

IN-HOUSE LITIGATOR

THE JOURNAL OF THE COMMITTEE ON CORPORATE COUNSEL

In-House Counsel Beware: Conflicts of Law May Spoil Your Privileges

By *Todd Presnell*

Despite the diligence with which an in-house lawyer may work to establish and protect privileged communications with company managers and employees, the varying scope of the corporate attorney-client privilege combined with the conflicts of law rules applied by state and federal courts may nevertheless operate to destroy the privilege. Consider this not-so-far-fetched hypothetical: Elise Franklin, an in-house attorney for Slovtu, Inc., a Dallas-based manufacturer of industrial filters, travels to meet with Anne Berg, a regional sales manager based in Slovtu’s manufacturing facility in Portland, Oregon. During the meeting, Berg and attorney Franklin discuss the increasingly poor job performance of Berg’s boss, 60-year-old national sales director Tom Mattingly, who is based in Dallas. A few months later, Mattingly is terminated, and he subsequently files an age discrimination suit in Texas. During discovery, Mattingly’s lawyer attempts to depose Anne Berg in Portland about, among other things, her conversation with in-house attorney Franklin. Is this communication protected from discovery? The answer, of course, is it depends. It depends on the interaction between the appropriate scope of the corporate attorney-client privilege and the applicable conflict of law rules.

Corporate Attorney-Client Privilege

In-house counsel are lawyers, too, and corporate employees’ communications with in-house attorneys are subject to the attorney-client privilege. The scope of this privilege, however,

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A Tidal Wave of Federal Enforcement, the Changing Role of In-House Counsel, and the Foreign Corrupt Practices Act

By *Sean O’D. Bosack*

American corporations face an increasingly intense regulatory and enforcement environment. The role of in-house counsel continues to evolve such that in-house counsel are no longer simply legal advisors and advocates. Today, in-house counsel participate in business decisions that transcend their traditional legal support function. In 2002, after a wave of corporate scandals heightened concerns that corporate governance had failed at many high-profile companies, Congress passed the Sarbanes-Oxley Act,¹ the Department of Justice (DOJ) established the Corporate Fraud Task Force, and the DOJ and Securities and Exchange Commission (SEC) made prosecuting corporate fraud one of their top priorities.² Since the enactment of Sarbanes-Oxley, the DOJ and SEC have obtained more than 1,200 corporate fraud convictions against corporations, their executives, and their lawyers.³

These legislative and policy initiatives impose unprecedented responsibility on in-house counsel to detect, prevent, and report misconduct within their corporations. Regulators and prosecutors now view in-house counsel as gatekeepers—corporate America’s first line of defense against fraud and corruption—responsible for ensuring ethical conduct and compliance with the law.⁴ In the past five years, the DOJ and

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COMMITTEE ON CORPORATE COUNSEL

COCHAIRS

Tracey Salmon-Smith

UBS Financial Services, Inc.
51 W. 52nd Street
16th Floor
New York, NY 10019
(212) 882-5725
Tracey.Salmon-Smith@ubs.com

Yuri Mikulka

Zuber and Taillieu LLP
10866 Wilshire Blvd., Ste. 300
Los Angeles, CA 90024
(310) 807-9700
ymikulka@ztlp.com

Robert R. Simpson

Shipman & Goodwin LLP
One Constitution Plaza
Hartford, CT 06103-1919
(860) 251-5515
rsimpson@goodwin.com

EDITORIAL BOARD

Christopher J. Akin, Coeditor

Lynn Tillotson Pinker & Cox
2100 Ross Avenue, Suite 2700
Dallas, TX 75201
(214) 981-3812
cakin@lynnllp.com

Leah M. Gerbitz, Assistant Editor

Miller & Martin PLLC
Volunteer Building
832 Georgia Avenue, Suite 1000
Chattanooga, TN 37402
(423) 785-8372
lgerbitz@millermartin.com

Stephen J. Siegel, Coeditor

Novack and Macey LLP
100 North Riverside Plaza
Chicago, IL 60606
(312) 419-6900
SSiegel@novackandmacey.com

Jeremy L. Ross Esq., Assistant Editor

828 O Place
Anchorage, AK 99501
(907) 301-0393
jeremyledgerross@gmail.com

Holly Loiseau, Assistant Editor

Weil, Gotshal & Manges LLP
1300 Eye Street, NW, Suite 900
Washington, DC 20005
(202) 682-7144
holly.loiseau@weil.com

Franz Hardy, Website Editor

Gordon & Rees LLP
555 Seventeenth Street, Suite 3400
Denver, CO 80202
(303) 534-5160
fhardy@gordonrees.com

ABA PUBLISHING

Jill Tedhams, Designer
Anna Sachdeva, Associate Editor



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Message from the Editorial Board

In this issue of *The In-House Litigator*, Todd Presnell's article titled "In-House Counsel Beware: Conflicts of Law May Spoil Your Privileges" provides an excellent discussion regarding attorney-client privilege issues regularly confronting in-house and outside litigation counsel. The article reminds us that not long ago, on September 19, 2008, a new law was enacted creating Federal Rule of Evidence 502. Rule 502 provides a new framework for determining whether the disclosure of communications covered by the attorney-client privilege or work product doctrine constitutes a waiver of the privilege or protection.

Rule 502 is a response to the dramatic rise in discovery costs in recent years caused by the exponential increase in the number of documents that must be reviewed prior to production as a result of the proliferation of email and other forms of electronic record keeping. Before Rule 502 in some jurisdictions, if a party disclosed a document protected by the attorney-client privilege or the work product doctrine, the privilege or protection could be deemed waived both as to the disclosed document and possibly to all other information related to the same subject matter. Waiver concerns coupled with the increasing volume of documents significantly increased the costs of discovery and litigation.

Rule 502 effectively eliminates subject matter waiver unless disclosure is intentional. Also, Rule 502 codifies the rule existing in most jurisdictions that inadvertent disclosures of otherwise protected communications will not result in waiver if "reasonable steps" were taken to prevent and then correct the disclosure. Further, the rule provides that if documents have been disclosed in a state proceeding, federal courts will apply the most protective rule—either federal or state—to prevent waiver. Last, the rule binds federal and state courts to non-waiver orders issued in any federal proceeding and recognizes the widespread use of clawback and other agreements designed to avoid inadvertent disclosures.

Rule 502 may give some comfort to litigants concerned with inconsistent interpretations of federal common law on waiver, but, on the whole, the rule provides relatively little in the way of waiver law that had not already been established by the courts (the notable exception being Rule 502(d), which extends non-waiver orders in federal actions to any other federal or state proceeding). Thus, while the new rule may encourage litigants to reduce the scope of pre-production document reviews because of diminished concerns regarding waiver, the very serious risk posed by an adversary accessing privileged information still remains. The reality is that disclosed information can still be used to the detriment of the disclosing party even if protected documents are returned promptly.

Diligent litigants at some point must know what protected materials are in their discovery, and nothing in Rule 502 can eliminate the significant expense associated with that process. In the end, in-house and outside counsel must still work together to devise the most efficient, cost-effective methods for discovery with an eye toward both the litigation objectives and the prevention of disclosure of privileged or protected information. ■

Message from the Cochairs

As an outside counsel, I have found that one of the great benefits of the ABA's Corporate Counsel Committee is the opportunity to hear in-house attorneys share their views on important topics. I recently interviewed Jill Dessalines, who is the chief litigation counsel for McKesson Technology Solutions. A full transcript of the interview will be posted on the Corporate Counsel Committee's website (www.abanet.org/litigation/committees/corporate). This interview is an example of what makes our committee special, and we'd like to share portions of the interview with you, our members.

Q. What are your responsibilities at McKesson Technology Solutions?

A. I manage litigation for the company. Last spring, I became the chief litigation counsel for one of our two business units. We have many wholly owned subsidiaries, and we have many business divisions, but they are basically divided into two business divisions: McKesson Distributions Solutions (MDS), which is a pharmaceutical distributions company, and McKesson Technology Solutions (MTS), which is a software company. I am chief litigation counsel for MTS, and I primarily focus on managing litigation for the technology side of the business.

Q. How would you describe your role as chief litigation counsel for MTS?

A. I give litigation advice to the business unit clients within MTS. I hire outside counsel and devise strategy for the resolution of matters. I manage the relationship between outside counsel and our internal business clients. I handle that from both the substantive strategic level and administratively. I manage budgets, as well as high-level strategy for any case that I'm responsible for.

Q. As chief litigation counsel for the MTS software business, what type of cases and issues keep you busy?

A. My case mix is primarily intellectual property related, typically patent cases, some trademark cases, trade secret cases, contract issues, and privacy matters. Health care is a very highly regulated industry, and software is an area of the industry in which there are many changes being played out, many boundaries being stretched from the technological side, and then sometimes the legal side has to catch up with the implications of technology. So you have issues of data security and privacy as well as personal health information.

