent cases, federal prosecutors have charged obstruction of justice based simply on false statements made to a company's outside counsel as part of an internal investigation. A necessary nexus for the government's charge is that the interviewee believed and intended that his statements to counsel were going to be shared with the government.

Computer Associates' former general counsel, Steven Woghin, faced such a charge as a result of the prosecution arising out of that company's revenue recognition scheme. Computer Associates retained a law firm to conduct an internal investigation and made clear to the government and the public that it was committed to cooperating fully with the government. In interviews with the company's law firm, Computer Associates executives lied to and misled the lawyers about the revenue recognition practice. Lies in these private interviews formed the basis for a string of indictments and convictions for obstruction of justice, including Mr. Woghin's plea in September 2004 to conspiracy to commit securities fraud and obstruction of justice. A similar scenario could arise in the stock options investigations, since it has been reported that the government is relying heavily on outside private law firms and internal investigations to identify fraud and bring it to the government's attention.[10]

The Hewlett-Packard Board Leak Investigation

The recent pretexting fiasco at Hewlett-Packard led to the resignation of long-time General Counsel Ann Baskins in September, state criminal charges being filed against former Senior Counsel Kevin Hunsaker in October and the assertions of the 5th Amendment by both Ms. Baskins and Mr. Hunsaker before the United States Congress in September. The public and prosecutorial outcry against Hewlett-Packard's counsel appears to stem from the conviction that counsel for public companies should steer their public company clients away from, not into, legally ambiguous—or worse—areas.

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The criminal action against Mr. Hunsaker and others is in its early stages. Regardless of the outcome, there are already important questions to ask and lessons to learn from the Hewlett-Packard matter. First, how far does an in-house lawyer have to go to satisfy herself that her client's conduct is legal? Despite assurances and reassurances by many at and outside Hewlett-Packard that the company's investigative technique of pretexting was lawful, it is unclear how far the company's counsel went to satisfy themselves that agents for Hewlett-Packard were employing lawful procedures in carrying out a Board-initiated investigation.

A now infamous e-mail exchange between Mr. Hunsaker and a Hewlett-Packard investigator, Anthony Gentilucci, is demonstrative. Mr. Hunsaker asked Mr. Gentilucci how the company's outside investigator, Ronald DeLia, obtained cellular and home telephone records of the investigation's targets. The following e-mail exchange ensued:

> GENTILUCCI:The methodology utilized is social engineering, he has investigators call operators under some ruse, to obtain the call record over the phone, its [*sic*] verbally communicated to the investigator, who has to write it down. In essence the Operator shouldn't give it out, and that person is liable in some sense. Ron [DeLia] can describe the operation better, as well as the fact that this technique since he, and others have been using it, has not been challenged. I think it is on the edge, but above board.
>
> HUNSAKER: I shouldn't have asked...[11]

Following that e-mail exchange, Mr. Hunsaker allegedly forwarded telephone numbers of targets of the investigation to enable Mr. DeLia to obtain their telephone records.[12]

Mr. Hunsaker also appears to have been warned explicitly that the investigation was likely illegal and certainly unethical. In February 2006, a Hewlett-Packard security official, Vincent Nye, wrote to Messrs. Gentilucci and Hunsaker:

> I have serious reservations about what we are doing. As I understand Ron [DeLia's] methodology in obtaining this phone record information it leaves me with the opinion that it is very unethical

at the least and probably illegal. If [it] is not totally illegal, then it is leaving HP in a position . . . that could damage our reputation or worse. I am requesting that we cease this phone number gathering method immediately and discount any of its information. I think we need to refocus our strategy and proceed on the high ground course.[13]

It is not publicly known if or how Messrs. Gentilucci or Hunsaker responded to Mr. Nye's concerns or shared them with anyone else. Mr. Hunsaker has been charged under California law with conspiracy, fraudulent use of wire transmissions, the improper taking, copying and use of computer data, and using personal identifying information without authorization.

