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European SOX Compliance After *McDonald's* and *Wal-Mart*

By Donald C. Dowling, Jr.

The Sarbanes-Oxley Act (SOX), at §301 and §406, affirmatively requires SOX-regulated companies to set up anonymous hotlines or other mechanisms that encourage employees to "whistleblow" on co-workers who commit financial, auditing, or accounting frauds. For multinationals, this seemingly-simple rule raises an international law issue that has mushroomed into a vital concern: How does SOX's hotline requirement apply to employees abroad?

American multinationals subject to SOX tend to offer their foreign employees an extension of their stateside SOX policy and hotline. The standard SOX policy requires employees to report co-worker audit/accounting frauds using a telephone, e-mail or postal mail hotline that accepts anonymous tips.

These policies, of course, are an excellent practice — from a SOX-compliance standpoint. Unfortunately, they now raise problems under laws in Europe. The conflict crescendoed last May and June, when a French data agency struck down McDonald's SOX policy on *data privacy* grounds just as a German labor court, virtually simultaneously, threw out Wal-Mart's SOX policy on completely different *labor law* grounds.

No employer wants its efforts to comply with one law actively to violate others. So how can a multinational reconcile its SOX obligations with European doctrines?

Friction in Europe

The French and German cases come as little surprise. They emerged from a European environment that had already been surprisingly hostile to SOX, for a number of reasons. Part of the problem is Europeans' resistance to all American laws that affect life in Europe. Another part of the problem is a belief in Europe that the SOX approach to preventing fraud is naive. But much of the friction comes from two features common to most SOX compliance policies: anonymous hotlines and mandatory reporting rules that force employees to whistleblow on co-workers' audit/accounting frauds.

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Punitive Damages: Focusing on Unfairness to Craft Winning Defenses

By Lori S. Nugent

What does it take for a corporation to win a punitive damages case? A traditional defense focus on liability and compensatory damages is insufficient. To win, a focused defense to punitive damages must be prepared.

Preparing a punitive damages defense requires careful crafting, based on the unique facts of the case and a clear understanding of the corporation. While the punitive damages defense of each case is unique, there are a few steps that must be addressed in every punitive damages case in order to win.

Reality Check

The first and most important step is to understand the harsh realities of punitive damages litigation. These realities must be accepted and analyzed before an effective plan to neutralize them can be developed.

The common second step is to defeat anti-corporation juror bias. Most jurors distrust corporations. To win, this anti-corporate bias must be countered.

The third common step to is to even the playing field by insisting on fair-trial procedures. Trial procedures in most jurisdictions significantly favor punitive

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The metaphor we Americans use — "blowing the whistle" — assumes a do-gooder exposing wrongdoing. But Europeans focus on the other side of this coin, and see an anonymous hotline as an invitation for abuse. Denouncing co-workers is a betrayal, and denouncing anonymously invites denunciations motivated by spite. To Europeans, facilitating anonymous reports can let a snitch hide from responsibility, and can encourage false and vindictive reports. Perhaps there is even an irony: Here it is Europeans — not Americans — championing the presumption of innocence and due process.

Especially in France and Germany, mandatory reporting via anonymous hotlines can smack of WWII-era authoritarianism, neighbor spying on neighbor. We know of a number of situations where a U.S. company in Europe rolled out an American-style whistleblower hotline, in good faith compliance with SOX — only to experience eruptions among Europeans furious at being forced to "denounce" their colleagues.

Exacerbating the problem is companies' strong interest in adequately investigating SOX whistleblower complaints. American-style whistleblower policies commonly retain employer control and confidentiality over internal whistleblower investigations. Investigatory "best practices" require a covert check on a target's actions. American companies actively *try* to keep a target in the dark, to catch him in the act (or at least to keep him from destroying evidence and covering tracks). For example, one American business that operates SOX whistleblower hotlines on an outsource basis advises, in a marketing report: "When investingating an incident based on a confidential hotline tip, it is important for the company *not to reveal that it is reacting to a tip*. Disclosing this information is a *breach of confidentiality* and may put the whisteblower *at risk*." But to a European, the very confidentiality of in-house investigations looks little different from a secret trial where a prosecutor doubles as judge, and reaches a verdict without letting the defendant put on a defense.

The French Cases

This context explains the perspective of France's national CNIL data privacy agency *(Commission Nationale de l'Informatique et des Libertés)* when, last May, it struck down McDonald's SOX compliance system, along with that of the Exide Technologies' CEAC unit. *See, McDonald's*, CNIL Délibération. n2005-110 (May 26, 2005); *Exide Technologies/CEAC*, CNIL Délib. n2005-111 (May 26, 2005). France's CNIL ruled that anonymous SOX hotlines violate the privacy rights of whistleblowers' denounced victims, because SOX hotlines deny the target of an investigation any right to be told of denunciations against him and any procedure to prove innocence. Therefore, the CNIL denied McDonald's and Exide Technologies permission to operate the hotlines. Indeed, word in France has it that the CNIL's chief concern is ensuring the target of a whistleblower be told of the accusation promptly.

Additionally, there is another — completely separate — data protection law issue in play here: Because many American companies' hotlines get staffed from the U.S., European whistleblowers' calls often transmit personal data (about the target) outside of Europe. This raises a distinct set of data privacy issues that the *McDonalds/CEAC* opinions did not even reach: SOX hotlines in Europe have to comply with the complex set of EU data privacy rules on transmitting personal data outside Europe. (Compliance tools include "model contractual clauses," "safe harbor," and data protection codes of conduct.)

The Case in Germany

Twenty days after the French *McDonald's/CEAC* data privacy rulings, a German labor court struck down Wal-Mart's SOX policy on completely separate *labor law* grounds. *See, Wal-Mart*, Beschluss des Arbeitsgerichts Wuppertal vom 15.06.2005, file no. 5 BV 20/05, June 15, 2005.

