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WHITE COLLAR CRIME AND CIVIL FRAUD UPDATE

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Editors, Spring 2006 Edition: Ed Magarian and Jonathan Wilson.

The Smartest Guys in the Courtroom: Lay and Skilling Face the Music

On February 24, 2006, Dorsey's White Collar Crime and Civil Fraud Practice Group hosted a breakfast meeting and panel discussion, "The Smartest Guys in the Courtroom: Lay and Skilling Face the Music." Panel members included Dorsey partners Zachary Carter and Robert Rosenbaum and University of Minnesota Law Professor Gregg D. Polsky, who is also an of-counsel attorney at Dorsey. The panel was led by Dorsey partner Bryn Vaaler. The following, which is not a verbatim transcript, contains highlights from that discussion. Meet the panel members on page 4.

Introduction

B. Vaaler: It's hard to believe, but more than four years have now passed since the seventh largest corporation in the United States came crashing down like a house of cards, practically overnight. Billions of dollars in stock value were lost almost overnight. Retirements were wiped out. Thousands of people lost their jobs. As we know, a chain reaction of scandal ensued from Enron which resulted in the launching of legal reforms that may well have contributed to market recovery but have done so at a staggering cost to American business. Now, all of this has come full circle and we're back to the two men who were at the center of it from the start, Ken Lay and Jeffrey Skilling. Rightly or wrongly, for many, I think the true measure of whether our legal system and our political institutions have dealt with Enron, or are up to dealing with Enron, remains what will happen at the trial of Lay and Skilling. Today, we want to do two things. First, we're going to do an assessment of the trial. What's the prosecution's theory? What are the actual claims against Skilling and Lay? What's the defense theory? How are the two sides doing to date? Who will be the key witnesses as the trial continues over what's projected to be a four month run?

Secondly, we want to briefly take a retrospective look at the last four years of legal reform. We're going to focus very narrowly on which changes we think really help prevent future meltdowns, like Enron, and which changes may be more in the category of quack corporate governance. What's missing from the mix?

In this Issue

The Smartest Guys in the Courtroom: Lay and Skilling Face the Music

Let's jump right into what's going on at the trial. Before I turn to our panelists, let me just do a very short recap, for those of you who may not be Enron junkies out there.

The criminal trial of Jeff Skilling and Ken Lay began on January 20 in the Federal District Court for the Southern District of Texas, in the Houston courtroom of Judge Simeon T. Lake III, a highly respected jurist with a reputation for moving things along briskly. He lived up to that reputation by completing jury selection on day one. Lead counsel to Jeff Skilling is Daniel Petricelli, a top civil lawyer who has had no criminal experience. He is very well known for winning a $33.5 million verdict for the family of Ronald Goldman in the wrongful death suit against O.J. Simpson that came immediately after O.J. Simpson beat the murder rap. The lead lawyer for Ken Lay is Michael Ramsey. A criminal defense legend in Texas.

These two lawyers and their teams are up against the Department of Justice Enron Task Force, which currently consists of eight lawyers and 10 FBI agents whose time is devoted exclusively to various aspects of the Enron case. To date, 16 Enron officers and employees have entered guilty pleas with the Department of Justice including former CFO Andy Fastow and his two acolytes, Michael Copper and Ben Glissen. Most of the people who have entered guilty pleas are expected to be witnesses. In fact, I believe all the witnesses to date have entered guilty pleas. More on that in a minute. To date, the government has had considerably less luck when it brings its Enron case into the courtroom before a jury. You may not know this, but if you've been keeping track, the Skilling and Lay case is actually the fourth time the government has come into a courtroom before a jury with an Enron criminal action. As of right now, out of those four attempts, they have only one set of guilty verdicts still standing. The batting average in the courtroom has not been spectacular, to date. Let's just jump right in.

The Case Against Lay and Skilling

B. Vaaler: What is the government alleging in this case? What are the actual claims, Bob, against Skilling and Lay?

B. Rosenbaum: Well, this is one of the first of many very interesting facets about this case, as opposed to some of the other corporate conspiracy cases we have been reading about. It's extremely focused. Enron has far and away the most complex and difficult to understand fact patterns and it appears as though the government has made a very, very conscious decision to try and strip all that away and get to the fundamentals. So, in this case, Jeff Skilling has 31 counts of fraud, conspiracy and insider trading lined up against him but only for the last 2 - year period that he was President and CEO. It's from 1999 through 2001. Ken Lay, perhaps more interestingly, ran this company for about 20 years. The counts against him are only seven. They are limited to fraud and conspiracy and largely confined to the second time he became CEO. Jeff Skilling, you may recall, abruptly resigned in mid-August 2001. Lay stepped back in. Between August and December, all the wheels came off and he is accused of making numerous false statements and some other bad activity. It's only that very narrow period.

B. Vaaler: What's going on exactly? Why, strategically, is the government just focusing on this and focusing only on misstatements and some trading issues at the end as opposed to the more systemic kind of things that people think about? The structural elements, the Raptors, and all of that.

Z. Carter: Classically, prosecutors are always going to try to simplify, if not oversimplify, the facts, particularly involving complicated financial transactions, in order for the jury to understand the facts and apply them to the law. I probably, as a prosecutor, told a white lie at the beginning, at every opening statement that I gave because I invariably said, no matter how complicated the case was, at the end of the day, this is a very simple case. Sometimes I even meant that. **[Laughter]**

B. Vaaler: Houston, the assistant attorney general, who did the opening statement to the jury, said: "It's not about accounting. It's about lies and choices." So, the last thing they want to do as prosecutors is make this about accounting because it's, number one, going to put the jury's feet to sleep and number two it's going to confuse them because they're not experts in accounting. Confusion may lead to reasonable doubt.