Q. How many lawyers are in your legal department?

A. Probably around mid-forties. It's interesting how these lawyers are deployed, because Alpharetta, Georgia, is the headquarters of the technology businesses, and then the corporate headquarters is here in San Francisco. So in Francisco, we have a fairly skinny staff. There might be 15, 16, or so lawyers here, and in a few in other cities, but most are in Alpharetta. The needs of the business units are different: MTS has a heavy need for lawyers and staff to manage the contract load. Because of the sales cycle and because of the number of software products we have, they need to have a lot of people devoted to administering those contracts, and those lawyers and legal assistants are in Alpharetta.

One of the things that I also like about managing litigation here is while business unit lawyers are dedicated to their business units, here in the litigation group, we have visibility across the entire company. We're really one of only a very small number of corporate functions that have that sort of breadth of visibility. I think it's absolutely crucial to understand what's going on in all business units to give the finest litigation advice that you can. Our world is getting so much smaller; I think our global financial crisis is a perfect

example of that. And as a result, it's essential to know how you're going to position yourself, not just based upon what one or two business units are doing, but based on all of the business units that might be involved in an issue.

Q. How will the global financial crisis impact your business?

A. Well, I think the most immediate way it will impact the business is that because of the tightening of credit, there is a tightening of spending. And that is, many of our software products are geared toward large users, such as large hospitals, and I think that hospital budgets are notoriously stretched. I think there is a disincentive for some to make large capital outlays, and that is one way it will affect our business. Fortunately, the corporation as a whole is very strong. There have been public filings that demonstrate that we are in very good shape financially. But of course, my point about the global financial situation is that nothing that we do is in isolation anymore. Everything has ripple effects that are larger than the actual actors in any given market segment.

Q. Do you take your BlackBerry when you travel?

A. Sometimes I do. Sometimes I don't. It really depends on what's going on in my work life. Mostly, I do, but what I try to do is to be circumspect about what I respond to, so I may be monitoring emails without actually responding because I find that, you know, the electronic world is nefarious. Once somebody knows that you're actually checking your emails—I don't care what your Out of Office Assistant says—they know you're there. I've had more than one vacation when I've spent half of the day, every day, working. What I try to do is when I'm truly attempting to vacation, I will set time during the day to check messages and try to

stay true to that schedule. Obviously, that's blown out the water if something comes up unexpectedly or if there is some hot case that's brewing that you've got to attend to, but that's one way to try to keep work from overtaking a vacation.

Q. Do you prefer to be able to reach your outside counsel at all times including on vacations?

A. I can be a very demanding client, but I don't think I'm demanding in that way. For example, I don't demand a home phone number or that you be accessible during your vacation. I think it's unhealthy to expect anybody's life to be so one-dimensional that they do nothing but work. But, I have found that many times outside counsel will give you their cell phone numbers and invite you to call them whenever you want. And I usually respect their downtime, so I would only do that during business hours unless there was an emergency. There have been times, however, when I've called outside counsel on their cell phone during business hours and been told that they were sitting out on the beach on vacation. I respect outside counsel's downtime just as I demand that they respect mine. Having said that, there is a big asterisk: that is, you do what you have to do. There are times when it's better to get away—knowing that you're going to have to deal with business issues a lot—than it is not to get away at all.

Q. What is your biggest outside counsel pet peeve?

A. I've got more than one. I say the big no-no is lack of responsiveness and lack of communication. I mean, if I were the type of client that calls people at all hours of the day and night, I could see where they might not take my calls all the time, but because I'm not, if I call somebody, or if I send them an email, I expect a response. Preferably that day, certainly no later than the next day. Even if it's just to say, "I'll find out for you," or "I don't know right now, but I'll get you that information," or whatever. Many times, because of

my functions of liaison between the internal clients and outside counsel, I'm called upon to answer questions, and if I don't know the answer to that question, then that puts me in a bad light and adversely affects my relationship with my clients. One of my other favorite sayings for outside counsel is "If you make me look good, I'll make you look good. If you make me look bad, then we've got problems."

Q. What percentage of your outside lawyers violates that?

A. Well, over time, the percentage is smaller, because I try to be candid about my requests, and when somebody does violate it, I try to call them out on it. And, most of the time, it's not repeated a lot, but I'd say there are probably a good 15–20 percent that have that issue. And, I'd say another one is trying to bill every minute of their living and breathing life. Every waking moment has to create a profit. And by that, I mean profitizing. That's a pet peeve for me. For example, charging for secretarial overtime, or charging for Westlaw service by the minute when you know that you're paying a flat fee.

Q. Do you communicate that to outside counsel at the outset regarding your expectations?

A. Absolutely. It's part of our standard retention agreement and supporting documents. But I find that because of the bureaucracy in law firms, there is often a disconnect between the billing partner and the billing policies of the firm. So, for example, a billing partner might be quite diligent in reviewing the actual time on the pre-bill and making sure it's appropriate, consistent, and reasonable. But, they are not necessarily looking at all at the add-on costs that have become part of that firm's policy to pass on to the client. Sometimes it requires repeated messages until you let them know "You need to talk to your billing department about this." I tell them "You need to decide, as a firm, if this is something that you want to continue

to do, because I'm telling you right now, it's not placing you in a good light, and it's not making it likely that I'm going to use you again." You put it like that and most of the time, they will make the change.

Q. Any other pet peeves?

A. Trying to circumvent me and going directly to the business client when I've not authorized it.

Q. Does that happen often?

A. It has happened in the past, and it's troublesome, especially because it ignores the nature of the relationship between in-house counsel, outside counsel, and the client. I try to be a trusted adviser to my clients, and when outside counsel attempts to interfere with my relationship with my clients, nothing good can come from that.

Q. What can lawyers do in this economic downturn to provide value to their clients?

A. Two things: One, you can think of more creative and economical ways to accomplish goals. Because of firm overhead and hierarchy, firms have not always had the incentive to focus on this. Two, be even more mindful and respectful of your budgets and the economic constraints that your in-house counterpart is experiencing, because they are real. I have never before in 24 years of practice had as much pressure to get budgets, update budgets, and stick to budgets in the face of the uncertainties inherent in litigation than I have now. And so, even though we know litigation is fraught with surprises—many of which are outside of your control since you're only in charge of one of three players of the field (the other two being the judge and the opposing counsel)—you still have to do everything that you can to be clear about what something will cost and try very hard to stick with it as opposed to coming up with the numbers and then forgetting about them as if you never had a budget to begin with. ■

—Yuri Mikulka

IN-HOUSE COUNSEL BEWARE: CONFLICTS OF LAW MAY SPOIL YOUR PRIVILEGES

(Continued from page 1)

varies between the states and between state and federal courts. Generally speaking, two tests have evolved to determine whether a particular corporate employee's communications with in-house counsel are privileged. The original assessment, labeled the control group test, provides that an employee's communications with counsel are privileged if the communication was intended to be and actually was kept confidential, the communication was obtained for the purpose of the in-house lawyer rendering legal advice to the company, and the employee was a corporate decision-maker or otherwise in a position to control or take substantial part in a decision about an action the company may take based upon the in-house attorney's advice.¹ This test is a narrow one, and it only protects from discovery the communications of high-level corporate employees who are in a position to make decisions based upon the advice of the in-house attorney. In the Slovtu hypothetical, Ms. Berg's communication would likely

