

CORPORATE LEGAL TIMES

VOLUME 13, NUMBER 137

THE MANAGEMENT MONTHLY FOR CORPORATE LEGAL EXECUTIVES

APRIL 2003 \$15

WHAT NOW?

Uncertainty, Transition And The Role 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-

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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Printed in the U.S.A.



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considerably more.

"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 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, Cutler & 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-

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.

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

Directors' involvement isn't merely limited to assessing board practices, GCs say. Board members now demand continuous updates on the changing regulatory climate, as well as the design of compliance mechanisms such as certification programs, disclosure controls and codes of conduct. Committees clamor for advice on new requirements. They all want to know what Sarbanes-Oxley means, and how the company will tailor its response.

"There's not a director of a public company in America who's not focused on, 'What does this mean to me?'" says one Fortune 500 GC who wished to remain anonymous. "It's a weather vane. The question is, do they trust you enough to believe you will protect them, or do they need to get somebody from Cravath or Davis Polk?"

ACCOUNTING

Governance isn't the only area whipped to shape by corporate scandals. The entire accounting industry has been rewired in the wake of Arthur Andersen's fall from grace. An October 2002 survey by the American Corporate Counsel Association found that 61 percent of corporate counsel said they were out of the loop on important accounting issues. And even when counsel is well-informed, they still were plagued with anxiety.

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

Consequently, in-house counsel have jumped into the deep end of the pool and reaped themselves in the particulars of lean accounting.

"I have become more involved in accounting issues than I ever was before," says Ronald L. Polasek, general counsel of Tecon/Optical Inc.

You would think Polasek would be sheltered from the winds of change. His client is a small, privately held defense contractor that makes reconnaissance cameras for military aircraft. But accounting sensitivity has spread far beyond the public sector.

"There is an exceptional emphasis these days on all things related to accounting," Polasek says. "Although Sarbanes-Oxley is not directly applicable to private companies, it's peripherally applicable to them. And that will pick up as the states get more involved."

Polasek's experience is evidence of just how profound the shift has been in business culture. Changes in accounting practice 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.

—Bill Bowe
Encyclopædia Britannica

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 Encyclopædia 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

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—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.

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 outsourced 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."

To be an effective general counsel is not just to be smart. People must listen to you

and take your advice. The most important factor in true efficacy is the perception of the power and influence of the general counsel.

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 in-house 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

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