



LEADERSHIP SERIES

the evolving role of **GENERAL COUNSEL**

Leadership in Challenging Times

A Roundtable

Discussion

Keynote Speaker:

James B. Comey

General Counsel of

Lockheed Martin Corporation

the
PANELISTS



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TO THE READER:

In the 5th edition of our continuing series, *The Evolving Role of General Counsel*, we present a lawyer who has been on both sides of the table in dealing with corporate conduct, James B. Comey, Senior Vice President and General Counsel of Lockheed Martin. Before assuming his current position, Mr. Comey was Deputy Attorney General of the United States — the second-highest ranking official in the United States Department of Justice. Prior to that, he was the U.S. Attorney General for the Southern District of New York. In each of his former roles, he was privy to the details of many high-profile corporate scandals — of corporations with the shared traits of flawed communication, flawed culture and flawed compliance.

Mr. Comey shared his observations on corporate conduct and the government's ongoing challenge to infiltrate the corrupt business and accounting practices of large, multi-national corporations — many of whom have ongoing contracts with the U.S. Government. He also discussed the DOJ's tactical decision to prosecute mid-level employees who knowingly participated in illegal conduct. The message is a simple one: the plea, "I was only following orders," will find no quarter in the offices of general counsel or government prosecutors.

Mr. Comey also reminded us that the familial structure inherent to any corporation needs to be treated with the same sense of responsibility that one would apply to one's own family: what you say matters, but it's what you do that really counts. Words like ethics and compliance mean little without action. It is the responsibility of the leaders — the *parents* to use Mr. Comey's analogy — to set the standard through their own conduct. A serious departure might find one grounded for life.

Our four distinguished panelists addressed several key issues pertaining to corporate ethics and compliance. Glenn Campbell, a partner at King and Spalding, focused on M&A, particularly in the areas of homeland defense & security and IT services. Of particular interest were Mr. Campbell's comments on U.S. export control laws and the dearth of understanding of these laws that can leave an otherwise law abiding and ethical company in a state of serious non-compliance.

W. Jay DeVecchio, a partner at Jenner & Block observed that while SOX has been and continues to be of prime importance to corporations and their boards, it should not be — cannot be — to the exclusion of the fundamental compliance and ethics measures that have kept reputable corporations in good stead all along. Mr. DeVecchio also addressed the liability issue prime contractors risk in taking the assertions of compliance made by their sub-contractors at face value.

Marcia Madsen, a partner at Mayer Brown Rowe & Maw, reminded us that companies doing business with the U.S. Government must be extraordinarily vigilant owing to the government's lax or non-existent internal controls. She specifically cited several gaffs in the government procurement process fueled by the consolidation of decision-making authority and the lack of meaningful internal monitoring and process. She also warned of the danger's posed by interagency contracting which bypasses the government's competitive bid process and the trend toward a combined workforce where private company employees are incorporated into the public sector workforce.

Last on this all-star roster was A. B. Culvahouse, Jr., Chairman of O'Melveny & Myers. He discussed the role of independent directors and how investigations made by these independents have changed in a post-Enron era. He also addressed the ongoing challenge Boards of Directors face in balancing the often competing interests of fully cooperating with the DOJ and SEC; vigorously defending against the ever-present threat of civil litigation from the plaintiff's bar; maintaining shareholder confidence; and preserving the consumer goodwill essential to business success.

Five renowned lawyers — all committed to helping American business do what it does best — innovate, grow and prosper — without cutting ethical corners (or worse) to do so. We learned a great deal from each of them, we trust you will too.

—Brian Corrigan, Esq.
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MR. FRIEDMAN: I'm Jack Friedman, Chairman of the Directors Roundtable. We are a civic group that offers programming in about twenty countries and about twenty cities in the U.S. Our goal is simply to have the finest programming focusing on Boards of Directors and their advisors.

The purpose of this particular series is to acknowledge the increasing importance of General Counsel. We are honoring not only an individual today, but the profession of corporate counsel and giving a wider understanding of the leadership role that the business community plays as corporate citizens. It is evident that it's almost impossible to find a positive comment about any corporation in the press. One might have the impression that the only way to get anything done properly is for the government to beat up on the business community. But, in my view, and I think in most people's view, it's really the reverse: If the business community doesn't take a lead, then the government is never going to be able to handle the problem adequately. Today's program will start with remarks from our Guest of Honor. Then each of the panelists will speak individually and as a group. Finally, we will open up the discussion to questions from the audience.

