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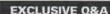
REGULATION Role SCANDA RNANCE ACCOUNTING

Uncertainty, Transition And The **Of The** General Counsel

BY STEVEN ANDERSEN

THE ROLE OF GENERAL COUNSEL IS transforming. Whether due to unprecedented corporate governance scrutiny, the lingering recession or the general sense of anxiety in corporate America, the demands on in-house counsel have ratcheted up in the past two years, and continue to grow.

General counsel share a common sense of concern and uncertainty. It lurks in the subtext of conferences and meetings. It's evident in their posture and eyes. General counsel are challenged as never before. For once, GCs have the full attention of boards and executives, but it's at a moment of little clarity. Their own stake in corporate affairs is grow-





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ing, but so too is their accountability and workload.

The pressing demand on inside lawyers is to provide counsel that will allow their skittish clients to sleep well, and do so in an extremely fluid environment. Every new law and regulation presents a moving target set against a fast-shifting background.

"People are running to us, whether it's the audit committee, CEO, CFO or directors," says the general counsel of a large pharmaceutical company who spoke on the condition of anonymity. "They all want to be sure we're doing what's necessary to protect them from liability. We're in the limelight. Everyone wants to make sure the company is up to speed on the changes."

The tension hinges on the fact that everyone knows more acts will play out before the drama subsides. How will a war with Iraq impact the economy? How will the Sarbanes-Oxley enforcement regime shake out? What accounting practices will prove best? Answers to these questions will emerge, but until then, most general counsel won't get close to a new status quo for some time.

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ONTINUED FROM COVER



IOVERNANCE

te most significant shift in the day-to-day trkload of general counsel is the amount time dedicated to corporate governance iues. Andy Sherman, the general counsel E.piphany Inc., a software manufacturer sed in San Mateo, Calif., says before the tron scandal came to light, he looked at vernance procedures and processes inually and when renewing directors and ficers liability insurance. Today it occues at least half his time, and sometimes

"When we're getting ready for board meetings, I'm spending 110 percent of my time on corporate governance," he says. "There's never been a higher price for not

considerably more.

paying attention to these things. You see companies go from a \$65-stock price to a 4-cent stock price in a matter of months. It's just amazing. There is a risk of catastrophic loss for failing to have the right system in place."

Unlike most legal issues, governance concerns beset the in-house counsel from all sides. Directors and committees, and especially the executives who now have to certify financial statements, have all gotten the message.

"The CEO and CFO who are accountable are laser-focused on ensuring processes and procedures are in place to protect them," Sherman says.

Focused, definitely. Patient? Not really. Although CEOs have grasped the significance of new requirements namely that their own hides are at stake—they often have a hard time shaking their big-picture focus to comb the nitty-gritty of financial statements. Helping them with that responsibility falls to the general counsel.

"Most CEOs don't think of SEC filings as part of their job," says Thomas W. White, a partner at Wilmer, Cuder & Pickering in Tysons Corner, Va. "They rely on other people to do it. Getting a CEO to sit still for several hours to go over the company's disclosure posture in detail can be very difficult for a general counsel."

Ironically, the general counsel's posi-

I have become more involved in accounting issues than I ever was before.

> -Ronald L. Polasek Recon/Optical Inc.



tion has become more isolated as all of this has played out. Executives, board members and junior lawyers turn to them for advice, but general counsel fear turning to others for help. Due to the SEC's hotly debated up-the-ladder reporting requirements, GCs now worry that consulting with outside counsel could increase exposure.

"Some general counsel have said their big concern is they don't have anybody to talk to," White says. "Someone reports a prob-

WHEN THE BASES ARE LUADED IN THE FINAL INNING, YOU BRING IN YOUR CLOSER.

lem to them, but they can't discuss it with other people, even outside counsel, because then outside counsel has the problem."

Increased governance responsibilities also mean lawyers are spending less time on sales, marketing and product development—areas they fought hard to enter in the 1990s. On the other hand, they're working more closely than ever with CEOs and CFOs to help design compliance programs. They're also spending more time dealing

with the board.