Z. Carter: That's true but the government won't be completely in control, obviously, of that process at trial. While on direct testimony, of all the witnesses so far, they've tried to keep it simple. They've tried to make their allegations as black and white as possible, with respect to whether or not either Skilling or Lay knew, or were willfully blind, to the fact that certain transactions were of a certain type or that certain accounting was of a certain kind or character. On cross-examination, they have explored the complexities of the transactions in order for the jury to understand, in the first instance, that particularly in respect to Lay, he may not have been aware, at his level, of the intricacies of the transactions themselves. But also that the issue of whether they're misrepresentations at all is not so clear cut.

B. Vaaler: The defense was equally clear, and I think this was really bold in their opening statements. Many people would have thought they might say, "Okay Enron had many problems internally and maybe it was rotten internally in some way but we just didn't know about it at the high level." Instead, they are taking the opposite approach: Skilling and Lay didn't do anything wrong. In fact, other than a small cabal of Andy Fastow, Ben Glissen and Michael Copper, nobody at Enron did anything wrong. The structures, all those things, they were signed off by Arthur Andersen. They were signed off by the lawyers. We were relying on their expertise. Even those poor souls who have entered guilty pleas, they were brow-beaten into it by heavy-handed prosecutors and they really didn't do anything wrong except Fastow, Copper and Glissen.

Z. Carter: It will be interesting to see – well, first of all, it's always a critical issue in any case, from a defense standpoint, whether or not to put on a defense at all. If you're going to hammer home the issue of reasonable doubt to a jury, it's best, where you can, to have your behavior consistent with that argument. That is, if you're insisting that the government has the burden of proof, then to behave in a way that is inconsistent with that in putting on a case, somewhat undercuts that argument. In a complex case, very often, you have no choice but to put on some sort of case. My expectation is that, at some point, they're going to put on some expert witnesses. Perhaps in the accounting field and perhaps academics to explain exactly how complicated these transactions were and how widely accepted, if not celebrated, they were.

B. Vaaler: They want to emphasize that this is about GAAP accounting. This is about rules that may be too complicated for people to understand because therein lies the route to, perhaps, reasonable doubt.

Z. Carter: Absolutely.

B. Rosenbaum: Well, they want to put it into their particular context. I don't know that I'd say they want to put it in context.

The Witnesses

B. Vaaler: What about the witnesses to date, what does the panel think? We've heard from four, I think, to date. We've had the IR Director, Mark Koenig, who was the first witness, Ken Rice, who was actually the senior-most person, he was the CEO of Enron Broadband. We've had a relatively low-level accountant. And then, the one that really hit the newspapers was the last one, Paula Rieker, who was the corporate secretary and Vice President - IR under Koenig, and who I think a lot of people thought, scored some points one way or the other in this. Any thoughts on this?

B. Rosenbaum: Well, its easy to start with Rieker because she has been the most credible, but maybe we should back up and start with the earlier ones. Koenig was put on the stand in order to demonstrate that he was in the inner circle and was there when Skilling and Lay were making all of these allegedly false, materially false statements to the analysts about where the profit was coming from and whether or not it was really a risky trading company, or a growth company in the logistics business. And his testimony, his direct testimony seemed to score some points, but then four days later when he staggered off the stand, I don't know that anybody remembered what he had initially said, because the defense counsel, in my view, and I'm not a trial lawyer, did a very good job of seeming to destroy his credibility. He never once, apparently, in any of these calls or in any sessions before or after, challenged Skilling or Lay about what they were saying or what they had said. The defense counsel made it appear as though Koenig was carrying a lot of water for prosecutors because he was trying to curry favor and get a lighter sentence.

Meet the Panel

Zachary Carter

Mr. Carter is a partner in the New York office of Dorsey & Whitney and co-chair of the firm's White Collar Crime and Civil Fraud Practice Group. Prior to joining Dorsey, Mr. Carter was a United States Magistrate Judge, and later served as U.S. Attorney for the Eastern District of New York. Mr. Carter frequently appears as a legal commentator on CBS and CNN

Robert Rosenbaum

Mr. Rosenbaum is a partner in the Minneapolis office where he practices as a member of the Corporate Securities Law, Corporate Governance and Compliance, and Mergers and Acquisition practice groups. Mr. Rosenbaum regularly advises a number of publicly held companies with respect to corporate governance, disclosure and other corporate and securities compliance issues. He also practices in the area of mergers and acquisitions, involving both publicly and privately held entities.

Bryn Vaaler

Mr. Vaaler is a partner in Dorsey's Corporate group and, as Director of Professional Development, oversees Dorsey U which produces over 500 hours of training annually for firm lawyers and clients. Mr. Vaaler was Professor of Law at the University of Mississippi for 11 years, teaching corporations, corporate finance law and securities regulation. He is a member of the ABA Committee on Corporate Laws and the author of numerous articles on corporate and securities law and legal pedagogy. He and Mr. Polsky taught a seminar on Enron at the University of Minnesota Law School in 2005.

Gregg Polsky

An of-counsel attorney at Dorsey & Whitney, Mr. Polsky has, since 2001, worked as an Associate Professor of Law and Vance K. Oppermann Research Scholar at the University of Minnesota Law School. He teaches and writes in the areas of tax law and policy. Previously he practiced tax law at the international law firm of White & Case LLP, focusing primarily on corporate and partnership taxation. He and Mr. Vaaler taught a seminar on Enron at the University of Minnesota Law School in 2005.

