



## Case Western Reserve Law Review

---

Volume 57 | Issue 2

---

2007

# Current Ethical Issues for Securities Lawyers - A Comment on Humes

Geralyn M. Presti

Follow this and additional works at: <https://scholarlycommons.law.case.edu/caselrev>



Part of the [Law Commons](#)

---

### Recommended Citation

Geralyn M. Presti, *Current Ethical Issues for Securities Lawyers - A Comment on Humes*, 57 Case W. Res. L. Rev. 357 (2007)  
Available at: <https://scholarlycommons.law.case.edu/caselrev/vol57/iss2/6>

This Symposium is brought to you for free and open access by the Student Journals at Case Western Reserve University School of Law Scholarly Commons. It has been accepted for inclusion in Case Western Reserve Law Review by an authorized administrator of Case Western Reserve University School of Law Scholarly Commons.

# CURRENT ETHICAL ISSUES FOR SECURITIES LAWYERS—A COMMENT ON HUMES

*Geralyn M. Presti, Esq.*<sup>†</sup>

## INTRODUCTION

As I reflected upon Mr. Humes' remarks, I recalled a quote by Haile Selassie that is quite on point: "Throughout history it has been the inaction of those who could have acted, the indifference of those who should have known better, and the silence of the voice of justice when it mattered most that has made it possible for evil to triumph."<sup>1</sup> The fraud and other illegal acts of corporate executives at Enron, WorldCom, and other companies resulted in egregious losses to their constituents, officers, directors, shareholders, and employees. Their acts of greed resulted in a plethora of new securities laws, commencing with the Sarbanes-Oxley Act of 2002.<sup>2</sup> Along with the Chief Executive Officer (CEO) and the Chief Financial Officer (CFO), the in-house counsel, particularly the General Counsel, bears the burden of and the great responsibility for compliance with the regulatory requirements of those laws.

First, I will discuss some of general observations about the positive changes in response to requirements of Sarbanes-Oxley, as well as the challenges that compliance presents. Second, I will address the up-the-ladder reporting requirement for lawyers specifically and in light of my role as an in-house chief legal counsel at a publicly traded company. And, lastly, I will make a few comments on proposed Federal Rule of Evidence 502 and the problem of selective waiver of confidential client information.

---

<sup>†</sup> Senior Vice President, General Counsel, Assistant Secretary, Forest City Enterprises, Inc.; J.D./M.S.S.A 1988, Case Western University School of Law (Order of the Coif and magna cum laude).

<sup>1</sup> Haile Selassie, Ethiopian Emperor, Opening a Special Session of the UN General Assembly (Oct. 4, 1963).

<sup>2</sup> Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 11, 15, 18, 28, and 29 U.S.C.) (2002).

## OBSERVATIONS ON CORPORATE RESPONSES TO SARBANES-OXLEY

I am currently the General Counsel of Forest City Enterprises, Inc. and have worked with the Company for almost nineteen years. Forest City Enterprises is a national real estate company, founded in 1920, and principally engaged in the ownership, development, management, and acquisition of commercial, residential real estate and land throughout the United States. It has been publicly traded since 1960 and lists two classes of common stock on the New York Stock Exchange. We currently hold \$9 billion of real estate assets and the Company is headquartered in Cleveland, Ohio, with seven additional offices throughout the country. We conduct our business through several strategic business units in our present core markets: the New York City/Philadelphia metropolitan area, Denver, Boston, the Greater Washington D.C./Baltimore metropolitan area, Chicago, and the State of California.

I stepped into the office of General Counsel the very same month in which Sarbanes-Oxley was enacted. I not only had the challenge of learning how to become the General Counsel of a large public company, but I also had the challenge of ensuring compliance with the new requirements under the securities laws that were proposed and subsequently enacted.