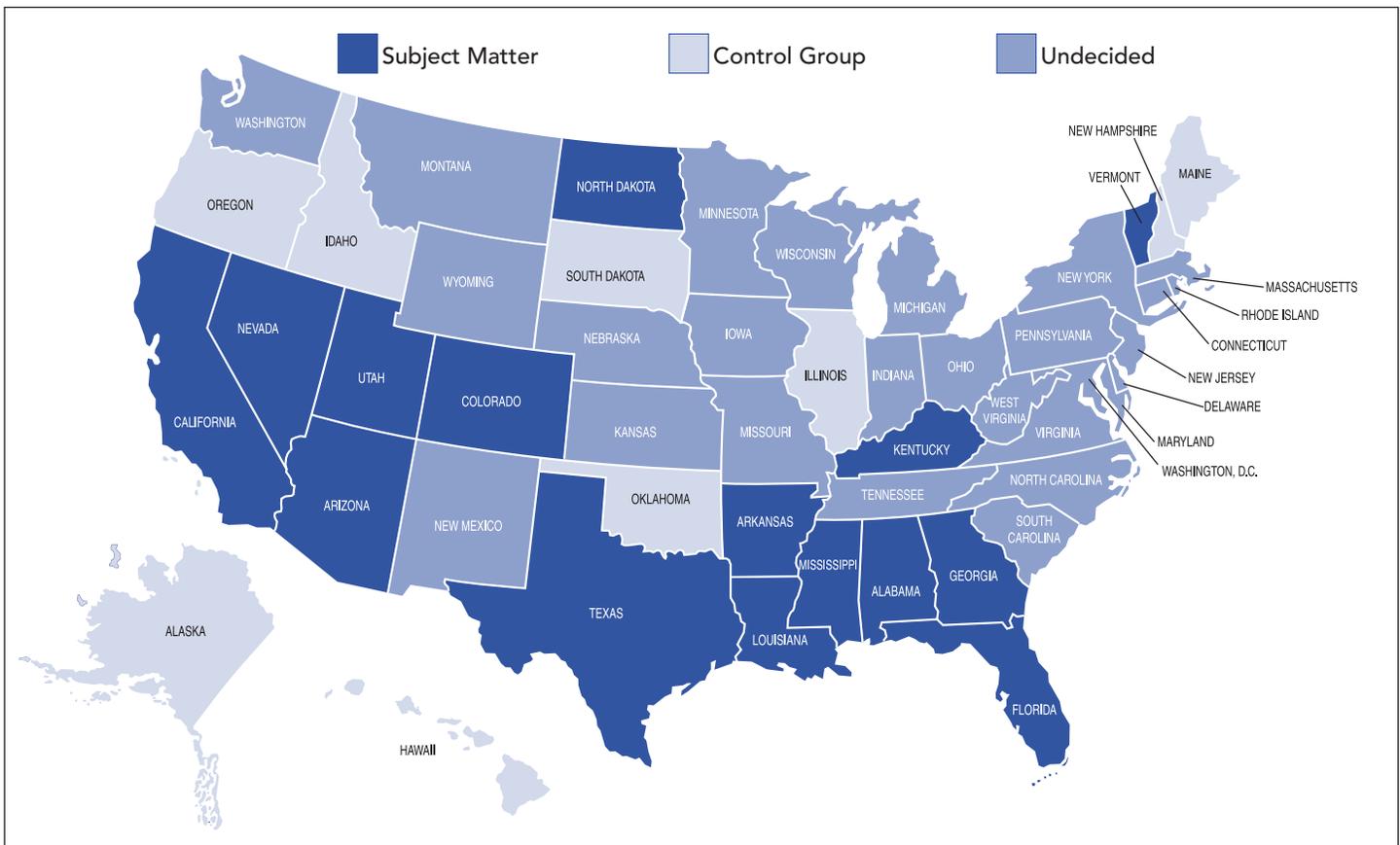
not be privileged under the control group test because, as a regional sales manager, she does not have authority to act on behalf of the corporation upon the advice of counsel.

Following the Supreme Court's decision in *Upjohn Co. v. United States*,² the so-called subject matter test became the more prevalent test to determine whether a corporate employee's communications with corporate counsel are privileged. Under this test, an employee's communications are privileged if it is made for the purpose of the in-house lawyer rendering legal advice to the company, the employee made the communication at the direction or request of his or her supervisor, the subject matter of the communication was within the scope of the employee's duties, and the communication was not copied or forwarded beyond those corporate employees who have a need to know.³ In the Slovtu hypothetical, Ms. Berg's communications would likely be privileged, because her comments to

attorney Franklin fall within the scope of her duties.

The control group test remains valid in a few states, including Alaska, Hawaii, Idaho, Illinois, New Hampshire, Oklahoma, Oregon, and South Dakota. The subject matter test is applied in all federal courts hearing cases under federal question jurisdiction (i.e., where a federal claim is involved) as well as a majority of states. Several states have not directly addressed the issue and therefore remain in the undecided column. For ease of reference, the map below shows the test applied in each of the 50 states.⁴

Regardless of the test that any particular jurisdiction may apply, in-house counsel must continually realize that they operate under a privilege microscope. Because in-house lawyers are perceived, whether real or imagined, as serving a legal and a business function (i.e., the proverbial two-hat theory), courts apply a heightened scrutiny when determining whether a communication to in-house



counsel is privileged. Under this increased scrutiny, courts require the proponent of the privilege to make a “clear showing” that the communication was made for legal rather than business purposes.⁵ The clear showing requirement means that the in-house attorney will need to set forth specific facts that the communication was for a legal purpose.⁶ Returning to the Slovtu hypothetical, the company’s claim of privilege for the Berg-Franklin meeting will be decided, as a threshold matter, on whether the communication was made for the purpose of Franklin rendering legal advice to the company.

Conflict of Law Issues

Conflicts of law may invoke painful memories of studying for the bar examination, but this area of law is critically important to the ultimate application of the corporate attorney-client privilege. The conflicts of law issues in the area of evidentiary privileges become readily apparent when reviewing the Slovtu hypothetical. In this scenario, the privileged communication between Berg and Franklin occurred in Oregon, a control group state, but Mattingly has the option of filing a state-law age discrimination case in a state court in Texas, a subject matter state. If there is diversity jurisdiction, however, Slovtu could remove the case to federal court, a subject matter jurisdiction. Alternatively, Mattingly could file a federal law age discrimination case in a Texas federal court, but he could also add supplemental claims under Texas law. The question, therefore, is whether the Berg-Franklin communication will be analyzed under Oregon, Texas, or federal law.

State courts have issued differing conflicts of law rules in tort and contract cases; unfortunately, however, courts have not been as prolific in deciding conflicts of law matters in the area of the attorney-client privilege. While a few states have an amalgam of choice of law rules, most states that have decided the conflicts of law issue with respect to evidentiary privileges follow either the “territorial approach” or the “most significant relationship” test. The territorial approach, as set forth in § 597 of the *Restatement (First) Conflict of Laws*, provides that the law of the forum determines the

admissibility of evidence. In tort cases, this rule mandates that the law of the state where the tort occurred governs. In contract cases, this rule holds that the law of the state where the contract was signed or was to be performed controls. In the context of evidentiary privileges, the law of the state where the action is pending would control. This rule appears to be followed in Alabama, Alaska, Arkansas, Nevada, and Virginia. Other states, including Connecticut, Georgia, Kansas, New Mexico, and South Carolina, have not specifically decided this issue but apply the territorial approach to other choice of law questions and, therefore, would likely follow this approach on the choice of law issue for evidentiary privileges.

While the territorial approach is simplistic, the most significant relationship approach requires a more detailed, complex analysis. This approach, enunciated in §139 of the *Restatement (Second) Conflict of Laws*, favors admission of communications. Under this approach, evidence that is not privileged under the law of the state that has the most significant relationship to the communication will not be admitted even if the law of the state where the action is pending considers the communication to be privileged, unless the admission of the evidence would be against the “strong public policy of the forum.”⁷ Similarly, evidence that is privileged under the law with the most significant relationship to the communication will nevertheless be admitted if the communication is not privileged under the law of the state in which the action is pending, unless “there is some special reason why the forum policy favoring admission should not be given effect.”⁸

These counterintuitive paragraphs can be abridged by saying that (1) a communication will be admitted if the state with the most significant relationship allows it; however, (2) if the law of the forum state permits the discovery and admission of a communication, then the communication will be admitted even if the law of the state with the most significant relationship provides that the communication is privileged. The only exception to the second provision is that “countervailing reasons” may negate this rule and preclude admission of the communication. These reasons

include the number and nature of the contacts in the forum state, the degree of relevance of the evidence sought to be precluded, the type of privilege involved, and fairness to the parties.⁹ Importantly, courts should be “more inclined to give effect to a privilege if it was probably relied upon by the parties.”¹⁰

In sum, this test utilizes the most significant relationship to determine whether to admit a communication between a corporate employee and an in-house attorney, but does so in a way that favors admission of the communication. For in-house counsel, who are already highly scrutinized in the area of privileges, this rule provides little reassurance that their communications will be precluded from discovery and trial. Unfortunately for in-house counsel, this test is applied in a majority of the states that decided the issue, including California, Colorado, Delaware, Florida, Illinois, Iowa, Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, New York, Ohio, Pennsylvania, Texas, Utah, Washington, and Wisconsin. Several states have not decided the conflicts of law issue with respect to evidentiary privileges but follow the approach of the Restatement (Second) in other areas and, therefore, would likely do so in a privilege analysis. These states include Arizona, Hawaii, Idaho, Indiana, Kentucky, Louisiana, Missouri, Montana, Nebraska, New Hampshire, New Jersey, North Carolina, North Dakota, Oklahoma, Oregon, Rhode Island, South Dakota, Tennessee, Vermont, West Virginia, and Wyoming. The illustration on the following page summarizes the approach taken by the various states.¹¹

The conflict of law rules in federal courts add another layer of analysis. When a federal court entertains a case under federal question jurisdiction, then the court will employ the *Upjohn* subject matter test to determine whether the corporate attorney-client privilege applies.¹² If the court entertains a state-law case under diversity jurisdiction, however, then the federal court will look to the law of the state in which it sits to determine whether the attorney-client privilege applies, including that state’s choice of law rules.¹³ In other words, the

federal court will first look to its home-state conflict of law rules to determine which state's privilege law should be applied.

