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Mind Your Legal P's and Q's Consequences Can be Serious!

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Mind Your Legal P's & Q's the Consequences Can Be Serious!

EVER NOTICE HOW MANY TIMES WE UTTER THE PHRASE, "LET'S RUN IT PAST THE LAWYERS"? The specter of individual investor or class action lawsuits or SEC, federal or state criminal investigation does hang over many public companies, especially those with well-known brand names. The public announcement or even rumor of such activities can send investors in a frenzy and the company's stock price toward the basement. "Headline risk" related to legal affairs is clearly a factor today in investor confidence (or lack of same).

The environment in the corporate counsel's office has dramatically changed since 2000, including "who" the company lawyers represent. It used to be simple: The CEO was acknowledged to be the client. Now counsel may find itself considering the interests of the company, shareholders, the board or investors as "clients."

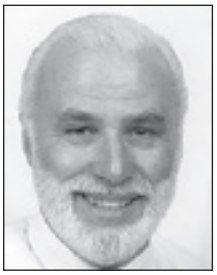
STAY TUNED … to serious discussions about who your corporate counsel represents in any given situation.

We all acknowledge that we are a very litigious society. There are many reasons why people file lawsuits, often beginning with investors who are upset by stock performance. The collapse of the bull market in 2000 created many unhappy investors; lawsuits followed, seeking redress.

We also had the spectacular financial collapse of Enron, followed by the bankruptcy of WorldCom and other companies, with the roots of the bad news allegations of serious fraud at the highest levels of corporate America and Wall Street. Fraud appeared to be epidemic in the corporate suite and capital markets.

Restatements of prior financial filings did become epidemic after the passage of Sarbanes-Oxley, as hundreds of companies announced changes in their prior accounting and financial reports. All this *sturm und drang* undermined investor confidence in the markets; even companies with sterling reputations and outstanding performance struggled to buck the tide of negative media reports, legal actions, public sector investigations and waves of reform measures. While public attention was riveted on SOX and the impact of many new rules issuing forth from SEC, a separate long-term response was being put in place by the federal government.

STAY TUNED … to the federal government's Corporate Fraud Task Force, created by Executive Order in July 2002 — just days before the passage of SOX. It was organized to assemble corporate investigations and prosecutions; eight U.S. attorneys around the nation assumed the point position on cases in their regions.



Hank Boerner

The long-term stated objectives of the task force included "cleaning up corruption in the boardroom, restoring investor confidence in our financial markets and sending a loud and clear message that corporate wrongdoing will not be tolerated." Within weeks there were high-profile cases under way involving Enron, ImClone Systems, Adelphia Communications and WorldCom.

The U.S. Attorney for the Southern District of New York, James B. Comey, took the lead for the administration. "The President's Corporate Fraud Task Force can do one thing, and that is what we are here to do: restore public confidence in our financial markets and our criminal justice system ... to make people know we will continue to work like crazy until we have brought all corporate crooks to justice. ..."

Now it's 2006, and the investigations continue. By August 2005, the end of its third year in business, the task force reported that it had:

- Secured 700+ corporate fraud convictions;
- Convicted more than 100 CEOs and presidents (in 600 cases brought);

- Convicted more than 30 corporate chief executive officers;
- Charged more than 1,300 defendants with wrongdoing; and
- Collected $266 million in restitution, fines and forfeitures from June 2002 to June 2005.

Strategies employed by the task force included negotiating guilty plea agreements, deferred prosecution agreements and non-prosecution agreements. KPM is an example of "deferred" prosecution — the company admitted to its conduct, agreed to reforms (including cooperation with ongoing cases) and established internal controls to prevent recurrence.

All this underscores the task force's declared primary objectives — of keen interest to IROs and CFOs:

- Restoring confidence in the financial marketplace
- Assuring fair and accurate information gets to investors
- Rewarding shareholder and employee trust
- Protecting the jobs and savings of hard-working Americans

STAY TUNED … to an alphabet soup of collaborating task force federal agencies that might someday look at your company, industry or sector. The task force also includes cooperation from the SEC, Commodity Futures Trading Commission, departments of Labor and Treasury, Federal Energy Regulatory Commission, Federal Communications Commission, U.S. Postal Inspection Services and the Office of Federal Housing Enterprise Oversight, regulator of Fannie Mae, Freddie Mac and other government-sponsored enterprises.

STAY TUNED … to some good news in the legal arena, such as declining market-bust investor class actions. *CFO Magazine* reported in January that the number of securities fraud class actions *decreased* in 2005 (from 213 cases a year earlier to 176). There were fewer "mega-filings," according to Stanford Law School and Cornerstone Research. Joseph Grundfest, former SEC commissioner and now a Stanford professor, sees two factors driving the reduction in case filings: (1) lawsuits resulting from "financial busts" are mostly behind us; and (2) improved corporate governance measures are reducing the actual incidence of fraud.

STAY TUNED … to your own potential risks in e-communication. If your company is involved in a civil or criminal probe in the future, what dangers and risk lurk in the shadows of cyberspace? Judges, lawyers and "e-discovery" consultants want corporate managers to think about the following:

- Virtually all corporate e-mail messages are now discoverable, including attachments.
- Data can migrate to many corners of your universe, including MP3 players, memory sticks, laptops, PDAs and cell phones. Watch what you say or write (and save) to your communication on the run; most devices keep data in memory.
- Many "documents" now produced in legal discovery never get printed and exist only in digital formats. These could easily outnumber "paper" documents in your office.
- E-communication can be very different from other forms of the written word; the speed of technology leaves little time for "reflection" of what you say or write. The sheer volume of messages can make retrieval difficult; one large financial services firm had certain documents and knew it but could not easily find them for "timely production." The court was not happy with its managers.
- Some companies tend to "keep everything." Older documents may be on legacy systems that have been discarded.
- SOX-derived regulations and numerous other regulatory protocols could greatly complicate your office record-keeping; even if you wanted to dispose of e-documents, think of HIPAA (mandating seven years' health care information); SOX (seven years' audit papers); the Bank Secrecy Act (five years of suspicious activity); the Patriot Act (financial institutions' identification programs); the SEC (trading and communication data); and the new European Union telecomm tracing data for global operators, as just a few examples.
- When sending back a message to a particular person, think about creating a new e-mail document instead of

hitting "Reply All" and creating a cascade of documentation that could become a long chain.

■ Consider setting up a repository, preservation archive policy for your key documents — putting e-mails in a "vault" for documents that you want to keep and retrieve.

■ Instant voice messaging, text messaging and voice mails are another peer-to-peer area of communication that is discoverable by attorneys. Nasdaq is said to have a keen interest in instant messaging communication.

■ Think "volume" in terms of legal cases. One gigabyte is 100,000 pages; the average investigation now can run to 500 gigabytes!

■ We are well beyond "key word search" in legal discovery and into "meta-tags," context and filtered data, which can yield troves of data, some coming through "back doors" built into software programs.

With newly filed class actions reported on the decline, chances are you may never need the above advice. On the other hand, federal investigations continue apace. Part of your corporate governance checklist should focus on creating clearly stated policies on document retention, nature of internal and external communication (such as board-IRO communication), what topics should or should not be addressed in writing and protected, non-protected ("attorney work product") communication. In striving to be transparent, candid and helpful, IROs also need to consider the unintended consequences of their communication, no matter how harmless a single document or exchange of views may seem at the time. (When in doubt, seek legal advice inside!) IRU

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