Wal-Mart's SOX policy, like most multinationals' could get someone fired for doing absolutely nothing. Consistent with SOX "best practices,"

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Wal-Mart imposes an affirmative duty on employees to whistleblow on co-worker frauds they witness. The German labor court found Wal-Mart had violated §87¶1(1) of the German Works Constitution Act by imposing its SOX rule without "co-determining" or "informing and consulting" with its "works council." In American jargon, Wal-Mart had committed an unfair labor practice by unilaterally implementing its SOX policy despite its being a mandatory subject of bargaining. (In addition, Wal-Mart's code of conduct contained other new, unilaterally implemented rules.)

Germany's *Wal-Mart* decision has not captured the attention that France's *McDonald's* case has because *Wal-Mart* simply reiterates settled law: An employer in Europe under an information and consultation obligation with a works council was never supposed to implement new work rules unilateraly. Still, *Wal-Mart* highlights critical issues that can pose real problems for U.S. multinationals:

- Refrain from announcing global employment rules (including SOX policies) that govern overseas employees until clearing them with local in-house labor experts abroad.
- See that global mandates to overseas subsidiaries and affiliates (including SOX policies) get properly ratified, implemented and communicated.

Too many multinationals neglect these key steps.

Penalties and Europe-Wide Application

Penalties for violating French and German data and labor laws include fines, injunctions, civil suits — and, for repeat offenses, criminal sanctions. Plus, the legal theories underlying *McDonald's* and *Wal-Mart* could span Europe: Both France's data protection law and Germany's labor law happen to be grounded in European Union directives. *See,* EU Data Protection Dir., 95/46/EC (1995); EU Information/Consultation Dir., 2002/14/EC (2002). Indeed, Germany's *Wal-Mart* analysis *already* applies in France: French labor courts regularly strike down unilaterally implemented corporate ethics policies for failure to inform and consult. *See, eg, SigmaKalon*, France TGI Nanterre court, 7/15/05; *Novartis*, TGI Nanterre, 10/6/04; *Schindler Group*, France TGI Versailles, 6/17/04 (all ethics policies, but outside SOX context).

Direct Conflict, or Reconcilable?

Americans talk about France's *McDonald's* and *CEAC* cases as if they directly conflict with SOX. The *Wall Street Journal* quoted an American lawyer as saying these cases put multinationals in the impossible position of "either chop off my left hand or my right hand." *See,* "Tip-Line Bind: Follow the Law in U.S. or EU?," *Wall Street Journal,* Sept. 6, 2005, at C-1. But do the French cases *really* conflict directly with SOX? Or can a multinational craft some compliance solution that integrates SOX *with* French (and European) data protection law?

What SOX Requires Abroad

Whether reconciling the French cases with SOX might be possible requires understanding what SOX does — and does not — mandate as to mandatory whistleblowing rules and anonymous hotlines abroad.

SOX does *not* require multinationals to compel foreign employees to whistleblow on their co-workers. SOX §406 merely requires companies to "promote" — not require — reporting among "senior financial officers." And while SOX §307 (and 17 C.F.R. §205.3) *do* require certain whistleblowing, this is limited to whistleblowing by "attorneys." Therefore, the mandatory employee whistleblowing rule common to U.S. SOX policies is — although a "best practice" stateside — not strictly required at all, and therefore not required abroad.

But the issue gets trickier when we turn to what SOX requires as to anonymous whistleblower hotlines overseas. SOX §301 mandates that companies give "employees" some avenue for "confidential, anonymous submission … of concerns." Interestingly, this SOX requirement in practice offers employees very little. After all, everyone able to use postal mail, e-mail, or a telephone already has the power to submit a "confidential, anonymous" whistleblower complaint to anyone — just mail an unsigned letter, send an e-mail from a generic mailbox address, or call in from a pay phone.

Nevertheless, because SOX mandates some "confidential, anonymous" whistleblowing mechanism, our question becomes whether companies must offer that mechanism to employees based overseas. The SEC appears to take the position that companies must. *Cf.,* SEC Act Release No. 33-8220 (4/9/03) (broadly discussing effect of SOX whistleblower rules on "multinational corporations with thousands of employees in many different jurisdictions"). Indeed, SOX compliance experts seem to assume that the SEC sees SOX, including its §301 anonymous procedure, as applicable worldwide. According to one treatise, "it would be prudent to assume" that SOX enforcers will treat SOX as extending abroad, "because foreign issuers whose shares are traded on U.S. stock exchanges are not exempted from securities filing requirements." *See,* D. Westman & N. Modesitt, *Whistleblowing: The Law of Retalitory Discharge* (2d ed., 2003), at 162.

But this view — while likely an accurate prediction of the position the SEC would take — is not necessarily supported in law. An analysis from a 1991 U.S. Supreme Court decision, adopted in a 2004 federal court opinion that interprets a SOX whistleblower provision (§806), would confine SOX whistleblower rules to U.S. soil — especially where, as here, SOX would conflict with foreign law. *See, Carnero v. Boston Scientific Corp.*, Fed. Sec. L.Rep.

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92,910 (D. Mass. 8/27/04), *relying on EEOC v. Arabian Am. Oil*, 499 U.S. 244 (1991).

In *Carnero,* a U.S. federal court held the SOX §806 whistleblower protection does not reach foreign employees: A U.S. company *can* fire a South American for whistleblowing without having to answer for SOX §806 retaliation, because SOX §806 does not reach South America. OSHA, which enforces SOX §806, has held the same way. This *Carnero* analysis, which expressly invokes the *EEOC v. Arabian Oil* Supreme Court analysis, logically should apply just as strongly to SOX §301's mandate for "confidential, anonymous" whistleblower hotlines. (Yes, §301 is different from §806, but both sections are equally silent on extraterritorial reach.)

How to Comply

The *McDonald's*, *Exide Technologies*, and *Wal-Mart* cases obviously make SOX whistleblower hotlines especially difficult in Europe. But perhaps the cases do not make compliance abroad completely impossible. There may be room for a multinational to comply with *both* sets of rules. In this regard, a SOX-regulated multinational would seem to have three viable (if less-than-ideal) choices:

1. Await political resolution. A multinational could wait for France and the U.S. to resolve the apparent conflict. France's CNIL and the U.S. Federal Trade Commission have actually launched a dialogue with meetings beginning this month. CNIL says on its Web site that it will publish a position paper on reconciliation with SOX. Indeed, many U.S. multinationals seem to be pinning their hopes on a political/diplomatic resolution of this sort.

