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Volume 5, Issue 1, April 2008

Corporate Counsel's New Dance Partner: "Criminal Lawyers Teach the Limbo Dance"

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Abstract

One of the unintended consequences of the influx of corporate electronic information is the potential liability it poses for today's corporations. The way companies retain (or in some instances, fail to retain) electronically created information subjects them to not only possible civil but potential criminal liability as well. Magnifying this potential liability are the United States Courts' efforts to modernize the rules of procedure related to discovery. Corporations are well advised to add another set of eyes to the liability issues created by the new technological sophistication. This paper looks at recent developments in the United States and provides some comparisons to European law.

DOI: 10.2966/scrip.050108.168

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1. Introduction

In today's corporate boardrooms the executives and board members who long relied on the civil courts to resolve questionable behavior are now seen as the great unwashed: mere criminals. Even well meaning Board members, acting in a way they believe is consistent with the corporate mandate and obligations look over their shoulder for potential criminal liability. This essay examines another concern which hovers over these corporate boardroom "criminal" worries –electronic discovery ("e-Discovery") -- and offers some suggestions on where companies can turn for stronger guidance. Further, we examine whether the concerns on American shores find their way into an international setting.

2. Analysis

For as long as most can remember, what happened in the American Boardroom stayed in the Boardroom unless the US Securities and Exchange Commission ("SEC") regulators wanted to chat.[1] All things done in the name of corporate activities seem to dance to the same music until the SEC or their brethren thought a company was going too low under the limbo bar.[2] Even when legal action was taken it was almost always resolved with mea culpas, more oversight, and a lot of money.[3] Even where criminal

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[1] Even then, the SEC's enforcement mechanism was seen as lax. See for example, T A Puz, "NOTE: Private Actions for Violations of Securities Exchange Rules: Liability for Nonenforcement and Noncompliance", (1988), 88 *Columbia Law Review*, 610. (The legislative history to the 1975 amendments is replete with congressional concern over SEC passivity in the realm of exchange rulemaking and enforcement, suggesting that the express remedies provided by the 1975 amendments were intended to supplement, rather than to supplant, the availability of private actions. In an expansive study prior to the 1975 amendments, a Senate Committee noted that "the major regulatory problems in the securities industry have not by and large been the result of the SEC's lack of authority but rather "tame watchdog" that exercises its direct supervisory powers over exchanges only sparingly, preferring instead to cooperate with and defer to exchanges in the area of rulemaking. Hence Congress observed that "[s]ixteen different years of amendments make clear Congress' readiness to assure the [SEC] the power to protect investors, but no amount of legislative tinkering can build within the SEC the commitment and vitality to make full use of the tools Congress provides.") And it was not until the early 1980's amendments to the regulations that more enforcement authority was provided. See for example, J D Cox and R S Thomas, "SEC Enforcement Heuristics: An Empirical Inquiry", (2004), 53 Duke Law Journal, 737. (By amending the securities laws in 1984, 1990, and 2002, Congress expanded significantly the SEC's enforcement arsenal).

[2] Available at: http://media.www.isubengal.com/media/storage/paper275/news/2001/11/14/Life/Isu-Caribbean.Steel.Band.Rocks-145825.shtml.

[3] Interview with Roderick Hills, Chairman of the Securities and Exchange Commission from 1975 to 1977, conducted December 20, 2002 available at http://www.sechistorical.org/collection/oralHistories/interviews/hills/hills1222002Transcript.pdf ("You may recall, as is still the case, that the authority of the SEC's Enforcement Division to threaten a case was probably more important than bringing a case..").

charges were threatened, though rarely filed, money, restitution, and fines seemed to assuage all involved.[4]

Since the "go go" days of the 1980's, as portrayed in Oliver Stone's movie, Wall Street, many criminal lawyers heard the distant din of the thunder clouds.[5] The corporate scandals of Michael Milken, Ivan Boesky [6] and Charles Keating[7] were transcended by the Enron,[8] Worldcom,[9] Adelphias[10] and Brocade[11] scandals.[12] The