An interesting issue arises when a plaintiff includes supplemental or pendent state law claims to a federal cause of action. In the Slovtu situation, this would involve Mattingly filing suit in federal court, alleging violations of the federal and Texas age discrimination statutes. The question is whether the privileged nature of the Berg-Franklin meeting would be decided under federal law (because there is a federal claim) or state law (because there is a state-law claim). Rule 501 is not clear on this issue.¹⁴ Most federal courts, however, apply federal privilege law even when state law claims are involved.¹⁵ This is especially true when the federal law does not recognize a privilege even if the applicable state law would recognize the privilege.

A return to the Slovtu hypothetical illustrates the operations of these rules. If Mattingly files suit in a Texas federal court, asserting only a claim under the Federal Age Discrimination Act, then the

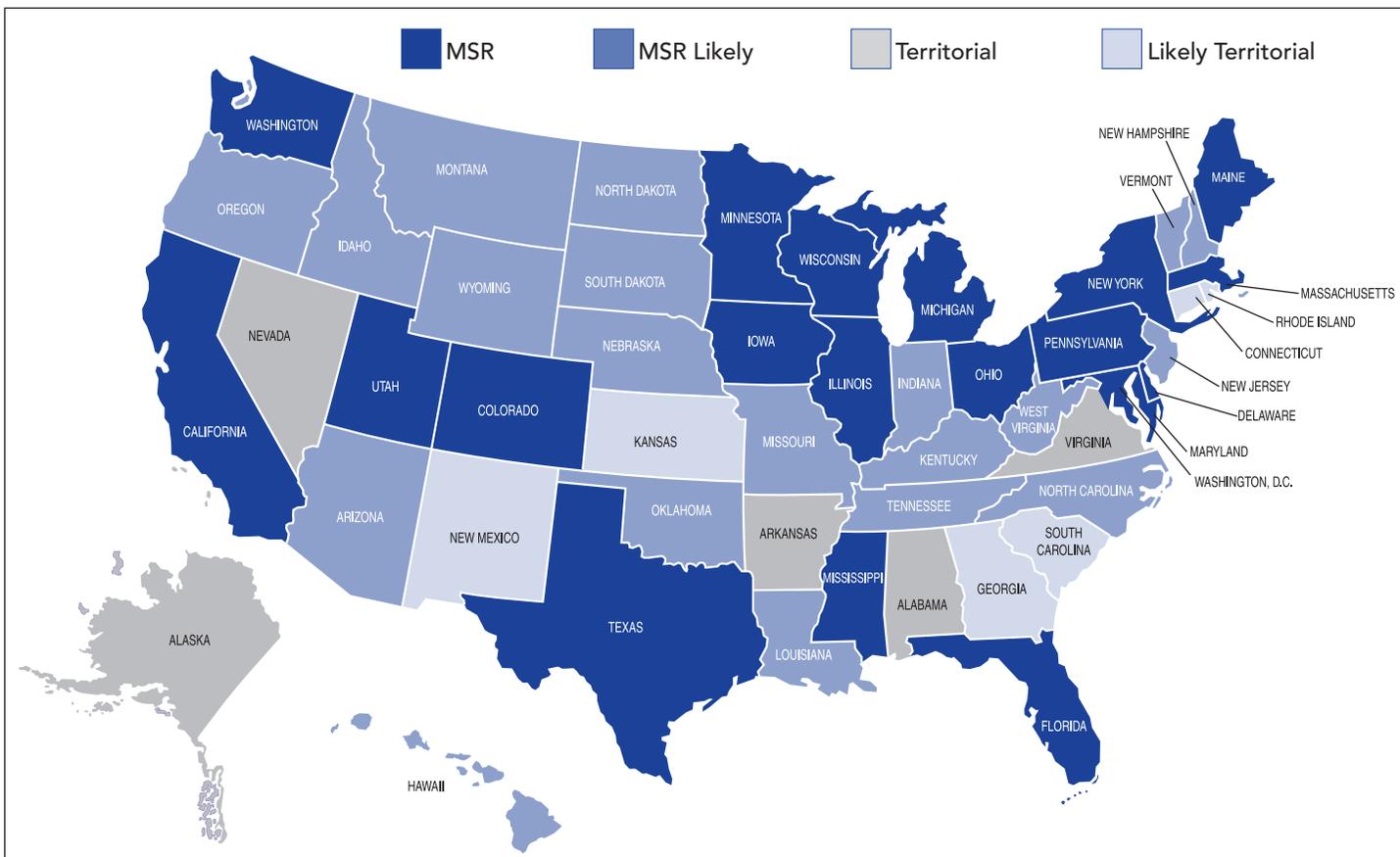
court will apply federal law—the subject matter test—and likely find that the Berg-Franklin communications are covered by the corporate attorney-client privilege. If Mattingly also includes an age discrimination claim under Texas law, the federal court will likely look to federal privilege law rather than looking to Texas's choice of law rules as to whether to apply Texas or Oregon state privilege law.

If Mattingly files a purely state-law age discrimination claim in a Texas state court, the privilege question becomes tricky. Oregon, where the Berg-Franklin communication occurred, is a control group state, whereas Texas, where the claim is filed, is a subject matter state. Thus, the decision of which state's law applies will determine whether this communication is privileged. To answer this question, the Texas court will look to its conflict of laws rules. Texas follows the most significant relationship (MSR) test¹⁶ and, therefore, will analyze whether Oregon has the more significant relationship to the communication to Texas. Assuming the answer is yes, then the Texas court will use Oregon's control group test

and likely find the communication not to be privileged. Thus, the communication will be discoverable in the Texas action—even though the communication would likely be privileged under Texas's subject matter test—unless the Texas court finds that there is some special reason for the communication not to be discoverable.

Practice Tips

The application of the control group test or the subject matter test will depend upon the type of claim (federal or state) that is asserted, the state in which the claim is asserted, and whether the claim is filed in federal court or can be removed to federal court. In any given case, however, a communication between an in-house lawyer and a corporate employee will not be challenged or reviewed by a court until months, and likely years, after the communication was made. Thus, it is at best difficult to know, at the time the communication is made, whether a challenge to its privileged status will be made in state or federal court or, because of conflicts of law



rules, will be analyzed under the control group or subject matter test.

What is the in-house practitioner to do? While there is no absolute answer to this question, some practice tips are noteworthy. First, in-house counsel must recognize that their communications will be more strictly scrutinized by the courts and, consequently, they must diligently and consistently ensure that their communications with corporate employees are in fact for the purpose of rendering legal advice rather than for business-related purposes. Regardless of whether the control group or subject matter test is involved, if there is little evidence of the legal reason for the communication, then the privilege will not apply.

Second, in-house counsel should attempt to predict as much as possible whether the potential claim that may arise from the subject matter of the communication will be filed in a federal court. For example, many wage and hour

hopefully the corresponding illustrations will aid in that endeavor.

Finally, in-house lawyers should consider including a specific choice of privilege law provision in the company's contracts. Many times, whether in a business agreement or an employment agreement, companies include general choice of law provisions in their contracts. Although there is relatively little law on the subject, these general provisions likely will not suffice to require a court to apply the privilege law of the chosen state rather than its state's own conflict of law rules. The court's decision in *Hercules, Inc. v. Martin Marietta Corp.*¹⁷ is constructive. In this case, Hercules and Martin Marietta were in a contract dispute, and Martin Marietta sought to discover documents that Hercules claimed were protected by the accountant-client privilege. Although most of the activities arising under the contract were performed in Utah, the case was filed in a Colorado federal court, and the contract between the parties included a choice of law provision designating Colorado law as the governing law. As to the accountant-client privilege, Utah did not recognize the privilege, but Colorado did. The question, therefore, was whether the choice of law provision in the contract included a choice by the parties that Colorado law would govern privilege questions. This issue was dispositive as to whether the documents would or would not be produced.