But waiting could be a dangerous game. The CNIL has not suspended enforcement of French data laws against SOX hotlines, so U.S. multinationals operating SOX hotlines in France are in open violation. And whether there ever will be an adequate political resolution is in doubt. French authorities seem no more prepared to change their data law to accommodate America that the U.S. is ready to amend SOX to help the French.

A few years ago, the similar EU Commission/U.S. Department of Commerce discussions over personal data transmissions from Europe to the U.S. took *years* to yield the "safe harbor" compromise — a resolution that, to this day, is seen as less than perfect. *See,* Rehder & Collins, "The Legal Transfer of Employment-Related Data to Outside the European Union," 39 Int'l Lawyer 129, 150 (2005) ("Safe Harbor is not conducive for many [U.S.] multinationals"; "the EU is not satisfied with the relatively low number of companies … self-certified under … Safe Harbor"). We have no reason to predict the CNIL/FTC data law discussions will be any quicker, or any more satisfactory, than the EU/U.S. data law compromise.

2. Rely on *Carnero*. A multinational could invoke the *Carnero* analysis (discussed above) to carve French (or all European) employees out from a corporate SOX whistleblower policy and hotline. That is, do not offer French (or European) employees any whistleblowing procedure, or else (consistent with works council obligations), offer only a watered-down procedure without an explicit anonymous reporting mechanism, and maybe also without a mandatory reporting requirement. So far, multinationals seem reluctant to adopt this strategy. But those companies bold enough to do so have a virtually on point, and recent, federal court opinion (*Carnero*) supporting them.

3. Craft three separate SOX policy/hotline frameworks. A multinational may also be able to reconcile its seemingly conflicting obligations here by establishing *three separate* SOX compliance frameworks: a) a "full-blown" U.S. SOX policy for U.S. staff; b) a broader SOX policy posted on the parent company global Web site in English and addressed to the world (employees and general public alike), stating a commitment to uphold SOX and eliminate fraud and inviting anyone (employee or otherwise) with knowledge of a SOX violation to come forward, anonymously or not, using a given address/telephone number hotline; and c) a watered-down "Europeanized" template (*without* an anonymous hotline and *without* a mandatory reporting rule) for local European subsidiary entities to adapt and ratify, consistent with local law and procedure.

This three-pronged strategy rests on the likelihood that U.S. SOX regulators would concede that a multinational's Web site-communicated anonymous SOX hotline complies with SOX §301, plus the likelihood that French regulators would not challenge (or could not reach) a U.S.-based parent company's English-language Web site policy addressed to the entire world.

	U.S.	EUROPE
Follow SOX?	Compliance critical: Important federal law	Sovereignty: Foreign countries have no business regulating behavior in Europe
Effect of whistleblowing?	Blow whistle = expose fraud	Denounce colleague = betrayal
Whistleblower's motives?	Exposing fraud helps company and society	Collaborating with authorities curries favor for personal gain
Social policy at stake?	Stop Enron-like corporate fraud	Protect *target's* presumption of innocence and due process
Legal barriers to policy/hotline	*None:* Whistleblowing policy/hotline is management prerogative	New work rules = "mandatory subject of bargaining" (inform/consult)
Legal barriers once call placed	*None:* Data from call unregulated	Call creates data file, implicating strict rules, especially if "sensitive data" or if sent EU-to-U.S.

Conclusion

French and German decisions from the summer of 2005 have shaken up multinational SOX whistleblower policies and hotlines. While there is no perfect solution, a multinational need not wring its hands in despair. Proactive steps and an imaginative strategy, plus good employee communications, may keep a company on the right side of the law — both in the U.S. and in Europe.

Wireless and Joint Commercial E-mail Messages Under CAN-SPAM

The Rules DO Apply to You and They CAN Be Used to Your Best Advantage

By Kristen J. Mathews

E-mail and wireless marketers have been coping with some confusion for the last 2 years over the application of the federal CAN-SPAM Act to certain kinds of promotional e-mail campaigns. The agencies responsible for promulgating regulations under the Act recently have provided some important, practical guidance on the use of e-mail messages sent to wireless devices such as cell phones and the conduct of joint e-mail campaigns. Now, with guidance from the regulators, corporate counsel can not only know the legal requirements, they can also guide their companies in using the regulations to their own best advantage.

Wireless Commercial E-mails

The most common myth about the FCC's wireless CAN-SPAM regulations is that "they don't apply to me."

A busy corporate counsel may assume that since his company does not have a wireless marketing campaign, he need not read the FCC's regulations under the CAN-SPAM Act. That corporate counsel would be wrong, and the company may be exposed to CAN-SPAM liability.

The FCC's Wireless CAN-SPAM Regulations (the Regulations) have strong implications for any company that sends promotional e-mail messages, even to a list of opted-in e-mail addresses. This is because:

1. It is very likely that any list of e-mail addresses contains wireless e-mail addresses, even if the company did not ask for them and does not know it; and
2. It is very unlikely that the opt-in language used (if there was any opt-in at all) when the addresses were collected meets the requirements of the Regulations, unless the language was written specifically with wireless e-mail addresses, and the Regulations, in mind.

The Wireless CAN-SPAM Regulations prohibit a company from sending promotional e-mail messages to a wireless e-mail address unless it has first obtained the "express prior authorization" of the account holder for that address. This includes any e-mail address that the company knows is that of a wireless device, *plus any address that contains a domain name that is contained on the FCC's list of wireless domain names.* In other words, knowledge is imputed onto a company that any e-mail addresses containing any of the FCC's listed domain names are, in fact, those of wireless devices, and are therefore covered by the Regulation's requirements.

The busy in-house lawyer may then say: "OK, but I am still safe because we only send promotional e-mails on an opt-in basis anyway." That lawyer would still very likely be wrong. This is because the definition of "express prior authorization" in the Regulations is burdensome enough that the company's opt-in notice (that is, for example, the wording next to the Web-based consent check box) and/or the means by which the opt-in is obtained by the company, probably did not satisfy the requirements of the regulations.

