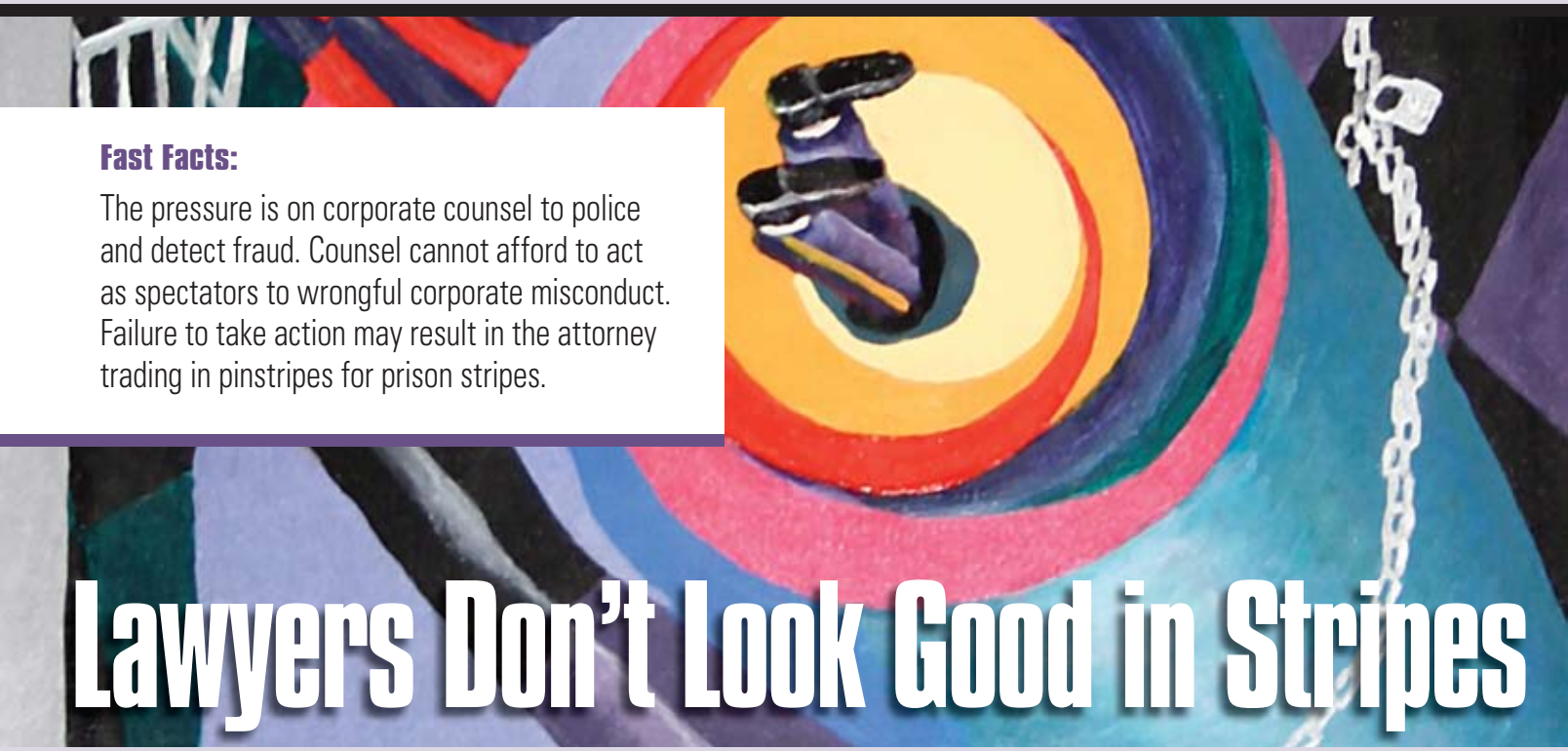

Fast Facts:

The pressure is on corporate counsel to police and detect fraud. Counsel cannot afford to act as spectators to wrongful corporate misconduct. Failure to take action may result in the attorney trading in pinstripes for prison stripes.