Generally, in-house counsel is closer to the business than outside counsel because we are physically located right in the middle of the business operations. I always felt I had a gatekeeper role even before Sarbanes-Oxley. Prior to Sarbanes-Oxley, in-house counsel was in charge of the regulatory compliance with our bank financing covenants, enforcing the obligations to our partners under partnership agreements, the obligations under our leases to tenants, and so forth. Thus, I have always viewed the role of the general counsel as both the protector and legal enforcer of the corporation, but clearly, when Sarbanes-Oxley came into being, this role was dramatically and significantly increased. As a result, I feel the great mantle of responsibility, as well as the potential liability.

I have to say there were a lot of positive changes that came with the implementation of the new regulations that stemmed from the effort to comply with Sarbanes-Oxley. Prior to the enactment of Sarbanes-Oxley, we had a Code of Ethics that was distributed when people came into the corporation, but I do not think it was subsequently reviewed or discussed, nor was training provided. We had a Governance Committee, but they did not meet regularly. We had Board committee charters, but we had not regularly reviewed and revised them. Since Sarbanes-Oxley, we now have more written policies to

better guide senior management in our compliance efforts. For example, I now get increased questions from my associates about buying and selling Company stock, such as, "When are the black out periods? What is the process for getting clearance?" This gives me an opportunity to ask them in return whether they possess inside information, and if so, what material, non-public information they possess.

The other positive results that have come about for me as General Counsel are that the implementation and monitoring of the compliance with the new governance rules has indeed increased my interactions with the CFO and the independent non-management directors who chair and sit on the Board committees. I participate on and actively contribute to the meetings of the Board of Directors and all the Board committees. While we have always had "Transaction Committee" meetings, in which senior management reviews our financial transactions before we file our quarterly and annual financial documents with the SEC, we have added the Disclosure Committee as required by Sarbanes-Oxley.<sup>3</sup> These meetings are now longer and we engage in deeper discussions about the Company's transactions and how they are reported in our public filings. Sometimes, our Audit Committee members and our outside auditor participate, and we are able to jointly analyze and discuss company issues, such as revenue recognition, discontinued operations, and other matters that are important to the auditors.

The overall increased interaction among senior management, the Board, and the various Board committees creates greater transparency and accountability. An important value of our corporation is to set the correct "tone at the top." The public accountants annually survey executives and employees about the tone at the top. I believe we set a tone of integrity and openness.

I also find that we now have more written policies to better guide senior management in our compliance efforts. We have enacted policies to review charitable gifts, related party transactions, and stock option grants.

Compliance with Sarbanes-Oxley has increased the demand for more information from our Board. The Audit Committee will ask us to research accounting matters, such as the inter-company accounts or to write a memorandum on the application of an accounting rule to a particular transaction. I think some of our most challenging times came with implementing the section 404 internal controls procedures.<sup>4</sup> This was especially challenging for Forest City because of our

---

<sup>3</sup> 15 U.S.C. § 7241 (2002).

<sup>4</sup> *Id.* § 7262.

decentralized accounting in the several strategic business units and the high number of manual controls. We conducted weekly Audit Committee meetings to track progress of the section 404 compliance. We were determined to pass, and we did so very successfully, I am proud to say.

We have also updated procedures under the new securities rules. For example, we always had an internal hotline but we have now hired an outside company to serve as an external hotline resource so that employees could feel more comfortable reporting any alleged violation anonymously. Our external hotline has been in place for two years now. I report quarterly to the Audit Committee the types of calls that come in and the business unit in which they originate. We publicize the hotline: we put it our newsletter; we put it on the website; and, we put it on paycheck stubs. I am pleased to report that we have had relatively few calls, and none of them have contained material accusations that were found to be true after investigation.

Maybe the best thing that has come out of our compliance efforts is that we have established a risk management department, in addition to the existing internal audit department. The Risk Manager reports directly to the Audit Committee and on a dotted line to the CFO and to me. The Risk Manager assesses the Sarbanes-Oxley section 404 compliance, supervises the annual assessment and reporting of results on the conflict of interest forms and fraud surveys, and oversees the compliance with the federal sentencing guidelines through risk assessments.