KNOWING WHO TO GO

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You get more directives from the board be sure you're dotting the Is and cross-, the Ts," says Gary D. Cohen, general insel of The Finish Line—a 460-store letic retailer based in Indianapolis. ou even get people asking if there's a way bring legal in sooner."

Directors' involvement isn't merely limd to assessing board practices, GCs say, ard members now demand continuous dates on the changing regulatory cliite, as well as the design of compliance :chanisms such as certification proims, disclosure controls and codes of nduct. Committees clamor for advice on w requirements. They all want to know iat Sarbanes-Oxley means, and how the mpany will tailor its response.

"There's not a director of a public comny in America who's not focused on, 'hat does this mean to me?'" says one rtune 500 GC who wished to remain onymous. "It's a weather vane. The quesn is, do they trust you enough to believe u will protect them, or do they need to get mebody from Cravath or Davis Polk?"

CCOUNTING

overnance isn't the only area whipped to lather by corporate scandals. The entire counting industry has been rewired in ie wake of Arthur Andersen's fall from ace. An October 2002 survey by the merican Corporate Counsel Association und that 61 percent of corporate counsel it they were out of the loop on important counting issues. And even when counsel ie well-informed, they still were plagued ith anxiety.

"A lot of in-house counsel feel illjuipped to challenge accounting judgients, because they're outside their area of opertise," says Kirby D. Behre, a partner Paul, Hastings, Janofsky & Walker in /ashington, D.C. "As an inside—or even a outside—lawyer, you're being asked to less some sort of conduct, yet you're not a accountant. It's one thing if you're sked to review a contract, but when you're sked to opine on something outside your rea, it's difficult."

Consequently, in-house counsel have imped into the deep end of the pool and seeped themselves in the particulars of ean counting.

"I have become more involved in ccounting issues than I ever was before," ays Ronald L. Polasek, general counsel of tecon/Optical Inc.

You would think Polasek would be heltered from the winds of change. His lient is a small, privately held defense ontractor that makes reconnaissance ameras for military aircraft. But accountug sensitivity has spread far beyond the ublic sector.

"There is an exceptional emphasis these lays on all things related to accounting," 'olasek says. "Although Sarbanes-Oxley is not directly applicable to private companies, t's peripherally applicable to them. And that vill pick up as the states get more involved." Polasek's experience is evidence of just now profound the shift has been in busiuess culture. Changes in accounting pracice aren't surface responses to a passing squall, but rather core transformations. "We're much more sensitive now because

there's a heightened awareness in the commercial world," he says. "Our outside auditors are more stringent. They bend over backward to look like they don't have a cozy relationship with anybody they audit."

As in the public sector, the volume of audits has swelled for private companies. And in addition to the heightened general sensitivity to accounting issues, Polasek must contend with the thorny requirements on government contracts.

"We have always had the Truth in Negotiations Act, and a whole slew of regulations where we get audited at virtually every phase of a contract," he says. "When there are more challenges to the accounting techniques, it pulls in the legal entity to look at those issues and see where you have to make adjustments."

ECONOMY

The gods of economic malaise have chosen some industries for special attention: telecom, travel, energy and, of course, anything that starts with a "www." Counsel in particularly hard-hit sectors spend their days dealing with zealous regulators, tough new laws and revised business plans.

"We're an energy company and our world has changed a great deal in the wake of Enron, Dynegy and others," says Randy Mehrberg, general counsel of Exelon Corp. in Chicago. "Fortunately, we didn't have those kinds of problems, but the industry was damaged nonetheless."

Fear of Enron-type cross trading has intensified the regulatory environment, federal legislation has targeted the industry and states have entered the fray with efforts to put the brakes on deregulation. At the same time, energy surpluses have driven down prices and revenues.

For Mehrberg, this means retrenching and creating a clear legal strategy that focuses on the basics: Keeping the lights on, reporting results honestly and finding investment opportunities in a consolidating industry.

"All general counsel today face challenges that weren't there a couple of years ago because of what some companies engaged in," he says.