Lawyers Don't Look Good in Stripes

Lawyers, the New Target of Federal Prosecutions

By Jeffrey G. Collins and Erin L. Toomey

Lawyers have increasingly become targets of federal prosecutions. The wave of corporate fraud prosecutions that has recently swept across the country has included lawyers as principal defendants. The position of general counsel has become the "most dangerous place to be," according to attorney Reid Weingarten, who earned an acquittal for former Tyco general counsel Mark Belnick. The government views attorneys as the "first line of defense" against corporate malfeasance.[1]

This article discusses the legal and ethical responsibilities of in-house counsel who become aware of corporate misconduct and defenses to allegations of corporate fraud.

The Model Rules of Professional Conduct Lack Guidance on a Lawyer's Ability or Duty to Report Corporate Malfeasance

It can be uncomfortable for any employee to report corporate misconduct. The general counsel is not immune from this discomfort. The general counsel may have worked with the wrongdoers for years, or the wrongdoer may be someone to whom the general counsel reports. For example, in the case of the chief executive officer as wrongdoer, the general counsel may serve at the CEO's pleasure and the CEO may set the general counsel's compensation. Notwithstanding this discomfort, the general counsel has a legal, if not an ethical, duty not to turn a blind eye to corporate misconduct. After all, the general counsel's client is not the individual wrongdoer, but the corporation itself. The general counsel's first and primary responsibility is to the organization, not the officers, directors, or employees.

For example, misdirected loyalties led to the conviction of Franklin Brown, former chief legal counsel for Rite Aid Corporation. The Rite Aid investigation stemmed from Rite Aid's $1.6 billion restatements of its earnings for 1997 to 1999, which at the time was the largest accounting revision in United States history.[2] Brown has provided legal advice to Rite Aid founder Alex Grass and his son Martin Grass for more than four decades and has been described as deeply loyal to both the Grasses and the enterprise.[3] According to Joseph Metz, one of Brown's former defense attorneys, "Martin was the rich kid who got his neck in incredible situations. And Franklin, with his good brain, was the one who got him out of [them]. That had been the history of their relationship since Martin was a kid."[4] As the evidence demonstrated at trial, this misdirected loyalty led Brown to bribe his secretary to backdate contracts, which resulted in convictions on 10 felony counts ranging from obstruction of justice to conspiracy.

Unfortunately, the Model Rules of Professional Conduct do not provide in-house counsel with much guidance on the counsel's duty or ability to report corporate misconduct to entities or individuals outside the corporate organization.[5] Model Rule 1.13(b), pertaining to counsel for organizations, provides:

> 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*. [Emphasis added.]

However, the model rules are silent concerning the conflict between actions that may be reasonably necessary in the best interest of the organization and the duty of confidentiality that an attorney owes to his or her client.[6] The only options the model rules provide counsel faced with constituents in an organization who intend to engage in fraud are (1) asking the constituents to reconsider the matter, (2) advising the constituents to seek a separate legal opinion, and (3) referring the matter to a higher authority within the organization.[7] The model rules neither authorize nor require in-house counsel to squeal on the corporation or contact legal authorities about potential or ongoing fraud.[8] The only option in-house counsel has upon learning about potential or ongoing fraud, especially if the counsel's work product is used to further the fraud, is to make a "noisy" withdrawal.[9] If counsel chooses to resign, the general counsel or outside counsel should clearly document the measures taken to notify the wrongdoing members of the organization of the illegality of their intended or ongoing conduct, the consequences of that conduct, and the counsel's attempt to deter the conduct.