For example, to obtain "express prior authorization" (as defined by the Regulations) through a Web-based consent, the recipient must be able to input the specific e-mail address to which the consent applies, and the consent notice must state that the individual is consenting to receive promotional messages to his or her wireless device from the specific identified company, that the individual may be charged by his or her wireless carrier in connection with such messages, and that the individual may revoke his or her consent at any time.

Furthermore, the required notice must be presented separately from other content, clearly legible, in sufficiently large type, and readily apparent to the individual. When a printed card is used to obtain consent instead of an online form (and therefore there is no "I agree" button), there needs to be a place for the subscriber to sign his or her name on the card. All electronic approvals must comply with the Electronic Signatures in Global and National Commerce Act (the E-Sign Act). And, according to the legislative history under the CAN-SPAM Act, consent cannot be obtained using a pre-checked consent box.

Additional requirements also apply to promotional e-mail messages sent to wireless devices that do not apply to general promotional e-mail campaigns.

The take-away: Don't dismiss the FCC's Wireless CAN-SPAM Regulations as inapplicable to your company's operations. Take a good look at them, and consult with outside counsel to decide how to ensure your company's compliance on a going-forward basis. Until your company begins to obtain the appropriate consents, it may be necessary for your company to scrub its e-mail marketing lists against the FCC's list of wireless domain names, since, in all likelihood, the legally-required consents have not been obtained by your company to use them.

Joint Commercial E-mails Under CAN-SPAM

When the CAN-SPAM Act was first enacted in 2003, corporate counsel addressing questions from their marketing departments and marketing service providers were quick to discover a number of ambiguities that were inherent in the Act. One such ambiguity concerned a very common marketing tool — the joint e-mail. On one side of the spectrum, a joint e-mail would include an e-mail promotion for a product or service that is offered jointly by two or more companies. On the other side of the spectrum, a joint e-mail could include an e-mail that is sent by one company, but that contains a banner ad for another company.

Under a strict reading of the Act, each company whose products or services are advertised in a joint e-mail message would be considered "senders" of the e-mail, and therefore each would be equally responsible for the e-mail's compliance with the Act's requirements. Each would also be equally responsible for the failure to comply, including potential fines

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Commercial E-Mail

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and enforcement actions.

Taken to its logical conclusion, treating each advertiser mentioned in a joint e-mail as the sender of the e-mail means that the list of addresses to which the e-mail would be sent would have to be scrubbed against each of the advertisers' suppression lists. Especially where an advertiser did nothing more than include a banner ad in an e-mail, this interpretation of the Act was certainly not consistent with the industry standard for dealing with e-mail opt-out requests. Furthermore, companies that, as they should, treat their e-mail suppression list as highly confidential, would not want to share those lists with a third party, even if just for scrubbing purposes.

The FTC, knowing that this was a significant compliance hurdle for companies who sought to implement legitimate joint e-mail campaigns in compliance with the law, solicited public comment on this issue through the course of three requests for comments since the Act became effective. In its proposed rule issued in May of 2005, the FTC proposed an interpretation of the joint commercial e-mail issue, along with a proposed revision to the Act's definition of "sender," that would enable companies to architect a joint e-mail campaign so that one, and only one, of the advertisers in the e-mail would be considered a "sender" under the Act.

Under the proposed rule, where a company advertises in the same e-mail as other entities, the company can avoid being responsible for the e-mail (*ie*, can avoid being considered the "sender," as defined in the CAN-SPAM Act), by making sure that one of the other advertisers is the sole entity that: i) initiates (*ie*, transmits) the message; ii) controls the content of the message; iii) determines the e-mail addresses to which it is sent; and iv) is identified in the subject line as the "sender" of the e-mail. In other words, none of the other advertisers can be allowed to serve any of these functions. If any other advertiser serves any one of these functions, then each advertiser in the e-mail would be considered a "sender," and therefore each would have to comply fully with the CAN-SPAM Act's requirements (*ie*, scrub the address list against its own opt-out list, include its own postal address and opt-out mechanism in the e-mail, clearly and conspicuously identify the e-mail as an advertisement, etc.)

To be sure that the requirements are met, contractual protections should be in place between a company and the initiator of the e-mail,

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Punitive Damages

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damage plaintiffs. These unfair procedures must be challenged, and fair procedures must be requested.

Using the three common steps, as part of a carefully crafted punitive damage defense, our clients have prevailed in some of the worst jurisdictions in the country. Here's a look at each of those steps.

Punitive Damage Cases are not Fair Fights

Whenever possible, plaintiffs file punitive damage cases in jurisdictions that are notorious for runaway verdicts. Some of these jurisdictions are corrupt. Some of these jurisdictions have very strong biases against outsiders, especially corporations. Trial and appellate procedures in some of these jurisdictions make it easier for plaintiffs to obtain runaway verdicts. In some jurisdictions, judges are notably pro-plaintiff. These factors make it difficult, and sometimes impossible, to obtain a fair trial.

Additionally, savvy plaintiff's counsel do not try a tort or contract case, they try a corporate death penalty case. They focus the jury on punishing the corporation, and not on whether liability has been proven. Trial judges tend to passively permit plaintiff's counsel to incite passion and prejudice, resulting in an unfair trial.

Corporations do not have to merely accept this reality. Instead, they should face each unfair aspect of a punitive damage case. For each unfair aspect, a counter-attack should be planned and implemented.

Juror Bias: Why Shouldn't the Jury Punish This Corporation?

Juror bias is a significant problem for corporate defendants. Jury science conducted across the United States indicates that jurors dislike and distrust corporations. Local biases against outsiders also are significant, absent a meaningful local corporate presence.

Corporate defendants lose punitive damage cases if they do not win the battle for the jurors' hearts and minds. Savvy plaintiff's counsel entertain jurors with simple trial themes that reinforce juror biases. Plaintiffs do not try a tort or contract case. They do not focus on the facts, the expert testimony, or the law. Plaintiffs create emotion to enhance juror biases. They try a corporate death penalty case, empowering jurors to make a difference by sending a message through a large punitive damage award.

