“Where was the Board? Where were the lawyers?”

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Ashley Bynoe, Associate, Womble Bond Dickinson, Atlanta, GA
Mary Pat Kang, Ethics & Compliance Officer, NCR Corporation, Atlanta, GA
Fredric S. Newman, Partner, Hoguet Newman Regal & Kenny LLP, New York, NY
Roland L. Trope, Partner, Trope and Schramm LLP, New York, NY

In the recent wave of corporate ethical crises (VW, Wells Fargo, Rolls Royce, Equifax, Yahoo!, Kobe Steel, Nissan, etc.), there is a trend towards asking if the Board or in-house counsel were in part responsible and should be among those held accountable. We will examine the emerging professional responsibility expectations for in-house and outside counsel to prevent institutional ethical crises, alert management and the Board to ethical “red flags,” promptly halt illicit conduct, advise on remediation and voluntary self-disclosure, and guide management and the Board if a crisis becomes public. We will conclude with recommendations for averting and responding to these ethical crises that might otherwise damage the enterprise’s credibility and reputation and risk the success of its commercial activities and pending corporate transactions.

Panelist Biographies:

**Ashley N. Bynoe**
Ashley Bynoe is an associate at Womble Bond Dickinson in its Atlanta, GA offices. Ashley’s practices draws on her background in finance, data analytics, and revenue management, and focuses on franchise development and commercial real estate transactions. Ashley advises commercial real estate clients related to real estate sales and purchases, corporate structuring, commercial finance, local zoning, leasing, and franchise negotiation issues. Prior to entering the legal field, Ashley was a Promotion Pricing Analyst in Revenue Management for Walt Disney Parks and Resorts. Ashley is a graduate of Boston College and Washington University in St. Louise School of Law. Ashley can be contacted at Ashley.Bynoe@wbd-us.com.

**Mary Pat Kang**
Mary Pat Kang is the Ethics and Compliance Officer for Atlanta-based NCR Corporation. She has been in-house counsel with NCR for thirteen years. Prior to her current role, she served as NCR’s Chief Counsel for its Public Sector and Healthcare businesses and as Senior Counsel, Litigation and Employment Law. In her role as Ethics and Compliance Officer, Mary Pat leads NCR’s Data Protection, Trade Compliance, and Anti-corruption functions, and she manages NCR’s Ethics hotline. Prior to joining NCR, Mary Pat worked a software product manager for two Fortune 500 companies, a role that has enabled her to understand her client’s needs. She holds her CIPP/US and CIPP/E certifications from the International Association of Privacy Professionals. Mary Pat lives in Raleigh, North Carolina, and is a frequent visitor to Atlanta,
GA. Outside of the office, she enjoys spending time with her husband, Ed, and their two children. Mary Pat can be contacted at Mary.Kang@ncr.com.

Fredric S. Newman
Fred Newman is a founding partner of Hoguet Newman Regal & Kenney, LLP, a commercial litigation firm in Manhattan. Fred is a legal generalist with decades of experience in commercial litigation, business advice, corporate transactions, employment counseling and alternative dispute resolution. As a litigator, Mr. Newman handles an array of commercial litigation and employment matters. As a counselor, Fred advises corporate owners, executives and entrepreneurs on business and personal issues. Fred has served on the board of directors of a private reinsurance company; he was appointed CEO of a public company in dissolution by its major creditor; and he was the general counsel and secretary of a public reporting subsidiary of a Fortune 50 company. Fred is an Adjunct Professor of Professional Responsibility at Fordham Law School and he has been a court-appointed member of the New York First Department Grievance Committee and its predecessor, the Departmental Disciplinary Committee, for 10 years. Fred earned a BA at Harvard College, a JD at Columbia Law School, and an MBA at University of Virginia Darden School of Business. Fred can be contacted at fnewman@hnrklaw.com.

Roland L. Trope
Roland Trope is a partner at Trope and Schramm LLP in New York City and an Adjunct Professor in the Departments of Law and of Electrical Engineering and Computer Science at the U.S. Military Academy at West Point. Roland has over 30 years of experience in cross-border commercial and corporate transactions. Roland advises on government procurement, protection and licensing of intellectual property, cross-border tech transfers, export controls, economic sanction regulations, anti-corruption laws, reviews by the Committee on Foreign Investment in the United States (CFIUS), and cybersecurity. Roland was a co-editor and contributing author to the book published in September 2017 by the Business Law Section, entitled Guide to Cybersecurity Due Diligence in M&A Transactions. Roland co-chairs the Cybersecurity Subcommittee in the Cyberspace Law Committee, and co-chairs the Intellectual Property Committee in ABA’s Public Contracts Section. Roland earned a B.A. at the University of Southern California, a B.A. and M.A. at Oxford University, and a J.D. at Yale Law School. Roland can be contacted at rltrope@tropelaw.com.
Where was the Board? Where were the lawyers?

