

## Dick Thornburgh

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If conflicts arise between the board and management, the CLO may have to advise the board to retain independent counsel to act on behalf of the board, the Audit Committee, or the independent directors.

**Editor: What should the CLO do if actions are taken by management that circumvent requirements for board review or approval?**

**Thornburgh:** This takes the issues we just discussed from the general to the specific. A CLO who believes that management is acting in contravention of the board must bring the matter to the board's attention. A lawyer in this situation can take guidance with respect to his or her legal position from the "up-the-ladder" reporting requirements of Rule 205 of the SEC Rules of Conduct. Rule 205 was promulgated in response to Section 307 of Sarbanes-Oxley and became effective three years ago, in August 2003. Rule 205 applies to both outside counsel and in-house lawyers appearing and practicing before the SEC, and to "evidence of a material violation," but it is instructive beyond those limitations. The Rule provides that the lawyer making the report is obligated to follow up to ensure that a reasonable and timely response occurs. However, if the attorney does not believe an appropriate response has occurred within a reasonable time, he or she is required to report the information, and the inadequacy of the response, "up the ladder" to the Audit Committee, the independent directors, or the full board.

The SEC's issuance of Rule 205 was preceded by widespread comment and it has generated concern about how to balance its requirements with the attorney-client privilege, the attorney's obligation to maintain client confidences, and well-established rules of professional conduct and ethics. While these concerns work toward some satisfactory resolution, CLOs can rely on Rule 205 as support for the necessity of resolving conflicts between management and the board in favor of disclosure to the board – consistent with the fact that the CLO's client is the company and its shareholders, not management.

**Editor: A common characteristic of option backdating, special purpose corporations and violations of the Foreign Corrupt Practices Act is that significant accounting and/or tax issues may be involved. How should CLOs handle such issues?**

**Thornburgh:** Although many of these risk areas can involve significant and complex accounting or tax issues, most can be boiled down to their essential requirements. Once the key provisions of the law are understood and illustrated with some recent examples of abuses, the CLO can then take appropriate steps to minimize the company's exposure. For example, with respect to the FCPA, the CLO can insure that steps are taken to look out for the "red flags" which have been identified by the U.S. Department of Justice as potentially providing

notice of corrupt conduct. Examples include: unusual financial arrangements; a pattern of corruption in the country in which the company is doing business; a refusal to provide FCPA compliance certifications; abnormally large commissions; lack of transparency in expenses and accounting records; an agent's reputation for unethical business practices; whether any transactions have been recorded as cash; unnecessary third parties or multiple intermediaries performing similar functions; requests for payments to a third party rather than the intermediary; and requests for reimbursements that are poorly documented.

**Editor: Do requirements by prosecutors that a corporation waive the attorney-client privilege or that the corporation refrain from indemnifying employees undermine the ability of the CLO to uncover compliance issues? What can the CLO do when confronted with such a request? Is any solution to these issues likely?**

**Thornburgh:** There is no neat and tidy solution to these issues that one can point to today. But there are some recent and important guideposts that are showing the way forward.

Judge Kaplan's recent decision in *United States v. Stein*, WL 1735260 (S.D.N.Y. June 26, 2006), the KPMG tax shelter prosecution, has indicated that there are constitutional limits to the pressure the Justice Department can impose on companies in the name of applying the Thompson Memorandum's criteria for demonstrating cooperation that can earn a company a favorable decision in connection with an investigation.

Last March, the Subcommittee on Crime, Terrorism & Homeland Security of the House Committee on the Judiciary held hearings on the threats to the attorney-client privilege posed by current governmental policies and practices. I testified at the hearing about the importance of the privilege and how unduly aggressive applications of the Thompson Memorandum by some prosecutors is at odds with the important values underlying the privilege. I included in my testimony the results of a survey of in-house and outside counsel, involving responses from over 1,400 lawyers, which showed that nearly 75% of both groups believe that a "culture of waiver" has developed in which governmental agencies expect companies under investigation to broadly waive attorney-client and work product protections.

Finally, this issue has been taken up vigorously by the organized bar. Just last May, my K&LNG colleague, outgoing ABA President Michael Greco, wrote to Attorney General Gonzales to call for specific revisions to the Thompson Memorandum, its predecessor the Holder Memorandum, and its Civil Division counterpart at the DOJ, the McCallum Memorandum. Adoption of recommendations along these lines would substantially reduce the risk of government-coerced waiver.

