

SEC AND CRIMINAL PROCEEDINGS  
AGAINST INSIDE CORPORATE COUNSEL

JOHN K. VILLA \*  
WILLIAMS & CONNOLLY LLP  
WASHINGTON, D.C.

SEPTEMBER 2005

\* I would like to acknowledge and thank Thomas G. Ward and Bradley J. Bondi of Williams & Connolly and my research assistant, Anne M. Foley, for their assistance

I.	Introduction and Summary .....	1
A.	SEC Actions.....	2
B.	Criminal Prosecutions.....	5
II.	SEC Proceedings and Orders Against Inside Corporate Counsel.....	7
A.	Introduction.....	7
B.	Survey of Enforcement Actions.....	10
1.	1998-2001 Enforcement Actions .....	10
2.	Post 2001 Enforcement Actions.....	23
III.	CRIMINAL PROSECUTIONS OF INSIDE CORPORATE COUNSEL.....	58
A.	Introduction.....	58
B.	Survey of Criminal Prosecutions of Inside Corporate Counsel .....	59
1.	Pre-2002 Prosecutions .....	59
2.	Post-2001 Prosecutions.....	65

## **I. Introduction and Summary**

Over the past four years, there has been a stream of news reports describing SEC enforcement actions and criminal prosecutions of inside corporate lawyers. Many in the corporate bar have questioned whether there are in fact a large number of such actions against corporate lawyers or whether the news coverage exaggerates the frequency of these cases. A related question is whether there are common factors that have prompted these proceedings. If there are, of course, inside lawyers could take preventive steps to reduce their risks.

This analysis undertakes to answer both of these questions. For the first time, to my knowledge, all or virtually all SEC proceedings against inside counsel and the criminal prosecutions of inside counsel since 1998 are collected and described, thus quantifying these actions. Although the reader can draw his or her own conclusions from the descriptions, the paper also attempts to distill common elements and themes from the cases.

## A. SEC Actions

The SEC has taken a dramatically different approach to inside lawyers than it has to outside counsel. Since the early 1980's, the SEC has declined to initiate enforcement action against outside counsel unless the lawyer has either been held civilly or criminally liable, or has been disciplined by the bar.<sup>1</sup> The SEC, however, pursues inside counsel without regard to whether there has been an independent finding of misconduct. These actions against inside counsel are collected and described in detail in Part II and are summarized in the following paragraphs.

**Rule #1: The Top Lawyer is Nearly Always the Target.** The most obvious common element in the SEC actions is that nearly all of them are brought against the chief legal officer of the company. The occasional case brought against a lawyer other than the chief legal officer usually involves the most senior lawyer in charge of a project or a disclosure document.

**Rule #2: Inside Lawyers Who Relied On Outside Counsel Advice are Seldom SEC Targets.** The factor most notable by its absence is that there are very few SEC enforcement actions where the defendant/respondent relied upon the advice of an outside law firm. One can divine from this fact either that inside lawyers who rely upon outside counsel rarely make mistakes or, what's more likely, that where the SEC finds that inside counsel followed the advice of an outside law firm, successful enforcement action would be unlikely.

We think the latter is surely the correct conclusion and that the inside lawyers' "advice-of-

---

<sup>1</sup>See Edward F. Greene, General Counsel, Securities and Exchange Commission, Lawyer Disciplinary Proceedings Before the Securities and Exchange Commission, Remarks to the New York County Lawyers' Ass'n (Jan. 18, 1982), reported in 14 Sec. Reg. & L. Rep. (BNA) (Jan. 20, 1982) (stating that the SEC would not pursue Rule 2(e) administrative proceedings against lawyers unless a federal court had first found the lawyer guilty of violating the securities laws); see generally Simon M. Lorne and W. Hardy Callcott, "Administrative Actions Against Lawyers Before the SEC," 50 Bus. Law. 1293 (August 1995).

outside-counsel’ defense must have a significant impact on the exercise of enforcement discretion.

**Rule #3: Putting Money in Your Pocket is Not Necessary to Prompt SEC Enforcement.** An unexpected observation is the relatively small role that financial rewards apparently plays in the SEC’s exercise of discretion. One might have expected that the SEC would take enforcement action only where inside counsel received unreasonably high compensation or bonuses, or benefited through increased stock value. That does not prove to be accurate. Many inside lawyers appear to have been the target of enforcement action where it appears their only motive was, in the SEC’s view, a misguided attempt to help their corporate employer.

**Rule #4: Disclosures, Particularly Omissions in Disclosures, are Usually the Problem.** Turning to the underlying conduct that has drawn enforcement attention, many of the cases against inside counsel involve allegedly false and misleading disclosures – more often than not, omissions. While there are some instances of outright fraud alleged – such as totally fictitious offshore operations or sham contracts – in others, the SEC has pursued inside lawyers on decisions that involve matters of professional judgment.

**Rule #5: A Generalist Lawyer Serving as General Counsel Must Seek Out Sound Advice or Pay the Price.** Although there are very few cases in which the SEC has brought an action where the inside lawyer appears to have relied on outside counsel,<sup>2</sup> the SEC

---

<sup>2</sup> In the case of Franklin Brown of Rite-Aid, the SEC alleges that Brown obtained an opinion letter from outside counsel. According to the SEC, Brown convinced outside counsel to include in the letter the erroneous statement that a litigation settlement was binding and enforceable as of a prior date, even though Brown knew that it was not binding and enforceable as of that date because of its contingent nature. See n. 97 and n. 98, infra, and accompanying text.

has chosen to bring actions where the inside lawyer claimed not to be an expert on a technical issue and either relied, unjustifiably, on an inside technical expert or saw a red flag and failed to seek outside legal advice. Put another way, the SEC appears to be willing to impose on an inside lawyer the obligation to seek expert legal and technical advice, or, face enforcement action. The “I am just a generalist lawyer” defense is *not* well-received, especially if the general counsel is on notice of a potentially serious problem. The message seems to be that if one chooses to become the general counsel of a public company, one is obliged to learn the rules or seek guidance from those who do. There are echoes of the SEC’s new attorney conduct regulations,<sup>3</sup> in which the SEC suggests that the question of whether counsel should have been aware of evidence of a “material violation” so as to trigger the reporting obligations under the regulations may depend on whether there were other lawyers available with whom counsel could have consulted on the matter.<sup>4</sup>

**Rule #6: If You Hold Several Corporate Offices, Your Company Failed, or You Sat on a Serious Problem You Could Have Taken to the Board, Your Risk Increases.**

There are a few factors that appear to increase the likelihood of enforcement action but the data is too limited to draw firm conclusions. For example, holding a position as inside counsel and director seems to increase the enforcement risk. In addition, large losses also increase the risk –

---

<sup>3</sup> Pursuant to 17 C.F.R. § 205.3(b), an attorney’s duty to report evidence of a material violation is triggered when the attorney “becomes aware” of such evidence, which is defined as “credible evidence, based upon which it would be unreasonable, under the circumstances, for a prudent and competent attorney not to conclude that it is reasonably likely that a material violation has occurred, is ongoing, or is about to occur.” *Id.* at § 205.2(e).

<sup>4</sup> See 68 Fed. Reg. 6296, 6302 (Feb. 6, 2003) (discussing the definition of “evidence of a material violation,” see n. 3, *supra*, and noting that one of the circumstances that may inform counsel as to whether he or she is obligated to report certain information up-the-ladder is “the availability of other lawyers with whom the lawyer may consult.”).

probably because the SEC is more likely to investigate those matters than other situations where there are no losses. One can speculate that in the situations where the company has failed or nearly failed, and the inside counsel does not have the resources for vigorous representation and defense, the likelihood of consented-to enforcement action also increases. Finally, the SEC seems to attach significance to whether an inside lawyer raised troublesome issues with the Board; those who choose not to do so are judged more harshly.

## **B. Criminal Prosecutions**

The criminal prosecutions are described in Part III. With only about a dozen prosecutions from which to draw, it is difficult to discern distinct patterns to the criminal prosecution of inside counsel in securities fraud and related cases. Some themes, however, emerge.

**Rule #1: Chief Legal Officers are Criminal Targets, Too.** The focus of criminal prosecutions seems to be almost entirely on the chief legal officers. There are no subordinate in-house counsel who have been charged with federal criminal violations.

**Rule #2: Big Losses Increase Risk of Prosecution.** No surprises here. The size of the losses sharply increases the likelihood of criminal prosecution, with several of the prosecutions resulting from the largest restatements and corporate failures in America.

**Rule #3: Having Outside Counsel Can Make a Big Difference.** Again, there is an almost total absence of outside counsel involvement in the conduct that led to criminal indictments. This is predictable as an inside lawyer could effectively deflect criminal criticism by showing reliance on a law firm – whose incentive to engage in or approve criminal conduct by a client is doubtful.

**Rule #4: Perjury and Obstruction Often Become the Crime Charged.** A

recurring theme in the prosecution of lawyers is allegations of cover-ups – obstruction of justice and perjury. Obstruction came from directing employees to lie or mislead investigators.

**Rule #5: Mere Knowledge of Conduct Later Deemed Criminal is Typically**

**Not Enough.** Perhaps the most important observation is that mere knowledge of the conduct and decisions that are later deemed to be financial fraud does not appear sufficient to charge in-house counsel with criminal conduct. One can discern this by examining many corporate failures and massive restatements that have occurred over the past four years and comparing that number to the small number of criminal indictments of inside counsel to reach this conclusion. Direct and active involvement of in-house counsel in the questionable conduct, with knowledge that the conduct is fraudulent, is necessary to bring federal charges.

**Rule #6: Counsel Are Seldom Charged Where the Alleged Fraud is Complex**

**and Its Propriety Debatable.** Conversely, a criminal prosecution of an inside lawyer has never resulted where the alleged fraud is complex and its propriety is debatable. The indicted cases have all alleged (at least some were not proven) out-and-out frauds involving sham companies, hidden financial interests, and phony documents where the lawyer not only knew and understood that the conduct was fraudulent but was an essential participant in it.

**Rule #7. The Prosecutors' True Goal: Undermine the Executive's Advice-of-**

**Counsel Defense.** Indeed, even in those cases where the in-house counsel is charged with broad misconduct, there are pleas to much lesser offenses with much lighter sentences. The most likely explanation for this is that in-house counsel are most often targeted in order to secure their cooperation against the real target – the CEO or very senior management. The presence of the in-house lawyer is a factor that many executives who are targets of investigations rely upon to

argue that their conduct was presumptively not illegal. After all, the in-house lawyer knew everything but failed to object! One effective way to strip a potential defendant of this quasi-advice-of-counsel-defense is to pursue the lawyer and give him the option of cooperating against the targeted executive or becoming a defendant himself.

## **II. SEC Proceedings and Orders Against Inside Corporate Counsel**

### **A. Introduction**

The corporate financial failures of late 2001 and the subsequent enactment of corporate governance measures, such as the Sarbanes-Oxley Act of 2002,<sup>5</sup> have unquestionably resulted in an increase in SEC enforcement activity directed at inside counsel. In the past two years alone, the SEC has initiated more than 30 enforcement actions<sup>6</sup> against corporate attorneys, most of which have been directed at those working in-house.<sup>7</sup> And, according to Stephen Cutler, then Director of the SEC's Division of Enforcement, the number of new enforcement actions against corporate counsel is expected to increase, due primarily to the SEC's "stepped up" scrutiny of corporate counsel<sup>8</sup> in what has been characterized as their role as "gatekeepers" or "sentries of the marketplace."<sup>9</sup>

---

<sup>5</sup>Pub. L. No. 107-204, 116 Stat. 745 (July 30, 2002).

<sup>6</sup> For purposes of this paper, an enforcement action includes both a civil injunctive action brought in federal district court, as well as a public administrative proceeding brought before the Commission.

<sup>7</sup> See Stephen M. Cutler, Director, Division of Enforcement, SEC, "The Themes of Sarbanes-Oxley as Reflected in the Commission's Enforcement Program," Speech before UCLA School of Law (September 20, 2004), available at [www.sec.gov/news/speech/spch092004smc.htm](http://www.sec.gov/news/speech/spch092004smc.htm).

<sup>8</sup> As explained by Cutler:

[W]e have stepped up our scrutiny of the role of lawyers in the corporate frauds we investigate.

Even before the highly publicized corporate breakdowns of 2001, the SEC brought isolated enforcement actions against inside counsel. The SEC's admitted focus on corporate counsel explains the growth in the number of enforcement actions from 1998-2001 to 2002-04. Are there, however, any similarities in the actions from both periods, such as the role of the defendant lawyer, the nature of alleged violations, the theories of liability, or the gravity of the sanctions, that may inform counsel on how best to protect themselves against the threat of an SEC enforcement action? To address this question, the following discussion presents a chronological summary of the enforcement actions, with an emphasis on those elements that appear common or recurring in these actions.

Attempting to distill patterns from the enforcement actions is an imprecise and hazardous undertaking for several reasons. First, the descriptions of counsel's conduct is provided, in most instances, only by the SEC. There is, in nearly all *contested* cases, another and much more innocent side to the story that is not reflected in the SEC's complaint. So, we are looking at the facts only through the eyes of the regulators. While this view admittedly slants the

---

....

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 . . . 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.

Id.

<sup>9</sup> Id.

facts, we must also recognize that the SEC’s perception of the facts is nearly as important as the “true facts” because it reveals the issues that presumably prompted enforcement action.

Second, the descriptions of counsel’s conduct in *consent* proceedings may also slant the facts but in the opposite direction:<sup>10</sup> defendants or respondents often negotiate for a less damaging description of the facts as a condition of consenting to the charges. For these two reasons, the allegations in a filed SEC proceeding may overstate or understate the nature of the underlying conduct that prompted regulatory action. This cautions against reading too much into the lessons of a single case and requires an observer to examine a large number of cases over a longer time period to identify accurately the underlying themes and trends.

Third, one must recognize that the SEC occasionally will bring a proceeding to raise the public awareness of its priorities – one could say it is “making an example” of one private party – but the standard applied in that case is not in fact being applied across-the-board to all similarly situated parties. This consciousness-raising proceeding is, nonetheless, important because it does identify issues of concern to the SEC and may signify changes in enforcement perspectives and approaches.

Fourth, and perhaps most significantly, the proceedings described below represent those where the SEC chose to act, thus prompting the question “what factors were present in the many matters where the SEC chose *not* to bring enforcement proceedings”? While this analysis necessarily involves some degree of speculation, there are some obvious factors that are notable

---

<sup>10</sup> By consent proceedings, we mean proceedings where the SEC and the respondent reach a settlement before the filing of the complaint or notice of charges. Typically, one important aspect of the pre-filing settlement is to “tone down” the allegations in the complaint or notice of charges in order to secure the defendant’s agreement.

by their absence which we will discuss below – for example, reliance upon the advice of outside counsel.

For purposes of this analysis, we are putting to one side conduct, such as insider trading, that is not integrally related to the function of an inside lawyer. In other words, any company insider who trades on material non-public information will find himself or herself subject to enforcement action and a review of those cases involving inside counsel is not likely to shed light on the SEC enforcement priorities.

## **B. Survey of Enforcement Actions**

### **1. 1998-2001 Enforcement Actions**

The SEC initiated enforcement actions against twelve inside counsel during the period of 1998 to 2001. Most of these actions were directed at the general counsel or the most senior legal officer directly involved in the preparation, approval, and/or signing of allegedly false financial statements or representations contained in SEC filings, securities offerings, and/or other publicly-disseminated documents. Most SEC actions were resolved by settlement. In five of the actions, inside counsel were either barred or suspended from appearing or practicing before the Commission.

In 1998, for example, the SEC filed two civil injunctive actions against inside counsel. In the first, in-house legal counsel for an infomercial marketing company was alleged to have engaged in a fraudulent financial reporting scheme, along with the company's CEO, CFO, and a member of the company's board of directors and its audit committee.<sup>11</sup> According to the

---

<sup>11</sup> The defendants were charged with knowingly or recklessly making materially false and misleading statements, and omitting to state material information in periodic filings and registration statements filed with the Commission, in violation of 15 USC §§77q(a), 78j(b), and 78m(b)(5), and 17 CFR §§240.10b-5, 13b2-1, and 13b2-2. In addition, they were charged with

SEC, the other defendants caused the recording of fictitious business revenues and receivables, which they supported with false and misleading sales documents and bank records showing payment by entities that were secretly owned by the defendants.<sup>12</sup> The payments allegedly consisted of over \$23 million taken from the company, transferred to these private entities, and then funneled back to the company.<sup>13</sup> The in-house legal counsel also served as corporate secretary and had been a director and member of the audit committee. He was alleged to have knowingly or recklessly prepared documents that concealed the other officers' ownership of one of the private entities and to have arranged for the receipt by one of these entities of \$1.6 million in company stock, which was sold and the proceeds used as payment for one of the fictitious receivables.<sup>14</sup> The SEC alleged that in-house counsel received undisclosed payments from these private entities.<sup>15</sup>

Without admitting or denying the allegations in the complaint, the in-house counsel consented to the entry of a judgment enjoining him from future violations of these reporting statutes and rules,<sup>16</sup> and ordering him to disgorge \$131,000 in unlawfully-obtained

---

controlling person liability for the company's violation of these reporting statutes. See SEC v. Arthur L. Toll, Bruce B. Edmondson, Gerald Levinson, and Elliot S. Fisher, 98-CV-2325 (HH) (E.D. Pa.), Litigation Release No. 15731 ; Accounting and Auditing Enforcement Release No. 1033 (May 4, 1998).

<sup>12</sup> Id.

<sup>13</sup> Id.

<sup>14</sup> Id.

<sup>15</sup> Id.

<sup>16</sup> See n. 11, supra.

profits.<sup>17</sup> Prior to the entry of judgment in the civil enforcement action, however, he was convicted of conspiracy to commit securities fraud and to make false and misleading statements to auditors,<sup>18</sup> and was subsequently suspended from appearing or practicing before the Commission as an attorney.<sup>19</sup>

In the second action, the SEC charged the vice-president and general counsel of a research and development company, with violating the antifraud and reporting provisions of the securities law by preparing materially false or misleading public statements in press releases, shareholder letters, and SEC filings relating to the nature and extent of the company's products and the status of the technologies being developed by the company.<sup>20</sup> According to the complaint, these statements represented that the company had developed certain technologies that were unqualified successes when, in fact, the technologies were only in the research and development stage.<sup>21</sup> The complaint further alleged that, after the dissemination of these public statements, the company's stock rose significantly in price.<sup>22</sup>

---

<sup>17</sup> SEC v. Arthur L. Toll, Bruce B. Edmondson, Gerald Levinson, and Elliot S. Fisher, 98-CV-2325 (HH) (E.D. Pa.), Litigation Release No. 17880; Accounting and Auditing Enforcement Release No. 1682 (Dec. 6, 2002).

<sup>18</sup> United States v. Elliot Fisher, No. 98-CR-63-3 (RFK) (E.D. Pa.) (judgment entered March 16, 2001).

<sup>19</sup> In the Matter of Eliot S. Fisher, Esq., Admin. Proc. Rel. No. 34-46954 (Dec. 6, 2002).

<sup>20</sup> SEC v. Solv-Ex Corp., et al., No. Civ. 98-860-LH (D. N.M.), Litig. Rel. No. 15817 (July 20, 1998) (charging Campbell with violations of Section 17(a) [15 USC § 77q(a)], and Section 10(b) [15 USC § 78j(b)] and Rule 10b-5, and with aiding and abetting Solv-Ex's violation of Section 13(a) [15 USC § 78m(a)]).