Sentencing Commission: Taking a Stand for the Attorney-Client Privilege

The U.S. Sentencing Commission voted to remove language in the U.S. Sentencing Guidelines that puts pressure on corporations under criminal investigation to waive attorney-client privilege and work product protection in order to be deemed cooperative. The contentious language, added in 2004, was highly criticized for its consequences.

The ABA told the Commission that corporate employees are less likely to consult counsel or cooperate in internal investigations if they think their confidential communications will be shared with the government; that breakdown in communications makes it more difficult for attorneys to counsel their clients on how to comply with the law. Critics have also maintained that the Department of Justice used the guidelines language to pressure corporations to waive privilege. Although the DOJ has said that it asks for waiver of the attorney client privilege and/or work product protection in rare cases only, a recent survey of 1,200 members of the Association of Corporate Counsel and the National Association of Criminal Defense Lawyers found that nearly 75 percent of the survey participants felt that waiver was routinely expected of corporations that want to demonstrate that they are cooperating fully with investigators.

The defense bar hailed the Commission's unanimous reversal of the language as a victory for effective corporate representation.

The change becomes effective November 1, 2006 unless Congress intervenes.

B. Vaaler: That's the common theme, there. Number one, they've been pounding on these folks to the extent you're alleging misstatements by Jeff Skilling or Ken Lay. Are you sure they're mistakes, or were they intentional misstatements? The whole state of mind, which is so tough, here. Number two, why didn't you stop him? Why didn't you say, "object," "don't say that." Number three, the impeachment thing, Zach aren't these, all of these guilty pleas, subject to impeachment in that they're trying to earn their way out of prison time.

Z. Carter: Sure, that's the number one thing that defense counsel will try to hammer home to the jury, and given the coercive effect of the sentencing guidelines and the fact that each of the government witnesses were likely to be called—would have been facing decades in prison if they had not agreed to cooperate with the government. First, it's likely that they pled guilty without regard to whether or not they were, in fact, guilty of the crimes for which they were accused. They were simply trying to limit their exposure to jail time. Second, because of the deal that they got, they had a motive to testify falsely, particularly in areas where they could contrive testimony without fear of contradiction. I think that's where the real challenge is going to be, both for the prosecution and the defense. To the extent that they testify in areas about discrete transactions and there is objective corroboration for their statements in terms of key elements of their testimony, that's obviously a good thing for the prosecution.

B. Rosenbaum: And, Zach, that leads pretty naturally into Ken Rice. For those of you who don't know, he was one of Skilling's close confidants and number 2 to him for many, many years at Enron, and was a super salesman. Enron, first and foremost, was a deal-making company. The way they, the root of their problems, in my humble opinion, is they used mark-to-market accounting, which enabled them to book profits on future revenues, whether or not those revenues ever came in, years into the future. So they would go out and get these 10-, 15-, 20-year contracts, book all the profit the day the contract was signed, and show this phenomenal growth curve. And Ken Rice was the number one salesman in the company for years. So he made millions of dollars, legitimately, through getting those contracts, and as a result, was one of Skilling's fair-haired boys. Toward the end of his run, he was asked to head up a brand-new broadband division, which was Skilling's next big idea, to convert Enron into an internet dot-com and get the kind of trading multiples that the companies that were true dot-coms were getting in the late 90s. The idea was that they would build a fiber-optic network and become a middle-man and market capacity at both ends to people who could offer it up and people who needed it, just like they had done in natural gas. Rice was brought in to run it, and this thing was a disaster. It's just a complete and total loss. Lots and lots of money brought in, some contracts entered into that were failures, and he knew that it was going poorly. According to his testimony, for example, at the end of the first year of operations, he came in and told Skilling, "We're going to lose 110, 120 million dollars." Skilling said: "Well, I understand it's a startup, the number's going to be 65." And they went out and they told the world it was 65. Which the analysts took as good news, because it was a startup, and they understood the parameters.

B. Vaaler: There was a lot of talk in the Rice testimony about something called "Dark Fiber," too, which I thought was interesting. Dark Fiber was unused capacity in broadband. The revenues that they were generating were, in large part, the result of selling off capacity that wasn't used, so-called "Dark Fiber." And one of the real hot contested items was whether Skilling had misled analysts in simply reporting a revenue number as opposed to noting the substantial effect of that was, it was sales of Dark Fiber, selling off the business.

B. Rosenbaum: Well, the allegations go one step further than that. Skilling, if you believe the others, went out of his way to tell the analysts and the investing public that the sales were not Dark Fiber. When Dark Fiber constituted anywhere from 50-75% of these essentially one-time gains, he was saying it was no more than about 25%.

B. Vaaler: Who will be the key government witnesses?

G. Polsky: Obviously, Andy Fastow. I think one of the things that's interesting about the witnesses today, these are all the people that pled guilty, and Zach mentioned the impeachment issue, but what's going on now is, these people testified that they committed a crime, but the defense basically says, "well, no, you didn't commit a crime."

B. Vaaler: In fact, we've heard that argument in the witness box.

G. Polsky: Right. No, you didn't commit a crime, and now you're just saying you did commit a crime to get the leniency. Of course, that's going to change when Fastow testifies. They are going to paint him as worse than he's showing himself. Zach is that unusual to have people plead guilty and then become witnesses, and the defense lawyers actually try to argue that people did not commit crimes?

