ALM
LAW JOURNAL NEWSLETTERS

The Corporate Counselor®

Volume 22, Number 3 • August 2007

Did the Delaware Supreme Court Break the 'Directors' Shield'?

Advising Boards of Troubled Companies on Their Fiduciary Duties

By Jonathan P. Friedland and Russell C. Silberglied

Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp., C.A. No. 12150, 1991 WL 277613 (Del. Ch. Dec. 30, 1991), stands for the proposition that directors and officers of a Delaware corporation that is either insolvent or in the "zone of insolvency" owe fiduciary duties to creditors as well as stockholders. In essence, *Credit Lyonnais* provided a "shield" to directors against shareholder suits alleging that directors breached their duties to shareholders by acting to protect creditors. Courts around the country have adopted this view, and attorneys have become accustomed to advising boards of directors based on the assumption that this is indeed the law.

The Delaware Supreme Court, in *North American Catholic Educational Programming Foundation Inc. v. Gheewalla*, 2007 Del. LEXIS 227 (Del. Supr. May 18, 2007), might have "broken the shield."

BACKGROUND

North American Catholic Educational Programming Foundation, Inc. ("NACEPF"), a purported creditor, sued the board of its alleged debtor, Clearwire Holdings, Inc. ("Clearwire"). NACEPF's complaint alleged direct claims against the directors for breaches of fiduciary duties while Clearwire was insolvent or in the zone of insolvency. For strategic reasons, NACEPF expressly disavowed any derivative claims it could have pursued.

In order for NACEPF to state a claim, the court had to find: 1) that NACEPF had pleaded sufficient facts that Clearwire was insolvent or in the zone of insolvency; and 2) that as a matter of law, a creditor has standing to sue directly (as opposed to derivatively) for breach of fiduciary duty. The Supreme Court first noted (and did not overrule) the Court of Chancery's finding that NACEPF had satisfactorily alleged facts that permitted a reasonable inference for purposes of Defendants' motion to

continued on page 2

Largest FCPA Fine In History Is Warning for All

By William Steinman

Earlier this year, Baker Hughes Inc. ascended to the top of an exclusive and prominent list, but it is one on which few companies would want be mentioned. On April 26, 2007, the Texas-based oil field products and services company announced that it was settling a federal probe alleging that it violated the Foreign Corrupt Practices Act ("FCPA"), and that it would pay fines and penalties in excess of $44 million — the largest combined punishment under that law. It was truly one for the record books — at least for the time being.

In a nutshell, the FCPA prohibits U.S. companies and persons from giving anything of value to foreign government officials in order to obtain or retain business. The law also requires public companies to ensure that their books and records are accurate, and to maintain robust internal controls on the expenditure of corporate funds. And while the FCPA was signed into law in 1977, there have been more enforcement actions brought by the Department of Justice and the Securities and Exchange Commission (the two agencies in charge of enforcing the act) in the last four years than in the prior 26 years *combined*. Baker Hughes' FCPA woes serve as a roadmap of what companies operating internationally should

continued on page 6

In This Issue

The 'Directors' Shield' 1
Largest Fine in History 1
Case Management and Analysis 3
EEOC Targets 'Unconscious Bias' . . .5
Hotline 11

Zone of Insolvency

continued from page 1

dismiss that Clearwire operated in the zone of insolvency during at least a substantial part of the relevant period. The Supreme Court also left undisturbed the Court of Chancery's holding that insolvency had been adequately alleged for at least a portion of the relevant period following execution of the Master Agreement.

THE ZONE OF INSOLVENCY

After it was found that the complaint's allegations of insolvency and/or the zone passed muster for the purposes of a motion to dismiss, the relevant inquiry became whether the allegations of insolvency and/or the zone of insolvency gave NACEPF standing to sue for breach of fiduciary duty owed to it in its role as creditor. The court first addressed the zone of insolvency. It held "that no direct claim for breach of fiduciary duties may be asserted by the creditors of a solvent corporation that is operating in the zone of insolvency." *North American Catholic*, 2007 Del. LEXIS at *24-25.

However, the court went further than limiting its discussion to the distinction of direct versus derivative claims. It stated that if a solvent corporation is "navigating in the zone of insolvency, the focus for Delaware directors does not change: directors must continue to discharge their fiduciary duties to the corporation *and its shareholders* by exercising their business judgment in the best interests of the corporation *for the benefit of its shareholder owners*." (Emphasis added.) *Id.* at *25.

The Supreme Court also analyzed whether creditors can bring direct claims against directors for breach of fiduciary duties if the corporation is insolvent in fact. Again, the court held that creditors cannot state a direct claim. However, unlike with respect to the zone, where the court did not mention derivative claims but its rationale implies that derivative claims also may not be stated by creditors, it stated that creditors of an insolvent company may obtain standing to sue derivatively. Citing liberally to the Court of Chancery's 2004 opinion in *Production Resources Group, LLC v. NCT Group, Inc.*, 863 A.2d 772 (Del. Ch. 2004), the court stated that when a corporation is insolvent, its creditors become the residual beneficiaries of any increase in value, and therefore "equitable considerations give creditors standing to pursue derivative claims against the directors of an insolvent corporation." *Id.* at *26. To recognize a right of creditors to bring a direct fiduciary duty claim against directors, however, would "create a conflict between those directors' duty to maximize the value of the insolvent corporation for the benefit of all those having an interest in it, and the newly recognized direct fiduciary duty to individual creditors." *Id.* at *31.

In other words, the Delaware Supreme Court stated that directors of a solvent company that is in the zone do *not* owe fiduciary duties to creditors; their "focus … does not change" and they continue only to owe fiduciary duties to stockholders.

This development was unforeseen by most insolvency attorneys, and it seemingly reverses *Credit Lyonnais* and its progeny. The court emphasized that its decision was guided by the need to provide clear guidance to directors regarding their fiduciary duties and specifically to whom they are owed. However, the decision is such a stark reversal of prior precedent (most of which was developed by bankruptcy courts and other courts outside of Delaware purporting to apply Delaware law), that it is not clear to many practitioners what this change means and how to advise directors of troubled companies.

continued on page 8

Jonathan P. Friedland, a member of this newsletter's Board of Editors, is a partner at Schiff Hardin LLP in Chicago. **Russell C. Silberglied** is a director in the Restructuring & Bankruptcy Group of Richards, Layton & Finger, P.A. in Wilmington, DE. The views expressed in this article are those of the authors only and not necessarily of their clients or law firms. The authors would like to thank Richards, Layton & Finger associate **Lee Kaufman** and summer associate **Lisa Goicuria** for their assistance in preparing this article.