Defendants must meet plaintiff's corporate death penalty focus directly. It is not enough for a corporation to prove that it had no duty, met the standard of care, did not cause injury, and/or that there was no compensable damage. Sadly, emotional juries are not interested in these issues.

To win, a corporation must prove that it is not *that* kind of a corporation. It must present testimony from employees to establish that the corporation is a good company. While this clearly is not an element of any claim at issue, the jury needs to know why

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Corporate Minutes: The Not-So-New Frontier

By Robert B. Lamm

Until recently, the subject of corporate minutes seemed about as interesting — and received about as much attention — as watching paint dry. However, for a number of reasons, the subject now receives considerable attention from the legal and corporate governance communities, and from boards of directors themselves.

WHY THE 'SUDDEN' INTEREST IN MINUTES?

The primary reason for this renewed interest is concern that inadequate or incomplete minutes can increase the exposure of directors and others — possibly including corporate secretaries — to litigation or even criminal prosecution. Section 802 of the Sarbanes-Oxley Act of 2002 states that any person who "knowingly … conceals, covers up or falsifies, or makes a false entry in any … document with the intent to impede, obstruct or influence the investigation or proper administration of any matter …" can be subject to fines and/or a prison term of up to 20 years. While it is debatable whether this language was intended to apply to minutes, representatives of the Justice Department's Enron Task Force have resolved any debate by publicly stating that incomplete and/or inadequate minutes can serve as the basis for prosecutions for obstruction of justice. The concerns raised by this statement have been reinforced by the trial-related publicity and intense scrutiny being given to the deliberations of the compensation committees of The Walt Disney Company and Tyco International, Ltd.

Of course, this reliance on minutes is grounded in the "black letter" legal concept that a contemporaneous written record is the best evidence of what actually happened during a negotiation or any other meeting — including a meeting of the board or a committee of the board. Minutes provide the necessary historical record of the persons who attended a meeting and what they said or did at the meeting. In other words, in considering the extent to which directors have exercised (or failed to exercise) the fiduciary duty of care, minutes likely constitute the most — and sometimes the only — reliable record of what actually transpired. If the minutes show that the directors acted in good faith and in a deliberate manner after considering the appropriate information, and possibly even that the board or committee acted reasonably and in the belief that its decision was in the best interests of the company, they will support a court's reliance on the business judgment rule. In contrast, cursory minutes that do not establish the above — or minutes that may even suggest the lack of a proper decision-making process — are more likely to support a finding of director liability. Phrased otherwise, if the board or committee has a good story to tell, the minutes should tell it; and if the minutes do not tell a good story (for example, two-page, double spaced minutes of a meeting that lasted for several hours), the courts may believe that there was not a good story to tell.

FOR WHAT MEETINGS SHOULD MINUTES BE KEPT?

Proceeding on the understanding that "good" minutes are desirable, an initial consideration is the extent to which meetings of various "bodies corporate" should be memorialized in minutes. There is strong legal and traditional support for the premise that minutes should be recorded for all meetings of the board, committees of the board and stockholders. However, should minutes be maintained for the Disclosure Committees that many companies have put in place to assure adequate disclosure controls and procedures? What about "Advisory Boards" comprised of non-directors who counsel the company in technological or other areas? And what about committees, comprised of members of management or, in some cases, a mix of management and directors that perform various duties? (A timely example might be the multiple executive, steering and other committees that many companies have created to manage the process of complying with Section 404 of the Sarbanes-Oxley Act.)

The proper answer may well be "it depends." As noted above, it is a given that minutes should be maintained for the board, its committees, and the stockholders. If the deliberations of a non-board committee or other corporate "group" are considered critical to the company's strategy or some other key aspect of its existence and/or success, it may be advisable to record and maintain minutes of that group, and to subject those minutes to a review process along the lines discussed below. However, it would seem advisable to set the bar high, as following this process for every gathering of corporate officials would become an onerous responsibility that could increase overhead and bureaucracy and could actually hamper the operation of the company.

Two related matters deserve some mention in this connection. First, compliance with Sarbanes-Oxley Section 404 has led to a plethora of recommendations that various processes be "documented," and these recommendations are frequently expressed as a requirement that minutes be kept for a variety of groups, including many several levels below the board of directors. While "documentation" may be necessary, it need not be in the form of minutes, which tend to take on a formality that should not be necessary for Section 404 purposes. For example, a meeting can be "documented" by preparing an agenda and marking it, even by hand, to indicate that the matters on the agenda were covered; "minutes" of the meeting should not be necessary in this case. Second, given the importance of minutes in demonstrating due care on the part of boards and committees, the use of unanimous written consents should be avoided for all but the most ministerial functions of boards and committees (such as fixing a record date for a routine stockholder meeting). Although the creative use of "Whereas" clauses can arguably suggest a deliberative

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Corporate Minutes

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process, the act of signing a sheet of paper cannot have the significance of a face-to-face discussion. Moreover, the use of written consents can create uncertainty as to the date on which an action has taken place; among other things, this can raise problems as to the required filing dates of reports under the federal securities laws.

HOW SHOULD MINUTES BE DRAFTED?

Now that we have covered the types of meetings that should be minuted, we should address how the minutes should be drafted. Minutes should not be too detailed (for example, a transcript or a running "he said, she said" narrative). From a practical standpoint, it would be very challenging for a corporate secretary to take the type of notes that would be necessary to create such detailed minutes; in addition, excessive detail can create a road map for the plaintiffs' bar and can be used to impeach directors' statements when they are deposed or called upon to testify. On the other hand, minutes that are too "bare-boned" would not show the requisite level of care and deliberation (*eg,* the two-page, double-spaced minutes for a multi-hour meeting, as discussed earlier). Thus, to quote Goldilocks, minutes should be "just right" — that is, they should adequately cover the subject matter without engaging in excessive detail. There are no detailed instructions or "bright line" tests covering the drafting of minutes, but the following pointers may be helpful:

- Each major matter (and the significant components of each major matter) should be mentioned.
- The minutes should reflect that both sides of each matter (pros and cons, benefits and risks), as well as alternatives to the action proposed, have been considered. Whether the minutes should actually describe and discuss the pros/cons, benefits/risks and/or alternatives may depend upon the facts, and reasonable men and women can differ on the advisability of providing those descriptions.
- The minutes should evidence the rationale or other basis for the action taken (assuming, of course, that the basis is discussed at the meeting).
- In general, minutes should be drafted from a defensive standpoint — in other words, as if they were to be read by a plaintiff's attorney (which may well be the case). For that and other reasons, the drafter should avoid the "no bad news" approach, in which the minutes contain only positive information. The absence of negatives or cautionary discussion could make it appear that the directors were not in possession of all the facts.

