

## Corporate Governance

Maureen Mulligan

The lead articles in this issue of *TortSource* focus on corporate governance. Each of the feature authors spoke at the TIPS May 2007 Task Force on Corporate Governance conference, “Beyond Legal: A Business Approach to Corporate Governance.” The event brought together attorneys, business leaders, and insurance professionals to discuss hot topics in corporate governance. We are pleased to offer *TortSource* readers condensed pieces from three articles presented at the conference.

Michael Perlis and Richard Johnson provide a brief overview of issues associated with stock option back dating. Sean Fitzpatrick reviews two articles written by law professors Tom Baker and Sean Griffith that examine the relationship between director and officer (D&O) liability insurance and corporate governance practices. Finally, John Allen examines the “culture of waiver” that has developed and the potential threats to the attorney-client privilege protection. Each of these topics demands far more attention than we can

devote in the pages of one newsletter. To access the unabridged papers presented by these authors at the “Beyond Legal” conference, go to [www.corpgovern.org](http://www.corpgovern.org), which will take you to the Task Force on Corporate Governance page on the TIPS Web site. From there, you can order materials from the conference.

In other articles, Perrin Rynders shares trial tips on winning without fighting; Christian Hicks explains how to preserve forensic computer evidence generated by departing employees; and Hervey Levin spotlights insurance-related legislation under consideration by the 110th Congress. We also are pleased to offer a summary of the TIPS spring meeting in Newport Beach by Nadia Bermudez, a preview of Palm Beach—site of the TIPS fall meeting—by David Deehl, and the inside scoop on our incoming Section chair, Peter Bennett, when he was a young lawyer, along with his mentoring advice for new members of the bar. Enjoy. ♦

Maureen Mulligan is a shareholder at Ruberto, Israel & Weiner in Boston. She is a member of the *TortSource* editorial board and cochair of the TIPS Task Force on Corporate Governance.

## Putting a Premium on Good Corporate Governance

Sean M. Fitzpatrick

In mid-2001, when I first proposed a class on directors and officers liability (D&O) insurance to Professor Tom Baker, director of the Insurance Law Center at the University of Connecticut School of Law, he told me that UConn—although offering America’s only LL.M. in Insurance Law—had never had a course focused exclusively on D&O and other professional liability coverages. By the time I faced my first class the following term, a series of epic scandals had rocked the corporate world and my suddenly popular course had acquired a new nickname: Enron 101.

Law students are not the only ones whose interest in D&O insurance has been piqued by the events of the past six years, which have included (for those who may have been in

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Illustration by Andrew O. Alcalá



## Stock Option Backdating Causes and Consequences

Michael F. Perlis and Richard R. Johnson

The stock option backdating scandal, characterized by the *Financial Times* as “one of the biggest scandals since the dotcom collapse,” involves the expanding investigation into the previously undisclosed but apparently widespread practice of manipulating the date on which stock options were granted to allow recipients to benefit from increases in the stock’s fair market value after the designated grant date. Briefly stated, a stock option gives the recipient the right to purchase a stock at a fixed price called the “exercise” or “strike” price. Generally, the exercise price is the stock’s market price on the date of the option grant. If the grant date is artificially assigned to an earlier date when the stock market price

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Illustration by Andrew O. Alcalá

## Meeting Round-Up Spring Meeting in Newport Beach

Nadia Bermudez

The Marriot Newport Beach Resort and Spa was a fabulous venue for this year's spring meeting in Newport Beach, California. Located across the street from world-class shopping at the aptly named Fashion Island, the Marriott provided a great location for the TIPS conference.

Ruby's Diner was the venue for Thursday night's social outing and dinner sponsored by LECG, LLC. The historic diner is literally perched above the Pacific Ocean at the end of a dramatic long pier with a panoramic view of the sea. The area is a favorite for fishermen, tourists, and surfers alike.

For Leadership Academy members, the Thursday event capped off a day chockfull of thought-provoking sessions related to leadership in the profession, as facilitated by Council member Janice Brown. Topics included fitness (with yoga and Pilates trainers), media training (led by a CNN executive producer, Jennifer Thomas), success within the profession (featuring top California trial attorneys Nathan Goldberg and Ken Turek), goal setting and implementation, alternative careers (featuring NFL Hall of Famer Kellen Winslow), and money and freedom.

CLE programs addressed a mix of interesting topics. Among them, the Staff Counsel Committee sponsored "Managing for Quality Work Product and Delivering Difficult Corporate News" and "What's Up Doc." "The Art of Storytelling: A



The inaugural class of the TIPS Leadership Academy smiles for a group portrait in Newport Beach.

Storyteller Shares His Secrets" and "Powerful Openings: How to Seize the Moment and Your Jury From the First Words On" were sponsored by the Trial Techniques Committee, and the Technology Committee offered "Data Insecurity: The Collision Between Technology and Privacy."

Thanks to David Cohen, TIPS spring meeting arrangements chair, baseball enthusiasts enjoyed great seats on Friday evening at the ballpark in Anaheim, where the Angels improved their stats with a 9-1 home win over the Dodgers. Prior to the game,

TIPS members Dick Semerdjian and Jan Mulligan and their respective firms hosted the Task Force on Plaintiffs' Involvement Reception in the resort's lovely rose garden, at which Sharon J. Arkin received a Pursuit of Justice Award.

Members were treated to a beach party buffet on Saturday evening at the Newport Dunes Waterfront Resort. Because the weather was unseasonably chilly—at least by California's standards—the DJ, heat lamps, and campfire pits on the beach were indispensable.