Z. Carter: In a white collar case involving complicated transactions under these circumstances, it's becoming less and less unusual. Think about this: it's not a matter that will ever come to the jury's specific attention in this case. But think about Duncan's testimony in the Arthur Andersen case. Arthur Andersen was reversed by the United States Supreme Court, and Duncan was permitted to withdraw his plea. And for people who were watching that prosecution at the time, there was always the suspicion that when he pled guilty, he pled guilty under circumstances in which it was clear from his allocution that he didn't really believe he was guilty. I've taken guilty pleas as a U.S. Magistrate Judge, and there's a time when you go through the ritual, when you're required by the law to determine whether or not the defendant is pleading guilty because he or she is guilty, in fact. And so you go through the litany of the facts that they acknowledge that they had, or the conduct that they acknowledge that they had engaged in, and then there's that magic moment where you ask, "Well, you admitted that you did this, you admitted that you did that. Did you know you were doing something unlawful at the time?" And then there's, under some circumstances, that pregnant pause that you kind of almost hear in the transcripts of some of these, of the Enron defendants, and you get an answer something like, "Well, I've conferred with my counsel, and he advises me that it was wrong, and I accept that." And now the judge has a dilemma. If the plea is accepted, someone has knowingly and intelligently waived their right to trial, consulted with able counsel and decided it is better to do 18 months in jail than 18 years in jail. If you accept the plea, that will be the cap on the sentence, very likely. On the other hand, if the person doesn't accept the plea and goes to trial, they could be facing, under the guidelines, even post-Booker, multiple decades in jail. Do you permit that plea to stand or not? And most judges are going to permit that plea to stand, but with a gnawing suspicion that the person who pled did not actually plead because they were, in fact, guilty of knowingly committing some financial fraud.

B. Rosenbaum: Zach, does that kind of point out something that defense counsel are able to communicate to a jury? It seems to me when you've got one key witness who may have turned state's witness, if you will, if I can be melodramatic here, that's one thing, but when you've got 16, three of whom even the defense are saying were bad, bad, bad. It seems to be a difficult argument to make to a jury.

Z. Carter: Not as difficult as you think. Because now you have the human nature factor. Lets assume that there are going to be 10 witnesses in this case who have pled guilty and that 8 of them actually believe they pled guilty because they had to, because of the coercive effect of the guidelines. They're dying to tell somebody that they're innocent. And you give them a little lead on cross-examination, you give them a little space to be able to get that off their chest in a way that they think is not going to offend the prosecutors so badly that the deal gets ripped up, they'll have the opportunity. Frankly, it happened at the Arthur Andersen trial. Duncan basically testified that he did nothing wrong.

G. Polsky: How do prosecutors take this into account? How do they actually, after the trial's done, decide on cooperation? I guess they make a recommendation.

Z. Carter: They make a recommendation to the judge. Its up to the judge at the end of the day, fortunately. But prosecutors can, it can be a half-empty or half-full, in terms of their presentation to the court in terms of their appraisal of the quality of the cooperation, that the cooperating defendant provided in the course of testimony.

B. Vaaler: Zach, were these corporate types just kind of lambs to the slaughter in front of the Enron Task Force?

Z. Carter: Well, put yourself in the position of someone who is 30 or 40 something, with school-aged children, and they're offered a choice of separating themselves from their kids for from 6 months to 18 months, or seeing their kids next when they walk down the aisle. And I've had that kind of conversation with folks.

B. Rosenbaum: I think it would depend on whether the kids were in elementary school or in middle school. **[Laughter]**

Z. Carter: Well, my daughter's going to be a teenager on Tuesday, and I still wouldn't want to be separated for that long.

B. Vaaler: What about for the defense? Who will be key witnesses for the defense. I know after the Department of Justice presents its case, I'm sure there will be motions. But who do you suspect will be key witnesses, or are they just going to keep beating away at this case by the Department of Justice?

Z. Carter: Very hard to tell. For any of you who've read either "Conspiracy of Fools" or "The Smartest Guys in the Room", you know that there are any number of executives who should have some insights into these transactions and may be able to shed some light as to whether or not Skilling or Lay knew. But to the extent any of these people have been subjects or targets of the Enron Task Force investigation, they're effectively unavailable to the defense counsel. And you can expect that if they're well-counseled, they're going to invoke their Fifth Amendment privilege. My guess is that it is likelier, again, consistent with the notion of trying to keep these—to invite the jury's attention to how incredibly complicated these transactions were, that they'll bring in expert testimony, to try to establish that.

B. Vaaler: That plays into their overall strategy of making this about the accounting. The indications to date from the defense have been that it is likely that Skilling and Lay will take the stand, what do you think about that?

Z. Carter: Well, that is the most difficult judgment that defense counsel ever has to make in a criminal trial. I mean, very, very strong presumption against it, where transactions are as complicated as these, sometimes its unavoidable, sometimes you have to make an assessment, a very subjective assessment based on who your clients are and how articulate they are and presentable they are. Actually the most dangerous kind of defendant witnesses are exactly the Skilling and Lay types who have a large part of salesmanship in them. They have this notion that "I can sell anything to anybody anytime." When I'm defense counsel representing somebody like that, I'm horrified.

G. Polsky: I think it's kind of interesting to think about the two different personalities, too. You've got Ken Lay, who's smart—Ph.D. in Economics, but much smoother around the edges than Skilling, who has the reputation of being brilliant but abrasive and—

B. Vaaler: I think everyone remembers Skilling's testimony before Congress back shortly after the company fell. He came off as a bit on the arrogant side. There have also been reports in the press (it's not clear that they're true) that Skilling's been trash-talking people in the hallway outside the courtroom. Calling them names.