<sup>21</sup> Id. (the complaint also alleged that the statements reported that the company had successfully tested one of its products when, in fact, the test was a failure).

<sup>22</sup> Id.

At the trial of the action in federal district court in New Mexico, the in-house contested the charges, but lost.<sup>23</sup> On appeal following the adverse judgment,<sup>24</sup> he disputed the district court's findings, arguing, *inter alia*, that he did not know that the statements were false or misleading, that he reasonably relied on information supplied by technology experts since he did not have a technological background, and that he had no reason to doubt the accuracy of the information and, therefore, did not attempt to verify it.<sup>25</sup> The Tenth Circuit rejected his contentions and affirmed the judgment of the district court.<sup>26</sup> In a related administrative proceeding, he was permanently barred from appearing or practicing before the Commission.<sup>27</sup>

Between January and August of 1999, the SEC brought three administrative proceedings<sup>28</sup> and three civil injunctive actions against inside counsel. Three of the cases involved counsel who served in specialized positions within the corporation, such as bond or securities counsel; two of the cases involved the general counsel; and one case involved an attorney on the in-house counsel staff. With the exception of this latter case, a civil injunctive

---

<sup>23</sup> *Id.*, Litig. Rel. No. 16502 (April 5, 2000).

<sup>24</sup> *Id.* (the district court found that Campbell had violated the anti-fraud provisions and had aided and abetted the company's violation of the reporting statutes, imposed a first-tier penalty of \$5,000, and enjoined Campbell from future violations of Sections 17(a), 10(b), and 13(a)).

<sup>25</sup> See Opening Brief of Appellant Herbert M. Campbell, Solv-Ex Corp. v. SEC, No. 00-2339 (filed March 8, 2001), 2001 WL 34720835.

<sup>26</sup> SEC v. Solv-Ex Corp. et al., No. 00-2339, 2004 WL 813535 (10<sup>th</sup> Cir. April 15, 2004), *cert. denied*, Rendall v. SEC, 125 S. Ct. 432 (Nov. 1, 2004).

<sup>27</sup> In the Matter of Herbert M. Campbell II, Esq., Initial Dec. Rel. No. 266; Admin. Proc. File No. 3-10268 (Oct. 27, 2004).

<sup>28</sup> One of the injunctive actions discussed here is one which was dismissed but followed by the institution of an administrative cease and desist proceeding two years later. See SEC v. ICN Pharmaceuticals, Inc., Milan Panic, Nils O. Johannesson, and David C. Watt, No. 99-1016DOC (ANX) (C.D. Cal.), Litig. Rel. No. 16249 (Aug. 11, 1999), discussed *infra*.

action for insider trading,<sup>29</sup> the conduct targeted in the 1999 cases dealt either with the preparation of allegedly false or misleading public statements, or with the drafting of agreements in connection with fraudulent accounting or securities' distribution schemes. One of these cases involved an administrative disciplinary proceeding instituted after counsel's conviction of securities and wire fraud.<sup>30</sup>

In the first of these enforcement actions in 1999, the SEC filed an administrative cease and desist proceeding against bond counsel for the County of Orange Investment Pools.<sup>31</sup> According to the SEC, in preparing or assisting in the preparation of the Official Statements for certain note offerings, the in-house lawyer failed to include material information concerning the investment strategy, its risks, and the losses sustained by the fund.<sup>32</sup> Although the SEC officials had previously suggested that only "egregious" behavior should support an administrative cease and desist proceeding against an attorney,<sup>33</sup> the SEC charged that bond counsel knew or should

---

<sup>29</sup> See SEC v. Brian Patrick Burns, Jr., No. 99CV1546 (GK) (D. D.C.), Litigation Release No. 16187 (June 15, 1999) (in-house attorney consented to entry of final judgment in action alleging violation of 15 USC § 77j(b) and Rule 10b-5 for tipping friends to possible acquisition of his company).

<sup>30</sup> In In the Matter of Robert D. Sichta, Admin. Proc. Rel. No. 34-41132 (March 3, 1999), Sichta, the securities counsel for U.S. Mint, pled guilty to charges that he prepared or assisted in the preparation of fraudulent statements relating to U.S. Mint's business as a provider of gaming tokens, and that he bribed registered representatives in exchange for their promotion of U.S. Mint stock, all in violation of 15 USC §§78j(b) and 78ff, and 18 USC § 1343. See United States v. Robert D. Sichta, No. 95-CR-212-S (D. Colo.) (judgment entered Jan. 29, 1997). Sichta settled the administrative proceeding, and consented to the imposition of the sanction barring him from participating in any offering of penny stock. In the Matter of Robert D. Sichta, In the Matter of Robert D. Sichta, supra.

<sup>31</sup> See In the Matter of Jean Costanza, Admin. Proc. Rel. No. 33-7621 (Jan. 6, 1999).

<sup>32</sup> Id. at III(B)(1).

<sup>33</sup> See Norman S. Johnson, "Suits Against Lawyers," Speech before the Federal Securities Law Committee of the American Bar Association (Nov. 8, 1996) (stating the he "would hope that the

have known that the Official Statements omitted material information, “that she knew or reasonably should have known about the Pools, the Notes’ interest rates, and [that] the tax exempt status of the Tax-Exempt Offerings could have been jeopardized.”<sup>34</sup> Therefore, the SEC maintained that she had violated Sections 17(a)(2) and (3) [15 USC § 77q (a)(2), (3)] of the Securities Act.<sup>35</sup>

Without admitting or denying the allegations, she settled the matter and consented to the entry of a cease and desist order.<sup>36</sup> In press statements made after entry of the order, her attorney decried the SEC’s decision to bring the action, stating that the SEC, by applying a “should have known” standard, had lowered the bar for imposing liability on attorneys under Section 17(a)(2) and (3).<sup>37</sup> Now, he argued, mere awareness of problems or a good faith mistake will subject counsel to SEC action.<sup>38</sup> The SEC responded that liability will be imposed whenever counsel has knowledge of a “red flag,” but fails to investigate to ensure that any subsequent disclosure is proper.<sup>39</sup>

---

cease and desist remedy would be limited to those situations where the attorney’s conduct was so egregious that he could properly be deemed a principal actor.”), available at [www.sec.gov/news/speech/speecharchive/1996/spch137.txt](http://www.sec.gov/news/speech/speecharchive/1996/spch137.txt).

<sup>34</sup> In the Matter of Costanza, *supra*, at III(C)(1)(b).

<sup>35</sup> Id. at III(C)(2).

<sup>36</sup> Id. at IV.

<sup>37</sup> “Municipal Bonds: Lawyers Have Duty to Investigate, Disclose ‘Red Flags’ in Offerings, SEC Official Says,” 31 Sec. Reg. L. Rep. (BNA) 672 (May 21, 1999).

<sup>38</sup> Id.

<sup>39</sup> Id.

Several months later, the SEC brought a civil injunctive action against the general counsel of a pharmaceutical company, and against its president and the vice-president of research and development, alleging that their failure to disclose information in a press release concerning the FDA's non-approval of the company's new drug application constituted a violation of Section 10(b) [15 USC § 78j(b)] and Rule 10b-5.<sup>40</sup> In an amended complaint, the SEC alleged that in-house counsel had knowledge of the FDA's not-approvable letter, had discussed the letter with the other defendants, and had a primary role in drafting the offending press release.<sup>41</sup> The SEC dismissed the civil injunctive action against in-house counsel,<sup>42</sup> and subsequently instituted an administrative cease and desist proceeding for his conduct in causing the company's violation of Section 10(b) and Rule 10b-5 with respect to the press release.<sup>43</sup> The SEC alleged that he was a cause of the company's violation, because he allegedly participated in meetings involving the not-approvable letter and the company's public response to it, and participated in the drafting of the press release. In-house counsel, therefore, "should have known" that the release omitted important facts of material interest to investors.<sup>44</sup> The court further found that, because of his

---

<sup>40</sup> See SEC v. ICN Pharmaceuticals, Inc., Milan Panic, Nils O. Johannesson, and David C. Watt, No. 99-1016DOC (ANX) (C.D. Cal.), Litig. Rel. No. 16249 (Aug. 11, 1999).

<sup>41</sup> The original complaint was dismissed as to Watt, but the SEC was granted leave to amend. Watt filed a motion to dismiss the amended complaint, arguing that the SEC failed to plead a "strong inference of scienter" as required by the Private Securities Litigation Reform Act (PSLRA), Pub. L. No. 104-67, 109 Stat. 737 (Dec. 22, 1995), and failed to provide specifics as to his alleged involvement in preparing the press release. The court denied the motion, finding that the PSLRA was not applicable to civil enforcement actions brought by the SEC. See SEC v. ICN Pharmaceuticals, Inc., et al., No. 99-1016 (C.D. Cal. Order issued Feb. 2, 2000), as reported in 15 No.9 Andrews Corp. Off. & Directors Liab. Litig. Rep. 13 (March 6, 2000).

<sup>42</sup> See SEC v. ICN Pharmaceuticals, Inc., Milan Panic, Nils O. Johannesson, and David C. Watt, No. 99-1016DOC (ANX) (C.D. Cal.), Litig. Rel. No. 17861 (Nov. 25, 2002).

<sup>43</sup> See In the Matter of David C. Watt, Admin. Proc. Rel. No. 34-46899 (Nov. 25, 2002).

<sup>44</sup> Id. at III.

admitted lack of expertise with FDA procedures and policies, he should have consulted regulatory counsel “to assess the significance of the not approvable letter” and determine what disclosures were necessary.<sup>45</sup> Without admitting or denying the SEC’s findings, he consented to the issuance of a cease and desist order.<sup>46</sup>

In the other enforcement actions of 1999, the SEC focused its attention on inside counsel’s role in allegedly promoting or effectuating a fraudulent scheme engaged in by others who had an interest in, or position with, the corporation.

The first case involved an allegedly fraudulent scheme to distribute unregistered securities of Market America, a direct-marketing company.<sup>47</sup> According to the SEC, the president of Market America and another individual, who controlled a shell corporation having no assets, entered into a sham “blank check” public offering for the shell corporation, making it appear that the shell corporation had shares that could be freely traded without registration when, in fact, the shares were owned by these two parties.<sup>48</sup> Afterwards, they completed a reverse merger between Market America and the shell corporation, resulting in their undisclosed ownership of most of Market America’s outstanding stock.<sup>49</sup> Since their ownership was concealed, these individuals were able to obtain a NASD Bulletin Board listing for Market

---

<sup>45</sup> Id.

<sup>46</sup> Id. at II.

<sup>47</sup>In the Matter of Market America, Inc. and Richard D. Hall, Jr., Admin. Proc. Rel. Nos. 33-7674; 34-41363 (May 4, 1999).

<sup>48</sup> Id. at III(B).

<sup>49</sup> Id.

America and thereby distribute unregistered shares of its stock.<sup>50</sup> In a settled administrative cease and desist proceeding brought against counsel to the president of Market America,<sup>51</sup> the SEC alleged that in-house counsel provided substantial assistance to this fraudulent scheme in two ways: by negotiating and drafting the terms of the merger agreement, even though he was aware of the parties' oral agreement to sell their shares of Market America stock and to divide the proceeds between them on a dollar for dollar basis; and, by concealing the parties' ownership of the Market America stock from the NASD by failing to disclose this information upon inquiry by the broker-dealer sponsoring the application for the listing.<sup>52</sup> As a consequence, the SEC alleged that in-house counsel was a cause of the violations of the registration and antifraud provisions of the securities laws,<sup>53</sup> and ordered him to cease and desist from any further violations.<sup>54</sup>

The second case involved an allegedly fraudulent scheme to inflate reported revenues through the execution of undisclosed side agreements that required the company to repay amounts purportedly "paid" by the counter parties to transactions. In a settled civil injunctive action against the general counsel and secretary of the company, the SEC alleged that

---

<sup>50</sup> Id.

<sup>51</sup> The SEC brought a civil injunctive action against the actual parties to the fraudulent transactions, the president of Market America and the owner of the shell corporation, who consented to final judgments requiring them to pay over \$2 million in disgorgement, interest, and civil penalties. See SEC v. Gilbert A. Zwetsch and James H. Ridinger, No. 99-1088 (LFO) (D. D.C.), Litig. Rel. No. 16131A (May 4, 1999).

<sup>52</sup> Id.

<sup>53</sup> Sections 5(a), (c) and 17(a) of the Securities Act [15 USC §§77e(a), (c); 77q(a)], Section 10(b) of the Exchange Act [15 USC § 78j(b)] and Rule 10b-5.

<sup>54</sup> In the Matter of Market America, Inc., Admin. Proc. Rel. Nos. 33-7674; 34-41363, at IV-V.

counsel acted in furtherance of the scheme by drafting some of these side agreements and/or by negotiating and finalizing these agreements with the legal representatives of the counter parties, all in violation of the antifraud, books and records, and internal controls provisions of the securities law.<sup>55</sup> The court enjoined in-house counsel from future violations of these provisions and assessed a civil penalty of \$25,000.

In a related administrative proceeding, the same in-house counsel consented to the entry of an order denying him the privilege of appearing and practicing before the Commission for a period of five years.<sup>56</sup> In addition, he was ordered to comply with a cooperation agreement that he executed as part of his settlement with the SEC. The agreement not only imposed disclosure and document production requirements on him, but also prohibited him from asserting any evidentiary or other privilege if required to provide testimony in any proceeding.<sup>57</sup> Unlike the current approach in government investigations and prosecutions,<sup>58</sup> the in-house lawyer was not prohibited from asserting the attorney-client and work product privileges.<sup>59</sup>

---

<sup>55</sup> SEC v. Jerald M. Banks, No. 99 Civ. 8855 (TPG) (S.D.N.Y.), Litig. Rel. No. 16251; Accounting and Auditing Enforcement Rel. No. 1153 (Aug. 12, 1999) (alleging that Banks' conduct constituted violations of Section 17(a) of the Securities Act [15 USC § 77q(a)], Sections 10(b) and 13(b)(5) of the Exchange Act [15 USC §§78j(b), 78m(b)(5)], and Rules 10b-5, 13b2-1, and 13b2-2).

<sup>56</sup> In the Matter of Jerald M. Banks, Admin. Proc. Rel. No. 34-41806; Accounting and Auditing Enforcement Rel. No. 1156 (Aug. 30, 1999).

<sup>57</sup> Id. at V.

<sup>58</sup> See generally, U.S. Department of Justice, Office of the Deputy Attorney General, Principles of Federal Prosecution of Business Organizations (Jan. 20, 2003).

<sup>59</sup> In the Matter of Jerald M. Banks, Admin. Proc. Rel. No. 34-41806; Accounting and Auditing Enforcement Rel. No. 1156, at V.

During the 2000-2001 period, four inside counsel were the subjects of SEC enforcement actions, together with their companies and/or other officers within the corporation.<sup>60</sup> In all of the actions, counsel held the top legal position, such as general counsel, and, with one exception,<sup>61</sup> also served in other capacities.<sup>62</sup>

Like the actions in previous years, these actions involved allegations of fraudulent reporting and accounting schemes engaged in by corporate officers; counsel were alleged to have assisted this conduct through knowing, reckless, or negligent preparation of materially false and misleading SEC filings, public statements, and/or undisclosed side agreements. More specifically, the complaints alleged the following wrongful conduct: knowingly or recklessly preparing documents relating to fraudulent real estate sales that had been included as assets on the company's SEC filings, and signing a Form 10-K reflecting these sales;<sup>63</sup> knowingly

---

<sup>60</sup>An administrative proceeding was also initiated against a fifth general counsel, Herbert Campbell, after judgment was entered against him in a civil injunctive action that had been commenced in 1998. See In the Matter of Herbert M. Campbell, Esq., Admin. Proc. File No. 34-43422 (Oct. 6, 2000) and SEC v. Solv-Ex Corp., et al., Litig. Rel. No. 15817 (July 20, 1998), discussed supra.

<sup>61</sup> SEC v. Jay Lapine, No. C-01-3650 (VRW) (N.D. Cal.), Litig. Rel. No. 17189; Accounting and Auditing Enforcement Rel. No. 1467 (Oct. 15, 2001).

<sup>62</sup> See e.g., In the Matter of Steven Wolis, Admin. Proc. Rel. No. 34-43123; Accounting and Auditing Enforcement Rel. No. 1290 (Aug. 4, 2000) (general counsel and director); SEC v. Countryland Wellness Resorts, Inc., et al., No. CV-S-00-1160-PMP (RJJ) (D. Nev.), Litig. Rel. No. 16732; Accounting and Auditing Enforcement Release No. 1327 (Sept. 27, 2000) (general counsel and director).

<sup>63</sup> In the Matter of Steven Wolis, Admin. Proc. Rel. No. 34-43123; Accounting and Auditing Enforcement Rel. No. 1290 (Aug. 4, 2000) (charged with violating Sections 10(b), 13(b)(5), and 13(b)(2) of the Exchange Act [15 USC §§78j(b), 78m(b)(5), (b)(2)], and Rules 10b-5, 13b-1, and 13b2-2).

including an unauthorized audit report in a registration statement;<sup>64</sup> knowingly or recklessly engaging in a fraudulent financial reporting scheme by negotiating, drafting and concealing unlawful side agreements to customer contracts and by backdating documents;<sup>65</sup> and participating in the drafting of materially misleading press releases concerning the company's financial condition and results of operation.

Consistent with preceding years, there was considerable variation in the nature of the enforcement actions and the extent of the sanctions imposed. Of the three actions that have been concluded,<sup>66</sup> two involved related administrative disciplinary proceedings resulting in consent orders barring or suspending inside counsel from appearing and practicing before the Commission.<sup>67</sup> The third case involved a settled administrative proceeding in which the general counsel of a public company, after cooperating with the SEC at the outset of its investigation,

---

<sup>64</sup> SEC v. Countryland Wellness Resorts, Inc., et al., No. CV-S-00-1160-PMP (RJJ) (D. Nev.), Litig. Rel. No. 16732; Accounting and Auditing Enforcement Release No. 1327 (Sept. 27, 2000) (charged with violating Section 17(a) of the Securities Act [15 USC § 77q(a)], and Section 10(b) of the Exchange Act [15 USC § 78j(b)], and Rule 10b-5).

<sup>65</sup> SEC v. Jay Lapine, No. C-01-3650 (VRW) (N.D. Cal.), Litig. Rel. No. 17189; Accounting and Auditing Enforcement Rel. No. 1467 (Oct. 15, 2001) (charged with violating Section 10(b) and 13(b)(5) of the Exchange Act [15 USC §§78j(b), 78m(b)(5)] and Rules 10b-5 and 13b2-1, and with aiding and abetting the company's violation of the reporting requirements of Sections 13(a) and 13(b)(2)(A) of the Exchange Act [15 USC §§78m(a), (b)(2)(A)] and Rules 12b20 and 13a-13). See Complaint, SEC v. Jay Lapine, No. C-01-3650 (VRW) (N.D. Cal. filed Sept. 27, 2001).

<sup>66</sup>The enforcement action against Jay Lapine, the former general counsel of McKesson/HBOC, remains pending. See SEC v. Jay Lapine, No. C-01-3650 (VRW) (N.D. Cal.), Litig. Rel. No. 17189; Accounting and Auditing Enforcement Rel. No. 1467 (Oct. 15, 2001).