The talk of the weekend was the golf outing at the gorgeous Strawberry Farms Golf Club and Saturday's lively Diversity in the Profession Reception hosted by the Farmers Insurance

Group of Companies in the resort's atrium.

Overall, the conference was a great meeting for committee planning and gearing up for the ABA's annual meeting. See you at the Annual Meeting in San Francisco! ❖

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## Tech Tips

Christian Hicks

### Capturing Forensic Evidence When Employees Leave

Increasingly, cases involve computers, and because they do so, they also involve forensic computer evidence. Most of us are familiar with the common forms of evidence—document files, pictures, and saved e-mails—and request them in discovery. But useful evidence may also be found in forms not captured in conventional electronic production, such as deleted files and information about actions taken on a computer by a user.

When an employee resigns, preserving electronic evidence of his or her pre-termination electronic activities may be critical. This forensic data is usually preserved by having a forensic expert document information about the employee's computer and then create a bit-for-bit exact copy, called a forensic image, of the computer's hard drive. Ideally, that expert will be involved in every aspect of evidence collection for the computer in question.

Consulting with a forensic expert whenever an employee resigns may not be practical, however. An employee *may* have breached his or her employment agreement, but certainly most have not. Suspicion of misconduct may not arise until some time after the employee has left. By then, his or her computer may already have been erased and reassigned, thereby destroying potential forensic evidence.

One option would be to have a forensic expert image the hard drive of each

departing employee before the computer is returned to circulation. But this is expensive: each forensic image costs hundreds of dollars. The company could opt to set aside the employee's computer for a period of time so that the untouched hard drive would be available for forensic imaging and analysis should suspicions arise. This also is costly, though, because the company would need to purchase sufficient additional computers to allow computers of departing employees to be held in quarantine.

A sensible compromise is to have a member of the IT staff establish a chain of custody by taking charge of the computer immediately after the departure. He or she should remove the hard drive and then fill out a form containing the departing employee's name, the computer's serial number, the hard drive's serial number, and the difference between the computer's internal BIOS system clock and the exact actual time, which can be checked online at [www.time.gov](http://www.time.gov). This form can also include pictures of the computer and hard drive. Then have the IT staff member sign and date the form and place it along with the hard drive into an envelope, which is then sealed, labeled with the employee's name, and stored in a secure location. A new hard drive is put in the computer, which can then be returned to circulation. This procedure costs very little, as it uses internal staff, and because hard drives are inexpensive, usually \$100 or less.

If necessary, a forensic expert can analyze the hard drive at a later date, and the IT staff member can testify to the chain of custody for the evidence. This procedure provides an inexpensive way for companies to preserve forensic computer evidence that might later be important in an employment dispute. Keep in mind that other possible sources of evidence—e.g., information on servers, cell phones, or personal digital assistants—are not covered by this procedure. Procedures relating to those sources of evidence should also be developed with a forensic expert. ❖

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# Repelling Assaults on the Attorney-Client Privilege

John W. Allen

The attorney-client privilege and work product protections confer enormous value on our society. The national and state Rules of Professional Conduct require attorneys to maintain the confidences of their clients. The underlying rationale of the privilege is that legal compliance is enhanced by persons and businesses being able to seek and rely upon confidential legal advice from their lawyers.

But this protection is under attack. In investigating corporate fraud allegations over the last few years, the federal government began to ask for waivers of the attorney-client privilege in exchange for leniency regarding criminal charging and sentencing. This coercion of a waiver of privilege has far-reaching effects beyond those involved in corporate investigations.

What began as a request by regulators for a waiver of attorney-client privilege has expanded and moved into the private sector. We are now seeing auditors and certified public accountants (CPAs) asking for waivers of privilege in engagement letters. The danger of this “selective” waiver is that it may become a blanket waiver, and thus this erosion of the safeguards of the attorney-client privilege is not to be taken lightly. Lawyers, themselves, may also be contributing to the erosion of this valuable right.

As the result of these assaults, the American Bar Association (ABA) created a Special Task Force on Attorney-Client Privilege to study and respond to attacks on the privilege. All lawyers must understand what precipitated this new “culture of waiver” and some resources for more information on the topic are provided. Now, more than ever, it is important for practitioners to review and understand the current parameters of privilege.

## Background: Governmental Requests for Waiver

Repeated requests for waiver of the attorney-client privilege began with the U.S. Justice Department's (DOJ) stepped-up investigation of corporate fraud. After the Enron and WorldCom debacles, waivers of the attorney-client privilege were sought more frequently by the DOJ under guidance provided by the 2003 “Thompson memorandum.” Corporations were inclined to grant these corporate waivers, or risk that a refusal would classify a business as a “noncooperative” party, exposing it to a much harsher sentence under the Federal Sentencing Guidelines. The Federal Sentencing Guidelines gave “credit” toward leniency to those who waived the attorney-client privilege. Although a waiver is “not a prerequisite” for a reduction in the culpability score under the guidelines, prosecutors contend that waiver is necessary in order to provide timely and thorough disclosure of all pertinent information known to an organization.

Under pressure from the ABA and other organizations, in December 2006 the DOJ issued revised guidelines in the “McNulty memorandum.” The revisions require high-level DOJ approval before waiver requests can be made and state that prosecutors cannot deny cooperation credit if a company refuses to waive the privilege but allow the government to grant credit to those companies that do waive.

## Migration into the Private Sector

What began as a request for waivers of privilege by the federal government has now migrated into the private sector.