G. Polsky: Making motions to witnesses while on the stand.

B. Vaaler: Yes. So, he could be a bit of a loose cannon.

B. Rosenbaum: Lets hope he testifies.

Z. Carter: I don't think there's ever as much to lose as many defense attorneys think at making an 11th-hour decision not to have a defendant testify. You can always make the claim to the jury, depending on how the prosecutor's case has gone in, very often credibly, that it's just simply not necessary. It wasn't my burden in the first place, and after listening to them, I think that you understand that they have not met their burden of proving guilty beyond a reasonable doubt in explaining why. Again, this is something you just have to keep your finger on the pulse of during the course of the trial. There are some questions that the jury is going to need to have answered, that if they haven't been answered, you just may not have any choice. But if you can avoid it, you avoid it.

The Legal Reforms Arising out of Enron

B. Vaaler: I want to shift now to the second segment of our program. But I want to talk a little bit about the legal reforms coming out of Enron, coming out of Congress, principally, but also other sources. I think most of us at least have an overall familiarity of this and we're not going to dig into all of these, but we know that what came out of Enron were a number of reforms, some of which constitute an unprecedented federalization of law, including an unprecedented federalization of corporate governance requirements. This included audit committee composition, audit committee responsibility, bans on loans to executive officers and directors. It also included a brand new and unprecedented federal incursion into regulation of the auditing industry, creation of a quasi-governmental agency, the PCAOB, to oversee public company auditing. Unprecedented federalization of lawyer ethics and professional responsibility, with the up-the-ladder reporting rules that the SEC was required to adopt. Massive changes to the disclosure regime, both speeding up Form 10K, Form 10Q and Section 16 reporting on short-swing transactions. New disclosures in the MD+A, new disclosures regarding non-GAAP financial presentation. And finally, a beefing up of sanctions for securities fraud. Personal accountability in the form of CEO and CFO certifications on 10Qs and 10Ks. All of this coming from a number of sources, both SEC initiatives that were already underway prior to

Anti-Fraud Network Continues to Grow

Recovering the proceeds of fraud and corruption is one of the truly global problems facing organizations today. Proceeds rarely stay in the country where they have been stolen. For organizations to recover stolen or corrupt assets they need access to lawyers specializing in their recovery across the world. That is why the **Anti-Fraud Network** exists. It is a network of lawyers who specialize in the pursuit of claims arising out of the theft, various other dishonest appropriation of assets, corruption, misuse of confidential information or similar breaches of duty.

The **Anti-Fraud Network** is dedicated to providing access to trusted points of contact across the globe and offering a unified first-class international service to clients, at a time when experience, speed, cooperation and highly responsive service are most important.

Members of the **Anti-Fraud Network** have access to many benefits and opportunities to improve the service provided to their clients. If you would like to enjoy access to the expertise of leading anti-fraud specialists across the world, or would like to receive the Network's e-newsletter, please contact Nick Burkill at burkill.nick@dorsey.com. You can also review the Network's website at http://www.antifraudnetwork.com.

Sarbanes-Oxley, the new corporate governance listing standards of the NYSE and NASDAQ. And of course, the Sarbanes-Oxley Act itself, signed into law on July 30, 2002 by President Bush. So, there was a lot to consider here. Roberto Romano took it all to the woodshed and gave it a whacking and called it quack corporate-governance, or at least most of it. We've got a panel of experts on this topic who have been doing nothing but this stuff for the last four years, so I asked Bob and Gregg and Zach, what was really accomplished here? What was an important reform addressing not only anecdotes coming out of Enron or WorldCom, but changing behavior for the better?

B. Rosenbaum: Well, let me take the first crack at that, Bryn. I think there are really two ways to look at it. At the micro level, there are any number of shots that can be taken at virtually every single reform that was done, the manner in which it was done, how the rules are written, the complexities in dealing with them—that's keeping people like me busy. Frankly, I'm happy about that. But at a macro level, I think significant change was effected. If you go back and look at Sarbanes-Oxley, while there's no official legislative history, it's absolutely clear from the preamble that what they were trying to do was restore investor confidence. And you have to put yourself back about five years. Enron was not alone, it was the largest single bankruptcy in the history of mankind, for about six months, and then WorldCom came along. And in between was Adelphia, Tyco, Xerox, and Qwest. Major, major corporations that millions of Americans had invested in, and confidence was shaken. So if you look at it from a macro perspective, has there been change in behavior for the better? I would say, yes.

B. Vaaler: Give us some examples.

B. Rosenbaum: Well, perhaps a very finite example, but one that I have been dealing with, pretty much on a quarterly basis, is the CEO and CFO certification. From one perspective you might say, well, this is no big deal, because those officers have been signing those reports quarter after quarter, but on the other hand, the "I didn't know what was going on" defense that might work for Ken Lay, is now gone forever. I think that's a very, very big deal. The companies come up with difficult disclosure issues, very legitimately, without an LJM partnership on the side or the CFO's making millions of dollars. Very, very hard questions. When we are talking, it's usually the CFO, not the CEO, who's in the room when we're talking about it. One of the very early questions was, "What's the effect on my certification? Can I sign my certification?" And everybody else in the room knows that if the certification isn't signed, the company cannot file the 10Q or 10K and be in compliance with their reporting regulations, which could have a great deal of spin-off, spillover effects. So, just that one little piece added to the pie, I think, has changed behavior significantly.