<sup>67</sup> In the Matter of Steven Wolis, Admin. Proc. Rel. No. 34-43123; Accounting and Auditing Enforcement Rel. No. 1290 (Aug. 4, 2000) (In 2000, Wolis consented to the entry of a permanent injunction in a civil injunctive action brought by the SEC in 1995, and, in 1998, pled guilty in a related criminal action to an obstruction of justice charge); In the Matter of Donald E. Studer, Admin. Proc. Rel. No. 34-43532; Accounting and Auditing Enforcement Rel. No. 1342 (Nov. 8, 2000) (general counsel for Countryland Wellness Resorts, Inc.).

agreed to cease and desist from committing or causing any further violations of Section 17(a)(3) of the Securities Act.<sup>68</sup>

In the one case from this period that remains pending as of this writing, a civil injunctive action against the former general counsel of McKesson/HBOC, Inc.,<sup>69</sup> the SEC seeks to impose a broad range of penalties and sanctions. The SEC alleged that he engaged in a massive accounting fraud scheme, together with members of top management, and was unjustly enriched because of his receipt of significant bonuses that were tied to the company's meeting projected earnings.<sup>70</sup> It seeks both an injunction against future violations of the securities laws and disgorgement of any wrongfully-received profits, in addition to the imposition of civil penalties and a permanent injunction against serving as an officer or director of a publicly traded company.<sup>71</sup> In his defense, in-house counsel has asserted, in part, that he acted in "honest and reasonable reliance" on the advice and expertise of accounting and business professionals.<sup>72</sup>

---

<sup>68</sup> The general counsel was charged with participating in the preparation of materially misleading press releases, while other members of top management were charged as principal actors in the fraudulent "cookie jar" scheme to misrepresent the company's results of operation.

<sup>69</sup>SEC v. Jay Lapine, No. C-01-3650 (VRW) (N.D. Cal.), Litig. Rel. No. 17189; Accounting and Auditing Enforcement Rel. No. 1467 (Oct. 15, 2001). Lapine is also subject to a pending criminal action. See United States v. Albert J. Bergonzi, Charles W. McCall, and Jay Lapine, No. CR 00-0505-MJJ (N.D. Cal.) (Second Superseding Indictment, June 3, 2003), available at [www.usdoj.gov/usao/can/press/html/2003\\_06\\_04\\_mckesson.html](http://www.usdoj.gov/usao/can/press/html/2003_06_04_mckesson.html)

<sup>70</sup> See n. 65 and accompanying text, *supra*.

<sup>71</sup> Complaint, SEC v. Jay Lapine, No. C-01-3650 (VRW) (N.D. Cal.) (filed Sept. 27, 2001); Litig. Rel. No. 17189; Accounting and Auditing Enforcement Rel. No. 1467 (Oct. 15, 2001).

<sup>72</sup> Answer to Complaint, SEC v. Jay Lapine, No. C-01-3650 (VRW) (N.D. Cal.) (filed Oct. 7, 2002).

## 2. Post 2001 Enforcement Actions

Because of the highly publicized corporate failures that began in the fall of 2001, the SEC has increasingly focused its attention on the role of inside counsel. This increased attention has resulted in a corresponding increase in the number of enforcement actions directed at inside counsel: since the beginning of 2001, approximately 20 inside counsel have been the targets of SEC enforcement actions. And, as indicated by the SEC's saber-rattling statements<sup>73</sup> and its issuance of Wells notices,<sup>74</sup> others may find themselves defendants in the near future.

In 2002, five civil injunctive actions were filed against inside counsel, all of whom served as the top attorney within the corporation.<sup>75</sup> Four of the attorneys also served in other capacities, such as vice-president and secretary,<sup>76</sup> vice-president and chairman of the

---

<sup>73</sup>See n. 8, *supra*.

<sup>74</sup> See, e.g., "Stock Markets: SEC Investigating AMEX Execs With Respect To Options Trading Probe," 36 *Sec. Reg. L. Rep.* (BNA) 2056 (Nov. 22, 2004) (noting that the SEC had sent Wells notices to three executives of the American Stock Exchange, including its general counsel, warning that civil enforcement proceedings could be brought against them).

<sup>75</sup> See e.g., *SEC v. Dean L. Buntrock et al.*, No. 02C 2180 (N.D. Ill.), Litig. Rel. No. 17435; Accounting and Auditing Enforcement Rel. No. 1532 (March 26, 2002) (general counsel); *SEC v. Frank M. Bergonzi, Martin L. Grass, and Franklin C. Brown*, No. 1:CV02-1084 (M.D. Pa.), Litig. Rel. No. 17577; Accounting and Auditing Enforcement Rel. No. 1581 (June 21, 2002) (chief legal officer); *SEC v. Bruce Hill, et al.*, No. 02-CV-11244 (D. Mass.), Litig. Rel. No. 17578; Accounting and Auditing Enforcement Rel. No. 1582 (June 21, 2002) (general counsel); *SEC v. Andrew S. Marks*, No. 02 CV 12325 (JLT) (D. Mass.), Litig. Rel. No. 17871 (Dec. 3, 2002) (chief patent counsel – highest ranking attorney within company).

<sup>76</sup> Herbert Getz was also a senior vice-president and secretary of Waste Management. See *SEC v. Dean L. Buntrock et al.*, No. 02C 2180 (N.D. Ill.), Litig. Rel. No. 17435; Accounting and Auditing Enforcement Rel. No. 1532 (March 26, 2002). Bruce Hill served as a vice-president and secretary of Inso Corporation, now known as eBT International, Inc. See *SEC v. Bruce Hill, et al.*, No. 02-CV-11244 (D. Mass.), Litig. Rel. No. 17578; Accounting and Auditing Enforcement Rel. No. 1582 (June 21, 2002).

board,<sup>77</sup> or just vice-president. Many of the attorneys are, or have been, defendants in well-publicized criminal proceedings brought in connection with the same conduct that is the subject of the enforcement actions.<sup>78</sup>

As in prior enforcement actions, the 2002 actions involve allegations that inside counsel, usually in concert with other corporate officers,<sup>79</sup> committed securities fraud and violated, or aided and abetted the violation of, the recordkeeping and/or reporting obligations of the securities laws through fraudulent accounting<sup>80</sup> and revenue recognition schemes,<sup>81</sup>

---

<sup>77</sup> Franklin Brown first served as both chief legal officer and executive vice-president of Rite-Aid Corporation, and then became its chairman of the board. SEC v. Frank M. Bergonzi, Martin L. Grass, and Franklin C. Brown, No. 1:CV02-1084 (M.D. Pa.), Litig. Rel. No. 17577; Accounting and Auditing Enforcement Rel. No. 1581 (June 21, 2002).

<sup>78</sup>United States v. Martin L. Grass, Franklin C. Brown, Franklyn M. Bergonzi, and Eric S. Sorkin, No. 1:CR-02-146 (M.D. Pa.); United States v. Graham Marshall and Bruce Hill, Crim. Action No. 03-10344 (DPW) (D. Mass.), Litig. Rel. No. 18699 (May 7, 2004); United States v. Marks, Crim. Action No. 03-10297 (DPW) (D. Mass.), Litig. Rel. No. 18360 (Sept. 24, 2003). For more discussion of the criminal proceedings, see *infra* at Part III.

<sup>79</sup> The sole exception is Andrew Marks, the chief patent counsel for a pharmaceutical company, who was charged with insider trading for liquidating all of his company stock immediately before the company's issuance of a press release announcing the suspension of a clinical trial of one of its drugs. See SEC v. Andrew S. Marks, No. 02 CV 12325 (JLT) (D. Mass.), Litig. Rel. No. 17871 (Dec. 3, 2002).

<sup>80</sup> See SEC v. Dean L. Buntrock, et al, No. 02C 2180 (N.D. Ill.), Litig. Rel. No. 17435; Accounting and Auditing Enforcement Rel. No. 1532 (March 26, 2002)(violations of Section 17(a) of the Securities Act [15 USC § 77q(a)], Sections 10(b) and 13(a) of the Exchange Act [15 USC §§78j(b), 78m(a)], and Rules 10b-5, 12b-20, 13a-1, and 13a-13); SEC v. Frank M. Bergonzi, Martin L. Grass, and Franklin C. Brown, No. 1:CV02-1084 (M.D. Pa.), Litig. Rel. No. 17577; Accounting and Auditing Enforcement Rel. No. 1581 (June 21, 2002)( violations of Section 17(a) of the Securities Act [15 USC § 77q(a)], Sections 10(b) and 13(b)(5) of the Exchange Act [15 USC §§78j(b), 78m(b)(5)], Rules 10b-5 and 13b2-1, 13b2-2, and controlling person liability under Section 20(a) of the Exchange Act [15 USC § 78t(a)] for the company's violations of the periodic and current reporting obligations, proxy statement requirements, and corporate recordkeeping and internal controls statutes).

<sup>81</sup> See SEC v. Bruce Hill, et al., No. 02-CV-11244 (D. Mass.), Litig. Rel. No. 17578; Accounting and Auditing Enforcement Rel. No. 1582 (June 21, 2002)(violations of Section 17(a) of the

undisclosed self-dealing transactions, and insider trading.<sup>82</sup> Two of the actions were precipitated by what, at the time, were the largest corporate restatements of revenue in history.<sup>83</sup>

Unlike the complaints in most of the prior actions, however, the SEC's complaints in the 2002 actions focus more on financial incentive, such as inside counsel's receipt of substantial performance-based bonuses, as a motivating force for the underlying conduct.<sup>84</sup> In the case of Waste Management's officers, including its then general counsel, the SEC begins its complaint by specifically alleging that the financial fraud "[was] motivated by greed and a desire to preserve professional and social status."<sup>85</sup> According to the SEC, because of the performance-based bonus program for senior officers, the defendants manipulated the Company's reported results in order to meet targeted earnings and thereby collect substantial bonuses in return.<sup>86</sup>

---

Securities Act [15 USC § 77q(a)], Section 10(b) of the Exchange Act [15 USC § 78j(b)] and Rule 10b-5, Section 13(b)(5) of the Exchange Act [15 USC § 78m(b)(5)] and Rules 13b2-1 and 13b2-2, and aiding and abetting the company's violations of the periodic reporting and recordkeeping requirements).

<sup>82</sup> See SEC v. Andrew S. Marks, No. 02 CV 12325 (JLT) (D. Mass.), Litig. Rel. No. 17871 (Dec. 3, 2002)(violations of Section 10(b) of the Exchange Act [15 USC § 78j(b)] and Rule 10b-5, and Section 17(a) of the Securities Act [15 USC § 77q(a)].

<sup>83</sup> See Complaint, SEC v. Dean L. Buntrock, et al., No. 02C 2180 (N.D. Ill. filed March 26, 2002), at ¶ 1 (alleging that company's restatement showed that profits had been overstated by \$1.7 billion dollars); Complaint, SEC v. Frank M. Bergonzi, Martin L. Grass, and Franklin C. Brown, No. 1:CV02-1084 (M.D. Pa. filed June 20, 2002), at ¶ 1 (alleging that company was forced to restate its cumulative pre-tax income by \$2.3 billion dollars, and its cumulative net income by \$1.6 billion dollars).

<sup>84</sup> In its 2001 complaint against Jay Lapine, the general counsel of McKesson/HBOC, the SEC also alleges that Lapine was unjustly enriched through the unlawful revenue recognition scheme by his receipt of significant bonuses that were tied to meeting expected earnings. See n. 70 and accompanying text, supra.

<sup>85</sup> Complaint, SEC v. Dean L. Buntrock, et al., No. 02C 2180 (N.D. Ill. filed March 26, 2002), at ¶ 1.

<sup>86</sup> Id. at ¶¶1, 337.

Similar allegations are included in the complaint against the general counsel and the other officers of Rite-Aid with respect to their alleged scheme to misrepresent the company's financial condition.<sup>87</sup> In another complaint against the general counsel of a software company, the SEC also suggests that financial incentives influenced him to engage in a fraudulent revenue recognition scheme.<sup>88</sup> And, in other cases, allegations of "looting" and "egregious self-dealing transactions" are sprinkled through the SEC's complaint.

With respect to counsel's specific role in the underlying schemes, the allegations vary in their characterization of the degree of counsel's complicity.

For example, the SEC alleged a fraudulent scheme orchestrated by the CEOs, CFO, and CAO of Waste Management, involving misrepresenting financial results by improperly eliminating or deferring current expenses. The SEC describes the general counsel as having questioned the practices,<sup>89</sup> but then as having "blessed the Company's fraudulent disclosures."<sup>90</sup> Throughout the complaint the SEC alleges that the other officers engaged in a

---

<sup>87</sup> Complaint, SEC v. Frank M. Bergonzi, Martin L. Grass, and Franklin C. Brown, No. 1:CV02-1084 (M.D. Pa. filed June 20, 2002), at ¶¶1, 67-68 (noting that the scheme was implemented "with the intent to enrich themselves through performance-based bonuses of stock and cash," and itemizing the amounts actually realized in cash bonuses and the amounts that could have been realized in stock options and long-term incentive plans had the fraud not been discovered).

<sup>88</sup> Complaint, SEC v. Bruce Hill, et al., No. 02-CV-11244 (D. Mass. filed June 21, 2002), at ¶¶20-21 (noting that "senior management had substantial financial incentives to meet revenue goals," and that Hill could earn a bonus of approximately 30% of his salary if company revenue goals were met, but would not receive a bonus if these goals were not met; also alleging that Hill "experienced firsthand significant repercussions" when the goals were not met, including the drop in stock prices, job restructuring and job cuts, and no bonuses).

<sup>89</sup> Complaint, SEC v. Dean L. Buntrock, et al., No. 02C 2180 (N.D. Ill. filed March 26, 2002), at ¶ 9.

<sup>90</sup> Id., at ¶ 18.

variety of improper accounting practices “with the [general counsel’s] knowledge.”<sup>91</sup> Because he attended periodic meetings with the company’s outside auditor to discuss auditing issues, such as the company’s lack of progress in implementing a new accounting plan (due to the fraudulent scheme of which the general counsel is alleged to have had knowledge), and because he attended all audit committee meetings, the SEC alleges that the general counsel “had the full picture of the accounting irregularities and misstatements.”<sup>92</sup> Accordingly, since he drafted, reviewed, and authorized the disclosures in the company’s periodic reports, registration statements, and press releases, the general counsel knew or recklessly disregarded facts indicating that the financial information contained or incorporated in these documents was false or misleading and omitted material information.<sup>93</sup> Without admitting or denying these allegations, the general counsel has consented to the entry of judgment against him in the civil enforcement action,<sup>94</sup> and has also agreed to the settlement of a Rule 102(e) administrative proceeding, pursuant to which he has been temporarily suspended from appearing and practicing before the Commission as an attorney.<sup>95</sup>

---

<sup>91</sup> See, e.g., *id.*, at ¶¶50-73.

<sup>92</sup> *Id.*, at ¶ 330.

<sup>93</sup> *Id.*, at ¶¶ 330-332.

<sup>94</sup> Under the terms of the settlement, the general counsel has consented to a permanent bar from serving as an officer or director of a public company, and to an order enjoining him from the commission of future violations of the antifraud and other provisions of the securities laws; in addition, he has agreed to pay a total of \$1,149,756, which includes \$472,500 in disgorgement, \$477,256 in prejudgment interest, and a \$200,000 civil penalty. See SEC v. Dean L. Buntrock, et al, No. 02C 2180 (N.D. Ill.), Litig. Rel. No. 19351; Accounting and Auditing Enforcement Rel. No. 2298 (Aug. 29, 2005).

<sup>95</sup> See In the Matter of Herbert A. Getz, Esq., Admin. Proc. Rel. No. 34-52452; Accounting and Auditing Enforcement Rel. No. 2313 (Sept. 15, 2005) (five-year suspension).

In another case, the SEC has alleged that senior executives defrauded the company by granting themselves numerous unauthorized loans from the company and causing their forgiveness, in directing others to falsify the books and records to conceal the loans, and in engaging in other undisclosed related-party transactions with the company. Separately, it sets forth its allegations against inside counsel: that he demanded and received a loan from the company for which he was ineligible; that he allegedly failed to disclose these loans on internal questionnaires when he knew, or was reckless in not knowing, that disclosure was required; and, that, he knowingly or recklessly sold large amount of company stock. The complaint further alleges that counsel was responsible for supervising the company's corporate disclosure, and that, as a result of the fraudulent misrepresentations and omissions discussed in the entire complaint, the company filed false and misleading reports and proxy statements with the Commission.

In contrast to the complaints in the two foregoing SEC actions, the complaints in several other 2002 actions allege direct participation by inside counsel in the fraudulent schemes. In the case of Rite-Aid, for example, the SEC alleges that in-house counsel "originated" the idea to report the proceeds of litigation settlement prematurely in order "to help plug . . . a \$100 million shortfall that otherwise would have to be reported for FY 1999."<sup>96</sup> He is alleged to have "convinced outside counsel to provide an opinion letter that erroneously stated that the litigation settlement was binding and enforceable" as of a prior date, when he knew that it was not yet binding because of its contingent nature,<sup>97</sup> and then later provided this opinion letter to the

---

<sup>96</sup> Complaint, SEC v. Frank M. Bergonzi, Martin L. Grass, and Franklin C. Brown, No. 1:CV02-1084 (M.D. Pa. filed June 20, 2002), at ¶ 45.

<sup>97</sup> Id. at ¶ 46.

company's auditors to support the recording of the settlement in the fourth quarter (even though he allegedly knew, or recklessly disregarded, that such recording was improper because of the highly contingent nature of the deal).<sup>98</sup> With respect to certain related-party transactions engaged in by the CEO, in-house counsel is also alleged to have used a false email and a back-dated document in an attempt to conceal one of these transactions.<sup>99</sup> Similar allegations of active participation in the fraudulent scheme appear in the complaint against the general counsel of Inso Corporation.<sup>100</sup>

Turning to the issue of sanctions, the SEC sought similar sanctions in 2002 as it had in prior actions: permanent injunctions against future violations, disgorgement of ill-gotten gains, and the imposition of civil monetary penalties. An additional sanction pursued with more frequency in 2002 is a prohibition against serving as an officer or director of a publicly traded company.<sup>101</sup>

---

<sup>98</sup> Id. at ¶ 61.

<sup>99</sup> Id. at ¶ 56.

<sup>100</sup> See Complaint, SEC v. Bruce Hill, et al., No. 02-CV-11244 (D. Mass. filed June 21, 2002), at ¶¶3-4 (in order to recognize revenue within the quarter from a failed sale of software licenses, Hill entered into a transaction with a third party knowing, or recklessly disregarding facts indicating the existence of an oral side agreement relieving the purported purchaser of any obligation to pay; “orchestrated” the provision of letters of credit to the purported purchaser to finance the transaction; “caused” the making of a false board resolution authorizing the letters of credit; provided false information to the CFO and outside auditors).

<sup>101</sup> See, e.g., SEC v. Dean L. Buntrock, et al., No. 02C 2180 (N.D. Ill.), Litig. Rel. No. 19351; Accounting and Auditing Enforcement Rel. No. 2298 (Aug. 29, 2005) (announcing entry of consent judgment enjoining the general counsel from future violations of the antifraud and other provisions of the securities laws, barring him from serving as an officer or director of a public company, and ordering the payment of over \$1.1 million); SEC v. Andrew S. Marks, No. 02 CV 12325 (JLT) (D. Mass.), Litig. Rel. No. 18956 (Nov. 2, 2004)(announcing entry of consent judgment in insider trading case, enjoining Marks from future violations of the antifraud provisions and barring him from acting as an officer or director of a publicly traded company).

