ACC Association of Corporate Counsel
NATIONAL CAPITAL REGION

Crisis Control in the General Counsel's Office

Identifying and Avoiding Problems for In-House Counsel In Departments and Organizations Of All Sizes

DISCUSSION GUIDE

June 11, 2015

Panelists:

Brian Brooks, Executive VP & General Counsel, Fannie Mae

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Dean Manson, Executive VP & General Counsel, EchoStar Corp.

Moderated by John Villa, Partner, Williams & Connolly LLP

ENRON

In his examination of the legal department … the bankruptcy examiner concluded that the general counsel could be found negligent in the performance of his duties in several respects, including (1) failing to inform himself and the board as to certain related party transactions, or to ascertain that those to whom he delegated the responsibility were fulfilling their responsibility with respect to those transactions; (2) failing to familiarize himself with the facts or the law underlying certain transactions so as to be able to advise the board on the matter; and (3) failing to inquire further into the content of the anonymous whistleblower letter that alleged accounting irregularities, or the extent of outside counsel's involvement so as to advise the chairman properly of the propriety of retaining outside counsel to conduct any internal investigation. [Note: This was the examiner's finding, not a finding by a court or regulator.]

ENRON

What went wrong? Questions To Consider:

- Was anything done here by in-house counsel that was a violation of law, regulation or ethical rule?
  - How were the lawyers to know that the transactions were wrong, illegal, a breach of fiduciary duty, etc.?
  - How much of an effort should the lawyers have made to understand the transactions and Arthur Andersen's accounting for them, to be able to inform/advise the Board?
  - What were the lawyers' obligations in that regard then, and what are they now – under revised Model Rules and Sarbanes Oxley? Where are the remaining gray areas?
- Scaling it down: On a day-to-day basis, if an aggressive business person is pushing the company's lawyers – "I won't do it if it's illegal" - how does the lawyer handle that situation?

ENRON

Relevant rules:

Model Rule 1.13 - Organization as a client:

[Note: This is the 2015 version, not the version in effect at the time of Enron]

(a) A lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents.

(b) If a lawyer for an organization knows that an officer, employee or other person associated with the organization is engaged in action, intends to act or refuses to act in a matter related to the representation that is a violation of a legal obligation to the organization, or a violation of law that reasonably might be imputed to the organization, and that is likely to result in substantial injury to the organization, then the lawyer shall proceed as is reasonably necessary in the best interest of the organization. Unless the lawyer reasonably believes that it is not necessary in the best interest of the organization to do so, the lawyer shall refer the matter to higher authority in the organization, including, if warranted by the circumstances to the highest authority that can act on behalf of the organization as determined by applicable law.

Comment 3: "When constituents of the organization make decisions for it, the decisions must ordinarily be accepted by the lawyer, even if their utility or prudence is doubtful. Decisions concerning policy and operations, including ones entailing serious risk, are not as such in the lawyer's province."

ENRON

Relevant rules: Now, as a result of Sarbanes-Oxley, Section 307 -

17 C.F.R Section 205.3(b)(1) - Reporting Requirements:

If an attorney, appearing and practicing before the Commission in the representation of an issuer, becomes aware of evidence of a material violation by the issuer or by any officer, director, employee, or agent of the issuer, the attorney shall report such evidence to the issuer's chief legal officer (or the equivalent thereof) or to both the issuer's chief legal officer and its chief executive officer (or the equivalents thereof) forthwith.

17 C.F.R Section 205.2(e) – Definitions:

Evidence of a material violation means 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.

ENRON

Relevant rules:

Model Rule 1.6 – Confidentiality of Information:

(a) A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation or the disclosure is permitted by paragraph (b).

(b) A lawyer may reveal information relating to the representation of a client to the extent the lawyer reasonably believes necessary: …

(2) to prevent the client from committing a crime or fraud that is reasonably certain to result in substantial injury to the financial interests or property of another and in furtherance of which the client has used or is using the lawyer's services;

(3) to prevent, mitigate or rectify substantial injury to the financial interests or property of another that is reasonably certain to result or has resulted from the client's commission of a crime or fraud in furtherance of which the client has used the lawyer's services…

ENRON

Relevant rules:

Model Rule 4.1 – Truthfulness in Statements to Others:

> In the course of representing a client a lawyer shall not knowingly: …
>
> (b) fail to disclose a material fact to a third person when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client, unless disclosure is prohibited by Rule 1.6.

Model Rule 1.2 – Scope of Representation and Allocation of Authority Between Client and Lawyer:

> (d) A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent, but a lawyer may discuss the legal consequences of any proposed course of conduct with a client and may counsel or assist a client to make a good faith effort to determine the validity, scope, meaning or application of the law.

HEWLETT-PACKARD "SPYING SCANDAL"

Under the direction of the senior counsel, who was also HP's director of ethics, HP retained independent security experts who, in turn, enlisted private investigators to investigate the board members. Through the use of pretexting – i.e., posing as HP directors and journalists – the private investigators were able to obtain from phone companies the home and mobile phone call records of the board members, company employees, and reporters for certain media organizations. According to news reports, the senior counsel/chief ethics officer was told of the use of pretexting and, after expressing concerns as to the legality of this investigative tactic, was informed that it was above board, though barely.