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[4] D M Weiss, "Reexamining the SEC's use of Obey-The-Law Injunctions", (2006), 7 *UC Davis Business Law Journal*. 239 ("During 2005, the Securities and Exchange Commission ["SEC" or the "Commission"] filed 947 enforcement actions and obtained a record amount of more than $3 billion in penalties and disgorgement. [1]As in any given year, the vast majority of these cases were not litigated but filed as settlements. [2]In addition to money penalties and disgorgement, most SEC settlements levy "obey-the-law" injunctions – injunctions [or consent decrees] against future violations of securities laws in which a perpetrator agrees to "sin no more" or risk contempt of court—as a remedy. The injunction has been a "cornerstone" of the SEC's enforcement program since the Commission's founding in 1934.").

[5] Available at: http://www.lehigh.edu/~ineng/stone/wallstreethome.html.

[6] J K Strader, "White Collar Crime and Punishment: Reflections on Michael, Martha, and Milberg Weiss", (2007), 15 *George Mason Law Review* 45, 60-61: "The government ultimately focused on a novel securities fraud theory, in Milken's case in connection with a 'stock parking' arrangement. Stock parking occurs when one party nominally sells stock to a second party, with the understanding that the second party will sell the sock back to the original owner at a later time…The government theorized that Nilken and Boesky had entered into a stock parking arrangement in order to conceal the Boesky's stake in a company's stock. This arrangement allowed Boesky to avoid publicity disclosing his stake in the filings with the SEC."

[7] S P Green, "Looting, Law, and Lawlessness", (2007), 81 Tulane Law Review 1129, 1139-1140: "…executives are said to have looted corporate bank accounts, while government officials are accused of looting national treasuries or the social security trust fund. A particular notorious example is the so-called looting of savings and loan institutions perpetrated during the 1980s by figures such as Charles Keating."

[8] D Millon, "Who "Caused" the Enron Debacle?", (2003), 60 *Washington and Lee Law Review* 309, 310: "At the heart of the Enron scandal was a group of exceptionally ambitious executives seeking to create a new kind of energy company. At its peak, Enron reported annual revenues of $100 billion and employed over 20,000 employees. *Fortune* ranked the company as high as seventh on its 'Fortune 500' list. We now know, however, that the edifice was an intricate house of cards build on a foundation of sham transactions and accounting manipulations. When the frauds surfaced during the fall of 2001, the structure quickly collapsed, leaving investors, employees, and customers with billions of dollars in loses."

[9] K T Cowart, "The Sarbanes-Oxley Act: How A Current Model in the Law of Unintended Consequences May Affect Securities Litigation", (2004), 42 *Duquesne Law Review* 293, 301: "In June 2002, Worldcom announced $3.8 billion in inflated profits; an announcement which led NASDAQ to force a halt on trading of the company's stock. Former Worldcom executives, Scott Sullivan and Buford Yates, Jr, were indicted on charges of securities fraud for allegedly hiding billions in expenses from investors and auditors. Worldcom's accounting irregularities were ultimately found to be approximately $9 billion. In July of 2002, Worldcom filed for Chapter 11 bankruptcy protection, surpassing Enron as the largest filing in United States history."

[10] *Id* at 302: "Adelphia was a leading cable provider where Chairman and Chief Executive Officer ('CEO') John Rigas, who founded Adelphia, sat on the company's nine member Board of Directors with five other Rigas family members, including his three sons. The Rigas family used their personal money tree, borrowing $2.3 million through various family owned partnerships. Unfortunately, all such transactions occurred off the balance sheets so that shareholders had to means of knowing about the massive borrowing taking place within the company."

hue and cry from individuals financially ruined after years of hard work appeared on the front page of every newspaper and television nightly news program.[13] The "Perp walk,"[14] embattled ex-corporate executives walking into court, seems to be a staple of the nightly news. To assist America's corporations quest to comply, civil firms have opened up entire new areas of practice focusing on corporate governance, compliance and more importantly, the white collar criminal practice specialty, tied to the more traditional business law practice.[15] Rarely in the business lawyer's office would one find a door that said "Criminal Lawyer." Criminal law in the boardroom has come into its own and prosecutors now have a new venue to explore, laws to prosecute, and shareholders to protect.

