

# WHEREVER THE EVIDENCE LEADS

**Are corporate counsel a new target of prosecutors? A cautionary tale of four GCs sheds some light on the impact of the federal government's new policies.**

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**W**hen the Department of Justice announced the indictment of top executives of McKesson HBOC, including its former general counsel Jay Lapine, on charges of securities fraud in June 2003, former Deputy Attorney General Larry D. Thompson, then head of the Justice Department's Corporate Fraud Task Force, hinted that corporate counsel would increasingly be the subject of prosecutors' scrutiny. Thompson stated, "Major corporate fraud cannot happen over an extended period of time without the complicity of accountants, lawyers, and other professionals." He added that the case demonstrated the government's "commitment to follow the evidence wherever it leads—to not only those executives but also those lawyers or other professionals who defraud the investing public."

Indeed, Lapine is not alone. The group of former general counsel who have recently found themselves the subject of criminal indictments includes Franklin Brown, former general counsel of Rite Aid Corporation, who was recently convicted on charges including making false statements

to the government and obstruction of justice; Mark Belnick, former general counsel of Tyco Inc., who is implicated in the alleged looting of that company by its top executives; and David Klarman, former general counsel of U.S. Wireless Corporation, who recently pled guilty to charges of mail fraud and money laundering.

Although the grounds for the charges are varied, these four men have one thing in common: They represent a group that might increasingly become the target of criminal authorities.

## [ IN BRIEF ]

It may be easy for general counsel to dismiss the specific personal relevance of recent cases brought against their peers—after all, the smoking guns were just about in plain sight. What's not so easy to dismiss, however, are the new rules of the game, which can implicate the seemingly innocent, turning nonfeasance into misfeasance—and job security into joblessness. Or worse. For example:

- Simply being implicated in a criminal investigation can result in a CLO's being asked to resign, even before charges are filed.
- Refusing to cooperate with investigators—which may be in the company's interest, but not the CLO's—may result in dismissal.
- Participating in general management functions, an increasingly important part of the CLO's role, can result in the CLO's unexpected participation in investigations and prosecutions as well.

The moral to the story: While malfeasance may be avoidable, nonfeasance may no longer be a defense.

## McKesson HBOC

Jay Lapine was general counsel of HBO & Co., which manufactured and sold information technology products primarily to customers in the health care industry. When HBO & Co. was acquired by McKesson Corporation, a health care supply management company, in January 1999, Lapine became general counsel of McKesson HBOC (since renamed McKesson Corporation). He was dismissed for cause in June 1999, after the board's audit committee concluded that he was involved in accounting improprieties.

Although other senior executives, including the former copresidents

CATHY GENDRON

of the company, were indicted in September 2000, Lapine was not indicted until June 2003, reflecting the fact that criminal investigations can take a long time. The U.S. attorney in San Francisco alleges that Lapine helped design a scheme to artificially inflate the earnings of HBO & Co. and later McKesson HBOC. At the core of the pending charges against Lapine is the allegation that he participated in a conspiracy to improperly recognize revenue on hundreds of sales contracts that were in fact subject to separate side letter agreements that gave the customers the right to cancel the deals. Lapine is specifically alleged to have discussed this conduct with other senior executives as a means to recognize revenue in quarters when the company's actual performance was expected to fall short of targeted goals. In addition, the government alleges that Lapine reviewed financial reports filed with the Securities and Exchange Commission and press releases knowing that they were false as a result of the improper accounting with which he was involved.

Lapine is awaiting trial.

### Rite Aid

Franklin Brown, former chief legal counsel and general counsel of Rite Aid Corporation, resigned in May 2000 after more than three decades with the company. The press release announcing his resignation offered no explanation.

In a 37-count indictment handed down by a federal grand jury in Harrisburg, Pennsylvania, in June 2002, Brown was charged with participation in an elaborate conspiracy of fraud, related-party transactions, and

## You May Be a Lawyer, But You're Going to Need One

**Here's what to do if you're facing a criminal investigation.**

**A**s a defendant in a civil litigation, an individual typically risks a money judgment. The stakes involved in a criminal investigation of an in-house attorney can be much higher and include damage to the attorney's personal and professional reputations. Being the subject of a criminal investigation can cost you your job; a criminal conviction can cost you your law license and your liberty. If you find yourself involved in any way in a criminal investigation, these are the most important and immediate steps you can take to protect yourself:

- **Hire experienced criminal defense counsel** at the first sign of investigative activity. Only experienced counsel can reliably assist in navigating what can be the treacherous waters of an investigation. Be aware that other in-house counsel of your employer have a primary ethical responsibility to the corporation and therefore cannot independently represent your interests. In many cases, once you are known to be represented by counsel, you cannot be contacted directly by government lawyers and investigators, though there are exceptions. Accordingly, retained counsel can serve as a buffer and limit opportunities for you to inadvertently make statements that might be deemed incriminating.
- **Take the Fifth.** Until you have retained counsel, you should probably not discuss matters related to the investigation with anyone. Talking to other witnesses might raise an inference of witness tampering in the view of prosecutors. After consultation with counsel, you might decide that you wish to speak with investigators, but only if the government will grant you immunity. Or you might decide to speak with the government even without a grant of immunity. Whatever course you take, it should only be after consultation with counsel and consideration of the risks.

obstruction of justice. Among the various manipulations with which Brown was charged, the government contended that he inflated earnings by causing millions of dollars of bogus charge-backs to be invoiced against Rite Aid's vendors by falsely characterizing the deductions as credits for damaged or outdated merchandise. The government also contended that he signed false annual reports filed with the SEC.