The Corporate Counselor®

EDITOR-IN-CHIEF . . . . .Adam J. Schlagman
EDITORIAL DIRECTOR . . . . . .Wendy Kaplan Ampolsk
MARKETING DIRECTOR . . . . .Jeannine Kennedy
GRAPHIC DESIGNER . . . . .Louis F. Bartella

BOARD OF EDITORS

HEATHER R. BADAMI . . . . .Bryan Cave LLP, Washington, DC
VICTOR H. BOYAJIAN . . . . .Sonnenschein Nath & Rosenthal LLP, Short Hills, NJ
JONATHAN M. COHEN . . . .Gilbert Randolph LLP, Washington, DC
DAVID M. DOUBILET . . . . . .Toronto-Dominion Centre, Toronto
SANDRA FELDMAN . . . . . . .CT Corporation, New York
WILLIAM L. FLOYD . . . . . . .McKenna Long & Aldridge LLP, Atlanta
JONATHAN P. FRIEDLAND . .Schiff Hardin LLP, Chicago
BEVERLY W. GAROFALO . . .Thelen Reid Brown Raysman & Steiner LLP, Hartford, CT
ROBERT J. GIUFFRA, JR. . . .Sullivan & Cromwell LLP, New York
MICHAEL L. GOLDBLATT . .Tidewater, Inc, New Orleans
HOWARD W. GOLDSTEIN .Fried, Frank, Harris, Shriver & Jacobson, New York
ROBERT B. LAMM . . . . . . .Financial Guaranty Insurance Company, New York
JOHN H. MATHIUS, JR. . . . .Jenner & Block, Chicago
PAUL F. MICKEY JR. . . . . . .Steptoe & Johnson LLP, Washington, DC
ELLIS R. MIRSKY . . . . .The Network of Trial Law Firms, Tarrytown, NY
REES W. MORRISON . . . . . .Hildebrandt International, Somerset, NJ
E. FREDRICK PREIS, JR. . . .Lemle & Kelleher, L.L.P., New Orleans
SEAN T. PROSSER . . . . .Fish & Richardson P.C., San Diego
DAVID B. RITTER . . . . .Neal, Gerber & Eisenberg LLP, Chicago
DIANNE R. SAGNER . . . . . .FTI Consulting, Inc., Annapolis, MD
MICHAEL S. SIRKIN . . . . . .Proskauer Rose LLP, New York
R. MICHAEL SMITH . . . . . .Dechert LLP, Washington, DC

The Corporate Counselor® (ISSN 0888-5877) is published by Law Journal Newsletters, a division of ALM. © 2007 ALM Properties, Inc. All rights reserved. No reproduction of any portion of this issue is allowed without written permission from the publisher. Telephone: (800) 999-1916
Editorial e-mail: wampolsk@alm.com
Circulation e-mail: almcirc@alm.com
Reprints e-mail: reprints@alm.com

The Corporate Counselor P0000-233
Periodicals Postage Pending at Philadelphia, PA
POSTMASTER: Send address changes to:
ALM
345 Park Avenue South, New York, NY 10160

Published Monthly by:
Law Journal Newsletters
1617 JFK Boulevard, Suite 1750, Philadelphia, PA 19103
www.ljnonline.com

Case Management And Analysis

A Veteran Perspective

By David J. Bradford

The great civilizations, dating back to ancient Babylon, resolved disputes by conducting trials. There are many reasons why "trials" have stood the test of time — validated by centuries and civilizations — as a universally recognized method of dispute resolution.

In the last few decades, "going to trial" has lost its luster. Corporate counsel and business leaders have grown wary of the risk, expense and diversion of resources associated with trials. As plaintiff lawyers availed themselves of new theories of liability and liberal discovery, courts have grown congested and the road to verdict has grown longer. Trials have become synonymous within the business community with aberrant verdicts and wasteful expenditures of time and money.

In fact, a recent report by the Administrative Office of the U.S. Courts shows that fewer cases are going to trial each year, despite the consistently large number of cases filed. The report states that in 2006 there were 259,541 civil cases filed in federal district courts, a 2.5% increase from 2005. However, the number of completed trials decreased by 3.3%, and that's been the story over the last decade. In 1997, more than 10,000 trials were completed — nearly double the 5121 trials in 2006 — and each year the figure has waned, indicating corporate America's growing distaste for resolving its business differences in a court of law.

But for those who are willing to look past the generalities, there are valuable opportunities in the courtroom. There is no better time to buy, than when everyone is selling. The current aversion to going to trial creates genuine opportunity for those who are willing and able to embrace the time-honored process. To be sure, many disputes should never result in a trial. In fact, many disputes should never result in complaints or in litigation. But smart corporate litigation counsel are beginning to recognize that certain cases are better tried than settled.

Among other things, in-house counsel should more often approach their case management as if they are going to trial; consider the use of expedited or accelerated trial procedures where appropriate; and never lose sight of the fact that trial will always offer the opportunity to settle, if it's in the best interests of the company to do so.

The North Star of Case Management

In deciding whether to settle or proceed to trial, several issues warrant close scrutiny. While there are no hard and fast rules, there is a north star for finding the right direction: you should manage *every* case as if you are going to try it and you will find out quickly whether your adversary is prepared to do the same.

Because of the general aversion to trial, most parties believe from the outset of the case that it will settle; after all, 99% of all cases settle. So parties engage litigators at firms that were involved in the deal at issue; they engage litigators who are not trial attorneys; and they look for ways to convince the other side that they have risk and exposure, and wait for nature — mediators and settlement conferences — to take its predictable course. Those who assume their adversary will ultimately resolve the case short of trial create a dangerous vulnerability — but one that is too infrequently exploited.

It is often clear very early in discovery and pre-trial motion practice, whether your adversary is really planning on trial. And when it is not, a favorable end — either in the courtroom or settlement table — is in sight, provided you are prepared to go the distance. Litigants who do not intend to try a case often signal that fact because they approach discovery as a means of imposing cost and disruption that make settlement attractive. Those who are really preparing to try their case are generally not interested in running roughshod in discovery. Rather, they approach discovery more thoughtfully as a means of blocking and tackling — securing answers that foreclose certain testimony or theories at trial, and securing admissions and ammunition for cross-examination. When adversaries hear that you only need three depositions, not ten, to get ready for trial — they understand you are interested in trying the case — and not interested in shaking the tree.

Making an internal emotional and financial commitment that you are prepared to try a case, if necessary, has two obvious benefits — it allows you to prevail in all those situations where the other side lacks that resolve, and it assures that you are never the victim of the safe assumption that the case will settle.

What happens when you meet an adversary who believes in its case and is prepared to present it in the courtroom? Often, you have a great opportunity to resolve your dispute efficiently and fairly. Litigants who are devoted to resolving their dispute in the courtroom — rather than to using the litigation process to bludgeon the other into submission — generally can agree on means to streamline discovery and trials.

A few recent experiences speak to the point.