Averting and Responding to Corporate Ethical Crises

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Volkswagen

6 Volkswagen Executives Charged as Company Pleads Guilty in Emissions Case

By ROBERT FREYER, JACOB KRIENZ and MATTHEW APSDEO  July 1, 2017

WASHINGTON — Federal prosecutors announced criminal charges on Wednesday against 6 Volkswagen executives for their roles in the company’s emissions cheating scandal, a long-term by a long-standing administrative that is trying to remove its stage of being off its corporate ethics.
The Recurrent Question:
How did Legal Let this Happen on their Watch?

- ABA Model Rules of Professional Conduct ("MRPC") and New York’s Rules of Professional Conduct ("NY RPC")
- MRPC Rule 1.2: Scope of Representation & Allocation of Authority Between Client & Lawyer
  "(d) A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent, but a lawyer may discuss the legal consequences of any proposed course of conduct …"
- NY-RPC Rule 1.2 adds:
  "(f) A lawyer may refuse to aid or participate in conduct that the lawyer believes to be unlawful, even though there is some support for an argument that the conduct is legal."
The Recurrent Question:
How did Legal Let this Happen on their Watch?

- MRPC and NY-RPC Rule 1.4 Communications

"(a) A lawyer shall:

(5) consult with the client about any relevant limitation on the lawyer's conduct when the lawyer knows that the client expects assistance not permitted by the Rules of Professional Conduct or other law."

Findings of Independent Committee of the Yahoo Board

"the Company’s information security team had contemporaneous knowledge of the 2014 compromise"
Findings of Independent Committee of the Yahoo Board

“in late 2014, senior executives and relevant legal staff were aware that a state-sponsored actor had accessed certain user accounts... While... security measures were implemented in response... it appears certain senior executives did not properly comprehend or investigate, and therefore failed to act sufficiently upon, the full extent of knowledge known by the Company’s information security team.”

Findings of Independent Committee of the Yahoo Board

“did not conclude that there was an intentional suppression of relevant information”

Findings of Independent Committee of the Yahoo Board

“the relevant legal team had sufficient information to warrant substantial further inquiry in 2014, and they did not sufficiently pursue it.”
Findings of Independent Committee of the Yahoo Board

“As a result, the 2014 Security Incident was not properly investigated and analyzed at the time, and the company was not adequately advised with respect to the legal and business risks associated with the 2014 Security Incident.”

Findings of Independent Committee of the Yahoo Board

“... [T]he Audit and Finance Committee and the full Board were not adequately informed of the full severity, risks, and potential impacts of the 2014 Security Incident.”

Yahoo Board Decisions

- CEO not awarded cash bonus for 2016
- CEO to "forgo any 2017 annual equity award given that the 2014 Security Incident occurred during her tenure"
- GC resigned – no payments made to him "in connection with his resignation"
Key Questions

1. What drives unethical conduct in large companies?
2. At what crucial moments does unethical conduct take root?
3. How should Boards and Legal respond to an ethical crisis?
4. What can Boards and Legal do to avert ethical crises?

How does the Contagion of an Ethical Crisis Start and Spread?

1. When enterprises, at critical junctures, go “off-course” ethically
2. Usually during challenging transitions (e.g., new markets, new unrealistic objectives) or when leaders subvert character (e.g., order misdeeds, ignore or trivialize “red flags”)
3. When personnel perceive a “sea-change” in the company’s ethical culture – formally (“tone at the top”), or informally (“don’t ask, do it”)
4. When “mission achievement” becomes a “zero-dimension” priority
5. When “doing the right thing” drops from the mission, and becomes “leave it back right”
6. When accountability becomes “not on my watch” syndrome – no instead of halting unethical activities, personnel struggle to make it “look good” or cover it up
7. When officers and boards adopt Casablanca’s Inspector Renault’s posture: “I’m shocked, shocked to find that gambling is going on in here” and lose credibility

“METTLE FATIGUE”

Slow, irreversible corrosion of character
Eventually prevents a person from:
- Recognizing reality,
- Accepting facts, and
- Responding with integrity.
Ten Sources of Ethical Crises

1. Pursuit of short term results “by any means” believed necessary, without considering the long-term unintended consequences [VW, Wells Fargo, Rolls Royce (“RR”), Uber]

2. Insistence on the pursuit of infeasible objectives with no tolerance for failure, or creating incentives for such pursuit [VW, Wells Fargo]