ANCILLARY MATTERS

Privileged/Confidential Information

There are a few ancillary matters that need to be taken into account in drafting minutes. First, how should minutes deal with privileged communications during the meeting? Again, it is difficult to state hard and fast rules, but statements made by counsel that are intended to be privileged should be identified as such. A request for counsel's advice should be treated similarly.

Confidential Data

Second, how should minutes deal with confidential data, such as compensation information relating to persons other than the "named executive officers" whose compensation will be disclosed in detail in the proxy statement? In this regard, it is important to note that the minutes — while they may constitute the "best evidence" of what has happened at a meeting — are not the *only* evidence. Materials, frequently including confidential information, are ordinarily distributed to the board and committees prior to meetings and are filed with the records of the meeting. It is appropriate to exclude confidential information from the minutes by referring to such records, although the reference should be specific enough to enable someone to find what is referred to.

Executive Sessions

A third matter that has generated much attention is the recording of minutes during "executive sessions" of the board or committees (*ie,* meetings from which some or all employees are excluded). Best practices are still being developed and appear to vary greatly; however, the following reflect some prevalent trends:

- Different procedures may be followed for the board and each of its committees. Generally, the board and the compensation committee will meet with no employees present, while the corporate secretary and others may remain for executive sessions of the audit and corporate governance committees. (However, recent trends suggest that the Chief Executive Officer's presence during an executive session of either committee can have a chilling effect on open communications, particularly when a lower-level employee may want to express concern about management pressure to achieve forecasted results or similar matters.)
- Some companies do not record the discussions that take place during executive sessions — particularly those of non-employee directors — on the ground that doing so would inhibit free discussion. Where that is the case, however, an effort should be made to have the Chairman, the Lead Director or another non-employee director communicate to the full board (or committee) the discussions that take place, and any conclusions reached, at the executive session. This communication can then be reflected in the minutes.
- Other companies include the executive session in the minutes. However, the minutes of these sessions tend to be more general in

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Joining A Board: The Porcupine Approach

By Paul Martin Wolff

The answer to the question "should I join a board of directors?" has changed in recent years from "I'm deeply honored," to "you must be out of your mind."

Nonetheless, I still advise people to go on corporate boards. They should, however, recognize that it's not an honor. It's not a position of social prestige. It's a hard and risky job. People should make the decision to join a board the same way we've been told in the old proverb that porcupines make love: carefully, very carefully. It is not a snap decision. It's a decision that requires considerable thinking and research.

I am a compulsive list maker. When others ask me whether they should they serve on a board, I give them my list of questions to ask.

First, look at the corporate culture. It makes no difference what the compliance documents say. If there's not a corporate culture of shared values, honesty and decency; it's not going to work. Recently in the *New York Times* crossword puzzle, the clue was a corporation with a 65-page book on ethics and compliance. The answer? Enron. The culture has to be ingrained in the company, not simply stored in a three-ring binder.

The idea that ethics must be part of the corporate DNA brings to mind Edward Deming, the esteemed guru on quality. He was opposed to quality-control experts. He believed that excellence had to be built into the enterprise and it if were, you didn't need quality-control inspectors. His teaching is relevant here. Look to see if excellence is built into the culture of the corporation, rather than found in "the quality-control experts" such as the lawyers, the auditors and accountants.

Look at the CEO. Is this individual a man or woman of integrity, energy and intelligence? Does this person have a passion for their business or do you think that they will go to the next company that waives a higher paycheck in front of them? Are they — like too many athletes — more interested in free agency than they are in a legacy? Note that I put integrity first before energy and intelligence.

Is this a board where you believe you're going to be useful?

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Corporate Minutes

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nature, covering the matters discussed but often not the substance of the discussions.

- Where the corporate secretary is asked to leave the executive session, he/she should be sure to record his/her absence in the minutes and to indicate the source(s) of any information about the session that is included in the minutes. In some cases, it may be desirable to have a director (or some other person who remains for the executive session) sign the portion of the minutes relating to the executive session.

Circulation, Review and Approval of Minutes

Drafts of minutes should be circulated as promptly as possible after the meeting is over; otherwise, people (including the corporate secretary) tend to forget details and nuances that can help to make the minutes more accurately reflect the reality of the meeting. Practices differ from company to company, but in general minutes are first distributed internally (including to in-house counsel) and to outside advisors, including independent auditors (in the case of the audit committee). Many companies do not regularly submit draft minutes for review by outside counsel, but for those that do, or in cases where the significance of a matter merits outside counsel review, early review seems desirable. In any case, it can be useful to have the minutes reviewed at an early stage by in-house or outside litigation counsel, since minutes often constitute critical evidence when claims are brought against the company or its directors — and since statements in the minutes "can and will be used against" the defendants.

Following these initial reviews, minutes should be distributed either to the Chairman or Lead Director (in the case of board minutes) or to the Chairman of the relevant committee, followed by a distribution to the full board or committee.

In any case, the board and its committees should formally approve the minutes at the following meeting. This reinforces the need for the directors to review the draft minutes and thereby assure that they track the individuals' recollections of what transpired at the meeting. Formal approval may restrict a director's ability to claim that he/she was not in possession of information later deemed critical; however, on balance, approval is desirable.

Of course, requesting formal approval raises the possibility that a member of the board or committee may have comments on the minutes. Unless the comments result in significant changes to the draft submitted, this should not pose a problem. Rather, the minutes of the meeting at which prior minutes are submitted can simply reflect that the prior minutes were approved, subject to certain changes.