Now that I have gotten through all the positive benefits, I have to tell you this compliance process has not been without its immense challenges. Primarily, and I am sure Mr. Richard Humes has heard, the SEC received many comment letters from corporations complaining that the compliance efforts in connection with the section 404 internal controls have been incredibly expensive. We hired a public auditor to assist us with our compliance. More importantly, it has been very time intensive. There was a point when it was difficult for the internal accountants to carry out their regular job responsibilities because they were so busy working to comply with the internal controls and procedures design and testing process. As a result, we had to hire additional accountants.

Initially, seventy-five percent of my attention had been on corporate governance compliance efforts. Sarbanes-Oxley compliance has been distracting from the business of the Company, however, maybe appropriately so. Nevertheless, it has taken a great deal of time and effort. Just when I think I have caught up, we have four hundred more

pages of securities rules that have been enacted regarding executive compensation and related party disclosure, which I am now trying to get up to speed on as well.

Another challenge has been some internal push-back from our associates when asked to sign representation letters to support the CEO and CFO certifications of financial statements required under the law. The CEO and CFO cannot possibly track the documentation of every financial entry throughout all the corporation's strategic business units. We have over four thousand people in the corporation.

These associates are not worried about committing fraud. They are concerned about their liability in the event of a mistake. Still, we have kept those representation letters in place. Furthermore, additional Board meeting time is occupied every March by an increased number of Board resolutions to comply with the laws—resolutions required to: elect our section 16(b) company insiders, affirm our Audit Committee's "financial expert" and the financial expertise of the remaining Audit Committee members, approve the amended charters and any other revised corporate governance documents and policies, and discuss the independence of our outside, non-management directors. These duties add time to the agenda and take away from some of the business agenda items at Board meetings.

Another challenge has been the change in the relationship with the public accounting firm. Because we are a family corporation, relationships are very important to us. Twenty years ago, the Company felt like it had a "partnership" relationship with the outside auditors. It was more of a team approach with the accountants, and even with the outside SEC counsel. To be perfectly frank, even though we have had no restatements or major issues that we have not resolved, sometimes it feels like these professional relationships may be more adversarial these days.

In many cases when attorneys are reprimanded, it is because they did not give full disclosure to their Board or gave distorted information to their audit committees. I think this is egregious behavior. I cannot imagine doing such a thing. I am really fortunate that I come from a culture where integrity and reputation are very important to the family members and to the Company. As such, we value the contributions we make to our shareholders and the communities in which we develop real estate projects. I am very fortunate to work for a company with this culture and with core values, such as integrity and openness.

## UP-THE-LADDER REPORTING

I would now like to address the up-the-ladder reporting issue. I have to admit that when this proposed rule came out it made me a bit uncomfortable. If there were an allegation of fraud, I would have to go directly to the SEC and possibly recuse myself from my role as chief legal officer of the Company. Such circumstances would cause me to lose my job, and I love my job and this Company. It was very disconcerting. But I do understand the need for this type of accountability from securities lawyers. I think that the process empowers lawyers and brings awareness to the Board and other senior management of the huge accountability standard that our financial personnel bear. We follow the law with our whistleblower policies and reference it in our Code of Ethics and Business Conduct. We make it very clear that if anybody comes forward with allegations of fraud about another associate that there will be no retaliation. Everybody is trained on the policy as part of the employee training session on the Code of Ethics.

I think it is really important for the corporation to clearly communicate expectations. If consequences do not exist or are not enforced for breaches of the Code of Ethics, then it does not matter how many rules and policies the corporation has. I think the fact that there are consequences at the federal level and with the SEC is absolutely appropriate. Although, I do not know how much morality can be legislated. And sometimes, as with the wrongdoing in the Enron case and other corporate cases, you wonder how people could even begin to engage in the types of fraudulent behaviors that corrupted the business and had such significant financial consequences on other employees, their families, and investors. I believe the recently enacted rules help to mitigate and deter potential wrongdoing.