Expedited and Streamlined Trials

We recently represented a party in a fairly complicated and high-stakes corporate control dispute. Our client asserted buy-sell rights in some 50 real estate limited partnerships in which a highly sophisticated Wall Street firm was the general partner. The general partner claimed to have lawfully sold the same properties to a third party buyer for whom it did investment banking work. The right to buy depended upon whether intercompany partnership transfers should be characterized as loans or distributions, and whether waterfall

continued on page 4

David J. Bradford, a Partner at Jenner & Block LLP, Chicago, is member of the firm's Litigation Department, and co-chair of its business litigation practice. Bradford has been lead trial counsel in numerous state and federal court lawsuits. He may be reached at dbradford@jenner.com.

Case Management

continued from page 3

distributions to partners should be calculated on a partnership-by-partnership or pooled basis.

Notwithstanding the factual and legal complexity, we agreed to try the case within 60 days of the filing of the complaint and further agreed to limit each side to presenting their case in 8 hours. We completed fact and expert discovery inside of 45 days. Within two months of the filing of the complaint, the case was over. We spent less time and money trying the case than most parties spend in discovery in cases of comparable magnitude. The experience looks even better in hindsight because we prevailed, but regardless of outcome, the efficiency of resolution was hard to surpass in any alternative dispute process.

In most cases, it is in both sides' interest to go to trial on an expedited basis, with limited discovery and/or limited trial time. Cycle time is the single biggest driver of litigation cost. Compressing trial preparation and discovery requires focus on the 80% of the case that matters most. And making the offer to expedite sends an important signal to your adversary. An adversary's refusal to accept an offer to streamline and expedite often sets the tone for resolution of the case. It is clear who has blinked and who believes in their case. By pressing persistently for quick trial dates and for the close of discovery, you reduce costs and secure more favorable settlements.

Settlement During Trial

In fact, trial itself offers a continuous opportunity for resolution. My last two federal court cases both settled in the middle of the trial. In the first, the issue of whether our client had a right not to proceed with a merger upon a material adverse change in the performance of the target company. The MAC clause had a carve-out, if the change in business was the result of the economy; and the economy had gone into a modest recession between the agreement to purchase and the scheduled closing. The target company ultimately went bankrupt and blamed its demise on our decision not to close. The stakes were in excess of $200 million and the plaintiff believed that a local jury would be very sympathetic to them. We could not settle the case on reasonable terms until the plaintiff recognized that our client had the temerity to present its case to their local jury.

In fact, by the end of the cross-examination of the plaintiff's second principal witness, the plaintiff knew three things: the trial would go on for some time; the loser would appeal; and the jury probably had heard enough to form instincts about the case that would be hard for either side to overcome. Both sides were relatively bullish on their case and it likely remained impossible to agree on a settlement number. But we were able to agree on a means for settling the case by submitting it to the jury in the middle of the plaintiff's case, subject to "brackets" on the result. Each juror was allowed to vote a private ballot: leaning plaintiff or leaning defense and each plaintiff ballot was worth money to the plaintiff on an agreed sliding scale. The plaintiffs traded in their *in terrorem* damages for the certainty of securing a modest recovery. The jury came back in the middle of the brackets. The case was resolved on terms that were significantly below any offer we had seen prior to the start of trial.

Civil Cases Filed in District Courts*		
Year**	Filings	Trials Completed
1997	272,027	10,155
1998	256,787	9,349
1999	260,271	8,532
2000	259,517	7,933
2001	250,907	6,513
2002	274,841	6,015
2003	252,962	5,830
2004	281,338	5,492
2005	253,273	5,294
2006	259,541	5,121

* From *Judicial Business of the United States Courts* at http://www.uscourts.gov/judbususc/judbus.html

** Based on fiscal years from September to September

Of course, there are times when arbitrations provide quicker and less expensive forums than courtrooms. And there are times when mediations and early settlement discussions allow both sides to achieve outcomes that approximate trial results, without the expense and delay. But counting on mediation or settlement to take you out of harm's way is a dangerous way to conduct business.

Cases Too Small to Try

There are cases where the stakes are simply too small to warrant the expense of trial. In those cases, you should settle as early as you can unless you can recover fees or believe that capitulation will attract others. If you face an unreasonable plaintiff, offers of judgment can at least shift the risk of costs. And involving the judge in settlement efforts very early on can work. There is no weakness in making clear that you will settle early to avoid costs of litigation, particularly if it is backed up by a willingness to go to trial if your adversary is unreasonable. You can often amortize the cost of the trial of a small case by pointing to it as an object lesson in the next hundred small cases that come your way.

Cases Too Large to Try

There are also cases where the stakes are so large that you may find it an unacceptable risk to go to trial. There are a few counterweights that can help. First, plaintiffs generally don't want to bet your company either — the last thing any plaintiff wants is a claim in bankruptcy. Most plaintiff attorneys recognize that runaway verdicts are often thrown-away verdicts on appeal. As a result, the ransom demands will almost always come down in size once they read your body language and know you really are prepared to stand firm.

Second, judges are generally willing to scrutinize damage claims that

continued on page 12

EEOC Targets 'Unconscious Bias'

All About 'E-RACE'

By Lynn D. Lieber

Could your organization be hit with a race discrimination lawsuit for "unconscious bias"? How do you prevent legal liability for unconscious acts? This is a question puzzling many legal counsel as they try to protect their organizations from becoming the next Walgreens, the nation's largest drugstore chain, which was recently sued by the Equal Employment Opportunity Commission (EEOC) for racial discrimination. "Unconscious bias" is a fundamental element of the EEOC's recent initiative called Eradicating Racism and Colorism from Employment (E-RACE), an enforcement effort that focuses on filing lawsuits challenging "subtle" discrimination and educating employers.

The Suit Against Walgreens

In the lawsuit, the EEOC alleges that Walgreens uses race as a factor to place managers and pharmacists in low-performing stores, and in locations in African-American communities. The company denies the charges. Although the racism initiative, which emphasizes public education and outreach, is not directly tied to the Walgreens action, the EEOC is making an example of the company.

According to the EEOC, race continues to be the leading basis of charges of discrimination. Of the 75,768 charges of discrimination filed with the EEOC in fiscal year 2006, 35.9% alleged racial discrimination. The EEOC also has seen a substantial increase in discrimination claims based on "color," which have soared from 374 in 1992 to 1241 in 2006.

How are prudent employers to prevent "unconscious bias" or "subtle" racism? How do you protect your company from a potentially devastating class action lawsuit like the one being faced by Walgreens? The best answers come from a non-binding "Guidance" issued on the subject of race and color discrimination last year by the EEOC. This very broad Guidance, which suggests employers need to take serious action and affirmative steps to eradicate race discrimination, demonstrated how seriously the EEOC takes race and color discrimination.