B. Vaaler: Although, wouldn't Skilling and Lay have signed a certification?

B. Rosenbaum: I'm not saying it's going to prevent fraud. Look at RevCo last year, it went public, what, about 12 months ago, and six months after that, it's in bankruptcy. It's not going to prevent fraud. I don't think you can actually legislate honesty and integrity, but you can push people to think twice.

G. Polsky: I think executives may perceive their criminal liability as higher than it actually is, once you add on the fact that the prosecutor would have to show intent when making the false certification.

B. Rosenbaum: I've got a little different perspective, again. First, just to reel it back, I think the last full year, Arthur Andersen made 50 million bucks. I should say that again, 50 million dollars from a single client. And it was the largest single client in the Arthur Andersen empire. And much of that, as Bryn said, was not the audit work. I have seen tremendous changes in behavior, and I don't think this region had the kind of auditing consulting culture that other parts of the country had. So, I can't really speak to a light-switch change in the behavior, but it's clear to me that auditors are much, much more cautious. They do not view themselves as aligned with management in trying to achieve particular goals. They view themselves as much more of a gatekeeper. They do take, in my experience, very seriously, the

fact that they are retained by the audit committee, they report to the audit committee, there are executive sessions with the audit committee every quarter. The head of the audit committee has regular communications with the audit partner, much more frequently than occurred five years ago. And I think there has been a change in the way the auditors view this. This has also, frankly, been a Full Employment Act for them.

B. Vaaler: Speaking of full employment, how about internal controls reporting? With an estimated cost of at least 8 million dollars per company to bring themselves in line with first-year internal controls reporting, that truly has been the gift that keeps on giving for the auditing community out there. Is that really important? Is it changing behavior?

Z. Carter: I serve on the audit committee at Marsh & McClennan, and I have to say, from my perspective, particularly as a relatively new board member, that it is extraordinarily distracting. I mean, at an audit committee meeting, certainly in the first year or two, you can easily spend 80% of the time just dealing with internal control reporting issues with the auditor. And I think what the danger of that presents is, particularly in the case of that particular company, not one of the issues that created the problems for the company arose out of internal controls. And so we were spending 90% of our time focusing on matters that weren't problems, and spending very little time trying to anticipate the corruption hazards that could be tomorrow's scandal.

B. Vaaler: One of the questions that clearly was left hanging on some people's lips was, and many of the people in this room are lawyers, you know, "where were the lawyers in the Enron case?" Professor John Coffey wrote a couple of articles, both of which were entitled some variation of, "It's About the Gatekeepers, Stupid," about the Enron scandal. And he was most hard on auditors and the analyst-type gatekeepers, but he also said there's some blame to be shared with the attorneys. Ironically, however, not one lawyer, who was functioning as a lawyer, has been indicted to date in Enron. What's the deal on that?

B. Rosenbaum: We write the laws.

G. Polsky: The bankruptcy examiner found a basis for a civil lawsuit, civil liability against the in-house lawyers, including Jordan Mintz, who was the one who actually went and got, on his own, an independent law firm to look at the Fastow deal. That's sort of ironic, because he was viewed as sort of the savior. But they found that he violated his professional responsibility not reporting up the ladder under the Texas ethical rules—

B. Vaaler: Which was not mandatory at the time. There was no mandatory up-the-ladder under 1.13 as it existed, I think, but the important—

Update

At the time this newsletter went to press, the trial was in its fourteenth week. Jeff Skilling had testified under both direct and cross examination. Ken Lay, who had testified during direct examination that he was living "the American nightmare," was responding to cross examination. Lay testified that while the company used "aggressive" accounting for the partnerships and related entities, the structures were approved by Arthur Anderson. "Aggressive accounting does not mean illegal accounting," Lay said. "People misunderstood things that were new and different as being wrong, and they weren't." It is anticipated that closing arguments will take place later this month, putting the case in the jury's hands by late-May.

G. Polsky: But there were 250 Enron in-house lawyers—

B. Rosenbaum: The way Enron structured its in-house legal group is very instructive. In some ways, I don't think it was intentional when it started, but it was a perfect design to enable the business guys to do whatever they wanted without being impeded. They were balkanized to a very great degree. Many companies have lawyers assigned to business units, but most of the companies that I'm aware of make sure that the lawyers, as lawyers, get together and share developments in the company and get direction from the general counsel and his or her direct reports, and work as a cohesive unit. Apparently, at Enron, it was just the opposite. There are stories of lawyers never, ever talking to the general counsel again, after the day they were hired.

B. Vaaler: And, the business people determined their pay, Bob. I mean that was one of the other criticisms, that the lawyer's pay was determined by the business units, not by the general counsel.

B. Rosenbaum: Well, you know, they, Jeff Skilling was very proud of Enron's Rank & Yank program that he instituted where he insisted that every business unit rank every employee, and it was on a curve, so the bottom 10% were given warnings, so that if they're not out of the bottom 10% a year from now, they'd be fired. And the system, when initially instituted, I think, was done for good purposes, but it was very quickly turned into a very political tool where those making the decisions would trade off to protect their favorites and, those making decisions would target people who were obstructionists. As I said earlier, this was a deal-making company, that mark-to-marketing accounting, you have to keep in mind, anybody who slowed down, much less tried to stop a deal was viewed as an obstructionist. They would be rated low, and the lawyers knew that. The business people, the people who they were supposed to be advising about whether or not the deals had problems in them, were ultimately the ones who were deciding whether or not they would stay at the company.