2003 saw five SEC enforcement actions brought against inside counsel, one of which was a settled administrative cease and desist proceeding. In all of the actions, inside counsel held the position of general counsel and also served in other capacities, such as vice-president and secretary,<sup>102</sup> president<sup>103</sup> and/or CEO,<sup>104</sup> and compliance officer.<sup>105</sup> Two of the attorneys were also directors of the corporation.<sup>106</sup> One of these attorneys has been indicted for the same conduct giving rise to the enforcement action.<sup>107</sup>

Like the allegations in previous enforcement actions, the allegations in the complaints filed against inside counsel in 2003 involve material misrepresentations and omissions in company records, SEC filings, press releases, and other documents disseminated to the public. With the exception of one case, the complaints allege that counsel, together with

---

<sup>102</sup>SEC v. Michael J. Pietrzak, Maurice W. Furlong, and Donald E. Jordan, No. 03C-1507 (N.D. Ill.), Litig. Rel. No. 18016 (March 6, 2003); SEC v. Oliver Hilsenrath and David S. Klarman, No. C-03-3252 (N.D. Cal.), Litig. Rel. No. 18275; Accounting and Auditing Enforcement Rel. No. 1831 (Aug. 6, 2003); SEC v. Heartland Advisors, Inc., et. al., No. 03 C-1427 (E.D. Wis.), Litig. Rel. No. 18505 (Dec. 12, 2003).

<sup>103</sup>In the Matter of Steven L. Hunt, Esq., Admin. Proc. Rel. No. 34-48330; Accounting and Auditing Enforcement Rel. No. 1840 (Aug. 13, 2003). In the Matter of Steven L. Hunt, Esq., Admin. Proc. Rel. No. 34-48330; Accounting and Auditing Enforcement Rel. No. 1840 (Aug. 13, 2003).

<sup>104</sup> SEC v. Tecumseh Holdings Corp., et. al., No. 03 Civ. 5490 (SAS) (S.D.N.Y.), Litig. Rel. No. 18251 (July 25, 2003).

<sup>105</sup> SEC v. Heartland Advisors, Inc., et. al., No. 03 C-1427 (E.D. Wis.), Litig. Rel. No. 18505 (Dec. 12, 2003).

<sup>106</sup> SEC v. Michael J. Pietrzak, Maurice W. Furlong, and Donald E. Jordan, No. 03C-1507 (N.D. Ill.), Litig. Rel. No. 18016 (March 6, 2003); SEC v. Tecumseh Holdings Corp., et. al., No. 03 Civ. 5490 (SAS) (S.D.N.Y.), Litig. Rel. No. 18251 (July 25, 2003).

<sup>107</sup> See United States v. Oliver Hilsenrath and David Scott Klarman, CR 03-0213 WH (N.D. Cal.). Klarman pled guilty to mail fraud and money laundering for his part in the fraudulent scheme. See J. Chorney, "U.S. Wireless GC Admits Fraud," The Recorder at 10 (Jan. 27, 2004).

other officers and employees, engaged in this conduct in furtherance of a fraudulent scheme to inflate stock prices,<sup>108</sup> offer unregistered or overpriced securities or bonds<sup>109</sup> or extract assets from the company for personal gain.<sup>110</sup> In the sole exception, the administrative cease and desist proceeding, no underlying scheme was alleged; instead, the SEC found that inside counsel's omission of material information concerning disciplinary action taken against an affiliate of the company was a willful act, done in violation of various provisions of the Investment Advisors Act,<sup>111</sup> and warranted the issuance of a cease and desist order and a temporary suspension from appearing and practicing before the SEC as an attorney.<sup>112</sup>

In one of the more publicized cases in 2003, the SEC charged both the general counsel, and the CEO of U.S. Wireless, with "egregious securities fraud" that allegedly led to the company's bankruptcy after a restatement of its financial results showed a \$6.3 million increase in losses.<sup>113</sup> According to the complaint, the general counsel set up offshore entities under his ownership and control and transferred company cash and stock to these entities as purported

---

<sup>108</sup> See Complaint, SEC v. Michael J. Pietrzak, Maurice W. Furlong, and Donald E. Jordan, No. 03C-1507 (N.D. Ill. filed March 6, 2003).

<sup>109</sup> See Complaint, SEC v. Tecumseh Holdings Corp., et. al., No. 03 Civ. 5490 (SAS) (S.D.N.Y. filed July 24, 2003) (securities offerings); Complaint, SEC v. Heartland Advisors, Inc., et. al., No. 03 C-1427 (E.D. Wis.) (bond offerings).

<sup>110</sup> See Complaint, SEC v. Oliver Hilsenrath and David S. Klarman, No. C-03-3252 (N.D. Cal. filed July 14, 2003).

<sup>111</sup> 15 USC § 80b-7.

<sup>112</sup> In the Matter of Steven L. Hunt, Esq., Admin. Proc. Rel. No. 34-48330; Accounting and Auditing Enforcement Rel. No. 1840 (Aug. 13, 2003).

<sup>113</sup> Complaint, SEC v. Oliver Hilsenrath and David S. Klarman, No. C-03-3252 (N.D. Cal. filed July 14, 2003), at ¶¶1, 35-36.

compensation for services or as purported sales of stock for valid consideration.<sup>114</sup> With respect to one entity, for example, the complaint alleges that the in-house counsel signed a consulting agreement on behalf of U.S. Wireless, which stated that the entity would provide legal services to the company regarding its overseas operations; however, no services or other consideration was provided by the entity in exchange for the cash and stock.<sup>115</sup> The complaint further alleges that he signed a legal opinion letter in support of a registration statement that contained false information; drafted or reviewed periodic reports from which he intentionally or recklessly omitted the fact that the company received no consideration for the cash and stock transferred to the offshore entities; drafted or reviewed periodic reports containing material statements that he knew, or was reckless in not knowing, were false; intentionally caused the recording of false information in the company's books and records; and, made statements to the company's auditors regarding related-party transactions which he knew, or was reckless in not knowing, were false.<sup>116</sup>

Without admitting or denying the SEC's allegations, the general counsel of U.S. Wireless has consented to the issuance of an order by the federal district court holding him liable for \$3.9 million,<sup>117</sup> permanently enjoining him from violating or aiding and abetting violations

---

<sup>114</sup> Id. at ¶ 2.

<sup>115</sup> Id. at ¶¶11-13.

<sup>116</sup> Id. at ¶¶27-33. Klarman was charged with violating Section 17(a) of the Securities Act (15 USC § 77q(a)), Section 10(b) of the Exchange Act (15 USC § 78j(b)) and Rule 10b-5, and Section 13(b)(5) of the Exchange Act (15 USC § 78m(b)(5)) and Rules 13b2-1 and 13b2-2, and with aiding and abetting the company's violations of Section 13(a) of the Exchange Act (15 USC § 78m(a)) and Rules 12b-20, 13a-1, and 13a-13, and Section 13(b)(2)(A) of the Exchange Act (15 USC § 78m(b)(2)(A)). See id., at ¶¶37-56.

<sup>117</sup>See SEC v. Oliver Hilsenrath and David S. Klarman, No. C-03-3252 (N.D. Cal. filed July 14, 2003), Litig. Rel. No. 19286; Accounting and Auditing Enforcement Rel. No. 2267 (June 27,

of the antifraud and other provisions of the securities laws,<sup>118</sup> and prohibiting him for 10 years from serving as an officer or director of any issuer with securities registered under Section 12 of the Exchange Act or with reporting obligations under Section 15(d) of the Exchange Act.<sup>119</sup> In a related administrative proceeding, the SEC has accepted the general counsel's offer of settlement and has suspended him from appearing and practicing before the Commission as an attorney.<sup>120</sup>

In the remaining enforcement actions for 2003, the SEC makes similar allegations with respect to inside counsel's direct participation in the underlying scheme. For example, in its action against the general counsel of a financial services company as well as its president and CEO, the SEC alleges that he was responsible for the management and operation of the company and was aware of all aspects of the company, including its accounting and financial issues.<sup>121</sup> The complaint further alleges that as a lawyer, he devoted all of his professional time to the company's legal work and wrote, or directed the writing of all of the company's offering memoranda as well as its newsletters and other investor communications.<sup>122</sup> Notwithstanding his knowledge of the company's history of losses and lack of profits, he is alleged to have knowingly or recklessly prepared offering memoranda and other public releases containing

---

2005). This amount represents \$3.2 million in disgorgement of ill-gotten gains, and \$700,000 in prejudgment interest. Id.

<sup>118</sup>Id. As to the specific provisions of the securities laws to which the injunction applies, see n. 116, supra.

<sup>119</sup> Id. (referencing 15 U.S.C. §§78l and 78o, respectively).

<sup>120</sup> See In the Matter of David S. Klarman, Esq., Admin. Proc. Rel. No. 34-51927; Accounting and Auditing Enforcement Rel. No. 2266 (June 27, 2005).

<sup>121</sup> Complaint, SEC v. Tecumseh Holdings Corp., et. al., No. 03 Civ. 5490 (SAS) (S.D.N.Y. filed July 24, 2003), at ¶ 51.

<sup>122</sup> Id.

materially false and misleading statements and omissions pertaining to a variety of matters, such as anticipated profits, the payment of dividends, the return on investments, the use of investment funds, and NASD's approval of the company's acquisition of a broker-dealer.<sup>123</sup> Because of his role in the company, he was charged with violations of the securities laws both directly and as a controlling person.<sup>124</sup>

In its complaint against the general counsel of what the SEC describes as a company "professed to be in various businesses . . . none [of which] were ever operational,"<sup>125</sup> the SEC alleges that he and the company's CEO shared responsibility for keeping the company's books, records, and accounts, and for maintaining its internal controls.<sup>126</sup> In order to inflate the price of its stock and the value of the company, the complaint alleges that the general counsel participated in the following wrongful conduct: recording, as assets, several transactions having no basis on which to assign a value;<sup>127</sup> recording certain real estate as an asset, even though he knew that the company never controlled the property, never derived an economic benefit from the property, never obtained legal title to the property, never obtained an appraisal of the

---

<sup>123</sup> Id., at ¶¶2, 28-50.

<sup>124</sup> See id., at ¶¶54-60, 64-66, and 71-73 (charging Milling directly and as a controlling person with violating Section 17(a) of the Securities Act (15 USC § 77q(a)), Section 10(b) of the Exchange Act (15 USC § 78j(b)), and Rule 10b-5, with violating Sections 5(a) and 5(c) of the Securities Act (15 USC § 77e(a), (c)), and with aiding and abetting the company's violation of Section 17(a) of the Securities Act and Rules 17a-3 and 17a-4).

<sup>125</sup> Complaint, SEC v. Michael J. Pietrzak, Maurice W. Furlong, and Donald E. Jordan, No. 03C-1507 (N.D. Ill. filed March 6, 2003), at ¶ 28.

<sup>126</sup> Id. at ¶ 50.

<sup>127</sup> Id. at ¶¶4, 50-51, 61-63.

property, and knew that the property was the subject of litigation;<sup>128</sup> recognizing and valuing advertising credit without obtaining the requisite support for the valuation from a broker or other qualified individual;<sup>129</sup> failing to ensure that the company's internal controls prevented certain assets from being recorded in a manner that did not conform to GAAP;<sup>130</sup> recognizing and valuing notes receivable when he had no basis to believe that the notes were collectible;<sup>131</sup> preparing false and misleading press releases relating to assets that had been improperly recognized and valued;<sup>132</sup> selling company stock knowing, or recklessly disregarding the fact, that the registration statements, reports, press releases and shareholder letters contained inflated values of the company's assets;<sup>133</sup> and, failing to properly file certain periodic reports with the SEC.<sup>134</sup> As a consequence of these allegations, the complaint charges in-house counsel with a range of securities law violations.<sup>135</sup>

---

<sup>128</sup> Id. at ¶¶87-91

<sup>129</sup> Id. at ¶¶104-106.

<sup>130</sup> Id. at ¶ 107.

<sup>131</sup> Id. at ¶¶117-118.

<sup>132</sup> Id. at ¶¶125-128.

<sup>133</sup> Id. at ¶¶163-166.

<sup>134</sup> Id. at ¶¶170-177.

<sup>135</sup> See id., at ¶¶180-187, 193-197, 202-209 (charging Pietzrak with violations of Section 17(a) of the Securities Act (15 USC § 77q(a)), Section 10(b) of the Exchange Act (15 USC § 78j(b)) and Rule 10b-5, and Section 13(b)(5) of the Exchange Act (15 USC § 78m(b)(5)) and Rules 13b2-1, and with aiding and abetting the company's violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act (15 USC §§78m(a), 78m(b)(2)(A) and (B)) and Rules 12b-20, 13a-1, 13a-11, 13a-13, and 13b2-1).

The final enforcement action against inside counsel in 2003 involves the general counsel of an investment company, whom the SEC alleges engaged in a scheme to sell municipal bond mutual funds at a fraudulently overvalued price. According to the SEC, the in-house counsel shared responsibility for assuring that the bonds were priced at fair value, and was “integral” in preparing SEC filings and promotional materials since she was responsible for reviewing all prospectuses, statements, and sales literature concerning the funds prior to their dissemination to the public.<sup>136</sup> In its complaint, the SEC alleges that the lawyer, together with others, knowingly or recklessly made material misrepresentations and omissions in these documents concerning a number of matters, including the risks of investing and the efforts undertaken to minimize the risks.<sup>137</sup> With respect to the overvaluation of the funds, the complaint alleges that she knew that the price of the funds were inflated, but failed to take corrective action to ensure that the prices reflected the bonds’ fair value.<sup>138</sup> Instead, the SEC alleges that counsel attempted to conceal the pricing fraud by urging the other defendants to eliminate certain materials, including any materials dealing with valuation issues.<sup>139</sup>

---

<sup>136</sup>Complaint, SEC v. Heartland Advisors, Inc., et. al., No. 03 C-1427 (E.D. Wis. Filed Dec. 11, 2003), at ¶¶29, 36.

<sup>137</sup> Id. at ¶¶37-40.

<sup>138</sup> Id. at ¶¶52-60.

<sup>139</sup> Id. at ¶ 59. The SEC alleges that Bauer’s activities violated Sections 17(a)(1) – (a)(3) of the Securities Act (15 USC § 77q(a)(1)-(a)(3)), Section 10(b) of the Exchange Act (15 USC § 78j(b)) and Rule 10b-5, and Sections 34(b) and 36(a) of the Investment Company Act (15 USC §§80a-33b, 80a-35b), and aided and abetted the company’s violations of Sections 206(1) and 206(2) of the Advisers Act (15 USC §§80b-6(1), (2)). Bauer was also charged with insider trading for selling her shares in one of the funds in order to avoid losses upon the funds’ devaluation. Id. at ¶¶90-100.

Consistent with prior civil injunctive actions, the sanctions sought in 2003 included permanent injunctions against future violations, as well as disgorgement and the payment of civil monetary penalties. In two of the actions, the SEC also seeks an order barring participation in any penny stock offering,<sup>140</sup> and, in one action, the SEC sought the imposition of a permanent officer and director bar.<sup>141</sup> The SEC also obtained preliminary injunctive relief that included an asset-freeze order.<sup>142</sup>

During 2004, the SEC initiated six enforcement actions against inside counsel, all of whom appear to have held the top legal position within the corporations.<sup>143</sup> Four inside counsel also served in other capacities within the corporation, such as vice-president and secretary,<sup>144</sup> or just vice-president,<sup>145</sup> and one inside counsel had been a member of the board of

---

<sup>140</sup> See Complaint, SEC v. Michael J. Pietrzak, Maurice W. Furlong, and Donald E. Jordan, No. 03C-1507 (N.D. Ill. filed March 6, 2003); Complaint, SEC v. Tecumseh Holdings Corp., et. al., No. 03 Civ. 5490 (SAS) (S.D.N.Y. filed July 24, 2003).

<sup>141</sup> Complaint, SEC v. Oliver Hilsenrath and David S. Klarman, No. C-03-3252 (N.D. Cal. filed July 14, 2003).

<sup>142</sup> SEC v. v. Tecumseh Holdings Corp., et. al., No. 03 Civ. 5490 (SAS) (S.D.N.Y.), Litig. Rel. No. 18353 (Sept. 17, 2003).

<sup>143</sup> Chris Gunderson is referred to as his company's in-house counsel, suggesting that he is the legal officer within the company. See SEC v. Universal Express, Inc., et. al., No. 04 CV 02322 (S.D.N.Y.), Litig. Rel. No. 18636 (March 24, 2004).

<sup>144</sup> See e.g., SEC v. Henry C. Yuen, et al., No. CV 03-4376 NM (MANx) (C.D. Cal.), Litig. Rel. No. 18530; Accounting and Auditing Enforcement Rel. No. 1937 (Jan. 6, 2004) (Jonathan Orlick was general counsel, executive vice-president, and secretary of Gemstar-TV Guide); SEC v. Symbol Technologies, Inc., et. al., No. CV 04 2276 (LDW)(WDW) (E.D.N.Y.), Litig. Rel. No. 18743; Accounting and Auditing Enforcement Rel. No. 2029 (June 3, 2004)(Leonard Goldner served as executive vice-president, secretary, and general counsel).

<sup>145</sup> SEC v. Steven Woghin, No. 04 Civ. 4087 (E.D.N.Y.), Litig. Rel. No. 18891; Accounting and Auditing Enforcement Rel. No. 2106 (Sept. 22, 2004).

directors.<sup>146</sup> In two of the cases, criminal actions were brought against inside counsel for conduct related to the subject of the civil enforcement action.<sup>147</sup>

Most of the actions in 2004 involve inside counsel's alleged complicity in securities law violations allegedly engaged in by others within the corporation. Like actions in preceding years, these actions reflect varying degrees of alleged participation by counsel in conduct targeted by the SEC in these actions, which ranges from the alleged failure to disclose material information or to correct materially false and misleading information in company reports and filings, to the drafting of opinion letters or transactional documents containing allegedly false or misleading information.

In its first enforcement action for the year, for example, the SEC charged the former general counsel of Gemstar-TV Guide,<sup>148</sup> with securities fraud in connection with a scheme to inflate licensing and advertising revenue that resulted in an overstatement of revenue

---

<sup>146</sup> SEC v. Henry C. Yuen, et al., No. CV 03-4376 NM (MANx) (C.D. Cal.), Litig. Rel. No. 18530; Accounting and Auditing Enforcement Rel. No. 1937 (Jan. 6, 2004) (Jonathan Orlick).

<sup>147</sup> Steven Woghin is one of the attorneys, see Press Release of October 6, 2004, United States Attorney's Office for the Eastern District of New York, "Former Computer Associates Executives Indicted on Securities Fraud, Obstruction Charges, Former General Counsel Pleads Guilty, Company Enters into Cooperation Agreement," available at [www.usdoj.gov/usao/nye/pr/2004oct06a.htm](http://www.usdoj.gov/usao/nye/pr/2004oct06a.htm), and Leonard Goldner is the other attorney. See Press Release of October 27, 2004, United States Attorney's Office for the Eastern District of New York, "Former General Counsel of Symbol Technologies Pleads Guilty to Conspiring to Obstruct the Internal Revenue Service in the Collection of Income Tax," available at [www.usdoj.gov/usao/nye/pr/2004oct27a.htm](http://www.usdoj.gov/usao/nye/pr/2004oct27a.htm).