The EEOC Guidelines

In April 2006, the EEOC issued comprehensive new Guidance as to what constitutes race and color discrimination under Title VII of the Civil Rights Act of 1964. The far-reaching Guidance alerts employers to the complex and profound ways that racial and color-based bias or stereotyping can affect recruitment and hiring, as well as all terms and conditions of employment. The EEOC notes that a review of recruitment and employment practices, as well as training, are among the key ways to avoid liability and to enable the assertion of an affirmative defense.

The new Guidance places affirmative responsibilities on employers and supervisors to avoid discrimination, such as reviewing hiring practices to ensure that recruiting is conducted in diverse applicant pools, not solely through "word of mouth." The EEOC emphasizes that unintentional discrimination can arise in subtle ways. For example, requiring a certain educational degree for a job may tend to screen out individuals of certain races and national origins; therefore, employers should only set such educational requirements if they are truly necessary for performance of the job. The EEOC also addressed the insidious ways discrimination can occur, even citing a lack of informal networking opportunities away from the office as potentially discriminatory.

Expansive Definitions of 'Race' and 'Color'

The Guidance defines "race" very broadly to include discrimination based on physical characteristics associated with race — such as hair, facial features, height, weight, body shape, type, racial or ethnic hairstyles, lip size, eye shape and skin color. Also included in the definition is discrimination based on ancestry, cultural characteristics (dress, grooming practices, accent, manner of speech) race-related illness, perception of an individual's race, association with someone of a particular race, "race plus" another protected category and "reverse" race discrimination.

The EEOC defines "color" discrimination as illegal treatment based on an individual's skin pigmentation (lightness or darkness), complexion, shade or tone. Such discrimination can occur "between persons of different races or ethnicities, or even between persons of the same race or ethnicity." Thus, a light-complexioned African-American could be treated discriminatorily by a darker-skinned African-American supervisor. An employer's preference for light-skinned individuals over dark-skinned employees would be discriminatory. In addition to defining "race" and "color" discrimination, the Guidance describes what it refers to as "related protected bases" — multiple protected bases of discrimination (national origin, religion) and "intersectional discrimination" — discrimination based on more than one protected category, such as race *and* gender.

Subtle Racial Stereotyping or Bias Is Discriminatory

The EEOC notes that Title VII prohibits not only intentional discrimination, but also practices that appear to be neutral, but limit employment opportunities for some racial groups that are not based on business need. Intentional discrimination "includes not only racial animosity, but also conscious or unconscious stereotypes about the abilities, traits or performance of individuals of certain racial groups." Even comments by an interviewer that "we were looking for a clean cut image" or "because of our sophisticated upscale location we need to look for certain 'soft skills'" — could be reflective of racial stereotyping or bias. The agency warns employers to be alert for "code words" that are neutral on their face, but in context convey a racial meaning.

continued on page 6

Lynn D. Lieber, an employment-law attorney, is the CEO and founder of Workplace Answers, Inc., a national provider of Web-based human-resource, financial and ethics compliance courses. She can be reached at llieber@workplaceanswers.com.

EEOC Targets

continued from page 5

Recruiting and Hiring Mandates

The Guidance instructs employers not to rely on "word-of-mouth" recruiting efforts that tend to seek candidates from homogenous labor pools, but instead to take affirmative steps to ensure that hiring efforts are targeted at diverse populations. For example, an employer in a largely Caucasian community could be engaging in discriminatory hiring practices by recruiting only from its own community, without outreach into a larger metropolitan labor pool that has a higher percentage of African-Americans.

The Guidance also cautions employers against imposing criteria for jobs that might be over-reaching and are not absolutely required for the position. Requirements such as possessing a certain educational degree or the absence of a criminal record tend to screen out minority applicants and must be based on strictly on business necessity rather than employer preference.

Is Failure to Socialize Outside of Work Discriminatory?

The Guidelines focus on some of the less common aspects of the principle that discrimination can occur in *any* aspect of employment — including job assignments, performance evaluations, mentoring, training, informal networking, appearance and grooming standards and discipline and termination.

The EEOC states that it would be illegal for an employer to assign African-American and Asian salespeople to sales territories with high percentages of African-American or Asian customers, in hopes that it will increase sales and benefit the salespersons' careers. Title VII would be violated because the employer deprived employees of employment opportunities by limiting, segregating, or classifying them on the basis of race. Similarly, making job assignments based on customer preference is not a defense to racial or color-based discrimination, even if the employer loses the customer's business by not following the customer's request. The Guidelines refer to a home healthcare employer whose customer expressed the desire for Caucasian home health-care aides. For the employer to follow a customer's discriminatory preferences is unlawful as it discriminates against the non-preferred employees.

Entering a new legal terrain, the EEOC gives an example of an organization that has an active networking culture, both during and after the workday. Failure of managers to invite certain employees to after-hours social events — or who invited them later than others — could be discriminating based on race or national origin if the lack of networking opportunities affects the individual's terms and conditions of employment.

When a Single Incident Is Sufficiently Severe

The Guidelines state that when conduct is racially derogatory in nature, or involves racial mistreatment, unwelcomeness is irrelevant, even when the alleged harasser and victim are of the same race. A single extremely serious incident of harassment might be sufficient to violate Title VII, especially if it is a physical act, such as depiction of a noose, a burning cross, a favorable reference to the Ku Klux Klan, the use of the "n" word or a racial comparison to an animal.

Employer Proactive Prevention

The EEOC makes clear that it is insufficient for employers to merely recognize and put an end to racial and color-based harassment — affirmative preventative measure are imperative. Employers must carefully scrutinize their recruiting and hiring practices to ensure that they draw from a diverse labor pool and do not use job criteria that impermissibly screen out candidates of certain races, colors or national origins. Similarly, employers must be attuned to the subtle and unconscious ways that race and color stereotypes and bias can negatively affect all aspects of an individual's employment, such as networking, mentoring, etc.

The Commission stresses that employers can avoid discrimination by:

- Having a strong, updated Equal Employment Opportunity Policy that is embraced the top levels of the organization;
- Training managers and employees on the policy;
- Enforcing the policy; and
- Holding managers accountable to the policy.

Conclusion

The social landscape of racial and color-based discrimination continues to evolve and become ever more complex and insidious. The EEOC is demanding that employers become more astute and engaged in reviewing employment practices and analyzing all terms and conditions of employment with these Guidelines in mind. By taking proactive steps now to "audit" their organizations' compliance with the broad Guidance by the EEOC, legal practitioners may have the earliest and best opportunity to prevent their organization from being the next case in the news.

Largest FCPA Fine

continued from page 1

and should not do, and boldly highlight the red flags that corporate counsel should be watching for.