In days gone by, the American public was interested in Wall Streets goings and comings but they were not overwhelmingly investing their retirement nest eggs on the Corner of Wall and Broad.[16] Enter the American public, who now invest in corporate America to the tune of trillions.[17] It is estimated that nearly 50% of the American public invests in Corporate America through a number of financial vehicles ranging from stocks, bonds and mutual funds, either individually or through their retirement 401K's.[18]

Of course, the Boardroom is not supposed to be run by nefarious criminal minds but corporations with criminal issues may reap significant consequences. One need look no further than the recent alleged criminal activity of Hewlett Packard's former chairwoman, Patricia Dunn, who avoided the original felony charges that stemmed

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[11] D I Walker, "Updating Backdating: Economic Analysis and Observations on the Stock Option Scandal", (2007), 87 *Boston University Law Review* 561, 575: "The potential tax and accounts consequences of revealed option backdating are illustrated by the SEC's complaint filed again executives of Brocade Communication Systems. The complaint alleges, inter alia, that Brocade granted options on two million shares of its stock on October 30, 2001, when in fact the grants were not approved until January of 2002. Brocade's average stock price for January 2002 was $36.56. The price on October 30, 2001 was $24.20. Backdating these options on October reduced the strike price by about one-third."

[12] The Past Enforcement Directors Roundtable, Hosted by SEC Chairman Christopher Cox, Video Webcast Transcript, Original Live Broadcast: Wednesday June 14, 2006, available at http://www.sechistorical.org/collection/papers/2000/2006_0614_SECEnforcement.pdf.

[13] Even years after the Enron scandal broke, it still makes headlines in major United States newspapers: http://www.nytimes.com/2008/02/29/business/29norris.html.

[14] "A slang term describing the police action of parading an arrested suspect in handcuffs before the media" available at: http://www.investopedia.com/terms/p/perpwalk.asp.

[15] Just a few examples from large international law firms: Jenner & Block (http://www.jenner.com/practice/practice_detail.asp?ID=59) and Baker Botts LLP (http://www.bakerbotts.com/departments/practice_detail.aspx?id=3018ad95-672d-4b6b-90a0-1e839e019991).

[16] J.P. Morgan & Company were one of the original occupants of the famous intersection of Wall Street and Broad Street in New York City, source: http://query.nytimes.com/gst/fullpage.html?res=9C05E5D7163AF933A15757C0A9659C8B63.

[17] Overview of United States Financial markets, available at: http://finance.yahoo.com/marketupdate/overview.

[18] Investment Company Institute, Equity Ownership in America (2005), available at http://www.ici.org/pdf/rpt_05_equity_owners.pdf.

from a scheme to illegally acquire other HP board member phone records using a method called pretexting.[19] Ultimately Dunn resigned at the request of the Hewlett Packard Board of Directors because of her unauthorized disclosure of confidential corporate information.[20] When CEO's and Board members make decisions that so deeply affect a large number of Americans financial well being, no stone will be left unturned if questions of impropriety are raised.[21]

As a result of United States corporate misdealing and misdeeds, regulatory changes were introduced in an effort to create transparency and, in theory, reduce corporate malfeasance.[22] Among other regulatory reactions, in 2006 the SEC promulgated revised regulations on executive compensation to make the Boardroom activity more transparent.[23] Everywhere in corporate America, Boards and their legal advisors are evaluating procedures, disclosures, and overall transparency to comply with developing legislation and laws.[24]

The Boardroom, for so long a bunker, is now under increasing scrutiny and subject to greater transparency.[25] As stated in the beginning of this article, activity by corporate Boards, CEOs and upper level management responsible for reporting to the Board is open for deeper scrutiny[26] and those who owe a fiduciary obligation to shareholders find themselves with the potential new label of criminal defendant. It therefore behooves the American Corporate Boardroom to add another watchful set of eyes and ears to listen for potential risks and consequences of Boardroom members' activities. Board members will be well served to involve criminal counsel to sort through and understand what may occur in litigation. For example, a criminal lawyer's experience with e-Discovery is starkly different from their civil counterparts.