<sup>148</sup> Orlick was fired from Gemstar "for cause" in June of 2003, just before the SEC filed its first action against Gemstar executives. Subsequently, he filed a defamation against Gemstar, claiming that the "for cause" designation indicated that he had been convicted of a felony or had been found guilty of fraud or embezzlement. See "Former Gemstar counsel sues for defamation," Los Angeles Business from bizjournals (July 9, 2003), available at <http://losangeles.bizjournals.com/losangeles/stories/2003/07/07/daily30.html>.

in the amount of approximately \$248 million.<sup>149</sup> According to the SEC, he participated in the company's manipulation of its financial results in the following ways: he knew that the company was improperly recognizing and recording licensing revenue from two companies, but omitted to disclose that information; he repeatedly signed management representation letters to the company's auditors that contained false information regarding the status of negotiations with one of the companies; and, he failed to disclose material information relating to certain revenue.<sup>150</sup> The SEC also charged him with lying to the company's auditors.<sup>151</sup> Without admitting or denying the allegations, the in-house counsel consented to the issuance of an order permanently enjoining him from future violations of the securities laws.<sup>152</sup> In a related administrative disciplinary proceeding, he consented to an order suspending him from appearing or practicing before the SEC as an attorney.<sup>153</sup>

In another action, the SEC instituted an administrative cease and desist proceeding against the chief legal officer of a public company. According to the SEC, the in-house counsel became aware that certain corporate assets were significantly overvalued and he was advised by the auditors that the company would therefore be required to restate its financial

---

<sup>149</sup> See SEC v. Henry C. Yuen, et al., No. CV 03-4376 NM (MANx) (C.D. Cal.), Litig. Rel. No. 18530; Accounting and Auditing Enforcement Rel. No. 1937 (Jan. 6, 2004).

<sup>150</sup> Id.

<sup>151</sup> Id. In all, Orick was charged with violations of Section 10(b), 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act (15 USC §§78j(b), 78m(a), 78m(b)(2)(A), and 78m(b)(2)(B)), and Rules 10b-5, 12b-20, 13a-1, 13a-13, 13b2-1, and 13b2-2. Id.

<sup>152</sup> Id., Litig. Rel. No. 19047 (Jan. 21, 2005) (also ordering him to pay disgorgement of \$150,000, reflecting a portion of bonuses received during the course of the scheme, interest of \$5,510, and a civil penalty of \$150,000).

<sup>153</sup> In the Matter of Jonathan B. Orlick, Esq., Admin. Proc. Rel. No. 34-51081; Accounting and Auditing Enforcement Rel. No. 2177 (Jan. 26, 2005).

statements. The company restated but allegedly mischaracterized the reasons in its SEC filings. The SEC alleged that the inside counsel effectively approved the filing when he knew or should have known that the filing mischaracterized the reason for the restatement. The SEC alleged that the in-house counsel reviewed and signed another SEC filing that he knew or should have known did not accurately reflect the company's cash and debt. Without admitting or denying the SEC's findings that the lawyer aided and abetted the company's violation of the reporting statutes, the lawyer consented to the entry of the cease and desist order, and agreed to refrain from preparing, reviewing, or signing any filings for a two-year period.

The three following enforcement actions allege active roles by inside counsel in the alleged fraudulent schemes.

In its enforcement action against the in-house counsel for a developmental stage company, the SEC alleges he engaged in the company's fraudulent stock distribution scheme by disguising the nature of the transactions through the preparation of false documentation, including the following: consulting agreements purporting to obligate the re-sellers of unlawfully-issued stock to perform services in exchange for the stock; legal opinions containing false assertions as to coverage of the stock under the company's registrations for its common shares; and fraudulent stock purchase agreements.<sup>154</sup> He is also alleged to have provided the company's auditors with misleading information about the stock issuances and with backdated stock purchase letters.<sup>155</sup> To underscore its view as to the severity of the charges, the SEC seeks third-tier civil monetary penalties against all of participants in the scheme, including in-house

---

<sup>154</sup> Complaint, SEC v. Universal Express, Inc., et. al., No. 04 CV 02322 (S.D.N.Y. filed March 24, 2004), at ¶¶23-28.

<sup>155</sup> Id. at ¶¶36, 38.

counsel.<sup>156</sup> Thus, in-house counsel faces a civil money penalty not to exceed the greater of \$100,000, or the gross amount of pecuniary gain received from his wrongful conduct if it “involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; and . . . directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons.”<sup>157</sup>

Similarly, with respect to a fraudulent revenue recognition scheme engaged in by the top executives at a large software company, the SEC alleged that the company’s general counsel participated in the scheme by signing SEC filings when he knew, or recklessly disregarded the fact, that they contained materially false and misleading information concerning the company’s prior revenue and earnings per share; by approving backdated contracts and drafting contracts with misleading dates; and, by permitting the legal department, which he oversaw, to approve contracts when he knew, or recklessly disregarded the fact, that the contracts contained false and misleading signature dates and that the company would recognize revenue from those contracts in the wrong quarter.<sup>158</sup> Additional allegations included charges that he obstructed internal and government investigations by instructing employees as to the manner in which they were to respond to questions when interviewed by outside counsel or the

---

<sup>156</sup> Gunderson is charged with the following violations: Sections 5(a) and (c) of the Securities Act (15 USC § 77e(a) and (c), Section 17(a)(1), (a)(2), and (a)(3) of the Securities Act (15 USC § 77q(a)(1), (a)(2), and (a)(3)), Section 10(b) of the Exchange Act (15 USC § 78j(b)) and Rule 10b-5, Section 13(b)(5) of the Exchange Act (15 USC § 78m(b)(5)) and Rule 13b2-1, and aiding and abetting the company’s violations of Sections 13(a) and 13(b)(2) of the Exchange Act (15 USC §§78m(a), (b)(2)), and Rules 12b-20, 13a-1, and 13a-3. *See id.* at ¶¶86-109.

<sup>157</sup>15 U.S.C. §§77t(d)(2)(C), 78u(d)(3)(B)(iii).

<sup>158</sup>Complaint, *SEC v. Steven Woghin*, No. 04 Civ. 4087 (E.D.N.Y. filed Sept. 21, 2004), at ¶¶24-34.

government.<sup>159</sup> As in its action against the in-house lawyer of the developmental stage company,<sup>160</sup> the SEC sought the imposition of third-tier civil monetary penalties for his violations of the securities laws<sup>161</sup> – i.e., a maximum penalty of either \$100,000, or the gross amount received from his wrongful conduct if warranted by the nature of the violation and the extent of the losses sustained by others as a result of the conduct.<sup>162</sup> Without admitting or denying the allegations, he consented to the entry of an order permanently enjoining him from future violations, and, in a related administrative disciplinary proceeding, he consented to an order suspending him from appearing and practicing before the SEC as an attorney.<sup>163</sup>

And, in its enforcement action against Symbol Technologies and several of its former officers, the SEC has alleged that its then general counsel, “devised and directed” a fraudulent practice with respect to the company’s stock option program during the course of a fraudulent accounting scheme.<sup>164</sup> Without connecting the lawyer to the accounting scheme, the SEC alleges that he manipulated stock option dates by calculating the cost of the exercise on the

---

<sup>159</sup> Id., at ¶¶35-36.

<sup>160</sup> See n. 156, supra.

<sup>161</sup> Woghin was charged with violating Section 17(a) of the Securities Act (15 USC § 77q(a)), Sections 10(b) and 13(b)(5) of the Exchange Act (15 USC §§78j(b), 78m(b)(5)) and Rules 10b-5 and 13b2-1, and with aiding and abetting the company’s violation of Sections 10(b), 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act (15 USC §§78j(b), 78m(a), 78m(b)(2)(A), and (2)(B)) and Rules 10b-5, 12b-20, 13a-1, and 13a-13. Id. at ¶¶37-54.

<sup>162</sup> See n. 157, supra.

<sup>163</sup> In the Matter of Steven Woghin, Esq., Admin. Proc. Rel. No. 34-50653; Accounting and Auditing Enforcement Rel. No. 2133 (Nov. 10, 2004).

<sup>164</sup> Complaint, SEC v. Symbol Technologies, Inc., et. al., No. CV 04 2276 (LDW)(WDW) (E.D.N.Y. filed June 3, 2004), at ¶ 122.

basis of a date that was more advantageous than the actual exercise date.<sup>165</sup> To conceal this “look-back” practice, the SEC alleges that he instructed his staff to backdate the requisite transactional documents and to use the false exercise dates on the forms on which the executives reported their acquisitions to the SEC.<sup>166</sup> The SEC further alleges that, in registration statements filed with the SEC, in-house counsel failed to disclose the “look-back” practice, and, therefore, filed false and misleading statements.<sup>167</sup> In addition to a permanent injunction against future violations of the securities laws,<sup>168</sup> the SEC also seeks an order requiring the payment of third-tier civil monetary penalties.<sup>169</sup>

The final enforcement action for 2004 represents a significant departure from all prior actions against inside counsel. Although acknowledging that the in-house counsel did not have any involvement in a fraudulent financial reporting scheme engaged in by his company and some of its senior executives, such as the CFO, the SEC has alleged that he violated one of the reporting regulations by failing to fulfill his role as corporate gatekeeper.<sup>170</sup> According to the SEC, he failed to provide important information to the company’s audit committee, Board of

---

<sup>165</sup> Id.

<sup>166</sup> Id.

<sup>167</sup> Id. at 125-128.

<sup>168</sup> The complaint charges Goldner with violations of Sections 10(b), 13(a), 13(b)(2), 13(b)(5), 14(a), 16(a), of the Exchange Act (15 USC §§78j(b), 78m(a), 78m(b)(2), 78m(b)(5), 78n(a), 78p(a)), Section 17(a) of the Securities Act (15 USC § 77q(a)), and Rules 10b-5, 12b-20, 13a-1, 13a-13, 14a-3, 14a-9, and 16a-3.

<sup>169</sup> See n. 157 and accompanying text, supra.

<sup>170</sup> Complaint, SEC v. John E. Isselmann, Jr., No. CV 04-1350 MO (D. Ore. Filed Sept. 21, 2004), at ¶¶1, 18-21 (charging violations of Rule 13b2-2); see Litig. Rel. No. 18896; Accounting and Auditing Enforcement Rel. No. 2109 (Sept. 24, 2004).

Directors, and independent auditors concerning an accounting transaction that resulted in the recording of a profit rather than a loss. The SEC alleges that at a meeting regarding the transaction, the elimination of benefits for the company's Asian employees, he failed to question the CFO's false statement that legal counsel had reviewed the decision to terminate the benefits. When he subsequently learned that the CFO's decision was not legally supportable, contrary to what had been told to the audit committee and outside auditors, the SEC alleges that in-house counsel failed to convey this information to the audit committee, outside auditors, or the board. The fact of the elimination of benefits was subsequently included in the company's quarterly report which he reviewed. For this reason, the SEC alleges, he was a cause of the company's filing of a false or misleading report.<sup>171</sup>

Without admitting or denying the allegations, the inside counsel settled the enforcement action and consented to an injunction against similar violations and to an agreement to pay a civil penalty of \$50,000.<sup>172</sup> In statements made after settlement of the action, he expressed surprise at the charges against him, saying that, as general counsel, he was a "generalist" who covered a variety of areas, and did not understand accounting issues but relied on the accountants and auditors to spot issues for him.<sup>173</sup> As noted by his lawyer, the SEC has

---

<sup>171</sup> Complaint, SEC v. John E. Isselmann, Jr., No. CV 04-1350 MO (D. Ore. Filed Sept. 21, 2004), at ¶¶7-17.

<sup>172</sup> See Litig. Rel. No. 18896; Accounting and Auditing Enforcement Rel. No. 2109 (Sept. 24, 2004). In a related administrative proceeding, Isselmann consented to the issuance of a cease and desist order. In the Matter of John E. Isselmann, Jr., Admin. Proc. Rel. No. 34-50428; Accounting and Auditing Enforcement Rel. No. 2108 (Sept. 23, 2004).

<sup>173</sup> T. Loomis, "SEC Gores GC in Sarbanes-Oxley Dust-Up," Legal Times, p. 18 (Jan. 24, 2005).

essentially created a strict liability offense, with no need for the SEC to establish intent or negligence.<sup>174</sup>

In January 2005, the SEC continued its close scrutiny of inside counsel by charging the general counsel of Google, Inc., with aiding and abetting Google's violation of Section 5(a) and 5(c) of the Securities Act [15 U.S.C. § 77e(a), (c)], by failing to register the issuance of stock option grants to employees or to provide certain information to the option recipients, as required by the securities laws.<sup>175</sup>

The SEC alleged that Google had granted stock options to its employees as a form of compensation since its inception, and did not register those securities with the SEC, relying on the exemption provided in Rule 701<sup>176</sup> for securities that are issued under compensatory benefit plans and whose value does not exceed \$5 million over a one-year period.<sup>177</sup> When Google became aware that its issuances might exceed the \$5 million threshold in September of 2002, the SEC alleges that Google temporarily stopped issuing the stock options because it "viewed the public disclosure of its detailed financial information as strategically disadvantageous" and was concerned that the information could reach its competitors.<sup>178</sup>

---

<sup>174</sup> Id.

<sup>175</sup> SEC News Digest, "SEC Charges Google, General Counsel for Illegally Issuing Over \$80 Million in Stock Options," Issue 2005-9 (Jan. 13, 2005), available at [www.sec.gov/news/digest/dig011305.txt](http://www.sec.gov/news/digest/dig011305.txt).

<sup>176</sup> 17 C.F.R. § 230.701.

<sup>177</sup> In the Matter of Google, Inc. and David C. Drummond, Admin. Proc. Rel. No. 33-8523 (Jan. 13, 2005) at III(C)(6).

<sup>178</sup> Id. at III(C)(7).

Several months later, however, Google reconsidered the issue of compensatory stock option benefits. As alleged by the SEC, the general counsel upon learning that the options being considered might exceed \$5 million, thereby triggering the registration and disclosure requirements of Rule 701, consulted with outside counsel and personnel within Google's legal department, and determined that other exemptions applied that permitted issuance of the options without having to comply with the registration and disclosure requirements.<sup>179</sup> Even if his analysis of the applicable exemptions was found to be incorrect, the SEC states that the inside lawyer determined that the company counsel could make an offer of rescission.<sup>180</sup> Accordingly, the SEC alleges that in-house counsel advised the Board to approve a new stock option plan, but did not report that the issuances might exceed the \$5 million threshold of Rule 701, and that other exemptions, such as the one provided in Rule 506,<sup>181</sup> would be relied upon to preclude application of the registration and disclosure requirements.<sup>182</sup> Subsequently, the in-house lawyer is alleged to have learned that Google "probably" had exceeded the threshold amount and that the Rule 506 exemption did not apply, but believed that the options might be exempt under Section 4(2) of the Securities Act.<sup>183</sup> The SEC further alleges that at a meeting in June of 2003, during which the Board adopted two new stock option plans, he did not advise the Board that the additional option grants would exceed the \$5 million threshold, or that there was a risk that the

---

<sup>179</sup> Id. at III(C)(8).

<sup>180</sup> Id.

<sup>181</sup> 17 C.F.R. § 230.506.

<sup>182</sup> In the Matter of Google, Inc. and David C. Drummond, supra, at III(C)(10).

<sup>183</sup> Id. at III(C)(13) (referring to 15 U.S.C. § 4(2)).

exemptions he believed applied would not apply.<sup>184</sup> In August of 2004, Google filed Form S 1 with the SEC, registering its offer to rescind the stock option grants and the purchases of shares in exercise of these options that were made between September of 2001 and June 2004.<sup>185</sup>

Without admitting or denying the SEC's findings, Google's inside lawyer settled the matter and consented to the issuance of a cease and desist order.<sup>186</sup> In public statements following disclosure of his settlement, SEC officials stated that he caused Google's violations "[b]y deciding Google could escape its disclosure requirements, and [by] failing to inform the Board of the legal risks of his determination."<sup>187</sup> The SEC disputed that it pursued him because of the advice that he provided to Google; instead, it pursued him because of his conduct.<sup>188</sup> The SEC also warned attorneys that "where [they] become actors in transactions, their conduct will be subject to sanctions, just as other participants' conduct."<sup>189</sup>

In February of 2005, the SEC initiated civil enforcement proceedings against the general counsel/chief financial officer of a corporation that owns and operates convenience stores and gas stations.<sup>190</sup> According to the SEC's complaint, outside auditors concluded in

---

<sup>184</sup> Id. at III(C)(15).

<sup>185</sup> Id. at III(C)(18).

<sup>186</sup> Id. at II.

<sup>187</sup> SEC News Release, No. 2005-6, "SEC Charges Google and its General Counsel David C. Drummond with Failure to Register over \$80 Million in Employee Stock Options Prior to IPO."

<sup>188</sup> Pamela Atkins, "Attorneys: SEC Officials Warn Lawyers of Going Beyond Advisory Role," 20 Corp. Counsel Weekly Newsletter (BNA) 07 d3 (Feb. 16, 2005).

<sup>189</sup> Id.

<sup>190</sup> See SEC v. Craig Scott, Civil Action No. 3-05 CV 0302 P (N.D. Tex.), Litig. Rel. No. 19077 (Feb. 14, 2005).

December of 2001 that the credit card receivables account was potentially overstated and recommended a review of the account.<sup>191</sup> The SEC alleges that, upon an initial review of the account for the period of January and February of 2002, the controller concluded that the account was overstated by almost \$2 million, but, in order to close the books for 2001, he provisionally entered the balance of the account as \$1.964 million and notified the general counsel/CFO of this entry.<sup>192</sup> The SEC alleges that in March of 2002, the controller initiated an extensive review of the account which, in mid-April, resulted in a finding that faulty bookkeeping resulted in both an overstatement in the credit card receivables account as well as an overstatement of net income affecting 1999, 2000, and the first three quarters of 2001.<sup>193</sup>

The complaint further alleges that in late March of 2002, the general counsel/CFO realized that the company would not be able to meet the Form 10-K filing deadline due to the ongoing review of the credit card receivables account, and, therefore, he prepared, signed, and caused the company to file a notice of late-filing (Form 12b-25) with the SEC on April 1, 2002.<sup>194</sup> According to the SEC, this notice was false and misleading in the following particulars: first, the notice fraudulently omitted to disclose that the cause of the delay in filing the periodic reports was due to an internal review into the credit card receivables account that appeared to be

---

<sup>191</sup> Complaint, SEC v. Craig Scott, Civil Action No. 3-05 CV 0302 P (N.D. Tex. Filed Feb. 14, 2005), at ¶ 7.

<sup>192</sup> Id. at ¶ 8.

<sup>193</sup> Id. at ¶ 9.

<sup>194</sup> Id. at ¶ 10.

overstated by more than \$1.9 million;<sup>195</sup> and second, the notices falsely attributed anticipated losses to certain business conditions, rather than to the write-down of credit card receivables recorded by the controller and reported to the general counsel/CFO at the end of February.<sup>196</sup> In addition, the SEC alleges that the general counsel/CFO prepared, signed, and caused the company to file another late-filing notice on May 15, 2002, in connection with its inability to file a timely Form 10-Q.<sup>197</sup> According to the SEC, this notice failed to disclose that the company would be restating its financial statements, even though the general counsel/CFO was aware of this fact at the time he prepared, signed, and caused the company to file the notice.<sup>198</sup> Because of his conduct with respect to the preparation, signing, and filing of these two notices (Form 12b-25), the SEC alleges that the general counsel/CFO committed securities fraud in violation of Section 10(b) of the Exchange Act and Rule 10b-5, and aided and abetted the company's violation of the reporting requirements under Rules 12b-20 and 12b-5.<sup>199</sup>

Without admitting or denying the SEC's allegations, the general counsel/CFO has settled the enforcement action and has agreed to pay a civil money penalty of \$25,000.<sup>200</sup> In a

---

<sup>195</sup> Id. at ¶ 12. Instead, the SEC alleges that the general counsel/CFO stated that reason the company could not make a timely filing of its Form 10-K was based on its inability to obtain the requisite financial and other data prior to the filing date. Id. at ¶ 11.