3. Suppression of open communication, and enforced by an intolerance for bad news and dissenting views [VW, Wells Fargo (Community Bank), Uber]

4. When ”tone at the top” emphasizes “obeying the rules”, without a matching insistence on “doing what’s right” [RR, Yahoo!, Wells Fargo]

5. When a company’s “informal culture” in the ranks undermines “tone at the top” [RR among others], or leaders disserve and subvert the brand [Wells Fargo, VW]

6. Departure from honesty in the chain of command and a reckless disregard for the consequences [RR, Wells Fargo, Uber]
Ten Sources of Ethical Crises

7. When reported results are "too good" to be true, and seemingly trusted without verifying the facts by asking "how did they do it?" [RR, VW, Wells Fargo]

8. Creation of software to cheat, rather than solve problems honestly – and protection of the corrupt practice from disclosure as if it were a trade secret [VW’s “defeat device”, Uber’s “Greyball”]

Ten Sources of Ethical Crises

9. Responding to ethical crises with "damage control" that trivializes or conceals unethical conduct. Instead of protecting the enterprise, the brand, and the credibility of management, Legal, and the Board [All]

10. Losing sight of the inherent corporate advantages of doing "what’s right" and succumbing to "mettle fatigue" [All]

Source 1
Results “By Any Means”
[Wells Fargo, VW, Rolls Royce]

- Pursuit of short term results – or market entry – “by any means” believed necessary or competitive … without considering the long-term, unintended consequences
When the Independent Directors of the Board authorized this investigation, the purpose was to examine the root causes of sales practice abuses and to assess how issues of corporate structure and culture as well as individual actions contributed to the injuries inflicted upon Wells Fargo's customers and the extraordinary damage to Wells Fargo's brand and reputation...

Wells Fargo's Community Bank (CB) Sales Practices Investigation Report – APR ‘17

• Business model emphasized sales volume – and unrealistic year-over-year sales growth
• Leadership recognized plans were “unattainable”
• "50/50 plans" = expected only half the regions could meet them
• "Jump into January" sales targets – prompted personnel to "sandbag" (temporarily withhold) December account openings till January to achieve targets
Wells Fargo’s Community Bank (CB) Sales Practices Investigation Report – APR ’17

• “Tone at the top” was abusive, threatened jobs for missed goals
• Regional President in LA emails expressed intolerance for failure
  • “we are at 99% of solutions [products], 93% of profit and 105% of checking. I hate numbers that start with 9! I like ones that have three digits and start with a 1, as in 105. 110.” [Similar to VW’s if a team fails, I’ll fire them all]
• President “suggested” subordinates “encourage customers to sign up for products regardless of need.”

Not a bank “services” model, but a retail “sales” model

Wells Fargo Crucial Moments When Misconduct Took Root

• 1st Moment – 2004: Wells Fargo Internal Investigations group prepared report on “sales integrity violations”
  • “whether real or perceived, teams members … feel they cannot make sales goals without gaming the system.”
  • “The incentive to cheat is based on fear of losing their jobs for not meeting performance expectations.”
  • “If customers believe that Wells Fargo team members are not conducting business in an ethical manner, it will result in loss of business and … diminished reputation in the community.”
  • Manipulation or misrepresentation of sales to meet goals rose from 63 in 2000 to a projected 233 in 2004.

Later Crucial Moments – 2013: Wells’ CEO informed that approximately 1,000 (or approximately 1% of Community Bank employees) were being terminated for sales integrity violations each year.

CEO reacted “positively to the 1% number”

• “Do you know only around 1% of our people lose their jobs for gaming the system … Nothing could be further from the truth, or having products we customers … Did some do things wrong - you bet and that is called life. This is not systemic.”

• Did not initiate any follow-up inquiry in 2013 or 2014
• Most of the 1% were in Los Angeles and Phoenix branches – 1,000yr fired for ethical violations

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Wells Fargo

Crucial Moments When Misconduct Took Root

• Later Crucial Moments – 2013: articles in Los Angeles Times highlighted Wells’ unethical sales practices
• Legal clearly knew of the articles
• Yet no investigation to identify and address injuries that customers might have suffered
• Not until May 2015 suit by Los Angeles City Attorney did Wells (or Legal) even recognize that customer harm in fees was possible with "simulated funding" (funding new unauthorized account without customer permission)

Wells Fargo

Crucial Moments When Misconduct Took Root

• Later Crucial Moments – May 2015: Board’s Risk Committee requested report on “L.A. issue” but with “broader perspective on sales practices”
• Early draft disclosed 1% terminations per year for unethical sales conduct, based on data gathered by Internal Investigations committee
  • “A lawyer questioned the basis for that 1% number…”
• In conference call with Legal, the Community Bank officers “argued the 1% was unreliable” – soon after, the figure was deleted from report.
• Risk Committee reported only “230 sales practice terminations” in 2011/2014.
• Community Bank officers knew actual figures: 1,229 in 2013; 1,293 in 2014.
• Board did not learn actual figures until well into 2016.

