

Gatekeepers

A balancing act for corporate counsel

- » Corporate counsel are having to balance their responsibilities to the corporation that hired them and the investing public.
- » The SEC has openly displayed its intent to pursue these counsel by the number of cases brought against inhouse counsel.
- » The scrutiny of the SEC raises a number of difficult questions about the role of the inhouse counsel.

The trend is not new but has gained momentum at an alarming rate. As in-house and outside attorneys have been compelled by the Securities and Exchange Commission (SEC) to assume the role of corporate “gatekeepers” – watchdogs against internal fraud and misrepresentation – they have increasingly become the subjects of federal litigation.

Although hired by public corporations to protect the institution, in the eyes of the SEC, lawyers are responsible for upholding ethical and legal standards on behalf of shareholders and society at large. More than ever before, corporate counsel are under intense scrutiny while trying to manage dual roles as executive team members and unwitting defenders of the public interest. It’s a high wire act for attorneys today, fraught with professional and personal liability as actions brought by the watchful SEC promise more high-profile cases in the months ahead.

Redefined Responsibilities

Muscling attorneys into the role of gatekeepers dates back six years, to the enactment of the Sarbanes-Oxley Act of 2002 (“SarbOx”). Congress passed SarbOx in

the wake of numerous high-profile corporate scandals to protect U.S. capital markets and shareholders from corporate fraudsters. Promoting greater transparency and effectiveness in financial reporting, the Act placed added responsibility on corporate directors, auditors and attorneys.

Specifically, SarbOx Section 307 stipulates “minimum standards of professional conduct for attorneys appearing and practicing before the Commission in any way in the representation of issuers.” Although at odds with bar associations, which sought to limit attorney obligation, the provision in broad terms requires counsel to report violations by the company and bear responsibility for monitoring the accuracy of corporate disclosures.¹

As the corporate fraud cases piled up, regulators (and, seemingly, society as a whole) began to look more sternly on the directors, auditors and attorneys as corporate gatekeepers who were believed to be in a position to detect and prevent fraud. The SEC, armed with the SarbOx provision, pursued a trend of litigation that leveraged ever greater pressure on the gatekeepers and changed the relationship between them and the corporate managers with whom they work.

Lawyers Under Fire

The SEC has made plain its intent to pursue attorneys, as evidenced in statements by its officers and in the numerous cases brought against counsel. During Stephen M. Cutler’s tenure as Director of the SEC’s Division of Enforcement, he spoke at UCLA Law School. In his speech of September 20, 2004, Cutler stated, “Consistent with Sarbanes-Oxley’s focus on the



Illustration by Peter Giesbrecht

important role of lawyers as gatekeepers, we have stepped up our scrutiny of the role of lawyers in the corporate frauds we investigate.”²

Cutler’s comments were echoed in a May 2007 speech by his successor, Linda Chatman Thomsen. Thomsen dedicated much of her talk to the “tremendous power of lawyers to do good,” but first cited several examples of SEC suits against former General Counsels of publicly traded companies, including GCs at Apple, McAfee, Monster Worldwide and Converse. “The conduct of several inside lawyers in the recent options backdating scandals should make us all pause,” she stated. Thomsen referenced additional examples of the Commission charging inside counsel, including cases at Morgan Stanley, Amkor Technology and, of course, Enron.³

SEC-imposed pressure on lawyers has given rise to a number of interesting questions among legal pundits:

- » What is the nature of the activity that the SEC considers volative of the “gatekeeper” function and worthy of sanctions?⁴
- » What are the practical effects for the practicing bar of trying to balance the attorney’s deeply engrained obligation to represent a client zealously and the newly minted “gatekeeper” duties that presumably run in favor of the more diffuse and abstract “public interest”?⁵
- » What is the role of the corporate attorney in securities transactions in the public markets?⁶

1. Coffee, Jr., John C. “The Attorney As Gatekeeper: An Agenda for the SEC”, April 2003. Available at http://ssrn.com/abstract_id=395181 (Accessed 31 March 2008).

2. Lowenfels, Lewis D. et al. “Attorneys as Gatekeepers: SEC Actions against Lawyers in the Age of Sarbanes-Oxley”, 2006. Available at <http://law.bepress.com/expresso/eps/991/> (Accessed 31 March 2008).

3. Thomsen, Linda Chatman. “Speech by SEC Staff: Remarks Before the 27th Annual Ray Garrett, Jr. Corporate and Securities Law Institute 2007”, 4 May 2007. Available at <http://www.sec.gov/news/speech/2007/spch050407t.htm> (Accessed 31 March 2008).