The choice of law provision provided that "[t]he contract shall be governed by, subject to, and construed according to the laws of the State of Colorado."¹⁸ Hercules therefore argued that this provision governed the discoverability of the documents and, because Colorado recognized the accountant-client privilege, the documents were privileged. The court, however, found that the clause pertained to the interpretation of the contract itself and that "[n]othing in the express terms of the contract applie[d] to the law of privileged communications."¹⁹ The court further noted that the choice of law provision did not "take into consideration the specific contract terms, the relevant evidentiary events, or the justification for application of any privilege."²⁰ Accordingly, the court rejected the Colorado choice of law

provision, found that Utah law applied, rejected Hercules's claim of privilege, and ordered that the documents be produced.

The lesson to be learned is that general choice of law contractual provisions will likely not be construed so broad as to govern application of evidentiary privileges. Thus, the in-house lawyer should consider adding specific language to the choice of law provisions in all contracts that provide that the law of the chosen state (i.e., the state with the broadest privilege application) will apply to all matters of privileged communications and documents. ■

Todd Presnell is a member in the Nashville office of Miller & Martin PLLC. He may be reached at tpresnell@millermartin.com.

Endnotes

1. *See, e.g., Hercules, Inc. v. Exxon Corp.*, 434 F. Supp. 136, 145 (D. Del. 1977).
2. 449 U.S. 383 (1981).
3. *See id.* at 386; *Diversified Industries, Inc. v. Meredith*, 572 F.2d 596 (8th Cir. 1978).
4. Please contact the author for specific case or rule citations.
5. *See In re Sealed Case*, 737 F.2d 94, 99 (D.C. Cir. 1984).
6. *See North Carolina Electric Membership Corp. v. Carolina Power & Light Co.*, 110 F.R.D. 511, 515 (M.D.N.C. 1986).
7. RESTATEMENT (SECOND) CONFLICT OF LAWS § 139(1).
8. *Id.* § 139(2).
9. *Id.* cmt. d.
10. *Id.*
11. Please contact the author for specific case or rule citations.
12. FED. R. EVID. 501; *Reed v. Baxter*, 134 F.3d 351, 355 (6th Cir. 1998).
13. FED. R. EVID. 501; *Samuelson v. Susen*, 576 F.2d 546, 549 (3d Cir. 1978).
14. *Jaffee v. Redmond*, 518 U.S. 1, 15 n.15 (1996) (noting the disagreement concerning the proper rule in cases where "evidence would be privileged under state law but not federal law").
15. *See, e.g., von Bulow v. von Bulow*, 811 F.2d 136 (2d Cir. 1987); *Pearson v. Miller*, 211 F.3d 57 (3d Cir. 2000); *Hancock v. Dodson*, 958 F.2d 1367 (6th Cir. 1992).
16. *See Ford Motor Co. v. Leggat*, 904 S.W.2d 643 (Tex. 1995).
17. 143 F.R.D. 266 (D. Colo. 1992).
18. *Id.* at 268.
19. *Id.*
20. *Id.*

In-house lawyers should consider including a specific choice of privilege law provision in the company's contracts.

claims and intellectual property claims are filed in, or are removed to, federal court. Thus, if the in-house lawyer's communications with an employee pertain to these potential claims, then the lawyer may feel more comfortable that federal privilege law will apply. Similarly, if the claim about which the communication is made pertains to a tort or breach of contract matter, then there is a better chance that these claims will be filed in state court where the conflicts of law rules will be more unpredictable. In these situations, the in-house lawyer should act under the assumption that the privilege will not apply and govern subsequent communications and documentation accordingly. The ability to predict is admittedly difficult, but the in-house lawyer will be better-served by making an attempt, and

A TIDAL WAVE OF FEDERAL ENFORCEMENT, THE CHANGING ROLE OF IN-HOUSE COUNSEL, AND THE FOREIGN CORRUPT PRACTICES ACT

(Continued from page 1)

SEC have initiated action against more than 50 in-house counsel.⁵ At least 24 of these have settled with the government or pled guilty, and 10 have been found guilty.

The DOJ's and SEC's recent commitment to aggressive enforcement of the Foreign Corrupt Practices Act (FCPA) underscores these trends. Although enacted in 1977, FCPA enforcement activity was largely dormant for almost 30 years.⁶ Since 2003, however, enforcement activity has increased exponentially. In 2007 alone, the DOJ and SEC together initiated 38 FCPA cases. Aggressive FCPA enforcement presents daunting challenges to in-house counsel, including overcoming a general sense of naïveté that still permeates many companies. Many management teams do not appreciate the fact that their companies may be at considerable risk.⁷

In-house counsel should anticipate that government investigators will assume that they are knowledgeable about their companies' overseas activities. They should also anticipate that they will be among the first to be questioned in the event of a government investigation and that they could be prosecuted if evidence suggests they ignored red flags signaling questionable conduct in their companies' foreign business practices. The SEC has recently announced that its FCPA enforcement activity will likely become more intense, and fines and penalties will increase. In addition, its staff members must carefully consider the role of "gatekeepers"—specifically lawyers—when contemplating any enforcement activity.⁸

In-house counsel should expect a continuing wave of enforcement activity and be prepared to effectively manage the risks it presents. In-house counsel must understand the government's enforcement trends, what the FCPA prohibits, and the manner in which a corporation's business practices could conflict with the FCPA. Recent FCPA enforcement activity reveals that exposure for corporations and their counsel can be minimized through robust, well-documented, and aggressively enforced compliance programs, reinforced by vigorous due diligence.

The Foreign Corrupt Practices Act

The FCPA was enacted in 1977 in response to large-scale questionable or illegal payments being made by American corporations to foreign government officials, politicians, and political parties to secure favorable action related to their businesses in those countries. The DOJ and SEC share enforcement duties with respect to FCPA violations. The government has targeted companies of all sizes,⁹ and the DOJ has assigned more than a dozen prosecutors and FBI agents exclusively to FCPA investigation and prosecution.¹⁰

The FCPA has two primary components: anti-bribery provisions and accounting provisions. Under the anti-bribery provisions, it is illegal to willfully or corruptly¹¹ offer, authorize, promise, or pay anything of value¹² to foreign officials¹³ to obtain or retain business. The accounting provisions require every "issuer" to maintain books and records that accurately reflect the expenditures of the issuer in a manner that establishes that payments are authorized by management and facilitate the preparation of financial statements in accordance with generally accepted accounting principles.¹⁴ Liability under the accounting provisions does not require proof of an improper payment. Rather, a company may be liable if it is unable to effectively account for a transaction that looks suspicious.¹⁵

Jurisdiction for the FCPA is broad. The anti-bribery provisions contain both territorial-based and nationality-based jurisdictional hooks. Territorial-based jurisdiction captures virtually any person or entity, U.S. or foreign, that uses any instrumentality of interstate commerce in furtherance of an improper offer or payment, and any foreign company or individual that commits any act in furtherance of an improper payment or offer while in the United States.¹⁶ Nationality-based jurisdiction captures any act of a U.S. person or an entity outside the United States in furtherance of an improper payment.¹⁷ Jurisdiction under the accounting provisions is more limited in scope as those

provisions apply only to "issuers," i.e., U.S. and foreign entities whose securities are registered in the United States and entities that are required to file reports with the SEC.¹⁸

There are exceptions and affirmative defenses to FCPA liability. An exception exists for so-called "grease" payments. Grease payments are those designed to expedite routine government actions, such as obtaining permits, licenses, or official documents. They will not trigger liability provided the defendant can establish that the payments are not intended to induce a foreign official to abuse his authority to show favoritism toward the payor.¹⁹

The FCPA establishes two affirmative defenses with respect to the anti-bribery provisions. First, a defendant can avoid liability by proving that an offer or a payment was lawful under the written laws of the foreign country.²⁰ Second, liability may be avoided if the payment was a "reasonable and bona fide expenditure, such as travel and lodging expenses" and was directly related to the "promotion, demonstration, or explanation of products or services," or performance of a contract.²¹

The penalty provisions of the FCPA are severe. Individuals can be sentenced to a maximum of 20 years in prison and fined up to \$5 million for accounting violations, and up to 5 years in prison with fines up to \$100,000 for anti-bribery violations.²² Corporations can be fined up to \$25 million for accounting violations and up to \$2 million for violating anti-bribery provisions.²³ Civil sanctions may include monetary penalties, disgorgement of profits, and injunctive relief, including debarment from government contracting and loss of export privileges.²⁴

Recent Enforcement of the FCPA and Government Objectives

The DOJ and SEC have initiated FCPA enforcement actions against a broad spectrum of companies. Companies and executives have been held liable for the conduct of foreign and domestic subsidiaries, joint venture partners, consultants, subcontractors, and distributors, and

significant fines have been imposed in the context of mergers and acquisitions where violations have been discovered during due diligence.