I would like to introduce James Comey, General Counsel of Lockheed Martin. Prior to his current role, Mr. Comey was Deputy Attorney General of the United States, serving in President George W.

Bush's administration. As Deputy Attorney General, Comey was the second-highest ranking official in the United States Department of Justice (DOJ) and ran the day-to-day operations of the Department. He was appointed to the position after serving as the United States Attorney for the Southern District of New York. In August 2005, Comey left the DOJ to assume his current role as General Counsel and Senior Vice President of Lockheed Martin. We are delighted to have Mr. Comey join us today. Thank you.

MR. COMEY: Good morning everybody. And I don't care what you may have heard from Judge Michael Luttig. I have the best general counsel's job in America and I didn't have to move to Chicago to get it.

I would like to spend just a few minutes with you sharing some perspectives on what I would call the Enron era, the last let's say four and a half years starting from late 2001. Perspectives drawn from my experience as a prosecutor, a U.S. attorney in Manhattan, and then the deputy attorney general, and a perspective supplemented by the last ten months working as general counsel inside a major American corporation that focuses almost maniacally on some of the compliance issues and ethics issues that we all talk about.

So let's start with the Enron era. What happened?

People have asked me many, many times over the last four years, did we see an explosion in corporate criminality in America starting with Enron, following through WorldCom, Adelphia, Imclone, HealthSouth. I mean, you pick off the list yourselves. And the answer is one that's frustrating to many people. I don't know. I honestly don't know. I talk to people with a much longer view, a much longer involvement in criminal justice than I and they tell me people are crooks. You're always going to have crooks. People are always going to commit crimes. People are going to do bad things. That's what's great about being in the law enforcement business. You will never run out of people to lock up. And in the white collar area, people's crimes, the manifestations of their flawed characters, tend to be reflected in many ways by the different market conditions.

People with a longer view have said, look what happened in the eighties. You had a boom in mergers and acquisitions. Boom in premium information. And what did you have? A huge number of information based crimes. Misappropriation, insider trading, that sort of thing. You saw tremendous prominence given to Boesky, to Milken, to Drexel Burnham and things of that sort. In these you saw a run up in the market unlike any we've ever seen before. And those conditions drew criminals in a different direction. They drew people to crimes that were rooted in people's belief that everything would make money.

Penny stocks, nickel stocks, crap stocks, whatever kind of stock it was, it was going to make money.

And we saw in the Southern District of New York during that period, La Cosa Nostra, this thing of ours, the Mafia drawn to the markets. They actually set up these boiler room schemes with these fabulous names to sell stocks to old people, to anybody who would answer the phone. To pump stocks and dump them, simply sell made up stocks, to find all manners of ways to make money. La Cosa Nostra, though, didn't call itself the Columbo family or the Gambino family brokerage house. They made up these names, and I have two favorites because these guys may be dumb but they come up with great sounding names that reek of sort of ox blood and dark wood paneling. Montgomery Sterling was one outfit. And Stratton Oakmont was another outfit. And it sounds nothing like what it was, which was three guys named Vinny in a basement in Brooklyn making phone calls to make money. But the market attracted those criminals for the same reason that banks attracted Willie Sutton. That's where the money was to be made by criminals. And those people who have given me this sense of the long view have said look, look what happened at the end of the century, the turn of the century. We had a change in those conditions that was as dramatic as any we had seen. The bottom fell out. We had had people who could make money with anything, always beat expectations, always get to the next quarter higher than you were before, always, always, always, all of a sudden take a dive.

Warren Buffet says it really well and it's not just because he has more dough than I do. Warren Buffet says, "just as a rising tide lifts all boats, a quickly receding tide exposes all naked bathers". What happened in late 2001? The tide was unbelievably high and always getting higher. There were people in that water that had lost their suits and rather than raising their hands and saying, I need a towel, I need some help here; they stayed in the water, and they treaded water convinced that that rising tide would enable them somehow to get to a point where they are fundamentally sound business model would pay off. Because right, *all the business models are fundamentally sound if I could just get to that next whatever. Yeah, I don't have the number of cable subscribers that I need. Yeah, I have wild over capacity in fiber, yeah, I have whatever*, fill in the blank. But it's going to work. If I can just stay in this water long enough. And then

something dramatic happened. That water went out. And standing on the beach were a whole bunch of people without their bathing suits. And those were the people that we at the Department of Justice wanted to talk to. Those were the people whose, *I'll just get to the next quarter* was exposed when the bottom fell out. At least, that's the way that people wiser than I look at it. And I think it's a way that makes a lot of sense to me.