G. Polsky: There were other incentives, too. Kristina Mordaunt, a low-level lawyer, was asked if she wanted to make an investment in one of these partnerships and she didn't. They said, "Don't ask any questions, just cut a check for $5,000." She cut a check for $5,000 and a week later, they were asking for her bank routing information, and they routed a million dollars into her account. So that was another way to keep you playing ball. The carrot instead of the stick.

B. Vaaler: So up-the-ladder reporting obligations now, which have been in place for a couple of years, have changed the ethics responsibility of individual lawyers. But it's hard to know how much structural change they've caused. Certainly they've caused some structural change within the law firms. But, I think some of the issues are really on the law department side of life and whether the obligation to direct report resulted in structural changes that, I think would bring about better behavior. Final question for Zach: one of the lessons that some have learned from Enron and from other white-collar events recently, is that lawyer-client privilege looks like it isn't much of a protection anymore. In 2002, the Enron board waived privilege—agreed to full cooperation with government investigators. The SEC has used substantial incentives to get other companies to do the same thing. Are people fooling themselves thinking that there's much of a protection there with lawyer-client privilege in these kinds of situations?

Z. Carter: That's a difficult issue. I'm actually a member of a task force on the New York State Bar Association that's looking at that issue, i.e., the reflexive demands by some prosecutors and some regulators, particularly SEC, for blanket waivers of attorney-client privilege. It's a sign that a company is fully cooperative with an investigation. Lots of people in the profession, I think, believe that it is short-sighted to demand these waivers reflexively, because if you really want to encourage, there's no way that the government will ever have enough resources to police every company on the planet. That's just not practical. And so what we need is for companies to police themselves. And if companies are going to be effective in policing themselves with well-resourced, in-house counsel and compliance office capacity

and with the assistance of outside counsel, there needs to be some comfort that employees and executives can take that at least in the matter routine, that when they answer questions of counsel, that except in extraordinary circumstances, that what happens in Vegas, stays in Vegas, to some extent. And I think there are lots of prosecutors, frankly, who agree, that it should not be, that the demands for waiver should not be reflexive. One of the pressures right now, is the sentencing guidelines place a substantial premium on the waiver of attorney-client privilege in order to gain for a corporation to get the benefits of cooperation. And that's a matter that the commission is currently reviewing. **[See the update on page 4]**

Conclusion

B. Vaaler: All right, final questions, we're coming up on the end of our little presentation. What if they walk? If Skilling and Lay walk is that a demonstration that our legal system works or that our legal system doesn't work? I think a lot of people will be gnashing their teeth if these two guys walk out the door. Is it OK if the seventh largest corporation in the United States is shot out from under you? Do you get to go free or should somebody swing?

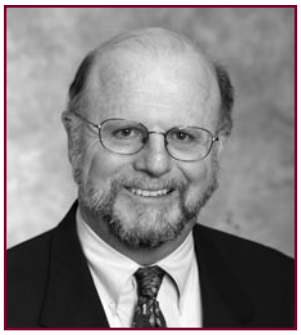
Z. Carter: Well, I don't think of this in terms of lessons that the public can take. The public will lose no matter what the outcome is because I think it's just as important for the public to learn the limits of the system, particularly the criminal justice system. The issue is whether or not the executives at the very top of an organization can be held responsible for everything that happens on their watch. That question should be complicated. It should be difficult to obtain a conviction under circumstances where those issues aren't so clear, and the transactions that are under scrutiny are complicated. And so I think that the issue really isn't whether or not someone, some human being, swings for what happened at Enron but more importantly whether or not an Enron situation could be prevented in the future. Or whether or not ….

B. Vaaler: I certainly think it demonstrates the limitations of our legal system as a remedy to all the things that can befall…

Z. Carter: But it would only demonstrate the limitations if you assume, out of the box, that they're guilty. There is the possibility that – you don't think so, everybody's shaking their heads.

B. Rosenbaum: I think the ship has sailed. Whether these two guys walk or don't walk to me in some way is irrelevant. The world has changed, things go in cycles, they will change again, but for the moment I think corporations are behaving differently. The ones at least that I work with take their roles very seriously and think hard about corporate governance and disclosure and transparency and kind of the fundamental do-the-right-thing approach, I think has spread throughout corporate America. I also think when you look at the fact that Dennis Kozlowski is in jail, Mr. Rigas is in jail, Bernie Ebbers is in jail, Scrushy isn't in jail but he just lost a civil case down in Alabama for about $40 or $50 million dollars. If these guys get off there will be civil cases going after them. I don't think senior executives in public companies are going to look at this and say, "Great, they got off, I think I'll do the same thing." ■

Attorney Profile: Robert C. Bundy



A partner in Dorsey's Anchorage office, Robert Bundy has practiced law in Alaska since 1971. Bob represents corporations and individuals in investigations by the Department of Justice, defends clients in criminal trials and appeals, and conducts internal investigation for corporate and government clients.

Bob is former chair of the Alaska Bar Association Rules of Professional Conduct Committee, a member of the Ethics Committee, and co-chair of the Gender Equality Section. He has received the Alaska Bar Association's Professionalism Award.

Bob regularly serves as faculty in National Institute for Trial Advocacy programs. He has taught at NITA programs in Seattle, Los Angeles, Albuquerque and Boulder. He is a frequent speaker at CLE programs in Alaska.

Bob was the District Attorney for the Second Judicial District in Nome, Alaska, and was also a felony trial lawyer and Chief Assistant District Attorney in Anchorage. He then served in the Alaska Attorney General's office, in the antitrust section, where he investigated and prosecuted criminal and civil antitrust and other commercial regulatory matters.