In addition to allegations of

accounting fraud, Brown was charged with conspiracy to obstruct justice for his alleged involvement in intimidating witnesses, directing the deletion of computer files, and providing false information to internal investigators. Brown was alleged to have coached a witness on what to say to internal investigators and to have encouraged another witness to withhold information from internal investigators, among other allegations of obstruction and witness tampering.

Before trial, in an apparent attempt to streamline its case, the government moved to dismiss 24 counts against Brown, including counts for securities fraud, wire fraud, and mail fraud. On October 17, 2003, Brown was convicted on 10 counts, including conspiracy to defraud the U.S., making false statements to a government agency, conspiracy to obstruct justice, and witness tampering. He was acquitted on the remaining wire fraud count.

Brown is awaiting sentencing and faces a maximum of 60 years in prison on the 10 counts on which he was convicted.

### Tyco

A former partner with Paul, Weiss, Rifkind, Wharton & Garrison, Mark Belnick joined Tyco Inc. in 1998. He was fired in June 2002; Tyco declined to comment on the reasons why.

Belnick was indicted in September 2002 and again in February 2003. He is charged by the Manhattan District Attorney with stealing \$12 million from Tyco by accepting "special bonuses" that were not approved by the board of direc-

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tors. Belnick also faces charges of securities fraud under state law for failing to make disclosures regarding his special bonuses and an interest-free loan of more than \$14.5 million from the company, and for failing to disclose a gain of \$25 million from his sale of Tyco stock. He is also charged with falsifying records in connection with the filing of false director and officer questionnaires.

Belnick was scheduled to go to trial in March 2004.

### U.S. Wireless

David Klarman was general counsel of U.S. Wireless Corporation from 1996 until he resigned in March 2001. His resignation came at the request of the board during an audit committee investigation into his involvement in improper transactions.

In an indictment returned by a grand jury in the Northern District of California, announced in July 2003, Klarman was charged, along with the company's former CEO, with defrauding investors. Specifically, the government alleges that Klarman and the CEO caused U.S. Wireless to issue cash payments, stock options, and stock shares to offshore shell corporations that they controlled and owned.

Klarman pled guilty to mail fraud and money laundering last December, admitting to embezzling more than 500,000 shares of U.S. Wireless stock and laundering more than \$9 million. He awaits sentencing and faces a maximum sentence of 25 years in prison and a \$750,000 fine.

### Lessons Learned

Corporate executives, including corporate counsel, implicated in

## CORPORATE SCANDALS—BUT NO GCS CHARGED

While senior executives of the following companies have become embroiled in investigations and prosecutions, in-house counsel are not facing criminal charges, at least not yet:

- Enron Corporation
- WorldCom Inc.
- Global Crossing Ltd.
- HealthSouth Corporation
- Adelphia Communications Corporation

criminal investigations will often be asked to resign or be dismissed by the corporation, even before formal charges are filed. This may be because the company's own investigation has concluded that counsel has engaged in misconduct, as in the cases of Lapine and Klarman.

But even if the company does not conclude that counsel acted improperly, termination or a request for a resignation might still occur. Often, in order to avoid prosecution itself, a company will seek to cooperate with prosecutors. Such cooperation typically includes requiring employees, including general counsel, to speak to investigators. Of course, this is often not in the individual interest of in-house counsel implicated in a criminal investigation. Under these circumstances, a company will be forced to fire employees who refuse to cooperate. Moreover, a company may have to demonstrate to authorities that it has taken remedial measures, including terminating employees the government deems responsible.

As the role of corporate counsel evolves in some companies to include participation in general management functions, it is perhaps not surprising that counsel will be ensnared in investigations and prosecutions when management's conduct is questioned by regulators. In fact, much of the conduct for which Brown was originally charged and for which Lapine is currently facing trial involved participation with other executives in schemes to improperly inflate their respective companies' balance sheets.

Nevertheless, at first glance it might appear that the govern-

ment is overreaching by prosecuting Lapine for merely reviewing and approving financial reports and press releases that the government believes contained false information. Even Brown, who allegedly actually signed at least one of his company's false financial reports, was not ultimately tried for securities fraud. Corporate counsel cannot be expected to be familiar with the bookkeeping underlying these reports or to be in a position to vouch for their accuracy.

The question remains whether this current flurry of criminal prosecutions of general counsel reflects the changing roles and conduct of counsel or a sea change in prosecutors' charging decisions.

Lapine's indictment has reportedly been touted by the Justice Department as its first of a corporate general counsel for securities fraud. Time will tell if these prosecutions are anomalies or the first in a long line of criminal charges against corporate counsel. If the former Deputy Attorney General's contention that corporate fraud cannot occur without the involvement of lawyers is taken at face value, it appears that so long as corporate corruption remains at the forefront of public concern, corporate counsel will no longer be viewed by prosecutors as mere bystanders. •

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