Once the minutes are approved, they should be signed. On occasion, the corporate secretary will be asked to sign minutes before they are approved. This practice is inadvisable, as it can result in multiple signed copies of minutes that are different from each other — often in ways that cannot be readily determined.

Finally, many companies are now following the practice of providing all committee minutes to the full board on an informational basis. This practice assures that the full board is aware of the matters being considered, and actions being taken, by the committees and reduces the likelihood that the committees will become "balkanized," taking action on their own without any oversight by the board.

Commercial E-Mail

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establishing that the initiator, and only the initiator (or its subcontractor), will serve each of these functions, that that none of the other advertisers will perform any of them, and that they will be performed by the initiator in full compliance with the CAN-SPAM Act.

If the FTC's proposed rule is issued, companies will then be able to use this construction of a joint commercial e-mail to satisfy the CAN-SPAM Act's requirements in the most efficient way.

Summary

Keeping up to date with all of the regulatory activity under the CAN-SPAM Act can save your company from lost time and resources that can be avoided by taking advantage of the clarity afforded to the Act by its regulators. Under the FTC's proposed rules, a company can easily construct a joint e-mail campaign with other companies without the requirement to honor all the companies' opt out lists, and without requirement that each company provide an opt-out mechanism in the e-mail — both of which requirements have effectively stymied legitimate joint e-mail campaigns since the Act became effective. Companies can also easily avoid violating the FCC's Wireless CAN-SPAM Regulations by scrubbing their e-mail address lists against the FCC's list of wireless domain names. Both these examples illustrate that the key to complying with the CAN-SPAM Act while also facilitating an efficient and practical e-mail campaign is to pay attention to regulatory activity under the Act and to learn to use the regulations to benefit your company.

Porcupine Approach

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Or are you going to be used? Are you being brought on as a director because they think that with your luster and pedigree they can probably approach business as usual because they have you to parade around in front of their shareholders and regulators?

Look at the audit committee — who is on it? "Goggle" them. Look at their backgrounds and decide if the person chairing the audit committee is a person that you would want running your corporation. Does the audit committee have the ability to (not that it must, but if it needs to) hire outside advisers, lawyers?

Check out the compensation committee. I think we've seen enough high-profile examples to know that compensation is a hot-button issue. Professor Bebchuk of Harvard Law School has put us on notice with his book, "Pay Without Performance." You must ask if the compensation committee has the kind of freedom you think it should have. Does the committee have the right to go out and hire compensation experts? Does it look at the cost across the entire corporation to find the true cost of an executive and not simply his or her income? How much influence does the CEO have on compensation? Is it a corporation that historically has been a pay-for-play corporation — when you hit 350, you're rewarded, and when you hit 245, you're not rewarded?

Is there a strong conflict-of-interest policy? Is there a policy that, if you're on the board, your firm — be it a law firm or other service provider — should not be providing services except on an independent competitive bidding process? Are family members of board members appearing in jobs, especially in jobs that seem to have really no ostensible purpose? Is the corporation making large gifts to favored charities of the board? If the corporation does have a philanthropic bent, how is the money given? Too often, we've seen that directors and corporation executives are listed as making huge contributions to charities and we find out that in reality the corporation whom they serve has made the payment.

Do you believe you're joining a board that would fire its CEO? If you answer positively all of the previous questions, you'll get a yes to the last question, which is ultimately the litmus test.

Check out the D&O insurance policy, if and when you've decided to join the board. See what is available and make sure there is the so-called side A coverage for independent directors.

Don't do it on the cheap. It's a difficult job. Even if you do it well, there is still a lot of risk involved. You ought to be well compensated. As a rule of thumb, you should get paid as a key member of an audit partnership or a senior partner in a law firm would be paid. We know from a Korn-Ferry survey that the average publicly traded corporation board director made about $57,000 last year and that many made in excess of a $100,000. If you do your job well and you take on the risk, this is fair compensation.

Be active. But not intrusive. Remember you're a director. Not a manager. The best guide on director's behavior was given to me almost 10 years ago while serving on a university board. My mentor on the board told me to keep your nose in and your fingers out. Sniff around and learn exactly what the company's doing, but keep out of the day-to-day management. If you think you have to get involved in day-to-day matters, then replace managers. Don't insert yourself.

Paul Martin Wolff is a Partner at Williams & Connolly LLP, and concentrates his practice on civil and criminal litigation as well as on counseling publicly traded corporations regarding officer irregularities and accounting restatements. Wolff has been lead or joint-lead counsel in over three dozen trials in state and federal courts, has argued numerous appeals in various United States circuit courts and state supreme courts and has participated in dozens of additional trials and appellate matters. He can be reached at 202-434-5000 or at pwolff@wc.com.

Punitive Damages

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it should not punish the corporation.

For example, a corporate defendant was sued for racial discrimination. Initially, its defense was focused on the specific allegations made by the plaintiff. Did the incidents asserted actually happen? What proof was available to counter the plaintiff's assertions? While it was very important to marshal fact and expert testimony concerning the allegations, the key to winning the case was proving that the corporation was not *that* kind of a company. We focused on identifying all awards that the corporation had received from any source. For example, the company had received an award for diversity from Operation Push; presented to the company by Reverend Jesse Jackson. The picture was worth a thousand words.

A one-size-fits-all solution is not effective. Each corporation must present its unique story. It must convince the jury that the corporation does not recklessly hurt people, and that it serves an important societal need. Effectively presented, this trial theme makes juries reluctant to punish. The result is defense verdicts and small punitive awards. Runaway verdicts often result from failure to address juror bias.

TRIAL PHASING: THE PLAYING FIELD TILTS IN PLAINTIFFS' FAVOR

Another unfair aspect of punitive damage cases that should be attacked stems from common law trial procedures. Common law punitive damage trial procedures in most jurisdictions strongly favor plaintiffs. Unfair procedures should be challenged as unconstitutional.