<sup>196</sup> Id. at ¶ 15. According to the SEC, reasons given for the anticipated losses included a decrease in gross margin on retail sales of motor fuels and on sales of merchandise, and an increase in general and administrative expenses. Id. at ¶ 14.

<sup>197</sup> Id. at ¶ 16.

<sup>198</sup> Id.

<sup>199</sup> Id. at ¶¶ 17-23.

<sup>200</sup> See Litig. Rel. No. 19077 (Feb. 14, 2005).

related administrative proceeding,<sup>201</sup> the general counsel/CFO has consented to the issuance of a cease and desist order<sup>202</sup> as well as to an order denying him the privilege of appearing and practicing before the Commission either as an attorney or as an accountant.<sup>203</sup> After three years, however, he may seek renewal of the privilege of appearing and practicing before the Commission as an accountant and as an attorney.<sup>204</sup>

In April of 2005, the SEC instituted administrative and cease and desist proceedings against a beverage corporation and two of its officers, including its general counsel who also serves as vice-president, secretary, and director.<sup>205</sup> According to the SEC, the company had registered with the SEC as a transfer agent in 2002, and, in the fall of 2003, the SEC's Office of Compliance Inspection and Examination (OCIE) commenced a cause examination of the company's transfer agent activities.<sup>206</sup> The SEC alleges that the company refused to provide documents to the OCIE pursuant to a document request, and that the company's general counsel

---

<sup>201</sup> See In the Matter of FFP Marketing Company, Inc., Warner Williams, and Craig Scott, CPA, Admin. Proc. Rel. No. 34-51198; Accounting and Auditing Enforcement Rel. No. 2185 (Feb. 14, 2005).

<sup>202</sup> Id. at Part IV(C). The only other individual subject to an administrative cease and desist order in connection with this matter is the controller of the company, Warner Williams, who supervised the accounting department. See id. at Part IV(B).

<sup>203</sup> Id. at Part IV(D).

<sup>204</sup> Id. at Part IV(E) – (G).

<sup>205</sup> See In the Matter of Phlo Corp., James B. Hovis, and Anne P. Hovis, Admin. Proc. File No. 3-11909 (April 21, 2005).

<sup>206</sup> Id. at ¶ 7. The complaint alleges that several months after registering as a transfer agent, the company sought to withdraw all of the company's shares held by an entity that was responsible for retaining custody of two million securities issues. The entity refused to release the shares since only shareholders of record were permitted to withdraw the shares. Subsequently, the company failed to fulfill its obligations as a transfer agent with respect to share certificates sent to the company by the entity. Id. at ¶¶5-6.

told the OCIE that the company could not make its transfer agent books and records available for examination.<sup>207</sup> The SEC further alleges that the company has failed to make periodic filings with the SEC.<sup>208</sup> Because of its conduct in connection with its transfer agent obligations, the SEC alleges that the company has violated Sections 17A(d)(1) and 17(b)(1) of the Exchange Act<sup>209</sup> and Rules 17Ad-2 and 17Ad-5, and that the general counsel has willfully aided and abetted and caused the company's violations of these statutes and regulations.<sup>210</sup> The action remains pending.

In late June of 2005, the SEC filed a civil injunctive action against the general counsel and several top officers of busybox.com, Inc., a now defunct company that sold photographs, film footage and video over the Internet, in connection with an allegedly fraudulent scheme to close an IPO.<sup>211</sup> The general counsel also served as a vice-president, secretary, and a director of the company.<sup>212</sup> According to the complaint, the defendants entered into an underwriting agreement with a firm, pursuant to which the firm agreed to purchase all of the shares of the offering at an underwriter's discount of 9% and the company agreed to pay the firm an expense allowance of 3% of the gross proceeds.<sup>213</sup> When the defendants learned through the

---

<sup>207</sup> Id. at ¶¶7-8.

<sup>208</sup> Id. at ¶ 9 (noting that the company's president and CEO was the sole signatory on all periodic reports, and was responsible for overall management of the company).

<sup>209</sup> 15 U.S.C. §§78q-1(d)(1) and 78q(b)(b)(1), respectively.

<sup>210</sup> In the Matter of Phlo Corp., James B. Hovis, and Anne P. Hovis, *supra*, at ¶¶10, 11.

<sup>211</sup> See Complaint, SEC v. Patrick A. Grotto, Mark B. Leffers, and Jon M. Bloodworth, No. O5 CV 5880 (GEL) (S.D.N.Y. filed June 24, 2005).

<sup>212</sup> Id. at ¶ 13.

<sup>213</sup> Id. at ¶ 20.

company's outside counsel and the president of the underwriting firm that the firm could not sell all of the IPO securities to bona fide investors, the SEC alleges that the defendants devised a scheme to close the IPO.<sup>214</sup> Under this alleged scheme, the defendants agreed to purchase the unsold IPO securities by using unearned and undisclosed payments from the company, which they characterized as "bonuses."<sup>215</sup> In addition, the SEC alleges that the defendants agreed to pay their outside counsel an inflated and undisclosed legal fee using the unsold IPO securities.<sup>216</sup> The complaint further alleges that the underwriting firm financed these transactions and the defendants caused the company to repay the firm out of its IPO proceeds.<sup>217</sup> None of the defendants, the SEC alleges, used any of their own funds for the purchase of these securities.<sup>218</sup> As a consequence of their undisclosed purchase of the IPO securities, the SEC charges that the defendants received approximately 20% of all the securities offered in the IPO,<sup>219</sup> which they used to benefit themselves at the expense of the company.<sup>220</sup>

---

<sup>214</sup> Id. at ¶¶3, 24.

<sup>215</sup> Id. The SEC alleges that, in order to facilitate the scheme, the defendants opened cash brokerage accounts at the underwriting firm which were used solely for accepting the IPO securities. Id. at ¶ 25.

<sup>216</sup> Id. at ¶¶3, 24, 28. Outside counsel has been subject to both civil and criminal sanctions for his role in this scheme, see SEC v. Thomas T. Prousalis, Jr. and Robert T. Kirk, Jr., No. 04 Civ. 0081 (S.D.N.Y.), Litig. Rel. No. 19150 (March 22, 2005) (announcing the entry of judgment against the defendants in the SEC's civil injunctive action, and noting that Prousalis is serving a term of imprisonment after having pled guilty to related criminal charges), and has been barred from appearing and practicing before the Commission. See In the Matter of Thomas T. Prousalis, Jr., Admin. Proc. Rel. No. 34-50986 (Jan. 6, 2005).

<sup>217</sup> Id.

<sup>218</sup> Id.

<sup>219</sup> Id. at ¶¶3, 27.

<sup>220</sup> Id. at ¶ 6.

According to the SEC, all of the defendants participated in the preparation of the registration statements filed in connection with the IPO.<sup>221</sup> The SEC alleges, therefore, that all of the defendants knew, or were reckless in not knowing, that the registration statements were materially false and misleading in that they failed to disclose several matters, including the following: (i) the actual nature of the underwriting agreement; (ii) the fact that the defendants would be acquiring company stock in order to close the IPO; (iii) the fact that the company would be paying out unearned “bonuses” in order to compensate the defendants for purchasing the stock; (iv) the fact that the company would be paying outside counsel in company stock in order to close the IPO; (v) the fact that the net IPO proceeds available to the company would be reduced by \$2.1 million; and (vi) the fact that the net proceeds would be further reduced by \$2.8 million due to planned but undisclosed expenditures within one week of the closing of the IPO.<sup>222</sup> The SEC further alleges that on the day after their receipt of the undisclosed IPO securities, the defendants certified that the registration statements were truthful in all material respects and that there had been no development that would materially affect their accuracy.<sup>223</sup>

Because of the allegedly fraudulent scheme to close the IPO, the SEC has charged the general counsel and all of the other defendant officers with violations of Section 17(a) of the Securities Act,<sup>224</sup> and with violations of Section 10(b) of the Exchange Act<sup>225</sup> and Rule 10b-5.<sup>226</sup>

---

<sup>221</sup> *Id.* at ¶¶5, 36.

<sup>222</sup> *Id.* at ¶¶4, 37-42.

<sup>223</sup> *Id.* at ¶¶5, 36.

<sup>224</sup> 15 U.S.C. §77q(a).

<sup>225</sup> 15 U.S.C. § 78j(b).

<sup>226</sup> SEC v. Patrick A. Grotto, Mark B. Leffers, and Jon M. Bloodworth, *supra*, at ¶¶43-50.

In its prayer for relief, the SEC seeks a permanent injunction against further violations of these statutes, an order requiring the defendants to disgorge all ill-gotten gains, and an order requiring the payment of civil money penalties.<sup>227</sup>

In July of 2005, an administrative law judge issued an initial decision in a matter involving four officers of an Internet company, including the general counsel who also served as a treasurer and as a director of the company.<sup>228</sup> The SEC alleged that the officers sold millions of dollars worth of the company's stock without registering the stock and without making the requisite disclosures concerning the sales; in addition, the SEC alleged that certain officers, including the general counsel, failed to file beneficial ownership reports as required by the securities laws.<sup>229</sup> The judge found, *inter alia*, that the general counsel violated Sections 5(a), 5(c), and 17(a) of the Securities Act,<sup>230</sup> Sections 10(b), 13(a), and 16(a) of the Exchange Act,<sup>231</sup> and Rules 10b-5, 12b-20, 13a-1, 13a-11, and 16a-3, and ordered him to cease and desist from further violations of these statutes and rules.<sup>232</sup> The judge also ordered the general counsel to disgorge approximately \$1.4 million of ill-gotten gains.<sup>233</sup>

---

<sup>227</sup> Id.

<sup>228</sup> See Initial Decision, In the Matter of John A. Carley, et al., Admin. Proc. File No. 3-11626 (July 18, 2005).

<sup>229</sup> See "John Carley Initial Decision," SEC News Digest, Issue 2005-137 (July 19, 2005).

<sup>230</sup> 15 U.S.C. §§77e(a), (c), 77q(a).

<sup>231</sup> 15 U.S.C. §§78j(b), 78m(a), and 78p(a).

<sup>232</sup> Initial Decision, supra, at 82.

<sup>233</sup> Id. at 82-83.

In September of 2005, the SEC filed a civil fraud action against a biotechnology company and several of its executives, including its general counsel, alleging that the defendants misled the investing public about the company's efforts to obtain the FDA's approval of one of its products.<sup>234</sup> According to the complaint, the company had applied to the FDA for a biologics license in August of 2002 in order to begin using its synthetic blood product, Hemopure, on certain patients undergoing orthopedic surgery, and, in March of 2003, sought approval from the FDA to begin clinical trials of Hemopure on trauma victims.<sup>235</sup> In April of 2003, the SEC alleges that the company began to receive negative information from the FDA, which imposed a clinical hold barring the company from conducting clinical trials of Hemopure.<sup>236</sup> In May, and again in July, of 2003, the FDA denied the company's request to lift the hold, and in July of 2003, the FDA sent the company a complete response letter in which it denied the company's application for the biologics license.<sup>237</sup> The SEC alleges that, notwithstanding the negative information, the company, through the individual defendants, repeatedly made false and misleading statements about the regulatory status of Hemopure in offering documents, SEC filings, and press releases.<sup>238</sup> When the truth about Hemopure's non-approval by the FDA became known, the

---

<sup>234</sup> See SEC v. Biopure Corp., et al., Civ. Action No. 05-11853-WGY (D. Mass.), Litig. Rel. No. 19376 (Sept. 14, 2005).

<sup>235</sup> Complaint, SEC v. Biopure Corp., et al., Civ. Action No. 05-11853-WGY (D. Mass. filed Sept. 14, 2005), at ¶ 2.

<sup>236</sup> Id. at ¶ 3.

<sup>237</sup> Id. A complete response letter means that the FDA has completed its review of the license application and that the company has an additional six months within which to correct the deficiencies noted in the letter and resubmit its application for a license. See id.

<sup>238</sup> Id. at ¶ 5.

SEC alleges that the value of the company's stock dropped from a high of \$7.30 per share, to below \$3.00 per share.<sup>239</sup>

As to the general counsel's role in the alleged fraud, the SEC alleges that she substantially participated in drafting, reviewing, and approving certain offering documents and registration statements,<sup>240</sup> periodic reports filed with the SEC,<sup>241</sup> and press releases<sup>242</sup> that failed to disclose, or falsely described, the regulatory status of the company's submissions to the FDA. With respect to one press release issued after the company's receipt of the FDA's complete response letter denying the application for the biologics license, the SEC alleges that general counsel contacted outside counsel who specialized in FDA regulatory matters concerning the complete response letter and a draft of the press release, which noted the company's receipt of a letter from the FDA but did not identify it as a complete response letter.<sup>243</sup> According to the SEC, outside counsel advised the general counsel that the letter looked like a complete response letter and that the draft press release, as written, looked "unduly optimistic."<sup>244</sup> The SEC further alleges that outside counsel advised the general counsel that even though the FDA's letter was sent 30 days prior to the deadline for responding to the company's license application, that fact was not a "great cause" for optimism.<sup>245</sup> The SEC alleges that the company, through the

---

<sup>239</sup> Id. at ¶ 6.

<sup>240</sup> Id. at ¶¶31, 35, 58, 65, 87, 91.

<sup>241</sup> Id. at ¶¶38, 56, 62, 95.

<sup>242</sup> Id. at ¶¶41, 49, 76, 98.

<sup>243</sup> Id. at ¶ 75.

<sup>244</sup> Id.

<sup>245</sup> Id.

defendants, issued the press release which did not identify the letter as a complete response letter and contained “misleadingly optimistic” information.<sup>246</sup> Soon thereafter, the SEC alleges that the general counsel again contacted outside counsel for advice on responding to the complete response letter, at which point outside counsel definitively identified the FDA’s letter as a complete response letter.<sup>247</sup> The SEC alleges that outside counsel again confirmed the letter as a complete response letter to all of the defendants and informed them that the FDA had six months in which to review any resubmissions by the company.<sup>248</sup> However, in subsequent public statements and filings which the general counsel is alleged to have participated in drafting, reviewing and/or approving, the SEC alleges that the company continued to misrepresent the complete response letter as well as the clinical hold issued by the FDA.<sup>249</sup>

The SEC alleges that the general counsel has violated Section 10(b) of the Exchange Act<sup>250</sup> and Rule 10b-5, Section 17(a) of the Securities Act,<sup>251</sup> and has aided and abetted the company’s violation of Section 13(a) of the Exchange Act<sup>252</sup> and Rules 12b-20, 13a-11, and 13a-13.<sup>253</sup> For relief, the SEC seeks a permanent injunction against future violations of

---

<sup>246</sup> Id. at ¶¶76-79.

<sup>247</sup> Id. at ¶ 80.

<sup>248</sup> Id. at ¶ 90.

<sup>249</sup> See id. at ¶¶93, 95.

<sup>250</sup> 15 U.S.C. § 78j(b).

<sup>251</sup> 15 U.S.C. § 77q(a).

<sup>252</sup> 15 U.S.C. 78m(a).

<sup>253</sup> Complaint, SEC v. Biopure Corp., et al., supra, at ¶¶107-114, 118-121.

these statutes and regulations, an order barring the general counsel from serving as an officer or director of a public company, and an order requiring the payment of a civil monetary penalty pursuant to Section 20(d) of the Securities Act and Section 21(d)(3).<sup>254</sup>

As the foregoing summary shows, the SEC has increased its actions against inside counsel but, for the most part, has relied on traditional theories for imposing liability. The two exceptions to date are its 2004 action, predicated on the gatekeeper concept of Sarbanes-Oxley, and its 2005 action against the general counsel of Google.<sup>255</sup> Whether this new theory suggests the beginning of a new trend in enforcement actions remains to be seen, but inside counsel has been put on notice that the SEC is focusing its enforcement activity on their conduct within the corporation.<sup>256</sup>

### **III. CRIMINAL PROSECUTIONS OF INSIDE CORPORATE COUNSEL**

#### **A. Introduction**

Prior to the creation of the Corporate Fraud Task Force (“Task Force”) in July of 2002,<sup>257</sup> the Justice Department did not have a unit devoted to the pursuit of corporations or their executives for criminal violations of the securities laws.<sup>258</sup> According to one former prosecutor, the Justice Department deferred to the SEC with respect to securities fraud cases, and focused its

---

<sup>254</sup> Id., Prayer for Relief (referencing 15 U.S.C. §§77t(d) and 78u(d)(3)).

<sup>255</sup> The SEC has reportedly advised attorneys to look at the Drummond case if they are unclear about their gatekeeper obligations under the Sarbanes-Oxley rules. See Michael Bologna, “SEC Enforcement: Officials Cite ‘Gatekeeper’ Duties of Lawyers for Public Companies,” Sec. L. Daily (BNA) d10 (April 18, 2005).

<sup>256</sup> See n. 8, supra.

<sup>257</sup> Exec. Order No. 13,271, 67 Fed. Reg. 46,089 (July 11, 2002).

<sup>258</sup> See Tamara Loomis, “The Fraud Squad,” Corporate Counsel (Jan. 12, 2005).

attention on “terrorism, money laundering, [and] drugs.”<sup>259</sup> The establishment by Executive Order of the Task Force changed the priorities.<sup>260</sup> As a consequence, there has been a sharp increase in the number of executives including in-house counsel who have been indicted and/or convicted of corporate fraud since the inception of the Task Force almost three years ago.<sup>261</sup> Although each prosecution of an in-house counsel has attracted nationwide attention, the numbers remain surprisingly low even after the Task Force’s inception. This section will examine the Task Force–era prosecutions as well as the pre-2002 prosecutions. Note that nearly all in-house counsel who were prosecuted were also subject to SEC administrative sanctions.<sup>262</sup>

## **B. Survey of Criminal Prosecutions of Inside Corporate Counsel**

### **1. Pre-2002 Prosecutions**

In the six years immediately preceding the creation of the Task Force, the Justice Department brought approximately five criminal actions against in-house counsel for their role in

---

<sup>259</sup> Id. (quoting Jacob Frenkel, now in private practice).

<sup>260</sup> Exec. Order No. 13,271, supra, 67 Fed. Reg. at 46,091 (directing the Attorney General to establish the Task Force, the purpose of which is “to strengthen the efforts of the Department of Justice and Federal, State, and local agencies to investigate and prosecute significant financial crimes, recover the proceeds of such crimes, and ensure just and effective punishment of those who perpetrate financial crimes.”).

<sup>261</sup> See Loomis, supra (noting that, since creation of the Task Force, the government has obtained convictions or guilty pleas of 4 former general counsels); see generally Corporate Fraud Task Force, Second Year Report to the President at 2.2 (July 20, 2004) (noting that, through the end of May of 2004, the Task Force had indicted over 900 defendants, and had obtained over 500 corporate fraud convictions). The financial failures of 2001 may also have generated an increase in state prosecutions of corporations and their top executives, especially in New York. See Jonathan C. Dickey, “Current Trends in Federal Securities Litigation,” SK027 ALI-ABA 241, 245 (2004) (noting that other states have also become more active in this area, including California, which has recently granted its attorney general broader powers to investigate and prosecute securities fraud).