As part of the audit process, some CPAs are increasingly making requests to lawyers for information outside of the scope of the American Bar Association-American Institute of Certified Public Accountants agreement, often referred to as “the treaty.” The treaty is

intended to control CPA audit requests and lawyer responses, as well as to preserve the privilege and work product protections. Lawyers should be on the lookout for any extra-treaty requests, including requests for lawyer opinions about

- illegal activities,
- internal investigations,
- attorney work papers regarding other evaluations,
- internal controls,
- environmental assessments,
- tax positions and reserves, or
- advance waiver of attorney-client privilege in auditor engagements.

The principal driver for these CPA requests is the continued threat of expanded CPA liability. In short, CPAs are attempting to shift that responsibility to lawyers, and, in the process, they are creating a risk to the client of complete waiver of the attorney-client privilege and work product protections.

To lawyers, there is also the added danger of increased potential for civil liability and for aiding and abetting in the event that losses are eventually realized. A disclosure of privileged and work product material originally done for nontreaty purposes (e.g., a settlement evaluation) could give the appearance of inconsistent simultaneous opinions, one set being offered internally to the client for private purposes and another being offered to the auditors under the quite different criteria of the treaty. This “apples and oranges” comparison will unfairly make lawyers appear untruthful.

A major problem is that an advance waiver of attorney-client privilege and audit engagement letters may not be considered a selective or limited waiver by the courts. Not all jurisdictions recognize selective waiver. As a result, clients could actually be waiving the privilege over the subject matter—for all persons, for all purposes. The big question for attorneys and their clients is whether a waiver of the privilege in one forum means the privilege is waived on that topic in all forums. The law is not uniform on this point.

Equally troubling is the growth of subpoenas served by lawyers on lawyers and law firms, frequently implicating privileged and protected information under Model Rule of Professional Conduct 1.6. Bankruptcy and probate matters are common places for these abuses, attempting to use lawyers and their files as primary sources, without first exhausting others. Shakespeare may have been correct: “The problem, dear Brutus, is not in the stars, but in ourselves.” *Julius Caesar*, act I, scene ii, 140–41.

## Defending the Privilege

The ABA continues to work to protect the attorney-client privilege. At the 2005 Annual Meeting, the ABA House of Delegates approved task force-sponsored resolutions making protection of the privilege an ABA priority. See [www.abanet.org/buslaw/attorneyclient/materials/hod/recommendation\\_adopted.pdf](http://www.abanet.org/buslaw/attorneyclient/materials/hod/recommendation_adopted.pdf). In 2006, the House of Delegates adopted additional resolutions focusing on requests by auditors. See [www.abanet.org/buslaw/attorneyclient/materials/hod/0806\\_recommendation.pdf](http://www.abanet.org/buslaw/attorneyclient/materials/hod/0806_recommendation.pdf). The ABA has also taken positions on the issue of selective waiver. For a full account of the waiver debate and potential consequences of waiver addressed by the ABA task force, see [www.abanet.org/buslaw/attorneyclient](http://www.abanet.org/buslaw/attorneyclient).

One of our touchstones must be the effect of all this on every lawyer and his or her clients. All lawyers do not represent Fortune 500 corporations, large financial institutions, big CPA firms, or publicly held businesses. There are lawyers for the “mom and pops,” the folks needing a divorce, a home purchase, or defense of a driving charge. If those clients—or potential clients—continue to read and see instances in the media of such waivers, with lawyers and their files appearing in high-profile cases as evidence against their clients and the clients' (former) employees, they will no longer trust their lawyers. Without such trust, they will not be candid with their lawyers, if they decide to call one. Many may simply opt not to consult a lawyer in the first place. Legal compliance in general, and the privilege in particular, will suffer. ❖

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## Stock Option Backdating: Causes and Consequences

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was low, the recipient will enjoy a larger profit when the option is later exercised.

The practice, in which over 150 public companies have already been implicated, has gained the attention of the Securities and Exchange Commission (SEC), the Department of Justice (DOJ), the Internal Revenue Service, and the plaintiffs bar. Thus far, at least 100 SEC investigations, 53 DOJ investigations, 29 securities class action lawsuits, 155 shareholder derivative suits, 5 ERISA lawsuits, 81 restatements or other charges to previously reported earnings, and executive resignations or terminations at some 33 companies have resulted.

### The Rationale for—but Illegality of— Backdating

This practice allows companies to maximize the true value of option-based compensation without facing any of the following consequences: (1) recognizing any compensation expense, which would negatively affect the company's attractiveness to investors by reducing publicly disclosed earnings and profit figures; (2) incurring the less favorable tax treatment that is afforded to in-the-money options; or (3) potentially violating the terms of shareholder-approved stock option plans, which often prohibit in-the-money grants.

The principal rationale offered for backdating is that companies considered the practice essential to attracting and maintaining executive talent. Granted, the competition for executive talent has been intense, and stock-based compensation constitutes a significant portion of the typical executive pay package at many companies. However, this competition does not, by itself, explain why so many companies resorted to backdating rather than openly granting in-the-money options.

While some commentators contend that backdating is not necessarily illegal, they seem to be referring instead to granting in-the-money options, which is legal, as long as it is permitted by the relevant stock option plan, properly disclosed in public filings, and subjected to the proper accounting and tax treatment. The practice of backdating, however, has no apparent rational purpose other than to misrepresent the value, taxability, and other material characteristics of option-based compensation.