What could counsel have done differently? In-house counsel may not be personally expert or experienced in many difficult legal issues that arise in the course of their varied and busy days. In those situations, counsel should seek reliable and respected advice from fellow colleagues or outside counsel. Regulators have made clear that they reject the "I'm just a generalist" defense. Mr. Prezioso said, "there are many cases where every securities lawyer ought to know the answer, or where a non-securities lawyer cannot in good faith fail to seek advice – and in those cases, the lawyer may properly be held responsible for corporate conduct in which he or she participated."[14]

What is the role of ethics when an in-house lawyer considers a company's course of conduct? Mr. Prezioso said in-house lawyers are expected to set the appropriate tone and culture of an organization to ensure its compliance with the law. Although he was referring to the top ranking legal officers at a company, it stands to reason that a lower level attorney who is appointed to head an investigation has to set the right tone for that investigation. In fact, Mr. Hunsaker was not only an attorney at Hewlett-Packard, he was also the company's ethics officer.

That the investigators that Hewlett-Packard retained were pretending to be directors, reporters and others in order to obtain their personal phone records should have been a red flag that halted the practice. From an ethical standpoint, deception is entirely inappropriate, as many of the subjects of this case have now acknowledged. The American Bar Association's (ABA) Model Rule of Professional Conduct 8.4(c) states: "It is professional misconduct for a lawyer to: engage in conduct involving dishonesty, fraud, deceit or misrepresentation."

A further question that arises out of the Hewlett-Packard scandal is, how should an attorney communicate substantively regarding legal advice and analysis? The short answer is: not by e-mail. For good reason, e-mail has become a dominant form of communication in legal circles. E-mail is fast, inexpensive and efficient. But it is also dangerously casual. Individuals often send and receive e-mails at almost the same pace as a casual oral conversation. Attorneys would cringe at the thought of doling out legal analysis and advice in a casual conversation, without the benefit of in-depth analysis and a carefully considered memorandum. Yet we increasingly see attorneys doing exactly that in e-mails.

E-mail should not serve as a substitute for thorough legal analysis and advice. There is simply too much at stake when evaluating the propriety of a particular course of conduct to discuss it in the sort of off-the-cuff communication to which e-mail lends itself. Consider the e-mail that Hewlett-Packard's outside counsel, Larry Sonsini, sent to former Hewlett-Packard board member Thomas Perkins concerning the propriety of the company's investigative methods. Mr. Sonsini wrote that the investigation was "well done and within legal limits."[15] This e-mail communication did not resolve Mr. Perkins' concern, and Mr. Perkins' counsel ultimately reported the situation to the SEC, the Justice Department, and the California Attorney General.

Conclusion

The recent stock options investigations and Hewlett-Packard scandal are reminders that the government continues to scrutinize carefully the role of in-house counsel in cases of corporate wrongdoing. As government speeches and charges make clear, in-house counsel are expected to protect the public from corporate scandals, not idly stand by or worse, facilitate misconduct. As ethically or legally questionable conduct unfolds at a public company, in-house counsel must understand the responsibilities they face in the current enforcement environment. **CL**

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Notes

1. Stephen M. Cutler, "The Themes of Sarbanes-Oxley as Reflected in the Commission's Enforcement Program," speech at UCLA Law School, September 20, 2004,

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President's Message
The CBA and the Legislature: Why Go to the Legislature?
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How Do We Decide?

When considered in the abstract, most of us would agree that there has to be some overarching decision about legislative positions. We must speak with a united voice at the legislature, so we need to have a process to resolve conflicting proposals. We also need to recognize that we can't do it all. In spite of the enormous amount of time and energy our members put into legislative projects, the assistance of paid, professional staff is essential to success.

It's no secret, and no surprise, that arriving at the requisite degree of concurrence on what to support in the legislature is not an easy task. Finding the right process has been difficult. The current review process for deciding whether to support or to oppose a particular legislative proposal appears to be thoughtful and sensible. Sections and committees submit their proposals for legislative positions to the CBA Legislative Counsel, and the proposals are circulated to all sections and committees for review and comment. The proposals are then reviewed by the CBA Legislative Review Committee which has two tasks: to make sure that proposals are sufficiently thought out and articulated so they can be considered for approval and to distinguish those that are technical or otherwise not controversial from those that require full debate by a CBA governing body (the House of Delegates or Board of Governors). If a governing body isn't scheduled to meet in sufficient time to take a proposal to the legislature, the CBA Executive Committee is authorized to approve or deny a request for a position.