<sup>262</sup> These attorneys have also been made defendants in SEC enforcement actions, most of which are discussed in Part II(B), supra.

fraudulent securities schemes engaged in by other officers or employees of their respective corporations.<sup>263</sup> Many of these defendants were originally indicted for substantive securities law violations,<sup>264</sup> and pled guilty to conspiracy to commit securities fraud. Several defendants also pled guilty to obstruction of justice -- an increasingly frequent addition to the indictment at the urging of the SEC.<sup>265</sup> One might conclude that the nature of the charges reflects the government's view that the in-house lawyers' blameworthy conduct prevented disclosure of primary criminal conduct by others.

One of the first prosecutions for this period represents a departure from the general overview given above. In 1995, the securities counsel for U.S. Mint, Inc., was indicted for the substantive offense of securities fraud arising out of his role in causing the collapse of the company which allegedly damaged more than 1000 small investors.<sup>266</sup> According to the indictment, he prepared or assisted in the preparation of fraudulent statements relating to the

---

<sup>263</sup> Another action that may be of interest but is not included in this discussion due to the nature of the charges is the prosecution of Charles Spadoni, the former general counsel of a Boston investment firm, for bribery and racketeering in connection with a scheme involving the Connecticut state treasurer and the state's pension fund. See United States v. Triumph Capital Group, Inc., et al., Crim. No. 3:00CR-217 (BBB) (D. Conn.) (indicted October 10, 2000; convicted, July 16, 2003). In a subsequent administrative proceeding brought by the SEC, Spadoni was barred from associating with any broker, dealer, or investment adviser. See In the Matter of Charles B. Spadoni, Admin. Proc. Rel. No. 34-50300; Investment Adviser's Act of 1940 Rel. No. 2291 (Sept. 1, 2004).

<sup>264</sup> Not all indictments are available in these particular actions; therefore, information pertaining to the exact charges alleged against an in-house counsel, as opposed to the charges to which counsel pled guilty, is based either on SEC releases or on media reports.

<sup>265</sup> Lisa I. Fried, "SEC Swats at Fraud; Faster Enforcement and Deterrence are Sought," 221 N.Y. L.J. 5 (March 4, 1999).

<sup>266</sup> United States v. Sichta, No. 95-CR-212-S (D. Colo.); see John Accola, "Attorney Pleads Guilty to Fraud in Stock Scam; Sichta Sold Insider Shares to the Public," Rocky Mountain News 3B (Aug. 23, 1996).

extent of U.S. Mint’s business, including statements claiming that the company was the largest supplier of gaming tokens in the United States.<sup>267</sup> In addition, the indictment alleged that he bribed registered representatives in exchange for their promotion and sale of U.S. Mint stock.<sup>268</sup> He pled guilty to one count of securities fraud in violation of Sections 10(b) and 32 of the Exchange Act,<sup>269</sup> and to one count of wire fraud in violation of 18 U.S.C. § 1343.<sup>270</sup> Although he faced 10 years imprisonment and a fine of almost \$1 million, Sichta’s cooperation with the government led prosecutors to recommend a reduced sentence.<sup>271</sup> Based on his fraud conviction, Sichta was subsequently disbarred by the Colorado Supreme Court.<sup>272</sup>

In 1996, the government indicted the general counsel of a publicly traded Florida company in connection with a scheme to misrepresent the financial condition of the company by falsely reporting that the company had earned a profit of almost \$5 million on the sale of certain real estate parcels.<sup>273</sup> As related by the SEC, he was alleged to have assisted in the scheme by preparing fraudulent real estate documents that reflected these purported sales and by signing a SEC filing that also reflected these sales.<sup>274</sup> For his role in the scheme, he was charged with

---

<sup>267</sup> See In the Matter of Robert D. Sichta, Admin. Proc. Rel. No. 34-41132, at ¶ III(C) (March 3, 1999).

<sup>268</sup> Id.

<sup>269</sup> 15 U.S.C. §§78j(b) and 78ff, respectively.

<sup>270</sup> In the Matter of Robert D. Sichta, supra, at ¶ III(B).

<sup>271</sup> Accola, supra, n. 266.

<sup>272</sup> “Court Suspends One Lawyer, Disbars 2 More,” Rocky Mountain News (Dec. 3, 1997).

<sup>273</sup> See United States v. Hugh Keith and Steven Wolis, No. 96-5204-CRIM-ZLOCH (S.D. Fla.), SEC Litig. Rel. No. 15186 (Dec. 12, 1996).

<sup>274</sup> Id.

multiple securities law violations, including conspiracy to defraud the SEC, to file false reports, and to commit securities, mail, and wire fraud, as well as with four counts of filing false reports with the SEC, and with perjury and obstruction of justice.<sup>275</sup> He subsequently pled guilty to one count of obstruction of justice,<sup>276</sup> alleging, *inter alia*, that he made false and misleading statements while testifying as a witness in a formal SEC investigation, and was sentenced to one year of probation conditioned upon 60 days of home confinement.<sup>277</sup> Because dishonesty and personal gain underscored the conduct giving rise to the offense to which he pled guilty, he was disbarred by the Florida Supreme Court.<sup>278</sup>

In 1997, an in-house lawyer was indicted in the Southern District of New York for his participation in a scheme involving the fraudulent sale of promissory notes that defrauded investors of more than \$470 million.<sup>279</sup> According to the indictment, the in-house attorney of a bill collection company assisted in drafting financial statements that falsely represented that the company was in sound financial condition when, in fact, it had sustained enormous losses.<sup>280</sup>

---

<sup>275</sup> *Id.*; see also Florida Bar v. Wolis, 783 So. 2d 1057, 1058 (Fla. 2001).

<sup>276</sup> Wolis pled guilty to a violation of 18 U.S.C. § 1505, which proscribes misrepresenting or falsifying oral testimony before a government department or agency with the intent to avoid, evade, prevent, or obstruct compliance with any civil investigation.

<sup>277</sup> See Florida Bar v. Wolis, 783 So. 2d at 1058; see generally “Attorneys: Florida High Court Disbars Lawyer in Wake of Guilty Plea over Stock Scam,” 33 Sec. Reg. & L. Rep. (BNA) 696 (May 7, 2001).

<sup>278</sup> Fla. Bar v. Wolis, 783 So. 2d at 1060.

<sup>279</sup> See “Two Ex-Executives of Towers Financial Indicted in Fraud Case,” Wall Street Journal (April 18, 1997), at A5A; see also Fried, *supra*, 221 N.Y.L.J. at 5.

<sup>280</sup> See Wall Street Journal, *supra*; see also SEC v. Michael Rosoff, 96 Civ. 7064 (WK) (S.D.N.Y.), SEC Litig. Rel. No. 15053; Accounting and Auditing Enforcement Rel. No. 816 (Sept. 17, 1996).

The indictment charged him with several offenses, including conspiracy to commit securities fraud, perjury, and obstruction of justice, and, upon conviction, he was sentenced to 87 months imprisonment.<sup>281</sup>

In December of 1998, the in-house counsel of a Pennsylvania infomercial company, together with the company's CEO and CFO, was indicted for his role in a scheme to inflate the company's stock through the false reporting of revenue from bogus transactions with entities secretly controlled by the CEO and CFO.<sup>282</sup> Counsel, who also served as corporate secretary and had been a director and member of the audit committee, had previously been charged by the SEC with knowingly and recklessly preparing documents that concealed the other officers' ownership of these entities and with arranging the transfer of company stock to one of these entities, which was then funneled back to the company as purported payment for a sales transaction.<sup>283</sup> In the indictment, he was charged with conspiracy to commit securities fraud and to make false and misleading statements,<sup>284</sup> while the CEO and CFO were charged with the substantive offenses of securities fraud as well as mail and wire fraud.<sup>285</sup> According to media

---

<sup>281</sup> See In the Matter of Michael Rosoff, Admin. Proc. Rel. No. 34-50556 at II(B) (Oct. 18, 2004); see also Fried, supra, 221 N.Y.L.J. at 5 (noting that Rosoff was also convicted of two substantive counts of securities fraud involving the company's fraudulent sale of more than \$270 million in promissory notes).

<sup>282</sup> See Shannon P. Duffy, "Fraud Indictment Charges In-House Counsel, Execs," 219 The Legal Intelligencer 5 (Dec. 4, 1998).

<sup>283</sup> See SEC v. Arthur L. Toll, Bruce B. Edmondson, Gerald Levinson, and Elliot Fisher, 98-CV-2325 (HH) (E.D. Pa.), Litig. Rel. No. 15731; Accounting and Auditing Enforcement Rel. No. 1033 (May 4, 1998). See discussion of this case, Part II(B), supra.

<sup>284</sup> See United States v. Fisher, No. 98-CR-63-3 (RFK) (E.D. Pa.), as noted in In the Matter of Elliot S. Fisher, Esq., Admin. Proc. Rel. No. 34-46954 at II(B) (Dec. 6, 2002).

<sup>285</sup> See Duffy, supra, 219 The Legal Intelligencer at 5.

reports of the case, he pled guilty to the conspiracy charges and agreed to cooperate with the government's continued investigation.<sup>286</sup> A judgment of conviction was entered almost two years later, at which time he was sentenced to six months in prison, with three years of supervised release, and was ordered to pay a criminal fine of \$10,000, and restitution of \$340,000.<sup>287</sup>

The final criminal action in this period involved the in-house counsel of a professional sports agency business who, along with the owner and several other individuals, was indicted for participation in a Ponzi scheme in which money purportedly invested with the company by professional sports player-clients was channeled into an illegal car-title loan company.<sup>288</sup> The inside lawyer pled guilty to one count of conspiring to commit wire fraud and to obstruct the SEC's parallel investigation, and one count of conspiring to commit money laundering.<sup>289</sup> The court sentenced him to a 54 month term of imprisonment, which was to be served concurrently with a 32 month sentence imposed by another federal court for a money laundering conviction in a related criminal action, and ordered him to pay \$12 million in restitution.<sup>290</sup> According to the SEC, the court's sentence represented a substantial downward departure from federal sentencing guidelines due to Franklin's post-indictment cooperation.<sup>291</sup>

---

<sup>286</sup> Shannon P. Duffy, "Former Infomercial Co. CEO Pleads Guilty; Defendant Charged in Stock Scheme to Defraud Public," 221 The Legal Intelligencer 3 (Aug. 9, 1999).

<sup>287</sup> In the Matter of Elliot S. Fisher, Esq., Admin. Proc. Rel. No. 34-46954 at II(B)-(C).

<sup>288</sup> United States v. William H. Black, et al., No. 1:00CR15 SPM (N.D. Fla.), SEC Litig. Rel. No. 17604 (July 9, 2002) (announcing sentence imposed by court).

<sup>289</sup> United States v. William H. Black, et al., supra, SEC Litig. Rel. No. 17604.

<sup>290</sup> Id.

<sup>291</sup> Id.

## 2. Post-2001 Prosecutions

Since the beginning of 2002, at least eight criminal actions have been brought against in-house counsel for various violations of the securities law, which represents a significant increase over the number brought in the preceding six-year period. Most of these actions have received considerable publicity due to the magnitude of the losses sustained by the companies and their investors, and the extent of the personal profits realized by the parties to the wrongful conduct. With one exception, all of the actions involve fraudulent securities and accounting schemes engaged in both by in-house counsel and by other officers and/or employees.<sup>292</sup> One of the actions remains pending; the rest have been resolved through one acquittal, two convictions, and four pleas of guilty.

The first of the high-profile criminal actions to be commenced during this period involved the chief legal officer of Rite-Aid, who was indicted in June of 2002 in the Middle District of Pennsylvania.<sup>293</sup> According to the indictment, Rite-Aid had been portrayed in its financial statements as a profitable company but, due to a fraudulent accounting scheme “devised, organized, and implemented” by inside counsel and the company’s CEO and CFO, the company’s expenses were significantly understated and its income overstated by hundreds of

---

<sup>292</sup> The one exception is Andrew Marks, the chief patent counsel for Vertex Pharmaceuticals, a biotechnology company, who was charged in a one-count information with insider trading in violation of Sections 10(b) and 32 of the Exchange Act (15 U.S.C. §§78j(b) and 78ff), and Rule 10b-5. See United States v. Marks, No. 03 CR 10297 (DPW) (D. Mass.) (Information filed Sept. 9, 2003). Marks pled guilty to the charge, see id., SEC Litig. Rel. No. 18409 (Oct. 14, 2003), and was sentenced to one year plus one day in prison and to two years of supervised release, and was ordered to pay a fine of \$3,000. See id., SEC Litig. Rel. No. 18548 (Jan. 21, 2004).

<sup>293</sup> See Indictment, United States v. Martin L. Grass, Franklin C. Brown, Franklyn M. Bergonzi, and Eric S. Sorkin, No. 1:CR-02-146 (M.D. Pa. filed June 21, 2002).

millions of dollars.<sup>294</sup> Because of the fraud, the company was forced to restate its financial results by \$1.6 billion, which, at the time, was reportedly the largest restatement in history.<sup>295</sup> In addition to the accounting fraud scheme, the indictment alleged that inside counsel and his co-defendants engaged in schemes to defraud vendors and financial institutions, and schemes designed for personal enrichment.<sup>296</sup> Specific charges against him included conspiracy to commit,<sup>297</sup> and the commission of, the substantive offenses of fraud in the purchase and sale of securities in violation of Sections 10(b) and 32 of the Exchange Act, 15 U.S.C. §§78j(b) and 78ff, and Rule 10b-5;<sup>298</sup> false statements to the SEC in violation of 18 U.S.C. § 1001;<sup>299</sup> mail and wire fraud in violation of 18 U.S.C. §§1341 and 1343;<sup>300</sup> obstruction of grand jury proceedings and government agency proceedings in violation of 18 U.S.C. §§1503 and 1505;<sup>301</sup> and, tampering with a witness in violation of 18 U.S.C. § 1512(b)(1)(2).<sup>302</sup>

---

<sup>294</sup> Id. at ¶ 31.

<sup>295</sup> Id. at ¶ 48.

<sup>296</sup> Id. at ¶ 49. In addition to receiving annual bonuses which they would not have received if the true earnings of the company had been revealed, Id. at Count I, ¶ 17, the defendants allegedly devised schemes to increase the amounts awarded under the company's long term incentive plan, id. at ¶¶25-28 and Brown allegedly executed a deferred compensation agreement that was not disclosed in Rite-Aid's proxy statements. Id. at ¶ 32-34.

<sup>297</sup> The conspiracy charges are set forth in Counts 1 and 33.

<sup>298</sup> Id. at Count 2.

<sup>299</sup> Id. at Counts 3-15.

<sup>300</sup> Id. at Counts 16-31.

<sup>301</sup> Id. at Counts 34 and 35.

<sup>302</sup> Id. at Count 36.

Unlike his co-defendants who pled guilty, inside counsel went to trial. Although portrayed by his attorney as a “zealous company lawyer”<sup>303</sup> who “did nothing wrong” but, instead, engaged in what would ordinarily have been considered normal business transactions in a different environment,<sup>304</sup> a jury convicted him of conspiracy to defraud, conspiracy to obstruct justice, obstruction of grand jury proceedings, obstruction of government-agency proceedings, witness tampering and five counts of lying to the SEC.<sup>305</sup> He was subsequently sentenced to 10 years in prison and fined \$21,000.<sup>306</sup>

In 2003, the year following the creation of the Task Force, the top legal officers of three corporations became defendants in highly-publicized criminal actions alleging their complicity in fraudulent accounting and securities schemes.<sup>307</sup>

One, a state prosecution, involved a general counsel who was charged with grand larceny, securities fraud, and falsifying business records in connection with receipt of interest-free loans from the company, receipt of large special bonuses, and receipt of millions in profits from the sale of his shares. The indictment alleged that both the CEO and the CFO engaged in

---

<sup>303</sup> Stephen Taub, “Jury Conviction for Former Rite-Aid Exec,” CFO.com (Oct. 21, 2003).

<sup>304</sup> “Ex-Lawyer for Rite Aid Is Found Guilty,” New York Times, Sec. C (Oct. 18, 2003). With respect to certain claims relating to accounting and securities fraud, the defendant has argued in post-trial motions that he had no accounting experience and was not an expert in securities law. See Memorandum of Law in Support of Defendant's Motion for Judgment of Acquittal and for a New Trial, United States v. Martin L. Grass, Franklin C. Brown, Franklyn M. Bergonzi, and Eric S. Sorkin, No. 1:CR-02-146 (M.D. Pa.).

<sup>305</sup> See id. (also noting that he was acquitted of wire fraud).

<sup>306</sup> See “Sentence Handed Down for Rite Aid Exec,” abc27 (Oct. 14, 2004) ([www.abc.27.com](http://www.abc.27.com)).

<sup>307</sup> In a fourth prosecution commenced in 2003, the highest ranking attorney within the corporation was charged with insider trading. See United States v. Marks, No. No. 03 CR 10297 (DPW) (D. Mass.) (Information filed Sept. 9, 2003), discussed at n. 292, supra.

this scheme and received similar benefits which were concealed from investors and the board. According to the prosecution, the general counsel received the loans and bonuses because of his assistance in covering up the CEO's and CFO's misconduct.

At trial, the defense asserted that the company had a reputation for awarding performance and that the general counsel had earned his bonus. It further argued that the general counsel relied upon the CEO's representation that the CEO had authority with respect to setting compensation. Moreover, since the general counsel was a litigator rather than a securities lawyer, the defense argued that he deferred to the CFO on issues relating to the disclosure of loans or bonuses on proxy statements. As summarized in one analysis of the case, "the central argument of the defense throughout the case . . . was that the prosecution's case was built on a fundamental misunderstanding of the general counsel's role in ferreting out corporate fraud."<sup>308</sup> The jury apparently agreed with the defense and acquitted the general counsel of all charges.

In June of 2003, the general counsel of McKesson/HBOC was indicted for his role in a fraudulent scheme to inflate revenue and earnings that was discovered after the merger of McKesson and HBOC and resulted in a substantial loss in value of the company's stock.<sup>309</sup> According to one of the cooperating defendants, the general counsel and other executives agreed to inflate reported revenues in the following manner: by recording revenue on contracts subject to undisclosed side agreements that permitted customer cancellations; by backdating contracts in order to record revenue in a prior quarter; and, by recording revenue as sales that were, in fact,

---

<sup>308</sup> Jay K. Musoff and Adam S. Zimmerman "Ethics and Off-Switches: What Next?" ¶ 2 N.Y.L.J. (Sept. 20, 2004), available at [www.law.com](http://www.law.com).

<sup>309</sup> Press Release (June 4, 2003), Office of the United States Attorney for the Northern District of California, available at [www.justice.gov/usao/can/press/html/2003\\_06\\_04\\_mckesson.html](http://www.justice.gov/usao/can/press/html/2003_06_04_mckesson.html). See Second Superseding Indictment, United States v. Charles W. McCall, Albert J. Bergonzi, and Jay Lapine, No. CR-00-0505-MJJ (N.D. Cal. filed June 3, 2003).

exchanges of cash and inventory.<sup>310</sup> In addition to conspiracy to commit securities fraud, he has been charged with substantive securities fraud in violation of Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b), and Rule 10b-5, filing false SEC reports in violation of Section 32 of the Exchange Act, 15 U.S.C. § 78ff, falsifying the books, records, and accounts of HBOC and McKesson/HBOC in violation of pertinent provisions of Sections 13 and 32 of the Exchange Act, 15 U.S.C. §§78m(b)(2)(A), 78m(b)(5), 78ff, and Rule 13b2-1, circumventing internal controls in violation of pertinent provisions of Sections 13 and 32 of the Exchange Act, 15 U.S.C. §§78m(b)(2)(B), 78m(b)(5), and 78ff, and falsifying a registration statement in violation of Sections 17(a) of the Securities Act, 15 U.S.C. § 77q(a).<sup>311</sup>

Although this prosecution remains pending at the time of this writing, several co-defendants have pled guilty with respect to their respective roles in the fraudulent accounting scheme and have agreed to cooperate with the government in its prosecution of the general counsel and the other remaining defendant, the former chairman of the board of McKesson/HBOC.<sup>312</sup> One of the hotly contested preliminary issues that was raised in this case concerns the right of the defendants to the release of an investigative report that was prepared by the company's outside lawyers and shared with the government pursuant to a confidentiality agreement.<sup>313</sup> The district court found that the report is not protected by the attorney-client

---

<sup>310</sup> Press Release (June 4, 2003), Office of the United States Attorney for the Northern District of California, available at [www.justice.gov/usao/can/press/html/2003\\_06\\_04\\_mckesson.html](http://www.justice.gov/usao/can/press/html/2003_06_04_mckesson.html) (paraphrasing statement of Jay Gilbertson, the former CFO of HBOC, who pled guilty to charges that he conspired with Lapine and other defendants to inflate HBOC's revenues and earnings).