The companies involved suggest that attorneys, accountants, and compensation consultants must have been advising boards of directors that the practice was permissible. This suspicion is bolstered by recent reports concerning the involvement of a number of highly regarded law firms with companies caught up in the backdating scandal and Deloitte & Touche's settlement of a \$15.5 million lawsuit in which Micrel Semiconductors alleged that its auditors had advised that a form of backdating was permissible.

### Considering the Consequences

When backdating is discovered, the consequences for the company can be enormous. Perhaps most significant, the discovery that the company has previously failed to recognize compensation expenses attributable to disguised in-the-money options will, if the amounts at issue are material, necessitate the restatement of its publicly filed audited financial statements.

Such a restatement can lead to serious consequences, including (1) delays in the filing of periodic reports with the SEC, which can lead to the delisting of the company from NASDAQ or other stock exchanges and constitute an event of default under typical bond or loan covenants; (2) increased liability for income and payroll taxes, along with interest and penalties for previous nonpayment; (3) limiting coverage available under directors & officers (D&O) liability insurance policies or rescission on the basis of misrepresentations in the application; (4) disgorgement by the chief executive officer and the chief financial officer pursuant to Section 304 of the Sarbanes-Oxley Act; (5) SEC and DOJ investigations; (6) securities lawsuits seeking damages incurred in connection with the

purchase of securities in actual or presumed reliance on financial statements and associated public disclosures that the company, by restating, has admitted to have been materially misstated; (7) rescission or repricing of employees' options and disgorgement of any profits received; and (8) loss of key employees.

### Assessing Litigation Risks

Because many of the affected companies have not seen any negative stock price movement following their announcements, the potential for significant damages awards in securities fraud cases under Section 10(b) and Rule 10b-5 is in doubt. To date, the harm sustained by companies that backdated, and by their shareholders, appears confined to the litigation, investigation, restatement, and other costs associated with cleaning up the mess. The lack of share price declines has prompted plaintiffs firms to concentrate on alternative strategies, including shareholder derivative suits (which outnumber securities class actions by five to one) and proxy fraud suits under Section 14 of the Securities Exchange Act of 1934. This remedy offers dubious value to shareholders if it impairs the company's ability to retain qualified employees. Derivative claims, in the absence of real damages, are likely to be settled by corporations in exchange for corporate therapeutic measures (e.g., rescission or amendment of affected options and/or corporate governance reforms) and payment of plaintiffs attorney fees.

### Conducting an Internal Investigation

Deciding whether to conduct an internal investigation presents a complex question. On the one hand, the SEC has indicated that it will consider the extent to which a corporation took remedial measures that might result from such an investigation when deciding whether to impose monetary penalties. On the other hand, there is a concern that DOJ prosecutors would likely pressure corporations to waive the attorney-client privilege with respect to information revealed in the course of the investigation in exchange for "cooperation" points.

Likewise, while the appointment of a special litigation committee could provide a strong basis for countering a plaintiff's "demand futility" arguments on a motion to dismiss a derivative complaint for failure to make a demand, any report on the findings of such a committee is likely to become Exhibit A in any subsequent litigation. Another factor to consider is the possibility that the SEC and other regulators could be so preoccupied and/or understaffed that they might not take any adverse action against the company or its executives with respect to options-related problems if the company does not, in effect, conduct the investigation for them. Further, internal investigations can be expensive, distracting, and potentially harmful to employee morale.

While all of these issues are among those most likely to be encountered, it is impossible to address all of the potential consequences of backdating in an overview article. Companies that discover or suspect the existence of options-related problems should seek the advice of experienced legal counsel. ♦

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## Mark Your Calendar

### TIPS Section Fall Meeting

October 4–7, 2007, Palm Beach, FL  
(312-988-5672)

### Aviation Litigation Meeting

October 17–19, 2007, Washington, DC  
(312-988-5708)

### Class Action Litigation Meeting

October 25–26, 2007, Washington, DC  
(312-988-5708)

### Fidelity and Surety Law Committee Fall CLE Meeting

October 31–November 2, 2007  
Orlando, FL  
(312-988-5708)

### TIPS/AIA Joint Program

November 7–8, 2007, Chicago, IL  
(312-988-5708) ♦



## Legislative Update

Hervey P. Levin

### Spotlight on Insurance: The Players and the Coverages

The machinations of the Congress are often viewed differently depending on the eye of the beholder. But no matter what eye beholds Congress, what it sees is a plethora of bills directed “at” or “for” the insurance industry. Some of the bills have caused different elements of the insurance industry to split and take opposing sides. From the Terrorism Risk Insurance Act (TRIA) to McCarran-Ferguson to surplus lines to federal charters to health courts, the Congress has energized TIPS’s Task Force on Federal Involvement in Insurance Regulation Modernization, chaired by Fran Semaya.

#### TRIA

As trade publications headlined the disagreements among insurers regarding coverage of unconventional attacks in the TRIA extension under consideration, the ABA Governmental Affairs Office called upon Fran Semaya and Alan Gamse to provide answers to House committee staff members who were in charge of drafting the bill that was ultimately introduced on June 18, 2007. H.R. 2761 would extend the program for 10 years and add coverage for nuclear, biological, chemical, and radiological (NBCR) attacks. The anticipated costs of the NBCR coverage have pitted the small- to mid-sized firms against the larger property and casualty insurance companies. The debate is expected to be divisive and contentious but needs to be completed before December 31. The bill would also include group life insurance and cover domestic acts of terrorism.