Why then, do disputes about legislative matters consume so much time, energy, and emotion? I'm convinced that our challenge stems from the fact that the many and varied CBA constituencies requires us to extensively research and debate each proposal. In addition, the CBA usually has a large number of legislative positions on its agenda. It is not always possible to predict how much time and effort will be required to pursue each of these positions and, by extension, the overall agenda. In short, it is sometimes hard to set priorities for our advocacy and for budgeting and allocating our resources.

Many of our committees and sections that have interests dealt with in the state legislature work very hard at understanding the issues, developing proposals, drafting language, and preparing advocacy strategies. The time and talent invested are considerable even before approval by a CBA governing body is sought. It is no wonder that passions run high if approval is denied or if resources (staff time) are stretched thin.

I believe the time has come to reassess the process for setting legislative priorities and determining the amount of resources we are willing to allocate to legislative activities each year. In the abstract, the solution is obvious: set broad priorities, decide how much time will be required to be successful, and then weigh each proposal to support or oppose specific bills against the priorities established and then assign some ranking based on the time that will be devoted.

Creating such a process will be a challenge. Because resources are not unlimited, there likely will be competition between sections and committees to make their issues paramount. Deciding how much staff time to devote in a given year has also proven to be difficult. The legislative process is thoroughly unpredictable. Issues that are of crucial importance to us may have no chance in a given session, and some measure that we believe would be terrible and should be opposed at all costs could emerge in the middle of a session well after a carefully budgeted plan was approved.

Nonetheless, I am confident that we can improve the decision-making process concerning our important work in the legislature. To this end, I have re-constituted the Legislative Policy Committee and asked it to recommend a process and criteria for setting priorities and making decisions about the necessary resources. The Committee will be asked to make a report and recommendation before the end of the current bar year. That should enable us to make more thoughtful decisions for the '08 legislative session and beyond. **CL**

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available at www.sec.gov/news/ speech/spch 092004smc.htm (hereafter, "Cutler Speech").
2. Source: The Wall Street Journal Online, "Options Scorecard," available at http://online.wsj.com/public/resources/documents/info-optionsscore06-exec.html.
3. Paul Davies, "A Second Comverse Ex-Executive Pleads Guilty," *Wall Street Journal*, Nov. 3, 2006 at A3.
4. Cutler Speech.
5. David Hechler, "Speak Truth To Power," *Corporate Counsel*, Mar. 1, 2006, available at www.law.com/jsp/cc/PubArticleCC.jsp?id=1140170710144.
6. *Id.*
7. Giovanni P. Prezioso, "Remarks before the Spring Meeting of the Association of General Counsel," Apr. 28, 2005, available at www.sec.gov/news/speech/spch042805gpp.htm (hereafter, "Prezioso Remarks").
8. *United States v. Alexander et al.*, Affidavit In Support Of Arrest Warrants at ¶¶ 66-67.
9. *Id.* at ¶¶ 74-78, 86.
10. James Bandler and Kara Scannell, "In Options Probes, Private Law Firms Play Crucial Role," *Wall Street Journal*, Oct. 28, 2006, at A1.
11. *California v. Dunn et al.*, Declaration In Support Of Felony Complaint And Arrest Warrant, at 5.
12. *Id.*
13. E-mail available at http://online.wsj.com/public/resources/documents/hp_p1.pdf.
14. Prezioso Remarks.
15. The e-mail is available at, among other places, the Wall Street Journal Online, at http://online.wsj.com/ public/resources/documents/HP06_sonsini.pdf. Apparently to make clear that Mr. Sonsini's conclusion was not based on his own analysis, he wrote that his conclusion was based on a report from Hewlett-Packard's counsel, and not his own independent analysis.