The Ostrich Defense is Not Available

Despite the lack of a requirement in the model rules for counsel to take affirmative steps to curtail corporate misconduct, the government has viewed a general counsel's failure to speak up as passive acquiescence to the improper behavior. The general counsel's omission could be viewed as an intentional act that provided the green light for corporate misconduct to continue. For example, in the widely publicized "pretexting" scandal involving Hewlett Packard Company (HP) and its former senior legal counsel, Kevin Hunsaker, several HP corporate officers were accused of hiring a team of investigators who used questionable tactics. The evidence showed that the investigators used false pretenses to gain access to personal phone records to spy on HP board members and journalists in an effort to determine the source of leaks regarding confidential details behind HP's long-term strategy.

In a now public e-mail to one of the investigators with the subject line "phone communications—privileged communication," Hunsaker asked the investigator: "How does Ron [an investigator] get cell and home phone records? Is it all above board?" When the investigator revealed his inappropriate tactics—"investigators call operators under some ruse"—Hunsaker replied, "I shouldn't have asked…." While it is true that Hunsaker "shouldn't have asked," he shouldn't have asked for reasons far different than those suggested by his e-mail message. Hunsaker, as HP's senior legal counsel who oversaw the investigative process, should not have directed questions regarding the legality of the investigative procedures to the investigators themselves. When employing an investigator, it is the duty of the attorney, as well as the investigator, to ensure that the investigative tactics are "above board." Hunsaker's tacit approval of the investigators' less-than-above-board tactics led to a felony conviction.

In-house and outside counsel may also find themselves liable for the questionable tactics of investigators hired during the course of litigation. In an Indiana case, counsel for the defendant hired an investigation firm to look into allegations of racial hostility at one of the defendant's facilities.[10] When evidence showed that the investigators had contacted several of the plaintiffs without the consent of the plaintiffs' attorneys and without other legal authorization, the plaintiffs petitioned the court for sanctions against the defendant's attorneys for violations of state ethics laws. In response to the defense attorneys' claim that they did not direct the investigators to initiate the unauthorized contact, the court stated:

> Whether instruction came from [the defense attorney, the lead investigator], or both is not significant to the Court. By all accounts, [the defense attorney] was, at the very least, present when [the lead investigator] instructed the investigators to follow up on previously learned information with Defendant's employees. *By failing to affirmatively instruct otherwise, [the defense attorney] implicitly ratified the instructions [that the defense attorney] alleges were given by [the lead investigator] only.*[11]

Chain Length Away from My Creator
by Jamie A. Wright

Counsel cannot afford to act as a spectator to wrongful corporate conduct. Although good faith is a defense to fraud, as described below, if the facts and circumstances warrant it, the government can nonetheless argue "willful blindness."[12] Counsel cannot close their eyes to an obvious fact. If there is a deliberate effort by counsel to remain ignorant of the misconduct, criminal liability may attach.

There have also been civil cases concluding that an in-house counsel has an affirmative duty to curtail corporate misconduct, even if not required by the model rules.[13]

Available Defenses

Attorneys operating in good faith have a complete defense to fraud. Even if it subsequently turns out that a lawyer was wrong about his or her interpretation of the law, criminal liability will not occur if the lawyer acted honestly and in good faith.[14] An honest mistake in judgment or an honest error in management does not rise to the level of criminal conduct. The burden is not on the attorney to show that he or she acted in good faith.[15] The government has the burden to show that the attorney was not acting in good faith.[16]

The government will have a difficult time sustaining its burden when the evidence shows that the attorney exercised due diligence. Having a record of research conducted before advising the organization, requesting independent advice from an attorney specializing in that area of law, and, when applicable, contacting federal regulatory agencies to ensure that the organization is in compliance with the law will all support a good-faith defense. In addition, the model rules clearly provide that if counsel is unsure whether the conduct is unlawful, he or she should encourage the corporation to seek a separate legal opinion.[17] For example, in *United States v Altiere,* exculpatory evidence at trial included letters sent by a company employee, at the request of in-house counsel, to the American Medical Association inquiring into the proper use of billing codes.[18]