#### Federal Regulation of Insurance

Federal charters and a parallel federal regulatory and oversight system for insurers, agents, and brokers—modeled after the banking industry—have also divided the insurance industry. In May, Sens. John Sununu (R-NH) and Tim Johnson (D-SD) introduced S. 40 to authorize the issuance of federal charters and licenses for carrying on the sale, solicitation, negotiation, and underwriting of insurance or any other insurance operations. In theory, this would provide a comprehensive system for the federal regulation and supervision of national insurers and national agencies, and that would provide for policyholder protections in the event of an insolvency or the impairment of a national insurer.

Rep. Ed Royce (R-CA) has promised to introduce similar legislation. However, hearings on S. 40 are not likely to begin until the fall at the earliest, and the chair of the House Financial Services Subcommittee has reportedly said that he does not “anticipate the House quite being in the position to introduce anything that will pass” this session.

#### Nonadmitted and Reinsurance Reform Act of 2007

Surplus lines and reinsurance reform was adopted by the House on June 25, 2007, when it passed H.R. 1065, a bill similar to one adopted in 2006 without opposition. The Senate failed to act in 2006 and has yet to act on companion legislation (S. 929) introduced in February 2007. The “core reform” would establish that only one set of state regulatory rules applies to policies that insure exposures in multiple states: those of the policyholder’s “home” state. Reinsurance issues will be “streamlined” by giving sole regulatory authority for certain reinsurance matters to the ceding insurer’s home state. The measure would also establish five different ways a risk manager would be qualified to buy insurance through the nonadmitted market. Briefly, the bill would also (1) prohibit any state, other than the home state of an insured, from requiring a premium tax payment for nonadmitted insurance; (2) allow an insured’s home state to require surplus lines brokers and certain insureds to file tax allocation reports annually; (3) restrict licensing of surplus lines brokers to the insured’s home state in order to conduct nonadmitted insurance business with respect to that insured; and (4) establish criteria for nonadmitted insurers

domiciled in the U.S. jurisdiction and prohibit a surplus lines broker from placing non-admitted insurance with, or procuring nonadmitted insurance from, a nonadmitted insurer domiciled outside the United States and listed on the National Association of Insurance Commissioners International Insurers Department Quarterly Listing of Alien Insurers.

#### Medicare as a Secondary Payor

Reforming the role of Medicare as a secondary payor in workers’ compensation cases was addressed by H.R. 2549, a bill reflecting the policies sponsored by TIPS and adopted by the ABA. The bipartisan bill introduced on May 24, 2007, has the strong support of all stakeholders in workers’ compensation and the ABA.

#### Fair and Reliable Medical Justice Act

Last year’s “health courts” legislation, addressing medical tort litigation in the states, has been revised and refiled as S. 1481 and H.R. 2497 on May 24, 2007. Health courts are not mentioned, and the “demonstration programs” to be funded for the states as alternatives to the current medical tort litigation system would allow the patients to opt out or voluntarily withdraw from the administrative alternative.

#### Asbestos Litigation

The TIPS Asbestos Task Force successfully established a working relationship with the National Center for State Courts. As a result, a survey was drafted and distributed by the Conference of Chief Justices. The survey is designed to determine the number of asbestos cases filed and pending, the use of case management orders, and other issues of interest.

#### Federal Product Liability Reform

Without a specific pending bill, and in the face of internal political opposition from Democrats, the Small Business Committee of the House of Representatives conducted a hearing on small business and federal product liability legislation. TIPS and the Litigation Section submitted a joint statement to the committee on behalf of the ABA. It is not expected that any further activity centered on product liability reform will occur in the House this session.

#### Insurance Industry Competition Act of 2007

After introducing S. 618 in February and having a hearing in March, no further hearings have been conducted concerning the abolition of the McCarran-Ferguson limited antitrust exemption. The companion bill in the House, H.R. 1081, was originally referred to four committees. As of June 26, 2007, none has held any hearings since February. ❖

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## In Motion

**Randy Aliment**, senior partner in the Seattle office of Williams Kastner, has been appointed chairman of the board of governors at City University of Seattle. His practice emphasizes commercial litigation and higher education law, and he served as legal counsel for City University from 2000 to 2006 when he was appointed to the board.

**Kendall Butterworth** of Atlanta, Georgia, has become chief litigation counsel for AT&T Southeast, with oversight responsibility for all commercial litigation in the region.

Cozen O’Connor has announced that **Richard M. Dunn** of Miami, **Thomas McKay** of Cherry Hill, New Jersey, and **Joseph A. Ziemianski** of Houston have been appointed as non-management committee members of the firm’s first board of directors. Each lawyer is the managing partner of his respective Cozen O’Connor office.

**Marco Hazan-Cohen** of Cozen O’Connor’s Dallas office has been elected to membership in the firm. He practices in the subrogation and recovery group and is one of only 17 associates recently promoted firmwide.

**Justin Howard** has joined the litigation practice of Helm Mulliss & Wicker, PLLC, in Raleigh, North Carolina. ❖

## Putting a Premium on Good Corporate Governance

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a cave) the infamous Enron and WorldCom bankruptcies, the resulting passage of the Sarbanes-Oxley Act of 2002, and the subsequent rise of a new scourge of corporate misconduct named Eliot Spitzer. Settlement payments in securities class actions and other scandal-driven litigation against corporate directors and officers have risen stratospherically. Given that most such settlements are fully funded by D&O policies, it is perhaps not surprising that corporate managers and investors alike have recently developed a keen interest in the availability, pricing, and effectiveness of this insurance. At a more fundamental level, industry observers continue to examine the relationship between D&O insurance and the corporate governance practices that both inform its underwriting and define its risks.