HEWLETT-PACKARD "SPYING SCANDAL"

What went wrong? Questions To Consider:

- Was anything done here by in-house counsel that was a violation of law, regulation or ethical rule?
  - Why do you think the lawyer fail to intervene when informed that the investigatory tactics were "above board, though barely"?
  - The in-house counsel's office didn't actually engage in pretexting. Why are they liable?
    - Criminal liability
    - Civil liability
    - Ethical issues
      - What was the GC's and/or other attorneys' duty to supervise – vis a vis subordinate lawyers, the investigators?
      - If one knows that corporate officials are conducting themselves in a fashion to violate the law, what is the lawyer required to do?
    - Fiduciary duties to the corporation
- Scaling it down:
  - Does the company look at employees' emails or social media accounts?
  - What tactics does it use to investigate allegations against employees? Allegations made by whistleblowers? Competitors?

HEWLETT-PACKARD "SPYING SCANDAL"

Relevant rules:

Model Rule 5.3 – Responsibilities Regarding Nonlawyer Assistance:

With respect to a nonlawyer employed or retained by or associated with a lawyer: …

(c) a lawyer shall be responsible for conduct of such a person that would be a violation of the Rules of Professional Conduct if engaged in by a lawyer if:

(1) the lawyer orders or, with the knowledge of the specific conduct, ratifies the conduct involved; or

(2) the lawyer is a partner or has comparable managerial authority in the law firm in which the person is employed, or has direct supervisory authority over the person, and knows of the conduct at a time when its consequences can be avoided or mitigated but fails to take reasonable remedial action.

Model Rule 8.4 – Misconduct:

It is professional misconduct for a lawyer to:

(a) violate or attempt to violate the Rules of Professional Conduct, knowingly assist or induce another to do so, or do so through the acts of another; …

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Model Rule 1.13 – Organization as a Client:

(a) A lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents.

(b) If a lawyer for an organization knows that an officer, employee or other person associated with the organization is engaged in action, intends to act or refuses to act in a matter related to the representation that is a violation of a legal obligation to the organization, or a violation of law that reasonably might be imputed to the organization, and that is likely to result in substantial injury to the organization, then the lawyer shall proceed as is reasonably necessary in the best interest of the organization. Unless the lawyer reasonably believes that it is not necessary in the best interest of the organization to do so, the lawyer shall refer the matter to higher authority in the organization, including, if warranted by the circumstances to the highest authority that can act on behalf of the organization as determined by applicable law.

(c) Except as provided in paragraph (d), if

(1) despite the lawyer's efforts in accordance with paragraph (b) the highest authority that can act on behalf of the organization insists upon or fails to address in a timely and appropriate manner an action, or a refusal to act, that is clearly a violation of law, and

(2) the lawyer reasonably believes that the violation is reasonably certain to result in substantial injury to the organization,

then the lawyer may reveal information relating to the representation whether or not Rule 1.6 permits such disclosure, but only if and to the extent the lawyer reasonably believes necessary to prevent substantial injury to the organization.

HEWLETT-PACKARD "SPYING SCANDAL"

Relevant rules:

Model Rule 1.10 – Terminology: …

(f) "Knowingly," "known," or "knows" denotes actual knowledge of the fact in question. A person's knowledge may be inferred from circumstances. …

GENERAL MOTORS
IGNITION SWITCH PROBLEM

With respect to the legal department, for example, the Valukas report notes that staff attorneys handling product claims involving airbag non-deployment occurrences were not aware, until 2012, of a 2007 study done by a state trooper that suggested a connection between the non-deployment of the airbags and the ignition switch problem, even though there was a copy of the study in the legal department files and the study was publicly available on the National Highway Traffic safety Administration's website. In addition, the report notes that, although the legal department finally requested the Product Investigation team to look into whether the mounting non-deployment cases involved a safety issue, it failed to convey the urgency of the situation by waiting six months to initiate the meeting with the Product Investigation team and over two and one-half years for completion of the team's investigation. The report further states that senior attorneys never elevated the non-deployment/ignition switch cases to the general counsel, even after having been warned by outside counsel on more than one occasion to the risk of punitive damages.

GENERAL MOTORS
IGNITION SWITCH PROBLEM

What went wrong? Questions To Consider:

- Was anything done here by in-house counsel that was a violation of law, regulation or ethical rule?
  - Basic issues:
    - Why do you think the lower-level lawyers who were aware of the situation failed to "own" it?
    - Was there "willful blindness"? Or negligence?
  - Possible criminal liability under a state tort law?
  - Ethical Issues:
    - Was there knowledge of corporate misconduct?
    - Did the lawyers have an obligation to report "up the ladder" or, even, to the victims of the conduct?
- Scaling it down:
  - When mistakes are made, can you ever just ignore it, and hope a problem won't arise?

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(b) A lawyer may reveal information relating to the representation of a client to the extent the lawyer reasonably believes necessary:

(1) to prevent reasonably certain death or substantial bodily harm;

(2) to prevent the client from committing a crime or fraud that is reasonably certain to result in substantial injury to the financial interests or property of another and in furtherance of which the client has used or is using the lawyer's services;

(3) to prevent, mitigate or rectify substantial injury to the financial interests or property of another that is reasonably certain to result or has resulted from the client's commission of a crime or fraud in furtherance of which the client has used the lawyer's services; …