Lack of Internal Controls

According to Baker Hughes' settlement agreements with the DOJ and the SEC, the company maintained insufficient internal controls to avoid FCPA violations. As stated above, the FCPA contains an affirmative obligation for public companies such as Baker Hughes to maintain robust internal controls. The settlement materials identify several of the firm's alleged shortcomings, including the following:

Failure to Do Due Diligence On Intermediaries

Baker Hughes had roughly 650 business intermediaries (reduced to less than 80 as a result of the internal investigation and settlements) around the world, including local sales agents hired to help identify potential

continued on page 7

Largest FCPA Fine

continued from page 6

business transactions and to promote the company to prospective customers. According to the SEC and DOJ, Baker Hughes did not conduct adequate due diligence on its intermediaries to ensure that they had a reputation for ethical business conduct, were qualified to perform the services for which they had been retained, or were not inappropriately close to influential government officials. The company repeatedly retained the services of local agents without determining who owned the agents. Sales commissions were unreasonably large, and in some instances, negotiated by a foreign official on behalf of an agent. The company had no written agreements with many of its intermediaries. It paid intermediaries outside of their home jurisdictions. In short, according to the SEC, Baker Hughes retained and made payments to intermediaries "under circumstances in which the company failed to adequately ensure itself that such payments were not being passed on" to foreign officials.

The lesson for multinational companies is clear. Working with third parties who know the local market is an extremely valuable tool. But companies should not enter into these relationships lightly. Public companies must ensure that they have internal requirements that require extensive due diligence on potential intermediaries. Not only can public companies be liable for illicit payments made by intermediaries under the FCPA's anti-bribery provisions, they can also be separately liable for failing to maintain adequate policies and procedures for vetting potential agents, even if those agents never place illicit funds into the hands of foreign officials.

Insufficient Supervision Of Employees

In addition to Baker Hughes' problems with intermediaries, its employees themselves engaged in activities that were highly suspect. One employee allegedly received kickbacks from a potential sales agent in return for advocating that the company engage that agent's services. In another instance, a company employee, without consulting with legal counsel, determined that paying bribes to local officials in Nigeria did not violate the FCPA because "all companies are doing the same" in that country.

It is essential for companies operating in challenging markets outside the United States to ensure that their employees are provided with adequate supervision. Employees should have access to experienced legal counsel, be trained in the substance of the FCPA and other laws regulating cross-border business, and be subject to procedures that require the approval of supervisors in circumstances when mistakes can be costly.

Review of Payments

Baker Hughes appears to have lacked sufficient accounting controls to ensure that payments made using corporate funds were appropriate and consistent with the law. Agents were sometimes paid in cash. One agent received payments in five different bank accounts outside of his home jurisdiction. Payments were made for an option to lease land from a company in Kazakhstan after a Baker Hughes employee determined that the company was "only a front for the real owners who are influential." Agents were reimbursed for expenses incurred in providing personal travel to foreign officials and their families. Commission payments to a local agent were described in the company's books and records as legal fees. In addition, $2.5 million was paid to customs brokers in Nigeria to resolve alleged underpayment of customs duties.

As indicated above, the FCPA requires public companies to maintain effective internal controls on the use of corporate funds, and to ensure that books and records are accurate. The expenditure of corporate assets — particularly to recipients outside the United States — should be subject to scrutiny. Companies should ensure that payments are made for bona fide and legitimate business reasons, are clearly documented, and are consistent with U.S. and local laws. Employees should not be able to dispense with thousands — let alone millions — of dollars from corporate coffers without strict controls.

COUNTRY RISK

For countries operating outside of the United States, the concept of country risk is not a new one. Traditionally, companies have evaluated the risks of doing business in a particular jurisdiction in terms of political or economic stability, the relative sophistication of the local legal system, the ability to enforce contractual rights, crime and personal safety, and even the potential for expropriation of in-country assets.

Companies operating in challenging markets should add local corruption to the risk analysis. According to the settlement materials, Baker Hughes was doing business in jurisdictions such as Nigeria, Kazakhstan, Indonesia, Angola and Uzbekistan, all of which fall squarely in the bottom half of Transparency International's 2006 Corruption Perceptions Index (available online at www.transparency.org/news_room/in_focus/2006/cpi_2006__1/cpi_table). Such countries have also served as the setting for numerous recent FCPA violations. For example, business dealings in Nigeria have played prominent roles in at least three other major FCPA cases, such as ABB Vetco Gray settlement in 2004, Vetco Gray's second brush with the FCPA this year, and the case of Louisiana Congressman William Jefferson.

The FCPA does not prohibit U.S. companies from doing business in countries with reputations for corruption. However, prudent companies should apply extra scrutiny to proposed business transactions in those jurisdictions. There is no defense or exception to the FCPA that bribes are "just the way business is done" in a particular country.

NO TIME LIKE THE PRESENT

Perhaps the greatest lesson to be drawn from the Baker Hughes settlement is that there is no time like the present to tackle FCPA risks and to

continued on page 12

William Steinman is a partner at Powell Goldstein LLP in Washington, DC, where he focuses his practice on international anti-corruption and FCPA matters. He can be reached at wsteinman@pogolaw.com or 202-624-7292.

Zone of Insolvency

continued from page 2

Reversal of *Credit Lyonnais*?

Credit Lyonnais Bank Nederland N.V. v. Pathe Communications Corp. is the progenitor, and perhaps the most famous opinion addressing directors' fiduciary duty in the "vicinity of insolvency." In this unpublished opinion, the Delaware Chancery Court stated that "[a]t least where a corporation is operating in the vicinity of insolvency, a board of directors is not merely the agent of the residue risk bearers [*i.e.,* shareholders], but owes its duty to the corporate enterprise." The corporation's "board or its executive committee ha[ve] an obligation to the community of interests that sustained the corporation, to exercise judgment in an informed, good faith effort to maximize the corporation's long-term wealth creating capacity." *Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp.*, 17 Del. J. Corp. L. 1099, 1991 WL 277613 at *34 (Del. Ch. 1991).

Sixteen years later, the Delaware Supreme Court appears to have disagreed, stating that directors of solvent companies operating in the zone owe fiduciary duties "to the corporation and its shareholders" and should use their "business judgment in the best interest of the corporation for the benefit of its shareholder owners." *NACEPF,* 2007 Del. LEXIS 227 at *25. That statement seems to overrule *Credit Lyonnais* and its progeny.

The Future of Zone of Insolvency Litigation

If directors of a solvent company operating in the zone of insolvency owe fiduciary duties only to stockholders, there does not appear to be a cogent reason to permit creditors to sue derivatively for breach of those duties to stockholders. Increasingly, these types of suits are filed in bankruptcy cases, either by debtors or trustees suing directly or by a creditors committee suing derivatively. Nothing in *North American Catholic* prevents such a suit from being filed. However, under the *North American Catholic* rationale, such suits would rise or fall on whether the plaintiff can show a breach of fiduciary duty to *stockholders*. Not only will this change the nature of such suits, but it largely makes the zone of insolvency a meaningless concept; a plaintiff need not plead the zone to invoke fiduciary duties to stockholders, which is the normal state for solvent companies.