### New Research Examines D&O Insurance

In two articles that will be published this year in the *University of Chicago Law Review* and the *Georgetown Law Journal*, UConn's Professor Baker and Professor Sean J. Griffith of Fordham Law School have examined this relationship in unprecedented depth. Their findings, which were presented as part of a panel discussion at the second annual TIPS Corporate Governance Conference in New York City on May 4, 2007, are based on interviews with more than 40 insurers, brokers, and risk managers.

In their first article, *Predicting Corporate Governance Risk: Evidence from the Directors' & Officers' Liability Insurance Market*, 74 U. CHI. L. REV. \_\_\_ (forthcoming), available at <http://ssrn.com/abstract=909346>, Baker and Griffith examine the underwriting of D&O policies, correctly noting that D&O insurers have a unique interest—given that they fund virtually all recoveries in suits against directors and officers—in assessing whether, and how, particular corporate governance practices correlate with reduced risk. Their research indicates that insurers continue to eschew an “index approach” to D&O underwriting in favor of individual risk selection based on the characteristics of each insured organization. Accordingly, the risk assessment factors that matter to D&O underwriters over time should give us important clues as to what really drives management liability—and what measures can effectively limit it.

This finding has several important implications for the broader fields of corporate and securities law. First, Baker and Griffith suggest that D&O underwriters' individualized approach may support the deterrence function of our corporate and securities laws by imposing higher costs on firms that dedicate fewer resources to corporate governance.

Second, underwriters' increasing focus on issues of corporate governance would seem to indicate that the merits do matter in corporate and securities litigation—that D&O litigation is more than simply a lottery of the unlucky. And third, the approach taken by D&O underwriters in assessing corporate governance quality suggests that issues of culture and character—what the authors call “deep governance”—is more fundamental to a firm's risk profile than the particulars of its more visible governance structures.

Having established that D&O insurers are among the most significant financial stakeholders in the effective management of governance risk, with enormous incentives to master its mysteries, Baker and Griffith's second article, *The Missing Monitor in Corporate Governance: The Directors' & Officer's Liability Insurer*, 95 GEO. L.J. \_\_\_ (forthcoming), available at <http://ssrn.com/abstract=946309>, notes a disturbing paradox: D&O insurers exert little real influence on the governance practices of the organizations they insure. Baker and Griffith suggest several reasons why this may be the case, ranging from the abundance of corporate advisors available—including lawyers, accountants, and bankers—to simple snobbery, with insurance underwriters and brokers losing out to their more “white shoe” cousins in the competition for corporate clients' attention. At root, however, the authors conclude that the absence of substantial governance oversight by D&O insurers is due, at least in part, to the “agency problem” in corporations. That is, corporate “insiders” who purchase D&O insurance primarily to insulate themselves from volatility in the financial results that determine their compensation impede—consciously or unconsciously—what might otherwise be a fruitful risk management dialog between D&O

underwriters and the boards of directors they insure. Baker and Griffith thus posit a fundamental challenge to the whole structure of our D&O insurance system.

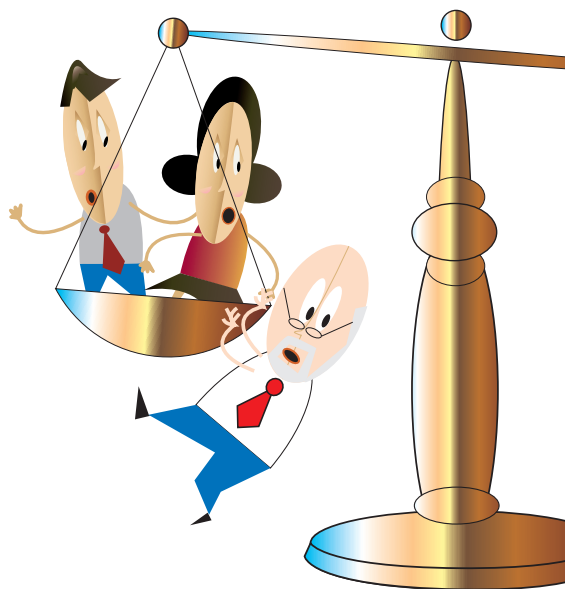
### A Debate Ensues

Grounded as they are in empirical research in the D&O marketplace, many of Baker and Griffith's observations about the D&O underwriting process and the surprisingly negligible influence of D&O insurers on the corporate governance practices of their insureds will ring true to those experienced in this field. Their conclusions about the value of D&O insurance in its present form will no doubt be met with more skepticism, but they may well have shifted the burden of proof to defenders of the status quo. In any event, by bringing an exceptional level of critical analysis to these issues and highlighting the contradictions between theory and practice in the management of D&O risk, Baker and Griffith have made an important contribution to an increasingly urgent and sophisticated debate.

The outlines of this discussion were on view at this year's ABA-TIPS Corporate Governance Conference, where I moderated a presentation by Professors Baker and Griffith, followed by commentary from leading representatives of the D&O underwriting, brokerage, and policyholder communities, namely, David Bell of Allied World Assurance Co., Kevin LaCroix of OakBridge Insurance Services, and Catherine Serafin of Howrey LLP. The exchange was spirited, but I think all who participated would agree that these issues are important ones, and that the questions Baker and Griffith have posed are both timely and valuable. How do their observations stand up to scrutiny from the “real world” of D&O risk management? Refreshingly well, on balance. By really listening to participants in the insurance market, they have avoided the common academic trap of elevating theory over observable fact in assessing economic behavior. Indeed, they display a very good ear, hearing undertones that enrich our understanding of what makes players in the D&O marketplace tick.