One example of an unfair procedure is trial of liability for compensatory damages and punitive damages in a single proceeding. When jurors consider compensatory and punitive damages at the same time, jury science shows that the jurors they tend to use punitive damages evidence to find liability for compensatory damages. It is easy to see why this happens. Jurors become infuriated by evidence of the defendant's recklessness, as well as evidence of other allegedly similar incidents. This evidence does not establish whether the defendant's conduct injured plaintiff, but it makes jurors mad at the defendant. The court permits the evidence to be presented, because it is relevant to punitive damages. Unfortunately for defendants, jurors are not able to disregard punitive damages evidence when deliberating on liability and compensatory damages. As a result, jurors tend to skim over gaps in plaintiff's proof of liability in order to punish the defendant.

The problem is exacerbated when plaintiff's counsel exhorts jurors to punish a corporate defendant, encouraging jurors to gain personal fame by assessing a large award. Arguably, this is what happened to Merck in the Aug. 19, 2005 Vioxx verdict. Reports indicate that jurors did not spend much time evaluating causation, which required analysis of complex scientific evidence. Instead, the jurors skipped quickly to the easier task of punishing of Merck.

To avoid this problem, corporate defendants should seek trial in three phases: 1) compensatory liability and damages; 2) whether punitive damages are warranted; and 3) the amount of punitive damages to be awarded. When jurors are not permitted to hear punitive damages evidence before compensatory liability is decided, their deliberations on compensatory liability and damages are not tainted by punitive evidence. Similarly, jurors' deliberations on whether punitive damages are warranted should not be tainted by evidence of the defendant's wealth. Separating these issues into separate trial phases protects a defendant's right to a fair trial. When a punitive damage case is tried in three phases, defense verdicts become possible. Even in jurisdictions like Mississippi, defense verdicts often result when punitive damage issues are separated from compensatory liability and damages.

Numerous decisions of the U.S. Supreme Court question whether common law procedures for awarding punitive damages may be unconstitutional. The Court cannot rule on this issue until it hears a case in which such a challenge is preserved. Defendants need to challenge unfair punitive damage procedures, like trial of compensatory and punitive damages in a single phase. Numerous federal constitutional challenges to punitive damages procedures and evidence should be raised at trial and on appeal in cases against corporate defendants. Absent these challenges, punitive damages trials will continue to be unfairly slanted against corporations.

WINNING DEFENSES COUNTER UNFAIRNESS

Punitive damages litigation is an unfair fight. The key to a winning defense is a focus on specific kinds of unfairness. Challenge unfair procedures using pretrial motions, objections, motions for mistrial, writs of mandamus, post-verdict motions and appeals. Meet juror biases directly with proof that this is not *that* kind of corporation. Each unfairness must be identified, met, and overcome through focus and creativity. A focused punitive damage defense ensures that these issues are identified and addressed. Corporations can and do win punitive damage cases. The key to winning is a focused punitive damages defense.

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HOTLINE

Federal judiciary supports citing unpublished opinions: The Judicial Conference of the United States has approved new Rule 32.1 of the Federal Rules of Appellate Procedure, which concerns the citation of unpublished opinions, which still must be approved by the Supreme Court and transmitted to Congress. The citation rule change would end a debate that has split the circuits. The Second, Seventh, Ninth and Federal circuits ban citation of unpublished opinions outright, while six other circuits discourage it. If approved, Rule 32.1 would permit the citation in briefs of opinions, orders, or other judicial dispositions that have been designated "not for publication," "non-precedential," or the like. The rule applies only to decisions issued on or after Jan. 1, 2007.

EEOC rule allowing for reduced benefits upon Medicare eligibility is upheld: The District Court for the Eastern District of Pennsylvania has ruled that an Equal Employment Opportunity Commission regulation authorizing employers to reduce the health care benefits of retirees when they become eligible for Medicare is entitled to "deference" pursuant to a recent U.S. Supreme Court opinion. *AARP v. EEOC,* No. 05-cv-509 (Sept 27).

The court vacated an earlier decision, striking down the proposed EEOC regulation on the grounds that it was not entitled to deference under *Chevron U.S.A. Inc. v. Natural Resources Defense Council,* 467 U.S. 837 (1984). At that time, the court ruled that the regulation directly conflicted with a previous Third Circuit decision, *Erie County Retiree Association v. County of Erie,* 220 F.3d 193 (2000), which expressly prohibited the practice of terminating private coverage that provided more generous benefits than Medicare. Just after this decision was announced, however, the Supreme Court decided *National Cable and Telecommunications Ass'n v. Brand X Internet Services,* 125 S. Ct. 2688 (Jun. 27, 2005), where the Court concluded that the Ninth Circuit had erred by relying on one of its own rulings, and that it's prior interpretation of a federal statute foreclosed a later, contrary construction by an administrative agency.

In the instant matter, the court found that the *Brand X* decision "altered the underpinnings" of its earlier ruling, holding that a federal agency's interpretation of a statute is entitled to deference, even if it conflicts with a judicial precedent, unless that precedent held that the statute "unambiguously forecloses the agency's interpretation." *Brand X*, the court stated, "stands for the broader proposition that a prior court interpretation of a statute cannot trump a subsequent agency interpretation unless the court holds that its interpretation is the only permissible, not merely the best, construction of the statute."

Antitrust claims against IPO underwriters reinstated: The Second Circuit has ruled that the federal antitrust laws were not intended by Congress to immunize the underwriters of initial public offerings who allegedly conspired to manipulate the price of stocks. *Billing v. Credit Suisse First Boston Ltd*., 03-9284 (Sept 28).

The lawsuits primarily allege that the underwriters violated antitrust laws by demanding "tie-in" agreements, in the form of extra payments or other commitments, from investors who sought allocations in highly sought after initial offerings. The suits were dismissed by the district court.

On appeal, the court stated that the claim of implied immunity for the tie-in arrangements is "in many ways, unlike any we have seen. Tie-in arrangements are recognized as means of dangerous manipulation, and there is no indication that Congress contemplated repealing the antitrust laws to protect them. Thus defendants insist that the SEC could exercise powers — powers the agency refuses to recognize — to immunize conduct that neither Congress nor the agency ever contemplated permitting."

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