Potential Problems in Advising Boards After NACEPF

'Definitive Guidance' or Merely Moving an Imprecise Line?

The very concept of the "zone of insolvency" has often been criticized, among other reasons, because it is imprecise and hard to define. [*See, e.g., Production Resources Group, LLC v. NCT Group, Inc.* 863 A.2d at 789 n.56; *People's Department Stores, Inc. (Trustee of) v. Wise,* [2004] 3 S.C.R. 461 (Canada Supr. Ct. 2004); Jonathan C. Lipson, *Directors' Duties to Creditors: Power Imbalance and the Financially Distressed Corporation*, 50 UCLA L. Rev. 1189, 1208 (2003)]. The Delaware Supreme Court's view that "the need for providing directors with definitive guidance compels us to hold that no direct claim for breach of fiduciary duties may be asserted by the creditors of a solvent corporation that is operating in the zone of insolvency" is quite understandable and commendable. Incepting fiduciary duties to creditors upon actual insolvency, rather than movement into the zone of insolvency, however, does not — in our view at least — provide "definitive guidance to directors."

"Actual insolvency" certainly sounds like a much more precise concept than the "zone of insolvency," but is it? Under Delaware law, a corporation is insolvent: 1) if "it is unable to pay its debts as they become due in the ordinary course of business" (the "unable to pay debts test"); *or* 2) "'when it has liabilities in excess of a reasonable market value of assets held'" (the "balance sheet test"). [*LaSalle Nat'l Bank v. Perelman*, 82 F. Supp.2d 279, 290 (D. Del. 2000) (internal citations and quotations omitted); *see also Geyer v. Ingersoll Publ'n Co.*, 621 A.2d 784, 789 (Del. Ch. 1992) ("an entity is insolvent when it is unable to pay its debts as they fall due in the usual course of business … That is, an entity is insolvent when it has liabilities in excess of a reasonable market value of assets held."). *See also Angelo, Gordon & Co. v. Allied Riser Comm. Corp.*, 805 A. 2d 221, 224 (Del. Ch. 2002) (finding that fiduciary duties were owed to creditors because defendant corporation was balance sheet insolvent, even though note payments were not yet due)].

While neither test is precise, the second of these, the so-called "balance sheet" test, is particularly subjective because it requires a valuation of the corporation's assets. When the issue is litigated, dueling expert witnesses often disagree with one another as to valuation by tens or even hundreds of millions of dollars. [*See, e.g., Helig-Meyers Co. v. Wachovia Bank, N.A. (In re Helig-Meyers Co.)*, 328 B.R. 471, 477 (E.D. Va. 2005) ("Not surprisingly in this case, the two valuation experts reached vastly different conclusions regarding the value of the debtor's assets."); *Helig-Meyers Co. v. Wachovia Bank, N.A.* (*In re Helig-Meyers Co.*), 319 B.R. 447 (Bankr. E.D. Va. 2004), aff'd, 328 B.R. 471 (2005) ("the fact that two qualified appraisers … both applying sound appraisal methodologies to the same set of assets could reach such absurdly disparate conclusions gives the Court pause.")]. Not surprisingly, that large difference of opinion on valuation of the assets leads one expert to testify that the company was solvent on the valuation date, and the other to testify that the company was insolvent on the same date.

If the Delaware Supreme Court's goal was to "provid[e] directors with definitive guidance" as to when their duties expand to include creditors, shifting the "line" to a concept that itself is so subjective that qualified valuation experts can disagree by material percentages does not appear to meet the goal. We submit that it was easier for a practitioner to advise boards before *North American Catholic* than in its aftermath. Before *North American Catholic*, for example, if two reasonable experts could disagree on valuation such that one would opine that the company was solvent and the other would opine that

continued on page 9

Creating the Office of Technology Counsel

By Dan Pelc and Mary Mack

It appears that the law and technology are conspiring to make life difficult for corporate counsel and IT departments. Invariably, the stresses of electronic discovery have been exacerbated by the increased demands placed on counsel through the promulgated amendments to the Federal Rules of Civil Procedure (FRCP). Specifically, the amended rules require exponentially more information about the technical framework of a corporation at the earliest stages of litigation. The more focused or litigious corporations are quickly recognizing the need to bridge the gap between law and technology to ensure compliance with these ever-changing legal requirements and advancing technologies. This pinpoint nexus between law and technology is creating the need for an Office of Technology Counsel (OTC).

In a legal sense, this new role will become accountable for managing the flow of documents beginning at the point of the litigation hold through production, recognizing the common efficiencies between different cases. On the technology side, the OTC will guide policies around document creation, preservation and destruction to ensure protocols are defensible and documented. The person or persons leading the OTC must be grounded in the law and clearly understand the technological make-up of their company. This department will help build the legal compliance roadmap and advance the efforts of both the general counsel and IT departments in identifying and building repeatable, defensible processes for managing the electronic discovery process.

In order to set up an OTC, it's important to understand the role of a Technology Counsel and its place inside the company.

The Role of Technology Counsel

Ten years ago, the failure to examine or request computer data from a litigant was understandable and commonplace. In most circles today, the failure to approach electronically stored information (ESI) is dangerous

continued on page 10

Zone of Insolvency

continued from page 8

it was insolvent, lawyers likely would have counseled the board that it should assume that the company was in the "zone of insolvency," and therefore that its members' fiduciary duties had expanded to include creditors. A plain reading of *North American Catholic* counsels that this may be bad advice today. In any event, boards will likely place increased reliance upon the company's financial adviser's opinion on solvency and valuation.

Does the 'Shield' Still Exist?

North American Catholic liberally cites to the Court of Chancery's 2004 opinion in *Production Resources*. Indeed, other than with respect to the "open question" left by *Production Resources* concerning direct claims, the Delaware Supreme Court appears to have gone out of its way to embrace and adopt portions of *Production Resources'* reasoning.

However, the Supreme Court did not mention, one way or the other, a key concept contained in *Production Resources*: the "shield to directors from stockholders who claimed that the directors had a duty to undertake extreme risk so long as the company would not breach any legal obligations." *Production Resources*, 863 A. 2d at 788. The Court of Chancery stated that "the *Credit Lyonnais* decision's holding and spirit clearly emphasized that directors would be protected by the business judgment rule if they, in good faith, pursued a less risky business strategy precisely because they feared that a more risky strategy might render the firm unable to meet its legal obligations to creditors and other constituencies." *Production Resources*, 863 A. 2d at 788.

As discussed above, *North American Catholic* specifically states that in the zone of insolvency, "directors must continue to discharge their fiduciary duties to the corporation and its *shareholders* by exercising their business judgment *in the best interests of the corporation for the benefit of its shareholder owners*." *NACEPF*, slip op. at 19 (emphasis added). This raises a significant question in advising boards of troubled companies: Did the Delaware Supreme Court mean to put an end to the *Credit Lyonnais/ Production Resources* "shield" for directors, or did the court simply not address the point (and not caveat its 'for the benefit of its shareholder owners" language) because it was not before the court? The question takes on increased significance, given older statements by the Delaware Supreme Court that favoring the interests of creditors over stockholders of a solvent company may well be a breach of fiduciary duty. *See, e.g., Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A 2d 173, 182-84 (Del. 1986).