Baker and Griffith plan to follow up with a third study, focused on the D&O claims process, and we can only look forward to their next contribution to this important conversation. ❖

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## TortSource

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# “When I Was a New Lawyer”

**Peter Bennett**  
**Managing Shareholder, The Bennett Law Firm**  
**Portland, Maine**

## What was your background like, and what inspired you to become a lawyer?

I grew up in Portland, Maine. My father was a lawyer, and he was very involved in bar leadership. He founded the Maine Trial Lawyers Association and served as its first president. He did a lot in the Association of Trial Lawyers of America (recently renamed the American Association for Justice), including 27 years on its board of governors. He also served on the board of the American Board of Trial Advocates. And he did a lot to promote responsible change in the law in areas such as jury service and liability that improved access to our courts and that ultimately served as model legislation during the sixties. His core belief was that all voices needed to be heard for the civil justice system to function effectively. My dad's accomplishments as a lawyer, his bar leadership, and, most of all, his dedication to the profession of law are what inspired me to become a lawyer.

## Where did you go to law school, and what did you do right after that?

I attended Boston University School of Law. I spent the summer after law school working for my first employer, Fulbright & Jaworski, as well as studying for and taking the Texas bar exam. I returned to Boston University for the fall semester and finished my MBA. After that, I returned to Houston and began practicing law full time.

## Do you have any young lawyer experiences that particularly stand out in your memory? If so, what have you learned from them/how have they helped you to become so successful?

Too many people do not tell the truth despite being sworn. One of my first cases was the defense of a sexual harassment case brought by a male manager against a female business owner. His story was so graphic that I had trouble not believing him. On the eve of trial, I received a tip that he had completely fabricated his claim, and it was only through hard work that we finally uncovered the truth. Hard work leads to victory.

One of my early jury trials was against a nationally prominent trial attorney. I was very intimidated by him. He bullied me for two years. We survived summary judgment. In front of the jury, he was nervous and ineffective. By the end of his opening, his shirt was soaked through to his skin. I obtained one of the best jury verdicts of my career. Rather than worrying about the stature of my opponent, I learned to focus on trying my case and telling my client's story. This case, including the lawyers, was a classic David and Goliath story.

## Whom do you most admire?

Anyone who puts principle ahead of personal gain. In terms of lawyers, my dad.

## What is your greatest source of professional pride?

The trust and confidence that the Section membership has placed in me by letting me lead TIPS.

## What got you started with ABA involvement?

In 1988, I attended the ATLA Annual Meeting. One of my dad's best friends was Leonard Ring. Lenny offered to bring me to a TIPS meeting, and he appointed me a vice-chair of the Employment Law Committee. I ultimately got my start in TIPS leadership through the graciousness of past Section chairs Sandy McCandless and Dudley Oldham.

## What was the worst professional advice you ever received?

While I am sure I received some pretty bad advice, I have forgotten what it was and am probably better for it.

## What was the best professional advice you ever received?

You possess nothing more valuable than your reputation and your word.

## What personality trait has served you best over the years?

Tenacity. I don't quit.

## What challenges you the most?

Not letting my drive to win override what is in my client's best interest.

## What is the one thing you cannot stand (regarding the law/lawyers)?

Actions that contribute to the perception that the civil justice system is somehow biased or tainted.

## What is your favorite type of legal work?

Collective bargaining or any type of trial. A large part of my practice involves collective bargaining on behalf of management, and I am proud

of my accomplishments in that area. I love trying cases, but the vanishing trial is real. The vanishing trial is a serious issue that will impact young lawyers for years to come.

## What would you most like to accomplish as TIPS chair?

My answer remains consistent with my

vice-chair speech that I delivered to Council. I will highlight three things. First, I want the plaintiffs leg of our stool to become stronger because a balanced three-legged stool is necessary for the long-term preservation of TIPS's unique franchise. Second, with our judicial independence project we have a national platform to be the voice to defend against the unprecedented attacks on our judiciary. We have an obligation to do so and to counter the critics who would just as soon emasculate the fairness and impartiality that is the hallmark of our system of justice. Championing this issue must be part of TIPS's franchise. Finally, we need to follow through on our commitment to diversity in Section leadership; we must persevere to ensure that it is part of our culture and no longer just part of our aspirations.

## What themes will you focus on for 2007–2008?

Preserving judicial independence, raising general committee profiles, promoting the TIPS Leadership Academy and our “graduates,” getting younger lawyers appointed to meaningful leadership positions (which I have done), delivering on our commitment to diversity in leadership, partnering with other bar organizations, and making sure we have fun at our Section meetings.

## What can the ABA do to be a good home to young lawyers?

Convince more law firms to make it financially possible for their young lawyers to be involved. Through leadership involvement in the ABA, young lawyers can develop myriad skills that will make them effective leaders in their firms, their communities, and their profession—but their firms need to take responsibility for supporting their participation. ❖



Peter Bennett  
then and now.



## Peter Bennett's Advice for New Lawyers

- Never underestimate your opponent.
- Always put the interests of your client first.
- Treat the practice of law as a profession and not a trade.
- Do not volunteer for bar service because you want to develop business for your firm. The best work my firm received as a result of my bar service has never come because I was looking for it.
- Always be accurate and truthful. Your credibility and your reputation hang in the balance. ❖



## Trial Tips

Perrin Rynders

### Winning Does Not Require Fighting

A wise leader plans success.  
A good general studies it.  
If there is little to be gained, don't act.  
If there is little to win, do not use your men.  
If there is no danger, don't fight.