Wells Fargo

Crucial Moments When Misconduct Took Root

• Early crucial lapse at Legal – 2002:
  • Employment section lawyers encountered sales misconduct and terminations (referred to as “mass terminations”)
  • Almost an entire branch in Colorado engaged in "gaming" a promotional campaign
  • On instructions from bank managers, tellers issued credit cards without customer consent
  • Wells, with advice from Legal, decided not to terminate everyone involved – as that would have eliminated most of branch’s tellers and personal bankers
Wells Fargo

Crucial Moments When Misconduct Took Root

- Continuing challenges to Legal:
- Additional “mass terminations” for gaming Wells Fargo’s incentive compensation system continued over next ten years
- Employment lawyers at “all levels” were aware or involved in addressing terminations
- Legal focused on litigation costs of sales integrity cases (in event of lawsuits by terminated employees)

2011: Employment lawyers – and their Deputy GC – began to recognize “sales pressure in the Community Bank ... as a root cause of gaming cases” – and recognized reputational risk

Nevertheless, “the perception persisted in the Law Department that sales integrity cases involved ‘gaming’ ... the incentive program and not conduct affecting customers.”

“That led them to underestimate the need to escalate and more directly manage sales integrity issues.”

Although Board told in 2014 that “sales practices” were “noteworthy risk”, the advice that accompanied that risk

- Financial highlights on identify the potential consequences of the misconduct that were distinctly legal in nature – e.g., a cascade of civil litigation, regulatory action from a host of federal and state agencies and the resulting severe harm to Wells Fargo’s reputation.”

Wells Fargo

Crucial Moments When Misconduct Took Root

Wells Fargo Raises Its Tally of Fake Accounts
MRPC Rule 4.1: Truthfulness in Statements to Others

“In the course of representing a client a lawyer shall not knowingly:

(a) make a false statement of material fact or law to a third person; or

(b) fail to disclose a material fact to a third person when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client, unless disclosure is prohibited by Rule 1.6.”

Issue in Wells: The “false statement of material fact” was to the client – i.e., the Board of Directors.

NY-RPC Rule 4.1: Truthfulness in Statements to Others

“In the course of representing a client a lawyer shall not knowingly make a false statement of fact or law to a third person.”

Issue in Wells: The “false statement of fact” was to the client – i.e., the Board of Directors.

Recommended Approach

- Identify crucial moments in these crises when – if salient facts had been reported to the Board – the Board could have ensured that management halted the wrong doing.
- These salient facts are the kind that a Board should reasonably expect management and the GC to report.
- These should be where you try to practice “ethics by design”
Sir Brian Leveson said, “it can properly be described as devastating and of the very greatest gravity ... that the investigation ... should reveal the most serious breaches of the criminal law in the areas of bribery and corruption (some of which implicated senior management and, on the face of it, controlling minds of the company).”
Rolls Royce (RR)
January 17, 2017
Queens Bench Approved Deferred Prosecution Agreement

Sir Brian Leveson

“I have pressed Rolls-Royce to disclose its present constitution and, in particular, the membership of its Board. Had any member of the today’s senior management who was implicated or been in a position where they should have been aware of the culture and practices which I have described and were clearly endemic at Rolls-Royce remained in his or her position, this, itself, would have been of real significance and could have affected my approach.”

RR’s Ethical Crisis
Costs to Date

- Reputation
  - RR entered Deferred Prosecution Agreement with UK’s Serious Fraud Office - approved by Queens Bench January 17, 2017 – RR admitted to:
    1. Agreements to make corrupt payments to sell aircraft engines in Indonesia and Thailand (1989 - 2006)
    2. Failure to prevent bribery in civil business in China (between commencement of UK Bribery Act 2010 and December 2013)

- Reduced Capital
  - Disgorgement of profits, fines, and settlements = approximately $1 billion

RR Critical Moment – 1
August 18, 2010
Customer Demands Bribes

- Three RR employees negotiating sale of T700 engines to China Eastern Airlines (CES) in Shanghai

- To “close the deal”, CES Board member requests “financial contribution”:
  - £3 million to “training programme” for senior managers at “premier business school” to be “rolled out” in the U.S.
  - £2 million to Pilots’ Healthcare Center (a “pet project”)
RR Critical Moment – 1
August 18, 2010
Customer Demands Bribes