<sup>311</sup> Second Superseding Indictment, *supra*, Counts 1-2, 4-8.

<sup>312</sup> See Jason Hoppin, "Another GC Readies for Trial," 3 *Corp. Counsel* 17 (Dec. 2003).

<sup>313</sup> *Id.*

privilege and should be shared with the defendants,<sup>314</sup> and its decision has withstood an appeal brought by the company, as intervenor.<sup>315</sup>

The third criminal action in 2003 involved the general counsel of U.S. Wireless, whose alleged participation in a fraudulent scheme resulted in the bankruptcy of U.S. Wireless after a restatement of its financial condition disclosed a \$6.3 million increase in losses.<sup>316</sup> The indictment alleges that he, together with the CEO of U.S. Wireless, caused the company to issue stock options, stock shares, and cash payments to offshore entities under their ownership and control as purported consideration for services under bogus consulting agreements.<sup>317</sup> The indictment further alleges that these options, shares, and wire transfers of cash were issued and sent without board approval or knowledge, and were concealed by the defendants from the company and from the SEC through materially false and misleading statements in financial reports and filings.<sup>318</sup> Following receipt of the options and shares, the indictment alleges that the defendants caused the offshore entities to sell the stock and to transfer the proceeds to themselves, their families, and third parties.<sup>319</sup>

---

<sup>314</sup> United States v. Bergonzi, et al., 216 F.R.D. 487 (N.D. Cal. 2003).

<sup>315</sup> See United States v. Bergonzi, No. 03-10511 (9<sup>th</sup> Cir. appeal filed Sept. 2004), dismissed as moot, 403 F.3d 1048 (9<sup>th</sup> Cir. April 1, 2005); see also Hoppin, supra; see also Eriq Gardner, “Share and Share Alike Rule Likely in Scandal Audits,” The Legal Intelligencer 4 (Sept. 17, 2004).

<sup>316</sup> Press Release (July 14, 2003), Office of the United States Attorney for the Northern District of California, available at [www.justice.gov/usao/can/press/html/2003\\_07\\_14\\_uswireless.html](http://www.justice.gov/usao/can/press/html/2003_07_14_uswireless.html).

<sup>317</sup> See Indictment, United States v. Oliver Hilsenrath and David Scott Klarman, No. CR-03-0213 WH (N.D. Cal. filed July 14, 2003), at ¶¶4-11.

<sup>318</sup> Id. at ¶¶12, 14.

<sup>319</sup> Id. at ¶ 13.

In addition to three counts securities fraud in violation of Section 32 of the Exchange Act, 15 U.S.C. § 78ff, he was charged with 16 counts of wire fraud in violation of 18 U.S.C. §§1343 and 1346.<sup>320</sup> He subsequently entered a plea agreement with federal prosecutors in which he pled guilty to mail fraud and money laundering for his role in the fraudulent scheme,<sup>321</sup> and agreed to cooperate with the government.<sup>322</sup> While awaiting sentencing, he also agreed to place \$5 million in an escrow account.<sup>323</sup>

During 2004, federal prosecutors indicted three former in-house counsel for various securities law violations. All of the defendants held the position of general counsel, and were implicated in a fraudulent scheme involving other executives of the corporation.

In the first indictment issued in May of 2004 the general counsel for a now defunct software company known as Inso Corporation was charged with multiple offenses arising out of a fraudulent revenue recognition scheme.<sup>324</sup> According to the indictment, his co-defendant, a vice-president of the company, arranged a sham transaction with a Malaysian distributor for the purchase of software licenses for approximately \$3 million dollars.<sup>325</sup> The

---

<sup>320</sup> Id. at ¶¶15-23, 26-27.

<sup>321</sup> Jeff Chorney, “U.S. Wireless GC Admits Fraud,” The Recorder (San Francisco) (Jan. 27, 2004), at 10; “High-Tech Exec Pleads Guilty to Mail Fraud, Money Laundering,” Silicon Valley/San Jose Bus. J. (Jan. 27, 2004), available at [www.bizjournals.com/sanjose/stories/2004/01/26/daily32.html](http://www.bizjournals.com/sanjose/stories/2004/01/26/daily32.html).

<sup>322</sup> “High-Tech Exec Pleads Guilty to Mail Fraud, Money Laundering,” Silicon Valley/San Jose Bus. J., supra.

<sup>323</sup> Chorney, supra.

<sup>324</sup> See Superseding Indictment, United States v. Graham James Marshall and Bruce Gordon Hill, No. 03-10344-DPW (D. Mass. filed May 5, 2004); see also SEC Litig. Rel. No. 18699; Accounting and Auditing Enforcement Rel. No. 2003 (May 7, 2004).

<sup>325</sup> Superseding Indictment, supra, at ¶¶14-18.

purpose of the transaction was to create the false appearance that Inso had sold the software and realized the revenue from the sale during the third quarter of 1998 in order to meet targeted revenue projections.<sup>326</sup> In order to create this appearance and conceal the circumstances surrounding the purported transaction, the general counsel allegedly executed a series of agreements with the distributor and arranged for Inso to provide \$4 million in letters of credit in exchange for the \$ 3 million payment for the software.<sup>327</sup> The letters of credit were obtained through false documentation prepared by Inso employees under the alleged direction of the general counsel.<sup>328</sup> Following a drop in share price in January of 1999 and the announcement that Inso would have to restate its revenues, the SEC began an investigation, during the course of which he is alleged to have provided false testimony as to the Malaysian transaction.<sup>329</sup>

In addition to securities fraud in violation of Sections 10(b) and 32 of the Exchange Act, 15 U.S.C. §§78j(b) and 78ff, and Rule 10b-5, he has been charged with wire fraud in violation of 18 U.S.C. § 1341, false statements to accountants in violation of Sections 13(b)(5) and 32 of the Exchange Act, 15 U.S.C. §§78m(b)(5) and 78ff, and Rules 13b2-1 and 13b2-2, and two counts of perjury in connection with an SEC investigation in violation of 18 U.S.C. § 1621.<sup>330</sup> According to some commentators, his alleged perjury may have prompted the government's decision to prosecute him for his involvement in the underlying scheme.<sup>331</sup>

---

<sup>326</sup> Id. at ¶ 15.

<sup>327</sup> Id. at ¶¶17, 58-75.

<sup>328</sup> Id. at ¶ 75.

<sup>329</sup> SEC Litig. Rel. No. 18699, supra, n. 302.

<sup>330</sup> Superseding Indictment, supra, at ¶¶1, 4, 6, 8, 9.

<sup>331</sup> See Tamara Loomis, "Tangled Web," Corp. Counsel (July 2004), at 26.

Following a jury trial in a federal district court in Massachusetts, the general counsel was convicted of only one count of perjury in connection with his testimony before the SEC during its investigation into whether fraud was committed with respect to the company's decision to restate its revenues.<sup>332</sup> As to the remaining counts – one count of securities fraud, two counts of wire fraud, one count of false statements to accountants, and a second count of perjury – the jury deadlocked and the court declared a mistrial.<sup>333</sup> The general counsel now faces a maximum penalty of 5 years imprisonment, followed by 3 years of supervised release, and a fine of \$250,000.<sup>334</sup>

In June of 2004, federal prosecutors indicted the general counsel of Symbol Technologies, in connection with a widespread accounting fraud scheme engaged in by top executives of the company, a leading manufacturer of wireless and mobile computing devices.<sup>335</sup> The indictment alleged that the CEO, the CFO, the CAO, and other officers of the company employed an array of fraudulent accounting manipulations in order to allow the company to meet performance targets that were established, and aggressively enforced, by the CEO.<sup>336</sup> These

---

<sup>332</sup>See United States v. Graham James Marshall and Bruce Gordon Hill, No. 03-10344-DPW (D. Mass.), SEC Litig. Rel. No. 19253; Accounting and Auditing Enforcement Rel. No. 2256 (June 7, 2005). According to the SEC, federal prosecutors presented evidence that contravened Hill's sworn investigative testimony and showed that Hill personally directed the preparation of fraudulent certificates purportedly reflecting the Inso board's approval of the issuance of \$4 million in letters of credit, thereby creating the appearance of Inso's receipt of \$3 million in payment of the reported third quarter sale of software. Id.

<sup>333</sup>Id.

<sup>334</sup>Id.

<sup>335</sup> See Press Release (June 3, 2004), Office of the United States Attorney for the Eastern District of New York, available at [www.usdoj.gov/usao/nye/pr/2004jun3.htm](http://www.usdoj.gov/usao/nye/pr/2004jun3.htm).

<sup>336</sup> Indictment, United States v. Tomo Razmilovic, et al., Cr. No. CR04519 (E.D.N.Y. filed June 3, 2004), at ¶ 23 (alleging that the CEO would reward those divisions that met these targets, and

manipulations included the premature recognition of revenue, “tango adjustments” or top-side journal entries in the corporate books and records, the fabrication and use of improper restructuring expenses and the creation of “cookie jar” reserves, and the creation of fraudulent accounting entries in the customer service accounts of the company’s books and records.<sup>337</sup> As a consequence of the accounting fraud, Symbol was required to restate its revenues which, for a three-year period, totaled approximately \$4.1 billion.<sup>338</sup>

In a separate scheme, not expressly linked to the overall accounting scheme, the indictment alleged that he devised and carried out a scheme to defraud Symbol and evade the payment of income tax through the improper exercise of stock options granted by the company.<sup>339</sup> According to the indictment, he manipulated stock option exercise dates for certain executives who were given a “look-back” period of 30 days from which to choose an advantageous exercise date based on the price of the stock on that day.<sup>340</sup> This practice allowed the executive to minimize the tax paid or maximize the profit made upon their exercise of the option,<sup>341</sup> and caused the company to receive a smaller tax deduction than it would otherwise receive.<sup>342</sup> Because the “look-back” scheme was prohibited under the terms of the stock option

---

punish those divisions that failed to meet them, and further noting that many of the executive’s bonuses and salaries were tied to meeting these targets).

<sup>337</sup> Id. at ¶ 24.

<sup>338</sup> Id. at ¶ 1.

<sup>339</sup> Id. at ¶ 77.

<sup>340</sup> Id. at ¶ 88.

<sup>341</sup> Id. at ¶¶ 88-89.

<sup>342</sup> Id. at ¶ 90.

plans, the indictment alleged that he took steps to conceal the practice, such as by failing to disclose it in SEC filings, and to hinder its discovery.<sup>343</sup>

The in-house counsel was charged with the following offenses: conspiracy to commit, and the commission of, the substantive offenses of mail and wire fraud in violation of 18 U.S.C. §§371, 1341, and 1343; conspiracy to impair, impede, obstruct, and defeat the Internal Revenue Service in violation of 18 U.S.C. §§371 and 3551 et seq.; income tax evasion in violation of 26 U.S.C. § 7201 and 18 U.S.C. §§3551 et seq.; and false filing in violation of 26 U.S.C. § 7206(1) and 18 U.S.C. §§3551 et seq.<sup>344</sup> After initially pleading not guilty,<sup>345</sup> he eventually pled guilty but only to the charge of conspiring to obstruct the IRS in the collection of income tax.<sup>346</sup> He faces a sentence of up to five years imprisonment and a maximum fine of \$250,000 or a fine amounting to twice the loss that he caused, whichever is greater.<sup>347</sup>

In the final criminal action brought against in-house counsel in 2004, the United States Attorney for the Eastern District of New York charged the general counsel, president, and senior vice-president of Computer Associates, for his role in a fraudulent revenue recognition

---

<sup>343</sup> Id. at ¶¶94-95 (alleging, for example, that Goldner encouraged other officers to prevent the expansion of the investigation into the accounting fraud scheme so as to avoid discovery of the “look-back” scheme).

<sup>344</sup> Id., Counts 15-24.

<sup>345</sup> See “Ex-Symbol Counsel Pleads Not Guilty to Fraud Charge,” available at [www.nysscpa.org/printversions/nysscpa/2004/604/2week/printversion34.htm](http://www.nysscpa.org/printversions/nysscpa/2004/604/2week/printversion34.htm).

<sup>346</sup> Press Release (Oct. 27, 2004), Office of the United States Attorney for the Eastern District of New York, available at [www.usdoj.gov/usao/nye/pr/2004oct27a.htm](http://www.usdoj.gov/usao/nye/pr/2004oct27a.htm).

<sup>347</sup> Id.

scheme.<sup>348</sup> According to the information, numerous officers and executives at the company, which was one of the largest suppliers of computer software for business use,<sup>349</sup> engaged in a practice of falsely and fraudulently recording and reporting revenue from certain license agreements, even though the agreements had not been finalized or signed within the quarter.<sup>350</sup> Known as the “35-day month” practice because it extended the reporting month beyond the end of the month, its purpose was to meet or exceed projected quarterly revenues and earnings.<sup>351</sup> The general counsel, it is alleged, participated in the scheme by negotiating, drafting, and approving agreements after the calendar-end of a fiscal quarter and backdating their execution dates to a date within the quarter.<sup>352</sup> The information further alleges that he obstructed internal and governmental investigations into the “35-day month” practice by failing to disclose or falsely denying the existence of the practice, and by instructing employees as to how they should respond to questions posed by the government during the investigation.<sup>353</sup>

Based on the allegations in the information, the general counsel was charged with several conspiracy offenses, including conspiracy to commit securities fraud in violation of Sections 10(b) and 32 of the Exchange Act, 15 U.S.C. §§78j(b) and 78ff, and Rule 10b-5; conspiracy to falsify the company’s books and records in violation of Section 13 of the Exchange

---

<sup>348</sup> Information, United States v. Steven Woghin, Cr. No. 04-847 (E.D.N.Y. filed Sept. 22, 2004); see also Press Release (Sept. 22, 2004), Office of the United States Attorney for the Eastern District of New York, available at [www.usdoj.gov/usao/nye/pr/2004oct06a.htm](http://www.usdoj.gov/usao/nye/pr/2004oct06a.htm).

<sup>349</sup> Information, supra, at ¶ 1.

<sup>350</sup> Id. at ¶ 12.

<sup>351</sup> Id. at ¶¶13-14.

<sup>352</sup> Id. at ¶¶15-16.

<sup>353</sup> Id. at ¶¶17-22.

Act, 15 U.S.C. §§78m(b)(2)(A), 78m(b)(5), 78ff and Rule 13b2-1; and conspiracy to circumvent internal accounting controls in violation of Section 13 of the Exchange Act, 15 U.S.C.

§§78m(b)(2)(B), 78m(b)(5), and 78ff.<sup>354</sup> In addition, he was charged with obstruction of justice in violation of 18 U.S.C. §§1512(c)(2) and 3551 et seq.<sup>355</sup> At the time of the unsealing of the information, he pled guilty to these charges.<sup>356</sup>

In a recent indictment involving officers of PurchasePro.com (“PurchasePro”), a federal grand jury has charged the general counsel of PurchasePro in connection with a scheme designed, inter alia, to fraudulently increase the reported revenue of PurchasePro.<sup>357</sup> According to the indictment, PurchasePro had formed a strategic partnership for the development of a business-to-business Internet marketplace that would generate revenue for it and a business partner.<sup>358</sup> When revenue was not realized,<sup>359</sup> the indictment alleges that the defendants conspired, to conceal the true financial condition of PurchasePro through various types of transactions, arrangements, and devices.<sup>360</sup> The general counsel is alleged to have participated in the fraudulent scheme in several ways, including: by making, or authorizing others to make,

---

<sup>354</sup> Id., Count One.

<sup>355</sup> Id., Count Two.

<sup>356</sup> Press Release (Sept. 22, 2004), Office of the United States Attorney for the Eastern District of New York, supra.

<sup>357</sup> News Release (Jan. 10, 2005), Office of the United States Attorney for the Eastern District of Virginia, available at [www.usdoj.gov/usao/vae/ArchivePress/JanuaryPDFArchive/05/11005AOLPR.pdf](http://www.usdoj.gov/usao/vae/ArchivePress/JanuaryPDFArchive/05/11005AOLPR.pdf).

<sup>358</sup> Indictment, United States v. Christopher J. Benyo, and Scott E. Wiegand et al., Crim. No. 1:05CR12 (E.D. Va. Filed Jan. 10, 2005), at ¶ 30.

<sup>359</sup> Id. at ¶ 33

<sup>360</sup> Id. at Count I.

undisclosed side deals with other purchasers of its marketplace software license; by recording sales in the wrong quarter; by creating, or authorizing others to create, a back-dated contract reflecting payment by others to PurchasePro for work purportedly undertaken in a prior quarter; by issuing materially false and misleading statements to the public and to PurchasePro's auditors, and by making false statements to the FBI.<sup>361</sup> With respect to this latter conduct, the indictment alleges that he asked a member of PurchasePro's technology department to delete his e-mails, but falsely stated otherwise in an interview with the FBI.<sup>362</sup>

In response to these charges, his lawyer contends that he was not involved in the fraudulent scheme; instead, he was a whistleblower who tried to expose the fraud to the government and cooperated in its investigation of the company.<sup>363</sup> Perhaps the SEC concurs, since it has brought related civil enforcement proceedings against all of the defendants – with the exception of the general counsel.<sup>364</sup> In prior criminal actions against in-house counsel, cooperation by the corporate entity itself appears to have resulted in fewer trials and more pleas.<sup>365</sup>

---

<sup>361</sup> Id. at Counts One-Five, Twenty-Nine and Thirty (charging Wiegand with conspiracy in violation of 18 U.S.C. § 371, with two counts of securities fraud in violation of Sections 10(b) and 32 of the Exchange Act, 15 U.S.C. §§78j(b) and 78ff, and Rule 10b-5, with two counts of making false statements to auditors in violation of Sections 32 and 13 of the Exchange Act, 15 U.S.C. §§78ff and 78m(a), (b), and Rule 13b2-2, and with two counts of making false statements to the FBI in violation of 18 U.S.C. §§1001(a)(2) and 3551 et seq.).

<sup>362</sup> Id. at Count Thirty.

<sup>363</sup> Heidi Moore, “No Credit for Whistle-Blowing,” Corp. Counsel (March 2005).

<sup>364</sup> See SEC v. Charles Johnson, Jr., Chris Benyo, Michael Kennedy, John Tull, and Kent Wakeford, No. 1:05 CV-0036-GK (D. D.C.), Litig. Rel. No. 19029 (Jan. 10, 2005).

<sup>365</sup> See Michael Bobelian, “Symbolic Victory,” 4 Corp. Counsel 28 (Dec. 2004).