So was there a run on corporate criminality? Was there a fundamental breakdown in the core human value system? I don't know. But I know something

the rest of the people in the bank. This generated great fear in the community and a sense that it was dangerous to go into banks. That there was a run on bank robberies. And I sat with the head of the FBI in Richmond and asked, what are the stats? How does it look? And the answer was bank robberies are actually down as against last year and against the year before. But it didn't matter because the good people of Richmond believed that it was dangerous to go into banks and that the law enforcers were not protecting them. And it became incredibly important to us to find some of those bank robbers and to



that mattered at the United States Department of Justice. A whole lot of people thought there was. This amazing constellation of Enron, WorldCom, Adelphia, and a number of others that happened in close proximity from October of 2001 to the spring of 2002 created a sense that the system was broken. That the rich people were getting away with it. That corporate executives were all crooks. That the system was tilted, was fixed, was broken in a fundamental way. And despite what your mother may have taught you about not caring about what other people think, when you're in the law enforcement business you must care what people think because their faith in the system is one of the pillars of that system.

Another very small, very different example was part of my life in Richmond, Virginia where I was an assistant U.S. attorney. We had a number of very high profile bank robberies where good people got hurt. A beautiful young gal who had just graduated from high school was shot and killed at point blank range by some psycho who just wanted to intimidate

hammer them and make sure the world heard about it.

The white collar explosion, whether it was or not, began with what I call sort of the summer of fraud, the summer of 2000 generated the same kind of pressure inside the government. It was powerfully felt that we needed to respond to reassure the good people and to send a shock wave of deterrence at the bad people. Two messages: One of reassurance for the good folks; one of fear, frankly, for the bad folks. So we set out to do something we had never done before and that is to push our white collar prosecutors to deliver cases within the memory cycle. You've heard about the news cycle. The memory cycle is that period of time during which people still remember the bad thing that happened and that there is a consequence for that bad thing. The problem with so many white collar cases is that they take so long to make that folks have forgotten what the bad thing was in the first place. And whether they know it or not they have internalized the notion

that the system doesn't work. People get away with it. Nothing ever happens. When something finally happens, they don't connect it up. So it became very important to us to deliver some results in the memory cycle. And how do we do that? My predecessor is Deputy Attorney General Larry Thompson, he started in inventory at the direction of the President. He became chair of the corporate fraud task force and created a spreadsheet of every investigation underway in the United States involving significant allegations of corporate fraud, accounting fraud, self-dealing, insider trading and things like that and started checking that inventory, aging that inventory. Every thirty days I want to know, where does this stand? Where does this stand? And the message we preached to our prosecutors was, the perfect is the enemy of the good. Do not bring me a hundred counts four years from now where you are going to nail this company or this person on every one of those hundred counts. Don't do that. Bring me five counts of clear crime that you can prove in the next six months. That was the message that was sent. And it is a message that is a hard one for a lot of white collar prosecutors because it is very difficult to make white collar cases. White collar cases, as they should be, face a very high hurdle. And all of you know what that hurdle is. The government must prove what's inside the mind. The government must prove that someone acted with criminal intent. And prove that to a jury of twelve who must unanimously agree and prove that beyond a reasonable doubt. That's very, very challenging.

Drug cases, of which I've done some of in my career, are very different. [They are] actually the reverse. In a drug case, the mission is to connect a person to a transaction. Right? All of you know this. I don't want to pick on anybody but I'll pick on this one, the photographers here. If that table is in a hotel room at an airport Marriott near Kennedy Airport and there is a kilo of heroin in the center of that table and the DEA bursts in, these three guys, even the guy with the camera, are in huge trouble. And it is not open to any of them to say, *this is illegal!* Or *my accountant has reviewed this kilo.* Or *I have a comfort letter from a reputable law firm and they have said that this kilo...* no. If you're at that table, you are going to jail. White collar cases are very different because no matter how complicated the case, no matter how many special purpose entities, off balance sheet, reverse repos, no matter how much complication there is, at the end of the day investigators are going to know what happened. They are going to know the transactions. They are going to know who was at the figurative table. The mission then though is, when they were sitting at that table, what were they thinking? And it is open to the folks at the table to say sometimes with justification, *right, my accountant looked at this transaction, my lawyer looked at this. It never occurred to me that this was wrong.* And the government's burden to make that case is to prove, inside the mind, that that person knew they were doing something criminally wrong. And that's the way it should be. I used to say to folks it's hard to remember now what the summer of fraud was like but I used to have people when I was the U.S. Attorney in Manhattan yelling at me at public