Attorneys with white collar crime are steeped in dealings involving economic transactions with millions of potential documents involved in discovery. And, since many white collar crimes are intent crimes which often hinge on circumstantial evidence, understanding how to comb through the mountains of evidence on behalf of the client's case is second nature. From the inception of the white collar attorney's legal careers, they recognize the importance of discovery. Their cases so often

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[19] For Dunn's story, see http://www.marketwatch.com/news/story/charges-against-ex-h-p-chairwoman-patricia/story.aspx?guid=%7B80A6AC3F-5B09-4440-920F-4CD70DDE41D8%7D, for pretexting, see also Remsburg v Docusearch, Inc., 149 N.H. 148, 816 A.2d 1001 (N.H. 2003).

[20] Available at: http://www.hp.com/hpinfo/newsroom/press/2006/060922a.html.

[21] Impact of globalization discussion is worthwhile to note as HP is a global company.

[22] Sarbanes Oxley Act of 2002, available at: http://www.soxlaw.com/.

[23] J S Martin, "The House of Mouse and Beyond: Assessing the SEC's Efforts to Regulate Executive Compensation", (2007), 32 *Delaware Journal of Corporate Law* 481, 487: "The Revised Regulations deal not only with compensation issues, but also with related-party transactions, director independence and corporate governance."

[24] See: "Proxy Voting Guidelines"; Ethos, Swiss Foundation for Sustainable Development, March 2001; download in English, French or German at www.ethosfund.ch.

[25] *See* note 22.

[26] *See* note 22.

depend on "[e]videntiary nuances and related inferences … and often involve numerous documents, many of which are complex financial records and sophisticated corporate materials that can only be fully understood with …..those familiar with the vagaries of the underlying business transactions."[27]

e-Discovery is becoming the norm in both American criminal and civil trials and consequently the electronic stored information from the Boardroom is subject to discovery.[28] The amended Rules seek to streamline the e-Discovery process and resolve ambiguity and uncertainty by requiring parties to address e-Discovery in the earliest stages of litigation. These Rules create new disclosure requirements and standards, new meeting and conference requirements, change or refine the scope of discovery requests, and grant some flexibility in the form of production.[29]

But what should the global corporations of today expect? Companies listed on the American stock exchanges or doing business in the United States already know (or should know) they need to meet the United States e-Discovery requirements. But what do the American corporations with a presence in Europe need to understand? The European Union ("EU") does not have an analogous government agency to the SEC but that does not prevent the EU from regulating activities in the boardroom. For example, competition in the EU is governed by a number of treaties adopted by member states of the EU over the last 60 years.[30] Articles 81[31] and 82[32] of the Treaty establishing the European Economic Community ("EC Treaty") contains anti-competitive provisions analogous to the Sherman Act in the United States.

England is one of the first countries within the EU to address electronic document production. England's Civil Procedure Rules ("CPR") refer to document production as disclosure instead of discovery. In February of 2005, England amended CPR Part 31 Practice Directions ("CPRPD") to account for electronic document production. Despite using different terminology, both the U.S. and the England have some similar provisions in their civil procedure rules. Specifically, each country requires parties to have a document production planning conference. In the United States it is required by FRCP 26(f), in England it is required by CPRPD 2A.2 and 2A.3.

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[27] M S Chan, "Paper Piles to Computer Files: A federal Approach to Electronic Records Retention and Management", (2004), 44 *Santa Clara Law Review* 805, 809.

[28] Available at http://www.uscourts.gov/rules/EDiscovery_w_Notes.pdf.

[29] *See* B Burdett, "Hiding the Inaccessible Truth: Amending the Federal Rules to Accommodate Electronic Discovery", (2006), 25 *The Review of Litigation*, 115.

[30] Treaty establishing the European Coal and Steel Community 1951 ("Treaty of Paris"), Treaty establishing the European Atomic Energy Community 1957 ("First Treaty of Rome"), Treaty establishing the European Economic Community 1957 ("EC Treaty"), Merger Treaty 1965, Budgetary Treaties 1970 and 1975, Single European Act 1986 ("SEA"), Treaty of European Union 1992 ("TEU"), Treaty of Amsterdam 1997 ("ToA") and Treaty of Nice 2000 ("ToN") available at: http://europa.eu.int/eur-lex/lex/en/treaties/index.htm.