In-house counsels bear much of the risk and the burden of deterring company employees from engaging in fraudulent and corrupt behavior. We are close to the business clients. We are the gatekeepers, and though we may not always be aware of all the actions our colleagues take on behalf of the corporation, we must work to protect the interests of the shareholders and the public. When I spoke in August 2006 to the incoming law class at Case Western Reserve University School of Law at their induction ceremony, I told them that with the privilege of being accepted into law school comes a huge mantle of responsibility, of integrity, and of ethical behavior. This mantle of responsibility weighs especially heavy on in-house counsel in this post-corporate corruption time.

## CONFIDENTIALITY AGREEMENTS

Finally, I want to comment on where I do not entirely agree with Mr. Humes' remarks regarding confidentiality agreements to protect work product and attorney-client privilege and the proposed Rule 502 of the Federal Rules of Evidence.<sup>5</sup>

I believe that the attorney-client privilege is the oldest privilege for confidential communications between attorneys and their clients, and I think it is really sacred. The purpose is to encourage full and frank communication from our clients, so that we can give proper advice. I think the worst thing that could happen is that I would be excluded from sensitive corporate discussions, due to a fear that I might disclose privileged information to the SEC. It would be very distressing for me, and it would not be a good consequence for the client. It is critical that I am able to give the client appropriate legal advice and that the client can trust the privilege between us and give me complete information.

Under the proposed Federal Rule of Evidence 502, if a selective waiver of a confidentiality agreement exists between the corporation and the SEC, then the courts might rule that such a confidentiality agreement does not protect the attorney-client privilege between in-house counsel and the company with which they work. In fact, in the *Steinhardt Partners* case,<sup>6</sup> the court held that the confidentiality agreement transforms the attorney-client privilege and is "another brush on an attorney's pallet, utilized and manipulated to gain tactical or strategic advantage."<sup>7</sup> This conception can destroy the client's trust in its counsel. On the other hand, attorneys or companies might want selective waiver of privileged information or work-product to delay the prosecution if they feel that the alleged claims are unfounded and also, perhaps, to obtain more lenient treatment from the prosecution.

In the *Qwest* case,<sup>8</sup> it is interesting to note that the majority argued that the government sought to establish a new privilege and not a selective privilege. Certainly, I think, there is more thought to be given to this concept of selective waiver. The SEC often receives voluntary cooperation from companies; however, the SEC has additional avenues to independently gain access to the same protected information and documents. For example, they can invoke other standard excep-

---

<sup>5</sup> Richard Humes, *Remarks of an SEC Associate General Counsel*, 57 CASE W. RES. L. REV. 341 (2007).

<sup>6</sup> *In re Steinhardt Partners, L.P.*, 9 F.3d 230 (2d Cir. 1993).

<sup>7</sup> *Id.* at 235.

<sup>8</sup> *In re Qwest Commc'ns Int'l, Inc.*, 450 F.3d 1179 (10th Cir. 2006).



tions to the rule, such as the crime or fraud exceptions to the privilege.

The question remains whether selective waiver is truly necessary for the prosecution to receive cooperation and whether the benefits outweigh the burdens of selective disclosure. I am still not convinced that it is necessary to consistently invoke such means to obtain cooperation from corporations. Moreover, I fear that the exception would totally waive the attorney-client privilege and protected information would get into an outside third party's possession.

In Justice Boggs' dissenting opinion in the *Columbia/HCA Healthcare* case,<sup>9</sup> he stated that it is not really clear what the negative consequences of selective disclosure will be—what hardship to the corporation might result.<sup>10</sup> I agree with Justice Boggs because we do not know what negative consequences will result to the corporation and its constituents, if any, from selective disclosure versus the benefit to the investing public. We should rely on voluntary cooperation and the already established fraud and crime exceptions to the long-standing attorney-client privilege. Therefore, at this time, it is more prudent to not forge ahead and pass the proposed Federal Rule of Evidence 502 allowing selective disclosure.

---

<sup>9</sup> *In re Columbia/HCA Healthcare Corp. Billing Practices Litig.*, 293 F.3d 289 (6th Cir. 2002).

<sup>10</sup> *Id.* at 307 (Boggs, J., dissenting).