—Sun Tzu, *The Art of War*, ch. 12:4

Several years ago, I defended a sexual harassment case. My client was the employer, which had terminated the perpetrator within four days of the first complaint but still got sued. During discovery, I was presented with an opportunity. The plaintiff's attorney intended to call a psychologist to explain his client's emotional injuries, but he missed the expert report deadline. My strong liability case had just improved on the damages front.

Nevertheless, I wrote him a letter. I noted the missed deadline and promised not to object to his calling the psychologist at trial if the report was submitted within a week. He got to work and sent the psychologist's report exactly one week later. At trial, he called the psychologist as a witness. I did not object.

As it turns out, the plaintiff would have been better off not calling her psychologist. His testimony turned out to be disastrous. Our defense rested upon the fact that the employer had responded as swiftly and decisively as possible, like a responsive day care provider answering a child's cries. More subtly, though, our case challenged the plaintiff's honesty. The psychologist ended up becoming a coconspirator.

You can deter your potential enemy by using his weakness against him.  
You can keep your potential enemy's army busy by giving it work to do.  
You can rush your potential enemy by offering him an advantageous position.

—Sun Tzu, *The Art of War*, ch. 8:3

The psychologist had used an unlicensed therapist to counsel the plaintiff. The sympathizing therapist reported the plaintiff's subjective complaints. Eventually, the psychologist reviewed the reports, conducted a few diagnostic tests, did his own interview, and concluded that the plaintiff was suffering from posttraumatic stress disorder. That was the substance of his report and his testimony on direct examination. On cross-examination, I got him to admit that the therapist was not qualified to testify and the impropriety of relying solely on her reports. He countered that he was relying on his own interview of the plaintiff. What he forgot was that the report he had so hastily prepared several months earlier was written *before* he had ever interviewed the plaintiff or administered the diagnostic tests. The cross-examination went well.

In my opinion, we advocates need to be more forgiving toward each other. Litigation is not about winning petty skirmishes. When my opponent failed to get his psychologist's report to me on time, giving him leeway was basic civility. I never intended to call my own expert to evaluate the plaintiff, so my client was not prejudiced by the delay. Looking back, I feel better knowing I gave a busy lawyer a break.

Either way, my benevolence ultimately strengthened my case. Like warriors, advocates can improve their position without direct fighting. Besides, what were the odds that our trial judge would have excluded the testimony of the psychologist knowing I had simply waited in the weeds? And would she have cut me slack when I fumbled through an unfamiliar jury selection process in that unfamiliar jurisdiction?

So be nice. Do someone a favor. Fight only when necessary. And when your opponent gives you a real opening, take full advantage with a clear conscience. ♦

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numerous dining options, including the Columbia Restaurant, Ruth's Chris Steak House, and Taverna Opa. CityPlace also has an Improv Comedy Club and a 20-screen movie theater. A few blocks north of CityPlace is the modern West Palm Beach Main Judicial Complex. The hallways adjacent to the courtrooms offer spectacular views of the Intercoastal Waterway. magnificent yachts, Palm Beach, and the Atlantic Ocean—with its rich fishing waters. It is well worth seeing, even if you are not a courthouse maven. October is one of the best times to visit, and bargains on hotel rates are available. Extend your visit and experience other renovated historical hotels, including the Boca Raton Resort and Club in Boca Raton, the Biltmore Hotel in Coral Gables, and the Casa Marina Resort and Beach Club in Key West. Check out the new Carnival Center for the Performing Arts in Miami, as well as the Broward Center for the Performing Arts in Fort Lauderdale. Enjoy! ♦

The Kravis Center for the Performing Arts is home to a variety of regionally based arts organizations, from ballet and opera to live theatre and pop artists. The adjacent CityPlace is a beautiful facility housing a world-famous collection.

October 5–7 at the Palm Beach County Convention Center. Nearby, the Norton Museum of Art is a beautiful facility housing a world-famous collection.

To see why the decor in Palm Beach residences is so acclaimed, visit the Home Show, Restaurant at The Chesterfield Palm Beach.

Ta-Boo, a self-proclaimed American bistro and bar on Worth Avenue, is a classic local haunt for those May–December Palm Beach romances, as is the Leopard Lounge and

week from 7:00 a.m. to 3:00 p.m. Another great local spot is Hamburger Heaven.

For food and nightlife, nearby is Cucina Dell'Arte (a dance club for all ages) on Royal Poinciana Way. And the Palm Beach Grill, a reasonably priced casual eatery. Given the heat lingering into autumn, people drive even a few blocks. My favorite dining spot in Palm Beach is Cafe Leurope—pricy, but worth it. My favorite casual place for breakfast or lunch is John G's on the beach in Lake Worth, a short drive south on ALA, open seven days a

gorguous landscaped homes, along the shoreline, and past Worth Avenue's shops.

be headquarters for the TIPS fall meeting. Built by Henry Flagler, whose seaside mansion is open to the public, The Breakers offers restaurants and activities to burn off calories: cro-

great restaurants. Let's start with The Breakers itself, the legendary hotel and resort that will oceanfront community with plenty of amenities, like fabulous Worth Avenue shopping and

ong an exclusive winter home for old-moneyed families, Palm Beach is a beautiful

TIPS Fall Meeting  
October 4–7, 2007

David L. Deehl



“My Palm Beach”

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