• RR employees discuss
• Decide - “RR will accede” to request
• Letter of intent signed

RR Critical Moment – 2
Sept. – Nov. 2011
Review by RR Compliance and Legal

• CES and Columbia Business School develop MBA course
• Includes “program of events” funded by RR’s $3 million
• RR Compliance and Legal learn of “MBA fund” and object via internal emails

RR Critical Moment – 2
Sept. – Nov. 2011
Review by RR Compliance and Legal

• October 19, 2011 email:
  “This is a big problem from an ABC (anti-bribery corruption) standpoint.
  We are not in the business of providing ‘high level business training.’
  By allowing CES to funnel their money through us for this purpose is a problem ...
  We are providing something of value to government officials.
  We will do our best to deal with this situation as it presently exists.”
RR Critical Moment – 2
Sept. – Nov. 2011
Review by RR Compliance and Legal

• RR engaged U.S. law firm to “advise on liability” under the FCPA
• Firm advised that funding MBA course “could risk potential FCPA violations” – suggested steps for RR to mitigate risk
• Compliance employee noted “none of the solutions would eliminate the risk” – and Pilots Healthcare Center was “so far afield as to be difficult to justify”
• 7 NOV 2011 a Supplemental Financial Assistance Agreement was signed.
• 9 NOV 2011: RR posts on website “RR wins $1.2 billion order from China Eastern Airlines”
• 11 NOV 2011 first T700 was due to be delivered to CES.

Viewing RR’s Crises Through Lens of the MRPC or NY-RPC

• MRPC Rule 1.16 Declining or Terminating Representation
  
  "(a) … a lawyer shall not represent a client, or where representation has commenced, shall withdraw from the representation of a client if:
  
  (1) The representation will result in violation of the rules of professional conduct or other law;"

• NY-RPC Rule 1.16 [focuses on existing representation and on what a lawyer “reasonably should know”]
  "(b) … a lawyer shall withdraw from the representation of a client when
  (1) the lawyer knows or reasonably should know that the representation will result in a violation of these Rules or of law;"
Viewing RR’s Crises Through Lens of the MRPC or NY-RPC

- MRPC Rule 1.16 Declining or Terminating Representation
  "(b) ... a lawyer may withdraw from representing a client if:
  ...
  (2) The client persists in a course of action involving the lawyer’s services that the lawyer reasonably believes is criminal or fraudulent;
  ...
  (4) The client insists upon taking action that the lawyer considers repugnant or with which the lawyer has a fundamental disagreement; ...
  or
  (7) Other good cause for withdrawal exists"

Viewing RR’s Crises Through Lens of the MRPC or NY-RPC

- NY-RPC Rule 1.16 Declining or Terminating Representation
  "(b) ... a lawyer may withdraw from representing a client if:
  ...
  (2) The client persists in a course of action involving the lawyer’s services that the lawyer reasonably believes is criminal or fraudulent;
  ...
  (4) The client insists upon taking action that the lawyer considers repugnant or with which the lawyer has a fundamental disagreement; ...
  or
  (13) the client insists that the lawyer pursue a course of conduct which is illegal or prohibited under these Rules."

Recommendations

- When an ethical crisis hits, a CEO and the Board each have one chance to salvage their credibility

- Don’t squander the opportunity to draw a line under the crisis

- Avoid tone-deaf, inauthentic, “damage control”
Recommendations

- Avoid denials that fudge facts and blur ethical lines:
  - **VW GOA CEO:**
    "To my understanding, this was not a corporate decision. This was a couple of software engineers who put this in for whatever reason."
  - **VW AG Chairman:**
    "The key finding is that we are not talking of a one-off error, but a whole chain of errors that was not interrupted at any point along the timeline."

- Avoid announcing equivocal new policies that prompt media ridicule and employee cynicism:
  - **Uber Board Member:**
    "Going forward there can be no room at Uber for brilliant jerks and zero tolerance for anything but totally respectable behavior in an equitable workplace environment."

Emerging Ethical Risks

- How can Legal help a Board ensure it receives timely, salient facts when new technologies make them hard to discern and assess?
- What causes "tone at the top" signals to become muddled and ineffective as they travel down the enterprise?
- How should Legal help a Board or its independent directors react:
  - When there are symptoms of any of the "10 sources" of ethical crisis?
  - When informal conduct of the enterprise resembles a "wall of silence" culture?
  - When enhanced cyber risks could cause operational disruptions that stress or exceed a company’s resilience?
- That’s the aim of “ethics by design”