AGA Medical Corporation

In 2008, AGA Medical Corporation (AGA), a privately held medical device company with approximately 330 employees, agreed to pay a \$2 million criminal penalty as part of a deferred prosecution agreement with the DOJ.²⁵ According to the charging document, AGA employees made improper payments to doctors employed by government-owned hospitals through AGA's local Chinese distributors. The government also alleged that AGA, through local distributors, made payments to government officials to secure patents. AGA voluntarily disclosed the payments, and as part of the deferred prosecution agreement, AGA agreed to implement enhanced compliance policies and procedures and to engage an independent corporate monitor for three years.

This case is significant for several reasons. First, AGA is a privately held company whose management may not have perceived any FCPA risk. Second, the illegal payments were made by independently owned Chinese distributors. Unlike salespeople or consultants who are typically treated as agents of the company for whom they work, many distributors are independent companies that buy products from manufacturers and, in turn, offer them for resale in their own country

under their own name and their own terms. As a result, they typically are not subject to the same scrutiny under compliance policies as the company's sales representatives or consultants. Third, this case illustrates the challenges associated with determining whether the "grease payment" exception applies to certain payments associated with obtaining government licenses or official documents. The government alleged that, under the FCPA, certain payments to members of the State Intellectual Property Office for purposes of securing patents that may have been viewed by the company as routine payments to expedite government action were illegal. Finally, the deferred prosecution agreement requires the company to hire an independent monitor—a measure demanded by the government in almost all cases—which results in substantial additional costs to the target company.

Faro Technologies, Inc.

In June 2008, Faro Technologies, Inc. (Faro), a Florida-based software and computer device manufacturer, entered a deferred prosecution agreement with the DOJ under which it agreed to pay a \$1.1 million criminal fine and to employ a monitor for two years in connection with bribes paid to Chinese government officials.²⁶ The DOJ alleged that Faro paid "referral fees" to employees of state-owned businesses through its Shanghai subsidiary to secure business. The DOJ also alleged that Faro routed

payments through a shell company and entered into bogus service contracts with an intermediary who invoiced Faro for the amount of the bribes and the services associated with facilitating the payments. Also in June 2008, Faro settled a SEC civil enforcement action associated with Faro's alleged failure to accurately account for the payments and to maintain sufficient internal controls. As part of its settlement with the SEC, Faro agreed to pay \$1.85 million in disgorgement penalties and interest.

Faro's case illustrates the need for companies and their counsel to carefully analyze the real purposes of their agreements with—and payments to—consultants. Such payments may be prevented if a company's accounting and compliance personnel carefully scrutinize its relationships with intermediaries.

Schering-Plough Corporation

In 2004, Schering-Plough Corporation settled charges brought by the SEC, alleging violations of the FCPA accounting provisions associated with approximately \$76,000 of donations by the company's Polish subsidiary to a legitimate charitable foundation in Poland.²⁷ The SEC alleged that the Polish subsidiary made the contributions to induce the charitable foundation's director, a doctor employed at a government-owned facility, to encourage government-owned hospitals to purchase Schering-Plough's products. The SEC alleged that Schering-Plough did not accurately account for the donations. Schering-Plough was required to employ an independent consultant to evaluate and enhance the company's FCPA compliance practices. This case illustrates that payments that may not have triggered alarm bells within the company (e.g., donations to what appears to have been a legitimate charity) can result in liability if made at the behest of a foreign official.

Syncor International Corporation and Monty Fu

A series of enforcement actions involving California-based Syncor International Corporation (Syncor) and its founder, Monty Fu, are similarly illustrative. In December 2002, the SEC settled

Practice Tip for Young In-House Lawyers

"What would you do if this were your company?"

What seems like a basic question is one that some outside attorneys fail to answer. When seeking advice from outside counsel, make sure that you receive actual guidance beyond the 30-page memo with an analysis of both sides of an issue. A good outside counsel will analyze the risks, provide you with a concrete course of action, and then stand behind that decision if called to do so at a later point in time. Treat the relationship like a partnership—one where your outside attorney is just as invested as you are in the ultimate decision-making process.

—*Sherrese M. Smith, Vice President and General Counsel,
The Washington Post Company, Washington, D.C.*

enforcement proceedings against Syncor for violating both the anti-bribery and accounting provisions of the FCPA.²⁸ The SEC alleged that between the mid-1980s and 2002, Syncor's foreign subsidiaries made illegal payments to doctors employed by government-owned hospitals to induce the hospitals to buy Syncor's products and services. The SEC also alleged that Syncor violated FCPA accounting provisions by booking the payments as "advertising and promotional" expenses and that the company failed to maintain sufficient internal controls. Syncor agreed to pay a \$500,000 civil monetary penalty and to retain a monitor.

Syncor's Taiwanese subsidiary pled guilty to one count of violating the anti-bribery provisions and agreed to pay a \$2 million fine. Later, in September 2007, the SEC settled accounting charges against Fu, Syncor's founder and former chairman. The SEC alleged that he had the authority and ability to make sure that the company maintained compliance with existing accounting controls and to ensure that Syncor Taiwan recorded payments in compliance with the accounting provisions of the FCPA, but recklessly failed to do so.²⁹

These actions confirm that foreign subsidiaries of U.S. companies can be held criminally liable for activity that occurs outside the United States. Further, Fu, who was not alleged to have had any direct involvement in the scheme, was sanctioned by the SEC because he failed to prevent FCPA violations from occurring on his watch. These FCPA violations were discovered during due diligence in a transaction in which Syncor was being acquired by a larger firm who voluntarily disclosed the problems to the government.

Titan Corporation

In March 2005, Titan Corporation pled guilty to a three-count information that alleged both anti-bribery and accounting violations³⁰ and settled a civil enforcement action with the SEC.³¹ The violations were discovered and disclosed to the government during due diligence performed by Lockheed Martin and Titan during an ultimately unsuccessful acquisition of Titan by Lockheed Martin.³² The government alleged that a senior U.S.-based Titan official authorized donations

to the reelection campaign of the president of Benin to enable Titan to win telecommunications contracts.³³ The government also alleged that Titan falsified documents filed with the U.S. government and underreported commissions paid in Europe and Asia. As part of its guilty plea and civil settlement with the SEC, Titan paid a total of \$28.5 million in fines and penalties and agreed to retain an independent monitor to evaluate its compliance program going forward.

The Titan case demonstrates that thorough due diligence investigations probing target companies' overseas operations can uncover problems and minimize the acquiring company's exposure. For Lockheed Martin, such an investigation allowed the company to call off the acquisition so that it did not acquire certain liabilities and risks. As for Titan, not only was it subjected to massive fines and penalties, but it also lost what could otherwise have been a profitable business combination with Lockheed.

Most of the FCPA enforcement actions discussed above are not headline-grabbing cases involving high-profile companies. This is exactly the point. These cases illustrate that the DOJ and SEC are aggressively pursuing actions against smaller companies, involving smaller payments, and involving conduct that, on its face, may not shock the conscience and may have been perceived by management as legitimate. They also illustrate that a primary objective of the government's enforcement programs is to create an environment in which corporations and their management take responsibility for implementing rigorous internal controls that ensure compliance with the FCPA. These cases provide in-house counsel with examples that the FCPA poses a real, not just a hypothetical, risk.

Understanding the Government's Enforcement Criteria

Effective management of FCPA risk requires that in-house counsel understand the substance of the FCPA and the analytical process undertaken by federal prosecutors when deciding whether to charge business organizations with crimes. The United States Attorney's Manual instructs prosecutors to consider certain factors

when deciding whether to initiate criminal charges against businesses.³⁴ In-house counsel should view these factors as questions to which they will be required to provide satisfactory answers to minimize corporate exposure and persuade the government that they have effectively discharged their gatekeeping functions.

The factors include (1) the nature and seriousness of the offense, including the risk of harm to the public; (2) the pervasiveness of wrongdoing within the corporation, including the complicity in, or condemnation of, the wrongdoing by corporate management; (3) the corporation's history of similar conduct, including prior criminal, civil, and regulatory enforcement; (4) the corporation's timely and

[T]he DOJ and SEC are aggressively pursuing actions against smaller companies, involving smaller payments, and involving conduct that, on its face, may not shock the conscience.

voluntary disclosure of wrongdoing and its willingness to cooperate in the investigation of its agents; (5) the existence and adequacy of the corporation's pre-existing compliance program; (6) the corporation's remedial actions, including efforts to implement an effective corporate compliance program or to improve an existing one, to replace responsible management, to discipline or terminate wrongdoers, to pay restitution, and to cooperate with the relevant government agencies; (7) collateral consequences, including disproportionate harm to shareholders, pension holders, and employees not proven personally culpable, and impact on the public arising from the prosecution; (8) the adequacy of the prosecution of individuals responsible for the corporation's malfeasance; and (9) the adequacy of remedies, such as civil or regulatory enforcement actions.³⁵

In October 2008, the SEC issued its own enforcement manual, which sets forth detailed standards and procedures to be followed by SEC enforcement attorneys and staff.³⁶ It requires SEC personnel to consider, among other things, whether “gatekeepers,” such as accountants or attorneys, were involved in the alleged misconduct.