[31] *Article 81* available at pg. 32 of 152: http://europa.eu.int/eur-lex/lex/en/treaties/dat/12002E/pdf/12002E_EN.pdf.

[32] *Article 82* available at pg. 33 of 152: http://europa.eu.int/eur-lex/lex/en/treaties/dat/12002E/pdf/12002E_EN.pdf.

Another central difference between England's planning conference rule and the United State's planning conference rule is the timing requirements. England has a relaxed disclosure planning schedule where as the United States has a stringent timeline. Furthermore, much like the United States, England requires a reasonable search for electronic documents. The United States and England are two of the only countries worldwide that have amended their rules of procedure to account for electronically created information.

There are a few differences between the United State's FRCP and England's CPR. The main difference between the two approaches is that the United States FRCP has much more detailed requirements for discovery than England's CPR. Another difference is that absent a prior agreement, in England the losing party pays the winning party's legal fees. In the United States the court might order the losing party to pay the winning party's legal fees as a form of sanctions but parties are not automatically entitled to fee shifting in the United States.

The International Court of Justice ("ICJ") has yet to address the production of electronically created information.[33] ICJ proceedings have two procedural components: written and oral.[34] The written portion is straight forward, the court may request production of documents before the hearing begins.[35] During the oral proceeding, the Statute of the International Court of Justice provides the Court ample latitude with respect to procedure: "the Court shall frame rules for carrying out its function. In particular, it shall lay down rules of procedure."[36] The ICJ does not have any formal rules on e-Discovery.[37] Instead the ICJ grants their judges latitude to rule on e-Discovery disputes.

3. Conclusion

As e-Discovery enters center stage and the latest cases on metadata, spoliation or cost-shifting receive scrutiny, both corporate and criminal lawyers are swarmed by vendors hawking bigger, better and faster document review tools.[38] Yet, even with this awareness, a growing number of corporate lawyers and in-house counsel neglect to

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[33] *Statute of the International Court of Justice*, available at: http://www.icj-cij.org/documents/index.php?p1=4&p2=2&p3=0.

[34] *Id* at Article 43.

[35] *Id* at Article 50.

[36] *Id* at Article 30.

[37] *Id*.

[38] Before the rules were changed, an article describing the corporate counsel response to the anticipated new e-Discovery issues appeared in the magazine "In House Counsel." The GC, in 2005, related that for many corporate counsel they cannot find enough ways to prevent disaster. Presciently, Marathon Oil's General Counsel suggested "…it could be five years before the e-Discovery frenzy calms down and the court offer clear directions on what companies must produce. *Until then [Marathon GC] Kerrigan adds, e-Discovery 'is like planning for Armageddon. No one knows how much is enough.'"* (emphasis ours), In House Attorneys Become IT Gatekeepers, October, 2005 available at http://www.law.com/jsp/ihc/PubArticleIHC.jsp?id=1128342926735.

perform a thorough review of their computer systems creating a significant risk for themselves and their clients. Why? Specifically, when these non-technical corporate attorneys construct policies and practices based only on assumptions about their IT system, the policies and practices can explode and create complex discovery problems in future litigation unnecessarily creating civil and criminal risks for their companies. Corporate counsel cannot rely on reports of how the system was set up to run or how IT staff thinks it runs; counsel must learn how the company's employees actually use the system[39] because reasonableness governs discovery obligations.

Corporate executives need more than just the "run of the mill" governance, compliance and regulatory attorneys; they need attorneys with criminal defense experience and e-Discovery experience. Companies that do not seek out these attorneys's advice for the corporate boardroom expose shareholders to unnecessary risks. In summary, corporate lawyers, both in American and abroad, need learn to collaborate with their criminal attorney brethren to help position companies to design e-Discovery (and other) policies and practices that are defensible. While it remains to be seen how much of the American model will become international, it can certainly be argued to understand and follow the United States trends will keep the international companies one step ahead.

[39] M Browning, "E-Discovery Looks Like Risky Business", *Law Technology News*, October 17, 2007 ("A significant challenge facing the profession is the need to attain sufficient competence to deal with the many deep complexities surrounding EDD.")