4. Lowenfels, 5.

5. Lowenfels, 5.

6. Lowenfels, 2.

Merri Jo Gillette, director of the SEC's Midwest Regional Office, sought to lend some clarity to the SEC's perspective on the obligations of securities attorneys to be SarbOx-compliant. Her comments while on a panel at the 25th Annual Ray Garrett Corporate and Securities Law Institute at the Northwestern University School of Law shed as much light on SEC policy as on its inherent complications. The Commission would not hesitate to take enforcement action against attorneys who ignore their gatekeeper obligations, she said, but the SEC does not expect securities attorneys to betray confidences or to spy on their clients. According to Gillette, the agency recognizes and respects counsel's duty to defend clients and provide them with the best legal advice possible.⁷

"There is a natural tension between wanting to hold lawyers to an appropriate standard in terms of their roles as gatekeepers, but at the same time avoiding a chilling effect," Gillette said, using a term that has come to denote the cautionary distance between attorney and client. "We want people to seek legal advice and get good legal advice and take it." Gillette said the SEC attempted to spell out attorneys' gatekeeper obligations within SarbOx in the Part 205 rules under Section 307.⁸‡

Job Definition

Just eight months after SarbOx was first passed, Joseph Coffee of Columbia Law School identified the core issues regarding the role of the securities attorney as recast by SarbOx. In his April 2003 paper, "The Attorney As Gatekeeper: An Agenda for the SEC," Coffee asked

*"Is the attorney's role that of (a) an advocate, (b) a transaction cost engineer, or, more broadly, (c) a gatekeeper – that is, a reputational intermediary with some responsibility to monitor the accuracy of corporate disclosures?"*¹⁵

Five years later, with corporate attorneys looking over their shoulders, we still seek a well-defined answer. ■□

THE SHAPE OF THINGS TO COME

Examples of headline-making cases brought by the SEC against attorneys – with a notable increase in actions against GC's – include:

- » **Backdating cases at Apple, McAfee, Monster Worldwide and Comverse Technology.** In her May 2007 speech, the SEC's Linda Thomsen stated that the Commission sued the former GCs of all four companies for allegedly backdating undisclosed in-the-money options to themselves and to others. "Sadly," she continued, "in each of the four cases we alleged that to further the respective scheme, the company's inside counsel altered or fabricated company records to advance or conceal the fraud."⁹
- » **Insider trading at Morgan Stanley.** In an action described by Thomsen as one of the largest insider-trading cases against Wall Street since the days of Ivan Boesky and Dennis Levine, Morgan Stanley's Randi Collotta and her husband allegedly provided information concerning imminent corporate acquisitions involving investment banking clients to a broker-dealer in Florida, who then traded on the information and shared his illicit profits with the Collottas. Both Collottas were attorneys, with Randi Collotta employed as a compliance officer at Morgan Stanley. In all, she and 13 others were charged.¹⁰
- » **Illegal trading at Amkor Technology.** The SEC sued Kevin Heron, the company's former General Counsel and chief insider trading compliance officer, for illegally trading Amkor securities prior to five public announcements relating to financial results and transactions. Based on information he had learned as GC, Heron allegedly executed more than 50 illegal trades of Amkor stock and options – nearly all of them in blackout periods during which he and other company employees were forbidden to trade in company stock.¹¹
- » **Misleading public statements by Biopure Corporation.** When the SEC pursued Biopure and its executives for misleading statements about the U.S. Food and Drug Administration's review of its products, the biopharmaceutical company settled without financial repercussions. However, General Counsel Jane Kober – deemed responsible for safeguarding shareholder interest – was slapped with a \$40,000 civil penalty.¹²

The SEC's mission to protect investors and maintain fair markets has taken on implications that even its Depression-era founders may never have envisioned. Zealous enforcement of SarbOx has resulted in a trend of litigation against corporate gatekeepers, the acceleration of which is quantifiable. According to research by David W. Porteous, a securities lawyer with Levenfeld Pearlstein in Chicago, the SEC brought 49 actions against lawyers between 1999 and 2001; in the following four-year period that number increased to 76 actions, yet seldom involved General Counsels.¹³ Between January and September of 2007, a record 10 General Counsels were charged with or pleaded to civil or criminal fraud in federal courts.¹⁴

7. Lowenfels, 9-10.

8. Lowenfels, 10.

‡. The complete text of Part 205 is available at <http://www.sarbanes-oxley.com>.

9. Thomsen.

10. Thomsen.

11. Thomsen.

12. Qualters, Sheri. "Gatekeeper GCs Increasingly Becoming Targets for Liability", The National Law Journal. 29 September 2006. Available at <http://www.law.com/jsp/ihc/PubArticleIHC.jsp?id=1159347927237> (Accessed 31 March 31, 2008).

13. MacLean, Pamela A. "Record Number of General Counsel Charged in 2007", The National Law Journal. 2 October 2007. Available at <http://www.law.com/jsp/ihc/PubArticleIHC.jsp?id=1191229387776> (Accessed 31 March 31, 2008).

14. Ibid.

15. Coffee, 2.