Applying the factors for prosecuting business organizations to the enforcement actions highlighted above is instructive. The resolution of each case illustrates the

Compliance programs must be vigorously enforced, as the government will carefully evaluate how corporations discipline offenders.

premium the DOJ and SEC place on effective compliance programs. In each case, the government required the companies to retain compliance monitors following resolution of the enforcement action. Further, most of the cases discussed above involve voluntary disclosure of violations by the company. In each instance, the illegal conduct had been underway for several years before individual offenders were disciplined and the violations were detected and reported. In most of the cases, the government concluded that internal controls were deficient and that senior management knew or should have known about the conduct. The government penalized the corporation in each case.

More robust and aggressively enforced compliance programs focused on detecting FCPA violations could have placed the sanctioned companies in a position to negotiate more favorable settlements with the government. The companies might have detected suspicious conduct before violations occurred. Likewise, the companies might have identified and disciplined offending persons sooner and so persuaded the government that it should punish the individuals but not the company.

Effective Risk Management Compliance Programs

Comprehensive and aggressively enforced compliance programs are essential to effectively manage the risks associated with corporate fraud and corruption. Compliance programs must have strategic structural and process-based components as well as tactical elements tailored to the unique risks facing each company based on its business. The United States Federal Sentencing Guidelines (the Guidelines) provide insight into elements that may persuade the government that a corporate compliance program passes muster.³⁷ Chapter 8 of the Guidelines is used by courts to evaluate corporations for the purpose of imposing penalties at sentencing. This chapter was modified by the Sentencing Commission in response to Sarbanes-Oxley, which required it to review and amend the Guidelines to ensure that they are sufficient to deter and punish organizational criminal misconduct.³⁸ Courts must consider whether a corporation exercised due diligence to detect and prevent criminal conduct and to promote a culture of ethical conduct and compliance with the law. Companies that are determined to have established and implemented effective compliance programs are eligible for substantial penalty reductions, and companies who have failed to do so may be subject to sentencing enhancements.³⁹

The Guidelines place responsibility on upper management to ensure that employees are trained and that specific personnel are responsible for oversight and enforcement of compliance programs. Courts must consider whether compliance policies are clear and readily accessible to all of a corporation’s employees and agents.⁴⁰ Corporations are expected to delegate the day-to-day operation of the compliance program to people who, in turn, must report to upper-level management at appropriate intervals.⁴¹ Further, compliance programs will be evaluated based on whether there is a framework for periodic auditing and modification and whether there are mechanisms that encourage confidential reporting of conduct without fear of retaliation.⁴² Finally, the program must be vigorously enforced, as the government will carefully evaluate how corporations discipline offenders.

FCPA compliance programs should focus on tactics designed to identify specific risks inherent in each company’s foreign business activities. Tactical initiatives should probe the company’s overseas operations and the operations of its foreign subsidiaries, vendors, and any potential merger or acquisition partner. Tactical efforts should examine risk factors such as (1) the countries in which a company and its subsidiaries do business; (2) the types of business the company and its subsidiaries perform; and (3) the relationships between the company and its subsidiaries, on the one hand, and on the other, vendors, such as subcontractors, consultants, distributors, and other intermediaries they may utilize to conduct business overseas.

Some countries pose greater risk with respect to fraud and corruption than others. Transparency International, an organization dedicated to raising awareness of international corruption,⁴³ has assigned a Corruption Perception Index (CPI) to more than 180 countries. A higher CPI score indicates that the country poses less risk than a country with a lower score. In-house counsel should insist that payments in countries with a low CPI score receive enhanced scrutiny.

Risk also varies by the types of business a company conducts. If a company’s business abroad requires it to obtain licenses, intellectual property rights, and other government approvals, any payments to obtain such documents or approvals should be carefully evaluated. While such payments may fall within the “grease payment” exception, companies must ensure that these payments are not designed to garner favoritism from foreign officials. In addition, certain industry sectors, such as energy, telecommunications, health care and pharmaceutical, agriculture, steel, and construction, have been identified as particularly high risk, because in many countries, such enterprises are likely to be owned or controlled by the government.⁴⁴

There must be mechanisms in place to detect red flags indicative of risky relationships with vendors, subcontractors, consultants, and distributors. Compliance and overseas personnel must be trained to determine whether, among other things:

- written agreements exist
- the consultant or vendor was recommended by a government official

- payments are disproportionate to the expertise or services provided
- invoices are vague
- the vendor demands anonymity
- substantial upfront payments are demanded
- payments are demanded in cash or by convoluted means

In-house counsel should gather as much information as possible about vendors' and acquisition targets' compliance history and internal controls and demand that they certify past and future compliance with anti-bribery laws. When red flags appear, or when the vendor or target refuses to provide representations and warranties, counsel must have the courage to advise the company to walk away from the deal.

DOJ Opinion Release Procedure

The DOJ permits issuers and U.S.-based companies to request an opinion as to whether certain prospective conduct will trigger enforcement by the DOJ.⁴⁵ Although used infrequently, this procedure may be helpful to in-house counsel when management requests advice about transactions that have characteristics that concern counsel. To qualify, the transaction must be prospective, the request must be submitted in writing by a party to the transaction,⁴⁶ and it must disclose all material facts regarding the proposed transaction along with copies of all relevant documents.⁴⁷ The DOJ must provide a response within 30 days of receiving all relevant information.⁴⁸ Although an opinion from the DOJ will not bind other agencies or excuse the requesting party from complying with the accounting provisions of the FCPA, it will contain the DOJ's opinion as to the conduct described in the request.⁴⁹

In July 2008, Trace International, Inc. (Trace), requested an opinion regarding an event for which it contemplated paying expenses to enable approximately 20 Chinese journalists employed by state-owned media concerns to attend.⁵⁰ The proposal outlined the expenses Trace planned to cover for each journalist. The DOJ issued a response stating that it did not intend to take enforcement action on the grounds that the expenses were reasonable and

directly related to the promotion, demonstration, or explanation of its products and services.

Similarly, a June 2008 opinion issued to Halliburton Company (Halliburton) illustrates the utility of this procedure in the context of mergers and acquisitions.⁵¹ During due diligence, Halliburton submitted a request claiming that British legal restrictions prevented it from completing its corruption due diligence until after closing. Halliburton asked the DOJ whether (1) the proposed acquisition would violate the FCPA; (2) Halliburton would inherit FCPA liability for pre-acquisition violations by the target; and (3) Halliburton would be liable for post-closing violations by the target company before completing its FCPA due diligence. Halliburton proposed to undertake an extensive disclosure and remediation process to reveal confidential information regarding FCPA violations in the event that its bid was accepted by the target company. The DOJ responded that it did not intend to pursue enforcement activity against Halliburton as a result of the transaction itself. The DOJ stated that it would not initiate enforcement action against Halliburton provided it complied with the proposal, but also informed Halliburton that it would be liable for any unlawful payments made by the target company or its employees after closing.

These examples further illustrate the value of effective compliance plans and thorough due diligence. In each case, company management was educated about the FCPA and sensitized to the risks associated with the proposed transactions. The companies identified potential problems early on and structured transactions that received DOJ approval.

Conclusion

There are no signs that the rising tide of regulatory and enforcement activity by the DOJ and SEC will ebb any time soon. The global financial crisis has fueled concerns that in the quest to maximize their own profits in the short term, many corporations have abandoned their risk management responsibilities to the detriment of the economy and society as a whole. The temptation for businesses to cut corners and ignore certain risks in their struggle

to maintain or return to profitability will be immense. Addressing these concerns, in a speech delivered to corporate compliance officers on November 13, 2008, SEC chairman Christopher Cox stated:

In a profit and loss driven world, there is always a risk that companies facing an uncertain economic future may choose to cut compliance expenses as a shortsighted way to save money. When a company cuts compliance, violations will occur. And if violations occur, punitive actions should and will be taken. In the current environment, that is true now more than ever. There will be no favor granted because a company made a cost-cutting decision to minimize their compliance budget.⁵²

With respect to the FCPA, in-house counsel should anticipate that SEC and DOJ enforcement will intensify. In November 2008, a representative for the SEC remarked "the dollar amounts in cases that will be coming within the next short while will dwarf the disgorgement and penalties in prior cases," and the SEC will bring more cases arising from its own investigative leads and whistle blowers.⁵³

Developing compliance programs that will withstand government scrutiny is challenging. In a difficult economy, overcoming the first hurdle—persuading members of management that rigorous compliance programs are worth their costs—may be the most challenging. Although it may not be immediately apparent, in today's enforcement environment, in-house counsel who have the courage and persuasive skills to convince management that everyone's interests are best served by vigorous efforts to manage the risks associated with corporate fraud and corruption are worth their weight in gold. Indeed, the company's future, and counsel's future, may depend on it. ■

Sean O'D. Bosack is a shareholder and cochair of the white-collar counseling and defense practice group at Godfrey & Kahn, S.C., in Milwaukee, Wisconsin.