This issue is not merely theoretical. Consider the following fact pattern, which occurs very frequently "in the real world." A company has $500 million of debt and its financial adviser has advised it that the fair market value of its assets is $500,010,000. The company has one million shares of common stock outstanding. The company has canvassed the market for years to determine if it could link up or be purchased by a strategic buyer, but none has emerged. Suddenly, a private equity firm makes an offer to purchase the company's assets for exactly what they are worth, $500,010,000 (or some small premium). Should the company accept the offer? The board, in the reasonable exercise of its business judgment, can conclude that this offer is the company's last, best hope; due to the slow deterioration of the company's business over the past few years, it is likely (but not certain) that if the company rejects the offer, it will be insolvent in six months. But if it accepts, the stockholders get only one penny.

North American Catholic, to say the least, is an interesting and challenging development. We look forward to future judicial clarification.

Technology Counsel

continued from page 9

at best and malpractice at worst. Establishing the role of Technology Counsel will help an organization identify a point person or department that can proactively direct how to manage ESI for litigation and governmental investigations. A Technology Counsel may establish protocols for the processes around document preservation, from human intervention through e-mail notifications to automated document destruction policies. He or she will also help analyze the paths that ESI and documents take from the preservation and collection phases of discovery all the way through trial. Ultimately, the Technology Counsel will monitor discovery activities to ensure compliance with legal and technological requirements.

Why Is This Role So Important for Today's Litigious Company?

For some, this may be the billion-dollar question. For many companies, establishing the role of Technology Counsel is simply long overdue. These companies may have just extinguished discovery fires in response to active litigation or governmental investigation only to have five more ignite. The processes may be somewhat established but are usually ad hoc and are often incapable of repetition. In addition, the technological infrastructure inside the corporation is constantly changing with the adoption of new e-mail archiving, content management and telephony systems. Understanding the application of these technologies and ensuring that proper evidence preservation and collection methodologies occur in a defensible manner takes a keen understanding of both law and technology. Compounding this conundrum are the FRCP amendments that have changed timelines and requirements around electronic discovery. Having a central team member or department that understands all of these nuances is driving the need the new role of Technology Counsel — the person(s) who can manage document and evidentiary workflows and manage the creation of repeatable business processes that will ultimately reduce the costs, risks and time inherent to the discovery process.

Who Can Fill the Role

Many companies already have legal and IT personnel acting in the role of Technology Counsel, or completing many of these responsibilities, without the benefit of title, budget or formal recognition. In order to determine who can fulfill this role, it's important to examine all of the different organizations that will be touched by the Technology Counsel's efforts. Clearly assessing the roles and responsibilities of the Technology Counsel will better relay the importance of this endeavor. The person or persons in the role of Technology Counsel must master several different areas, including:

- Internal, currently applied technologies;
- Proposed technologies for both litigation and regulatory compliance;
- Litigation requirements for pertinent jurisdictions and governmental entities ;
- Outside expert capabilities and service offerings; and
- A deep understanding of past, current and future network architectures.

For individuals categorizing themselves as strictly "legal" or "technological," the requirements for such a position fall far outside their comfort areas. However, the skills required to bridge the chasm can be trained and maintained. Two important skills must be brought to the table before training can ever begin. The first is a willingness to learn about areas outside one's comfort zones. The second is a mastery of the mutual communications that must occur to bridge the chasm. Clear communication is necessary in order to establish sensible milestones and paths to success.

IMPLEMENTATION

Part of the charter for a Technology Counsel should be devoted to implementation. In many instances, key resources from different departments, such as IT or Human Resources, may be assigned as liaisons to the Technology Counsel for the purposes of providing specialized access to key resources and serving as a conduit for OTC mandates. A staged implementation is required in most corporations in order to account for the growing pains that may be experienced through the creation of most new departments. A needs assessment of a company's current discovery practices will help identify gaps in current processes and provide a foundation for developing an effective response plan. This baseline analysis can then be used to assess the company's current compliance state.

BENEFITS TO THE CORPORATION

Some of the major benefits a corporation can achieve by applying the role of Technology Counsel include:

Improved communication between legal, IT and other departments by enabling staff members to perform their roles with a greater sense of focus and purpose, as well as gain a better understanding new investments will have on the corporation's overall discovery practices.

Greater flexibility in discovery response practices with a centralized expert that can help legal and IT amend strategies to ensure defensibility in court or with governmental investigations regarding legal holds and document retention policies, as well as in the preparation for "meet and confer" conferences .

Improved efficiencies by having a central person oversee and supervise the current of data coursing to different outside experts and counsel.

In addition, when the services of an outside expert are required, the Technology Counsel will manage the selection and supervision of these experts to maximize the effectiveness of the document flow and review processes. In a sense, by harnessing the "pinpoint nexus between law and technology," the adoption of the role of Technology Counsel will

continued on page 11

Daniel Pelc is a licensed attorney in the state of Minnesota with several years of experience managing high-profile and complex electronic discovery engagements on behalf of national law firms and Fortune 500 corporations. **Mary Mack** is Technology Counsel for Fios. She has more than 10 years of experience handling electronic material for legal purposes and 20 years' experience delivering enterprise-wide software projects with IT departments in publicly held companies.

HOTLINE

TIME BARRED CLAIMS

In overruling a district court decision with significant potential consequences, the Third Circuit has ruled that when one federal district court transfers a case to another district due to "improper" venue, the original filing in the transferor court is the proper "filing date" for purposes of calculating any statute of limitations period. *Lafferty v. St. Riel*, No. 05-5357 (June 17).

A personal injury suit was dismissed by the district court, which found that the two-year statute of limitations had run out by the time the case was transferred from the New Jersey District Court to the Eastern District of Pennsylvania. In dismissing the suit, the court focused on the differences between the two types of federal transfers, § 1404(a), which allows cases to be transferred for the convenience of the parties, and § 1406(a), which allows the transfer of cases initially filed in an improper forum. The lower court found that for § 1406(a) transfers, the initial filing in the improper forum does not toll the statute of limitations in cases where the claims are based on state law. Instead, because the transferee court must apply state law, it must use the date of transfer as the filing date.