In 1984, Bob joined the Anchorage office of Bogle & Gates, and was named partner in 1986. The majority of Bob's litigation practice involved large, complex cases in state and federal courts in the areas of commercial litigation, real estate, products liability, antitrust, professional liability and personal injury. He served as local counsel in defending Exxon Shipping Company in the federal criminal prosecution resulting from the Exxon Valdez oil spill.

In 1994 Bob was appointed by President Clinton as United States Attorney for the District of Alaska, serving in that position until 2001. During his term, he served on the Attorney General's Advisory Committee, as Chair of the Environmental Issues Subcommittee, and a member of the Native American Issues and Civil Issues Subcommittees. He was also Co-Chair of the Department of Justice Environmental Crimes Policy Committee and a member of the Senior Environmental Litigators Forum.

After his term as United States Attorney, Bob joined Dorsey & Whitney LLP as a partner. He has handled complex litigation matters for Alaska Airlines, BP Exploration (Alaska) Inc., Exxon Mobil Corporation, Fred Meyer Stores, Inc., EFJ, Inc., Hageland Aviation, Cook Inlet Region, Inc., and Western States Investment Corporation. Bob's major focus is responding to federal criminal and regulatory investigations and prosecutions. He also conducts internal investigations for corporate and government clients. For example, he conducted an ethics investigation of the Alaska Attorney General on behalf of the Governor of the Alaska.

Bob is also active in pro bono legal work. In the summer of 2004, he was unexpectedly pulled from a remote fishing trip in Alaska to handle a week-long evidentiary hearing in a federal habeas corpus proceeding in the United States District Court in Lubbock, Texas, on behalf of a Dorsey & Whitney pro bono client. Due in part to Bob's efforts, the client had an unjust death sentence overturned.

Bob received his J.D. from Boalt Hall, University of California at Berkeley in 1971; and his B.A., cum laude, from the University of Southern California. He is admitted to practice in Alaska, the United States District Court for the District of Alaska, United States Court of Appeals for the Ninth Circuit, and the United States Supreme Court. ■

Dorsey in the News

Hold the Date! Upcoming seminar on forensic accounting investigation: June 15, 2006, 12:00 to 4:00 pm. Location TBD. PricewaterhouseCoopers Investigations & Forensic Services team and the best of Minneapolis' white collar crime bar will sit on panels to explore three specific themes:

• SEC and DOJ investigations • Top five investigative issues • Global risks and E-discovery issues

Dorsey & Whitney's Ed Magarian will participate in panel discussions at this conference. Additional details will

Zach Carter was honored by The New York Lawyers for the Public Interest with the 2006 Public Interest Law & Society award on February 28, 2006. The award honors the attorney who best combines outstanding legal skills with a long-standing commitment to public service and the New York community. Past winners include Kenneth R. Feinberg, Special Master of the 9/11 Victim Compensation Fund, Justice Ruth Bader Ginsburg, and former New York Governor Mario Cuomo. In endorsing the honor, State of New York Chief Judge Judith S. Kaye declared that "Zach Carter's energy and effectiveness are true example of the very best of our profession, whether the issue is foster children, or judicial selection, or mentoring young lawyers, or a host of other subject that make us a fairer, and better society."

Kent Schmidt will be a featured speaker at a Foreign Corrupt Practices Act conference in Washington D.C. September 18-20, 2006 sponsored by the International Quality & Productivity Center. The presentation will include a discussion about how to maintain an effective FCPA compliance program and considerations relating to a corporation's decision whether to voluntary disclosure known or suspected FCPA violations to the government.

At the invitation of the Office of the Attorney General for the State of Minnesota, Ed Magarian will participate in a panel about racial bias in the criminal justice system. The presentation will take place from 10:00 a.m. to 12:00 p.m. on May 10, 2006 at the Radisson City Center, 411 Minnesota Street in St. Paul. The presentation will be given primarily to approximately 175 public/law/government attorneys, ranging from state attorneys, county attorneys, city attorneys, attorneys from the legislature, public defenders, and judicial law clerks.

Nick Burkill, Jean-Pierre Douglas-Henry and James Curle of Dorsey's London office are partnering with Kroll Ontrack to present a workshop in London on "Document Management - Dangers and Opportunities." The workshop will take place at 9:00 a.m. on May 11, 2006. For further details, please contact Nick Burkill, burkill.nick@dorsey.com.

On February 1, 2006, Page Hall gave a presentation at the Georgetown Law Center's annual International Trade Update program on how to manage a customs case at the U.S. Court of International Trade. On April 6, 2006, he gave a presentation on NAFTA verifications at the American Bar Association's International Law Section's Spring Meeting in New York. Mr. Hall also authored a chapter in the book The Laws Behind International Trade, which will be published by Aspatore Books in July, 2006, and an article on Trade Adjustment Assistance which was published in the most recent volume of The John Marshall Law Review.

On April 22, 2006, Ed Magarian was featured on a WWTC radio (Minneapolis-St. Paul) talk show in a segment discussing wrongful convictions and the work of the Innocence Project to identify and seek the release of people convicted of crimes they did not commit. Dorsey is a supporter of this organization, and has contributed hundreds of thousands of dollars in time and money to that cause.

Largely through the efforts of Nick Burkhill in Dorsey's London office, a new anti-fraud network of attorneys has been established. The network includes attorneys in Dorsey offices and other firms around the world. If you are interested in the capabilities of that network, you can learn more by visiting http://www.antifraudnetwork.com. The network currently has members in North America, Europe, Asia, Africa and Australia.

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WHITE COLLAR CRIME AND CIVIL FRAUD UPDATE

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