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35. UNITED STATES ATTORNEY'S MANUAL, Title 9, Chapter 9-28.000, *Principles of Federal Prosecution of Business Organizations* (August 28, 2008), available at www.usdoj.gov/opa/documents/corp-charging-guidelines.pdf.
36. SEC DIVISION OF ENFORCEMENT MANUAL, Office of Chief Counsel (October 6, 2008); available at www.sec.gov/divisions/enforce/enforcementmanuel.pdf.
37. See U.S. SENTENCING GUIDELINES MANUAL, *Chapter Eight: Sentencing of Organizations* (2008).
38. U.S. SENTENCING GUIDELINES MANUAL § 8B2.1, Application Notes, Background (2008).
39. *Id.* at § 8C2.5(f).
40. *Id.* at § 8B2.1(b)(1)-(2).
41. *Id.* at § 8B2.1(b)(2)(C).
42. *Id.* at § 8B2.1(b)(5), (7).
43. See *Transparency International, the Global Coalition against Corruption*, TI Corruption Perceptions Index 2008, available at www.transparency.org/policy_research/surveys_indices/cpi.
44. See Jonathan R. Woetzel, *Reassessing China's State-Owned Enterprises*, MCKINSEY QUARTERLY, *Forbes.com* (July 8, 2008), available at www.forbes.com/leadership/2008/07/08/china-enterprises-state-lead-cx_jrw_0708mckinsey.html.
45. 28 C.F.R. § 80.1.
46. *Id.* at §§ 80.2, 80.3.
47. *Id.* at 80.6.
48. *Id.* at 80.8.
49. *Id.* at 80.11, 80.13.
50. *DOJ Opinion Procedure Release 08-03* (July 11, 2008).
51. *DOJ Opinion Procedure Release 08-02* (June 13, 2008).
52. Speech by SEC Chairman: *Address to the 2008 Outreach National Seminar*, Chairman Christopher Cox (November 13, 2008) available at www.sec.gov/news/speech/2008/spch111308cc.htm.
53. Lynne Marek, *Larger Foreign Corrupt Practices Act Fines Ahead*, *THE NATIONAL LAW JOURNAL*, (November 25, 2008).

IN-HOUSE TOP 10

By James W. Quinn and David R. Singh, Weil, Gotshal & Manges LLP

The *In-House Top 10* provides insightful comments from in-house counsel put in David Letterman-esque list form.

Top 10 Things to Do to Win the “Battle of the Experts” While Keeping Expert Witness Fees under Control

How can counsel win the “battle of the experts” while keeping expert witness fees under control? It is nearly impossible in most complex cases to avoid paying expert fees altogether, but several steps can be taken to avoid incurring unnecessary fees.

- 10. Know exactly why you need to retain an expert witness.** Before searching for potential experts, review the law applicable to your case to determine the issues on which expert testimony is needed. Once an expert has been retained, try to limit the scope of his or her work to achieving only those objectives. Before expanding the scope of the expert’s work, ask yourself how such expansion would prove or disprove the legal elements of you or your adversary’s claims.
- 9. Retain key expert witnesses early.** Some attorneys prefer to wait until fact discovery is nearly complete to retain expert witnesses because they believe that this will reduce expert witness fees. In such cases, the expert may actually bill more total hours because of the need to develop arguments that are “catch-up” in nature, rather than being planned in advance. If the expert is retained early, he or she can advise you about discovery that would facilitate rendering opinions in the case, such as documents that should be requested or questions that should be asked.
- 8. Consider using an in-house corporate employee rather than a third party as an expert witness.** In cases where the quality of a corporation’s product, manufacturing process, or service is at issue, in-house corporate employees will necessarily have more specialized knowledge about the issues than anyone outside of the company. With respect to such technical issues, an in-house employee may actually be more persuasive than a third-party expert. The obvious drawback to using an in-house employee as an expert is that he or she might be perceived as biased, but it is also doubtful that a third party who was paid hundreds of dollars an hour for services would be perceived as any more objective. Moreover, if the credibility of the corporation is at issue, such as allegations of fraud, a third-party expert can be retained to validate the in-house employee’s expert report. Because the third-party expert will not be conducting firsthand analysis other than peer review, this approach should result in lower expert witness fees.
- 7. Do your due diligence.** Do not rely solely on an impressive résumé or a generic recommendation. Make sure you get a recommendation from someone with specific knowledge about the expert’s strengths, weaknesses, and billing practice.
- 6. Conduct an in-person interview.** If the potential expert is not persuasive in your interview, how will that person persuade the tier of fact?
- 5. Identify the right expert for your case.** At the outset, do research and solicit recommendations from your colleagues and/or clients to identify a list of expert candidates. Next, conduct in-person or telephone interviews to identify the person who is most ready, willing, and able to opine about the issue in your case. Identifying the right expert witness will result in a significant reduction in expert fees, because the expert’s preexisting knowledge and/or studies can be applied to your case.
- 4. Memorialize the details of the fee arrangement in writing.** If the expert candidate proposes working with others at his or her consulting firm, find out whether there is a rate structure for other employees at the firm and who will be doing the work. Advise the expert in advance of the level of detail your client expects in terms of billing reports. To avoid any misunderstanding, discuss your client’s policies on reimbursement for meals, travel, and other expenditures.
- 3. Clearly communicate the approved scope of work, budget, and time frame.** Once the expert has been retained, discuss with him or her the preliminary work that needs to be done to render an opinion in the case. Ask for estimates regarding how many hours he or she anticipates spending on each proposed task and whether there will be any additional out-of-pocket expenses. After checking with your client, let the expert know what tasks have been approved and the budget for each task. Advise the expert that your client will not pay additional fees without prior approval. Provide the expert with a target deadline for each task and keep the expert abreast of the case schedule, including the deadline for expert reports and the trial date.
- 2. Try to reach agreements with your adversary regarding draft reports and scheduling.** There is a split in authority in the federal courts regarding the discoverability of draft expert reports or communications of attorney-work product to expert witnesses. The resulting uncertainty has a significant impact on the way attorneys and experts communicate, and it decreases efficiency and increases expert fees. To avoid this, counsel should try to reach an agreement with the adversary that draft expert reports and experts’ communications with counsel are not discoverable. Counsel should also try to reach agreements regarding the timing of expert reports and depositions to facilitate planning and avoid frantic last-minute preparation.

And the number one thing to do to keep expert witness fees under control:

- 1. Frequently check in with your expert regarding progress.** More often than not, when expert fees start to spiral out of hand, it is because counsel has not been vigilant about always knowing what the expert is working on. Nothing is more important to keeping expert witness fees under control than constantly monitoring what the expert witness is doing and how much the client has been billed. This is especially true when working with an expert for the first time. Monitor the progress of the expert’s work—and the size of his or her bills—frequently. Hold regular calls with the expert to discuss preliminary opinions and to answer any questions. If the expert is not making sufficient progress, or if the expert’s bills are higher than expected, promptly address these issues.

If you are on the inside and would like to submit your own Top 10, please contact Christopher Akin, coeditor, at (214) 981-3812 or by email at cakin@lynmlp.com. Topics can be instructive, humorous, or anything of interest to the committee’s membership.



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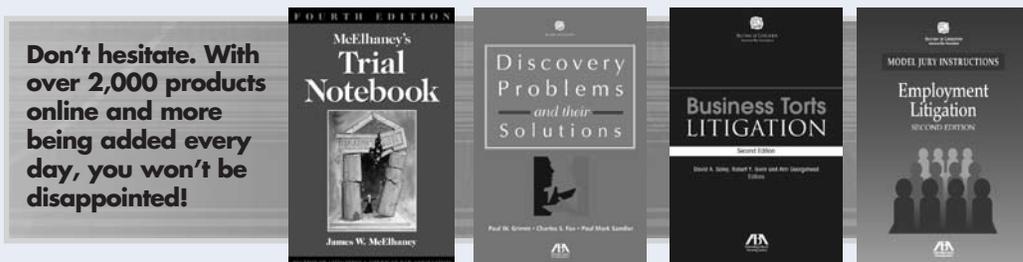
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