

New Reporting Requirements Keep Counsel On Edge

Whistleblower Provision Transforms The CEO–GC Relationship

SEC RULES under the Sarbanes-Oxley Act have been finalized and go into effect this summer. The most troubling aspect for corporate counsel is the new reporting responsibilities, which—in the worst-case scenario—turn lawyers into whistleblowers.

Any practicing lawyer, inside or out, is now required to report material violations of securities laws up the chain to the general counsel. And outside counsel who don't feel the general counsel is responding adequately are obliged to take their concerns to the feds.

A group of 13 in-house counsel from various industries and six law firm partners recently met in New York to discuss this issue, as well as other post-Sarbanes-Oxley reporting concerns.

The session—"Legal Adviser, Business Adviser or Tattler?: Changing Expectations of In-House Counsel"—was part of Martindale-Hubbell's ongoing Counsel to Counsel series that allows law firms' partners and corporate counsel to share ideas and best practices relating to the management of corporate legal departments.

Gray Areas

The conversation opened with an overview emphasizing how vague the new whistleblower regulations can be. To make the point, a participant read one section of the new reporting rules out loud, a feat jokingly compared to a tongue-twisting Dr. Seuss book, albeit one with subpar rhyme and meter:

"Reporting obligation is triggered when an attorney becomes aware of evidence of a material violation which must be 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."

All the participants agreed this sentence is

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so chock-full of value judgments that it renders it useless as a guide. What constitutes credible evidence? What is reasonably likely? Just what is "unreasonable under the circumstances?" There is ample room for interpretation, which is seldom a comfort zone for lawyers.

The overarching fear is that the requirements and their lack of clarity create a barrier between lawyers and businesspeople. If executives fear in-house lawyers will act as whistleblowers, there's a disincentive to consult with the legal department. As a result, the businessperson loses the lawyer's advice, and the lawyer loses the chance to avert a problem and keep the company on the straight and narrow.

Most participants agreed that these fears, while not totally irrational, were overblown.

"I really don't think that this is going to have a chilling effect, except in limited circumstances," said Richard Rowe, a partner in the Washington, D.C., office of Proskauer Rose. "By and large most corporate officers want to do the right thing. They want to go to their lawyers, whether it's the chief legal officer inside or their lawyers outside, and be advised as to what the law is. Our clients just don't want to push, they don't want to do anything that will even come close to raising questions."

However, some did envision specific problems. One worry mentioned was that particularly idealistic outside counsel could present a reporting liability. Sometimes the best advocates have an uncontrollable zealous streak. If such an individual has a genuine disagreement with an in-house counsel over whether there is a material violation, or whether a problem is being handled properly, that lawyer has the responsibility

to report a violation up the chain of command.

Another participant took the reasoning one step further.

"You have to think very carefully about whether you'd go outside at all at an early stage," he said. "You have a much greater risk that things are going to get out of control early on if you bring in outside counsel at the first level."

Art vs. Science

Participants also discussed how best to approach the new reporting rules from a procedural standpoint. Some favored implementing new internal reporting procedures and protocols, while others maintained it's best to deal with these rules in less regimented ways.

"I have always found the informal approach works best," said Kathleen Cully, general counsel of CIFG North America, a financial guaranty company. "Get people talking to each other. To do that, you have

At a Glance: C2C Forum

Legal Adviser, Business Adviser or "Tattler?" Changing Expectations of In-House Counsel

Co-Chairs:

›Peter Altabef, vice president and general counsel of Perot Systems Corp.

›John Gatlin, deputy general counsel of The Gillette Co.

Law Firm Co-Hosts:

›Alston & Bird

›Proskauer Rose

›Wilmer, Cutler & Pickering

Facilitator:

›Deborah McMurray

to be open, reasonably friendly and non-accusatory. Once you do that, they will bring you questions in the very early stages.”

Counsel who favored a less structured approach to compliance felt a formal procedure should come into play only in the case of someone who is determined to do something wrong. Other participants viewed the new rules as a significant baseline shift in governance that merits a complete overhaul of the organizational structure.

“We looked at legal, finance, human resources and the operating units,” said John Gatlin, deputy general counsel of the Boston-based Gillette Co. “The sense was that we needed to develop an interconnection and interdependence between these in order to understand facts, which may lead to a material, reportable issue, in a way that was different than we had gone about it before.

“We formed a high-level committee to map out how we would do business differently, how we would share information and, ultimately, conduct certifications both down the organization and back up to the CEO. The ultimate question of liability is an unknown. But our feeling is that you have to approach it differently and link these formerly independent islands at the corporate level.”

All participants agreed that the challenge in addressing reporting requirements was to foster a culture of collaboration among senior executives amid a strict regulatory environment, which tends to cultivate concealment. Regardless of a company’s size or philosophy, counsel’s difficult responsibility to foresee and prevent problems that inevitably arise remains.



(Clockwise from top left): Peter Altabef, general counsel of Perot Systems Corp.; John Gatlin, deputy general counsel of The Gillette Co.; Alex Alexander, director and senior counsel of Deutsche Bank Americas; Kathleen Cully, general counsel of CFIG Services Inc.; Richard Rowe, partner at Proskauer Rose; and Dale Schreiber, partner at Proskauer Rose.

Building Relationships

In the course of the nearly four-hour meeting, participants discussed at length how these new rules will affect compliance programs and D&O insurance. Underscoring each topic was the importance of constant and effective communication between the legal department and senior management.

Open communication, particularly with the CEO, can be harder in a large corporation than in a small- or mid-sized company, but it remains essential. A weekly meeting to exchange business and legal concerns is a minimum requirement, participants noted,

and hopefully that frequent dialogue will build trust and confidence. Ultimately, the general counsel is most effective when CEOs share their most significant ideas, plans and fears. Then the GC can participate in business deals from the word go, instead of being drawn in at a later date when problems erupt.

The participants also agreed the goal of all these efforts is to prevent inadvertent or aberrant offense on the part of management. There’s little anyone can do to stop someone who is determined to do wrong. It’s just as certain, however, that the dedicated criminal will be caught. There are simply too many systems—old and new—geared to find and catch crooks. The ambition is to prevent dabbling in gray areas and catch the occasional mistake.

In the end, one participant said these reporting requirements demonstrate the need for in-house counsel to seek a balance between being a business enabler and police officer.

“Any reputable in-house or outside counsel understands they have a policeman function, as well as a business promotion function,” he said. “The problem here is not changing expectations of in-house counsel but rather changing perception of the inside counsel or outside counsel role in the minds of our clients. We all have to work out this nice balance. When you do, people start to rethink how much they want to spend time with you in casual conversation about their deepest and innermost thoughts.” ◀