forums, *why don't you go out at arrest Ken Lay? Why don't you go out and arrest Bernie Evers?* And I used to say to them, look you don't want to live in a country where I can go out and lock somebody up, or would lock somebody up because we are all whipped up about it. You don't want to live in that country because someday you'll be in the cross hairs. You want the burdens I just laid out. You want the burden of proof, you want criminal intent to have to be proved, you want a unanimous jury. You want it to be hard.

Now, having said how hard it is, the great thing about living in this century is that we have inherited the last century's great gift of law enforcement which is e-mail. There was never a window into the mind like e-mail. All of you today, and some of you may have gotten this out of the way already, will say something stupid on e-mail. You will say something where the reader can't see context, can't see body language, can't read that you are just kidding, can't read sarcasm. You will say something that can be misinterpreted, or you'll say something brutally honest. People say things on e-mail that they would not say to their best friend at the top of Mount Everest whispering through an oxygen mask. I don't know why that is. There is something about e-mail, about the freedom of e-mail, about I don't know what it is, but people will say things on e-mail that you wouldn't believe.

All of us in law enforcement or have had law enforcement experience have a favorite. My favorite comes from a case involving an advanced fee scheme, which was just a rip-off of a bunch of people who were desperate to borrow money from small business people. And this outfit had these brokers that would e-mail each other when they were bored during the day. And one e-mailed the other saying: *I just hope the SEC doesn't find out what we're doing here.* And the other knuckle-head e-mails back saying: *Forget about the SEC, when the FBI comes, I'm out the window.* Now, that's a pretty good window into the mind that those guys knew that they were doing wrong. And yeah, I could prove to a jury who would agree unanimously that they did because of that. I've tried explaining to people saying, look, what is it about cars that make people feel safe? You've all seen this, right? Someone sitting in an automobile, surrounded by glass that can easily be broken, flipping people off in traffic. Right? Some huge guy is just going to get out of his car and just beat the daylights out of you. But you feel safe in a car. There is something about e-mail that offers that same sense of safety and anonymity and ease of transmission also makes it so much more tempting. So that's where we looked. That's where we always look in law enforcement for a window into the mind. What did somebody say in e-mail? And it's for that reason, I don't have time to talk about it in great detail, but it's for that reason that cases involving obstruction became so important to the government. A case involving anyone screwing around with e-mail, anyone screwing around with documents, and it extended, obviously, to anyone lying during interviews. All of those things became incredibly important to the government during the Enron era.

So we set out in the summer of 2002 to age an inventory and to send a shockwave. And we thought

JAMES B. COMEY



Jim Comey has been Senior Vice President and General Counsel of the Lockheed Martin Corporation since October 3, 2005. From 2003 through 2005, he served as U.S. Deputy Attorney General supervising the operations of the Department of Justice. Prior to becoming Deputy Attorney General, Mr. Comey was U.S. Attorney for the SDNY. From 1996 through 2001, Mr. Comey served as Managing Assistant U.S. Attorney in charge of the Richmond Division of the U.S. Attorney's office for the Eastern District of Virginia.

Mr. Comey attended William & Mary and the University of Chicago Law School (J.D. 1985). He served as law clerk for then-U.S. District Judge John M. Walker, Jr. in Manhattan, and worked for Gibson, Dunn & Crutcher in their New York Office. He joined the U.S. Attorney's Office for the SDNY, where he worked from 1987 to 1993, eventually serving as Deputy Chief of the Criminal Division.