Good faith negates the specific intent required for a fraud prosecution. Prosecutors will often try to prove intent by pointing to financial gain. However, financial motive, by itself, is insufficient to establish intent. In *In re Tyco Int'l, Ltd,* the general counsel allegedly received a $17 million loan from the company.[19] In *Altiere,* the in-house counsel was alleged to have participated in a modest bonus plan offered by the company. The jury rejected financial-gain theories in both *Tyco* and *Altiere.*

Conclusion

The pressure is on corporate counsel to police and detect fraud. General counsel are not only expected to take proactive steps in implementing effective internal controls to guard against fraud, but they may also be legally and ethically obligated to take action once fraud is discovered. Counsel cannot afford to look the other way. Failure to take action may result in the attorney trading in pinstripes for prison stripes. ■

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FOOTNOTES

1. Strassberg, Pitofsky & Schreiber, *Lawyers on trial,* NY L J, July 18, 2005, available at <http://www.goodwinprocter.com/~/media/C1BF11E069FE4E2E-9CA606C99B7B85DE.ashx> (accessed November 18, 2007).
2. See Gardner, *The ties that bind: Rite Aid Corp general counsel Franklin Brown charged with conspiracy to manipulate accounts,* Corporate Counsel, p 17, October 2003.
3. See Johnson, *How employees get hooked on fraud,* The Standard, Opinion Section, March 26, 2005, available at <http://www.thestandard.com.hk/stdn/std/opinion/GC26Df02.html> (accessed November 19, 2007).
4. See Gardner, *supra.*
5. See Miller, *The attorney's duty to reveal a client's intended future criminal conduct,* 1984 Duke L J 582 (1984).
6. See Model Rules of Professional Conduct, R 1.6.
7. Model Rules of Professional Conduct, R 1.13(b).
8. See Harris, *Taking the entity theory seriously: Lawyer liability for failure to prevent harm to organizational clients through disclosure of constituent wrongdoing,* 11 Geo J Legal Ethics 597 (1998).
9. *Id.* at 607 ("Rule 1.16, together with other provisions of the *Model Rules* and comments to the Rules, has been interpreted to allow such 'noisy' withdrawal where the lawyer's work product is being used or will be used to perpetuate a fraud. A lawyer who discovers that her work product has been used to perpetuate only a past fraud is not required to withdraw and not permitted to make a noisy withdrawal even if the harm resulting from the fraud is continuing.").
10. See *Allen v Int'l Truck & Engine,* 2006 WL 2578896 (SD Ind, September 6, 2006).
11. *Id.* at *5 n 8 (emphasis added).
12. Pattern Criminal Jury Instructions for the District Courts of the First Circuit, Rule 2.14 (1998), available at <http://www.med.uscourts.gov/practices/crpji.97nov.pdf> (accessed November 17, 2007).
13. See *FDIC v Clark,* 978 F2d 1541, 1545–1546 (CA 10, 1992) (the defendant lawyers "negligently failed to uncover and prevent" the fraud by failing to investigate claims in a civil lawsuit that the company had engaged in a fraudulent scheme); see also *In re American Continental Corp/Lincoln S&L Securities Litigation,* 794 F Supp 1424, 1453 (D Ariz, 1992) ("Where a law firm believes the management of a corporate client is committing serious regulatory violations, the firm has an obligation to actively discuss the violative conduct, urge cessation of the activity, and withdraw from representation where the firm's legal services may contribute to the continuation of such conduct.").
14. Sixth Circuit Pattern Criminal Jury Instructions, Rule 10.04 (2005), available at <http://www.ca6.uscourts.gov/internet/crim_jury_insts.htm> (accessed November 17, 2007).
15. *Id.*
16. *Id.*
17. See Model Rules of Professional Conduct, R 1.13(b).
18. *United States v Altiere,* 2006 WL 515609 (ND Ohio, March 1, 2006).
19. See Strassberg, Pitofsky & Schreiber, *supra* (discussing *In re Tyco Int'l, Ltd* and Mark Belnick under the heading "Lessons for Prosecutors.").