So there is hard work ahead but the issue has been joined, at both the executive and legislative branch level. We just have to keep focused on the issue because the protection of the privilege is too important for us not to act.

## Corporate Counsel Organization Highlights

### Letter From The President Of The Bar Association Of San Francisco



To The Readers Of *The Metropolitan Corporate Counsel*:

Sign up now for a fun evening on October 10 at the BASF Foundation's Third Annual Gala. Over 850 people attended last year's gala, and more than \$700,000 was raised to support BASF's charitable programs.

Richard North Patterson will keynote the foundation's signature event. A former attorney at Bingham McCutchen LLP, he is the author of the international best seller *Balance of Power*, which confronted one of America's most

emotional and divisive political and social issues – gun violence.

The evening also features presentation of the Champion of Justice Award by BASF and its Volunteer Legal Services Program (VLSP). The award goes to individuals who have shown exemplary leadership and commitment to either the advancement of justice or to the philanthropic support of the charitable efforts of BASF, including VLSP. The 2005 Champions of Justice are William M. Audet of Alexander, Hawes, & Audet, LLP; the Honorable Richard A. Kramer, San Francisco Superior Court; and the Honorable Fern M. Smith (Retired), United States District Court for the Northern District of California

I encourage you to support the BASF Foundation in helping to change lives by:

- Leveraging the legal aid resources of our community
- Supporting diversity in the legal profession
- Providing educational support to our Bay Area youth

You can learn more about the good work being done by BASF and sign up to join our fun at BASF's October 10 gala by contacting BASF's Communications and Public Relations Director Ann Murphy at [amurphy@sfbbar.org](mailto:amurphy@sfbbar.org).

Best regards,  
Joan Haratani

### Seminar Will Review Litigation Tax Issues

The Bar Association of San Francisco (BASF) this month has scheduled a seminar titled Tax Issues in Settling Litigation.

The program will take place on Tuesday, September 12 from noon to 1:30 p.m. at the CLE Auditorium, 465 California Street, San Francisco. Registration begins at 11:30 a.m.

The featured speaker is John A. Hartog, Law Offices of John A. Hartog.

For information on program fees and available CLE credits, see the Bulletin Board on *The Metropolitan Corporate Counsel* website at [www.metrocorp-counsel.com](http://www.metrocorp-counsel.com).

To register for the seminar, visit [www.sfbbar.org](http://www.sfbbar.org).

### Policy Issues Alert!

## Legal Reforms In California Threatened By Campaign Finance Initiative

By John H. Sullivan

A November ballot initiative in California threatens Proposition 64, the landmark business law reform overwhelmingly passed by voters in 2004.

The initiative – Proposition 89 – would virtually block future legal reforms and set the stage for nullifying even earlier reforms, such as the State's 20-year-old joint and several liability law.

Proposition 89 is not a civil justice measure, but an across-the-board, anti-business scheme posing as election reform. It would cripple the business community's ability to participate in the political process in California by

- *prohibiting* a corporation from directly or indirectly contributing to an independent expenditure election campaign, which is the only constitutional way a company has to make its views on candidates known to voters. In recent years the Civil Justice Association of

*John H. Sullivan is President, Civil Justice Association of California.*

California has sponsored independent expenditure committees which countered trial lawyer candidates and help send pro-legal reform lawmakers to the State Legislature.

- placing a \$10,000 corporate contribution *limit* on supporting or opposing initiatives. In 2004 voters passed Proposition 64, a major legal reform that stopped extortion lawsuits under state business law. Corporations raised \$15 million for this win. Plaintiffs' lawyers spent about \$5 million in their losing campaign. Had *Proposition 89* been in effect, the same businesses would have been limited to well under \$5 million in contributions, and the measure would have been defeated – if it would have been put on the ballot at all.

Personal injury lawyers and other plaintiffs' lawyers are largely unaffected by Proposition 89's limits.

In summary, Proposition 89 would, in the legal reform arena, mean unilateral disarmament for business in the very political areas where gains have been won and balance restored. More information on Proposition 89 is available at [www.noprop89.org](http://www.noprop89.org).