The Third Circuit rejected this analysis and reversed. The appeals court held that the district court failed to "distinguish between the effects of transfers as opposed to dismissals." The court concluded that "filing a complaint (otherwise proper) in a 'wrong division or district' does not make the complaint disappear, only to appear anew when it is transferred to a proper forum." Rather, "when a judge elects to transfer rather than dismiss a case filed in an improper forum, he elects to allow parties to preserve their claim 'in the interest of justice.'" Consequently, "when cases, timely filed in an improper forum within the limitations periods of the transferor and transferee forums, are transferred rather than dismissed pursuant to § 1406(a), the date of filing is the initial filing date in the transferor forum, even if the case is not docketed in the new forum until after the limitations period there has run."

CORPORATE COMPLIANCE

On July 3, 2007, the Securities and Exchange Commission published a proposal for public comment that would eliminate the current requirement that foreign private issuers who file their financial statements using International Financial Reporting Standards (IFRS), as published by the International Accounting Standards Board (IASB), also file a reconciliation of those financial statements to U.S. Generally Accepted Accounting Principles (U.S. GAAP). John W. White, Director of the Commission's Division of Corporation Finance, commented that this proposal "represents another significant action to tailor the regulatory environment for foreign companies in the U.S. public capital markets." The comment period extends for 75 days after the proposal is published in the Federal Register. The proposal is available at www.sec.gov/rules/proposed/2007/33-8818.pdf.

Technology Counsel

continued from page 10

enable corporations to run more efficiently and smoothly.

HOW TO IMPLEMENT THE ROLE OF TECHNOLOGY COUNSEL

The question that invariably follows is, "How do I implement this role within an already functioning organization"? As is the case with most wise decisions, the first course of action is to properly assess the corporate conditions. In evaluating the situation, corporations must ask some key questions:

- How much litigation do we currently face and of what type?
- What is our expecting litigation flow in the near future?
- What is my company's current level of readiness in terms of process and staffing to respond to discovery?
- Where can I envision unseen gaps that may arise through different situations?
- In implementing such a role, is there a clear path through a cost/benefit analysis to justify the execution of this course of action?

After answering these questions through a formal assessment process, the next step is to better define the role. In addition, internal and external research will be required to further define factors such as:

- Identification of key Technology Counsel staff members;
- Costs in implementation;
- Skills creation and development ; and
- Models from similarly situated companies.

> ***Examining the resources upon which the position will be constructed will better define the options and courses of action that are sensible.***

CONCLUSION

Examining the resources upon which the position will be constructed will better define the options and courses of action that are sensible. Some companies will immediately see the need after identifying key gaps and will quickly set course towards a rapid implementation. Others will see some of the need and determine that further research may be required. Still others will either leave the implementation of the position for a later date or decide to outsource the function. Regardless of the outcome, these are key questions and decisions that each and every business entity must investigate.

The publisher of this newsletter is not engaged in rendering legal, accounting, financial, investment advisory or other professional services, and this publication is not meant to constitute legal, accounting, financial, investment advisory or other professional advice. If legal, financial, investment advisory or other professional assistance is required, the services of a competent professional person should be sought.

Case Management

continued from page 4

are based on principles of terrorism; you will often find a friend in motion practice that's designed to reduce the range of damages and/or the risks of liability. Judges will often sense when the risk level is too high for a case to settle and will work with the parties to reduce that risk.

Third, exceptions notwithstanding, trials generally produce just results. Generally, the outcome reflects the vindication of an important principle. Generally, judges and juries follow the rule of law. Generally, the truth has an uncanny ability to come out.

The first case I ever tried involved a classic credibility dispute. The opposing party claimed it sent a letter, through counsel, making clear that it was not amenable to the deal that we alleged. We had little proof of the agreement — but we had a client who believed in his cause and persevered in going to trial. My client was adamant that he did not receive the letter and that it was never sent — because he had conversations with its author, an attorney, at the time that the letter was purportedly sent, who that was at odds with the substance of the letter. This was in the days when all lawyers in a firm were listed on letterheads. It was only the night before opening statement that we noticed a name in the list on the letterhead. The name was not on the letterhead in a letter dated a month earlier nor in the letterhead on a letter dated a month later. This name belonged to someone who was not admitted to practice law until a year after the letter was purportedly written. His name on the letterhead proved the letter was backdated by a year.

Justice and truth have a way of coming out in the courtroom. Cross-examination is a great crucible that yields truth. It's why the institution of the trial has endured the centuries and been embraced by civilizations worldwide. Like every product and financial statement, litigation now comes with a disclosure: No one can guarantee the outcome. But aberrant verdicts are an exception that should not obscure a general truth: Those business leaders and corporate counsel who make a commitment to taking cases in which they believe to trial will find rewarding opportunities both in the courtroom and on the path there.

Largest FCPA Fine

continued from page 7

ensure that internal compliance controls are suitably robust. The company's record-breaking punishment included an $11 million criminal penalty, a $10 million civil penalty, the requirement to disgorge almost $20 million in ill-gotten profits, and prejudgment interest of $3.1 million. Moreover, the company reported that the five-year internal probe cost over $50 million, involved 330 lawyers, 31 forensic accountants, the review of hundreds of thousands of pages of hard-copy documents, and 1.69 tetrabytes of electronic data (the approximate equivalent of 90 million pages) from computers in 20 cities on four continents.

Baker Hughes is also required to appoint an independent compliance consultant — also known as a compliance monitor — to review the company's ongoing efforts to comply with the FCPA. The compliance monitor's activities will not be directed by the company, and the monitor will report its findings to U.S. enforcement officials on a periodic basis. The information it gathers is not subject to the attorney-client privilege.

Compliance is expensive. The costs of setting up and maintaining a compliance program that is a part of a company's daily activities is certainly inconvenient, and falls on the negative side of the balance sheet. Compliance does not, in and of itself, generate revenue. Due diligence is invasive and can delay fast-paced deals. Yet the cost of Baker Hughes' FCPA issues should be powerful ammunition for in-house counsel seeking to convince corporate executives of the necessity of state-of-the-art FCPA compliance. Resolution of the matter cost Baker Hughes almost $100 million in out-of-pocket costs, not to mention the disruption caused by a five-year internal probe and other complications sure to be caused by the compliance monitor's on-going review. One can only imagine that it would have been cheaper to institute up-front compliance programs.

Individuals are themselves personally subject to government fines and prosecution for their roles in FCPA violations.

If these numbers are not enough, Baker Hughes has pointed out that almost every member of senior management that was at the helm during the period that the FCPA violations is alleged to have taken place have been replaced for one reason or another. And unemployment is only the beginning. Individuals are themselves personally subject to government fines and prosecution for their roles in FCPA violations. The SEC has already initiated a civil action against one Baker Hughes employee who was allegedly involved in the company's problematic activities in Kazakhstan. That individual joins more than 20 others who, since May 2005, have been prosecuted, fined, arrested, indicted or imprisoned for violations of the FCPA. For both the corporate and individual senior management, the risks of not being prepared in advance are extremely high and the costs often insurmountable.

To order this newsletter, call:
1-877-ALM-CIRC

On the Web at:
www.ljnonline.com