The legal budget is lean and mean. As a result, you have to figure out how to get the legal work done without any surplus.

The pressures are different in the Internet sector, where the gushing spigots of venture capital have long since run dry and companies have had to make big changes to survive. One such company is Encyclopedia Britannica Inc.

Although the Chicago-based publisher is by no means a startup, it was in the midst of its transformation from book publisher to online content provider when I'm spending 110 percent of my time on corporate governance. There's never been a higher price for not paying attention to these things.

> -Andy Sherman E.piphany

the Internet bubble burst.

It had to scrap its free web service and rewrite the business plan to generate revenue in the here and now.

"The critical event for us was the decision in July 2000 to return to a subscription Internet model, " says Bill Bowe, Encyclopædia Britannica's general counsel Bill Bowe.

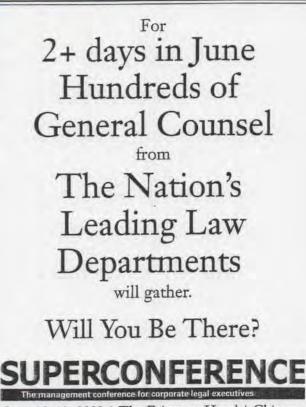
He suddenly had more work to do and fewer resources.

"The pressure on our business was a

changing market that required restructuring, coupled with the external pressures of the recession," he says. "But the legal budget is lean and mean. As a result, you have to figure out how to get the legal work done without any surplus."

All GCs have to do more with less these days, but there is one small consolation. In the last recession many companies oursourced their legal function as a cost-sav-

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ing measure, and many more considered it. The combination of profound regulatory change and public scrutiny of corporate governance means legal departments are safe, but shorthanded.

OPPORTUNITY KNOCKS

If there is a silver lining to the many challenges of the moment, it's that motivated general counsel have the opportunity to

turn the focused attention of their executives and board members into greater clout and authority within the company.

"Hopefully one of the changes ... will be that general counsel in marginal positions will be empowered," says Charles Morgan, general counsel of BellSouth in Atlanta. "You'll never have a better time than right now to assert yourself. If you don't have what you need, this is the time to think about getting it. Don't be shy. Whatever the CEO or the board wants, the fact of the matter is that as general counsel you will be held accountable. If you have the accountability, but not the power, you're in a dangerous position."

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Although they are loath to admit it, general counsel in some companies still are not part of the inner circle. In fact, the legal department may be in a separate building from senior management, or the GC may not even report directly to the CEO, but to an administrative officer. In such cases there is no perception that the general counsel really has the ear of management, which is especially deadly to compliance efforts.

But because even comparatively weak general counsel now have the attention of managers and directors, they have a chance to strike while the iron is hot and secure the structural changes necessary to enter the loop.

Morgan says his position at BellSouth affords him constant access to senior management and an office next door to the CEO. Based on his experience as an inhouse and law firm lawyer, he knows that's not always case.

You'll never have a better time than right now to assert yourself. If you don't have what you need, this is the time to think about getting it.

> -Charles Morgan BellSouth

"I had a call recently from a major company looking for a general counsel," he says. "It was a big company, but the position didn't report to the CEO. Aside from not wanting to leave where I am, I said good luck finding someone any good. In today's world no thinking person should ever put up with that. That structure shows you that the CEO doesn't really understand what the role of the general counsel should be."

It's clear the role has increased greatly in exposure and importance. Boards have more to be concerned about, and managers at all upper strata face greater accountability. They, in turn, expect more of their legal counsel.

The bottom line, Morgan says, remains straightforward.

"What you have to do is deliver added value," he says. "It's not just protecting the company and its executives, but also doing it in the most efficient way. You can have great corporate governance, but if the business is falling apart, that's not so great for the shareholders."

Now companies rely on in-house counsel in ways they didn't a few years ago. The GCs who meet the challenge will find their lot greatly improved when all the trouble blows over.

"This too will pass." says Sherman of E.piphany. "We're in the eye of the storm right now, but people will adopt new and improved governance mechanisms. Once those are in place, things will settle down." •