// The virtue of deterrence and talking about deterrence in the white collar arena is you have an audience that listens; that watches CNBC; that reads the Wall Street Journal; that pays attention. You have an audience that doesn't commit crimes high on crack or desperately emotional. You have an audience that commits crimes after reflection . . . you have an audience that is very responsive to pain, to fear because they are a people that have a lot to lose. **//**

GLENN C. CAMPBELL



Glenn Campbell is a partner in King & Spalding's Mergers & Acquisitions Practice Group. Mr. Campbell's practice involves advising clients on acquisitions, divestitures, joint ventures, collaborations and licensing transactions; the fiduciary obligations of directors in connection with the evaluation of transactions; the registration and distribution of debt and equity securities; and the disclosure and reporting requirements of the federal securities laws. His clients include companies in the defense, homeland security, consumer products and pharmaceutical industries. He is a member of the American, Maryland and District of Columbia Bar Associations and serves as a member of the Corporation Laws Subcommittee of the Maryland Bar Association.

// In many cases you have individuals, well meaning individuals, who don't appreciate the fact that when they are having a conversation with someone who happens to be a foreign national and they are talking about some technology they are working on, that conversation, in fact, involves an export of technical data, which may violate the U.S. export control laws. //

that we could send a message of reassurance. And we also thought, and I still believe, even outside government, that deterrence works in the white collar arena. Again, [it's] different than in other arenas. It's sometimes hard to fit the deterrence model to some drug crimes, violent crimes, things like that. The virtue of deterrence and talking about deterrence in the white collar arena is you have an audience that listens; that watches CNBC; that reads the Wall Street Journal; that pays attention. You have an audience that doesn't commit crimes high on crack or desperately emotional. You have an audience that commits crimes after reflection. And third, you have an audience that is very responsive to pain, to fear because they are a people that have a lot to lose. People with community roots and families and the ties of a normal successful person. That recipe, we believed, made deterrence work in the white collar arena and if we could send a scary message we would change behavior.

So what happened? I think a very scary message was sent. We thought an awful lot about deterrence and making decisions about who to charge. And one of the hardest decisions I made personally was to charge the middle level accounting people at WorldCom. There was a woman named Betty who was in charge of accounting in Clinton, Mississippi, and knew she was doing wrong when she made top-side adjustments to their records after the close of quarters; knew she was getting an illegal order; knew it was absolutely wrong; she was having trouble sleeping about it. But she did it anyway. And I insisted that she plead guilty. Not because I ever thought that Betty would re-offend. Not about personal deterrence. But because I thought it was very important to send the message that, 'I was only following orders', was not good enough. That if you find yourself in that position you could think about someone like Betty. And Betty went to jail for five months and got credit for cooperating. Very hard decision because she was a decent person.

Why did she do it? She told us. Because she had no other alternative, she thought. There was no one I could go to at WorldCom. I knew the orders were coming from the top. I need this job. I'm the main breadwinner for my family. I support my husband and my kids. And there is no better job in Clinton, Mississippi than the one I have. What am I going to do? And the answer we tried to be a small part of was that you are going to do something other than intentionally break the law. And that's a hard thing, but I think it's a message that had to be sent. I think at the end of the day a broad message was sent. I think some good was accomplished from what the United States Department of Justice did in response to the summer of fraud. But I think there is a tremendous limit to what we tried to do.

Now that I just talked about how great we were as prosecutors, let me explain why prosecutors don't matter that much. You can't arrest your way to a healthy urban neighborhood. You can't. I have locked up a lot of people for gun crime and for drug crime. That is not the answer alone to creating a healthy urban neighborhood. It's a very important thing to do to create the space for the good people of that community to claim it. For the good people to grow

healthy kids. But you're not going to arrest your way to healthy kids. You cannot prosecute your way to a healthy corporate culture. It just doesn't work.

The prosecutor's role is a lot like what I think my role is as a parent. I have five children. I have two high school daughters. One of them is on her way to college this fall. And my wife has taught me how to be a parent in all respects but here is one of the tools she has given me. We say to these beautiful bright young girls when they go out in the evening, look, someone offers you a beer, or a joint, or some boy wants to express his admiration for you in ways that are inappropriate, you need to say no and should say no because of the way we raised you. Since you were this tall we've talked to you about what's right and what's wrong. Your character really your culture, but I don't say that – but your character should get you there. I don't do that. But let me help you out. If you find yourself wavering and weak and you want that joint or that beer or that inappropriate expression of admiration, you say to that boy, *Gee, I'd love to, you know, fill in the blank, I'd love to do 'X', but my father is a maniac. Okay? My father would kill me and you if I did that. So I can't.* I said let me be your excuse. That's my role as a dad: To be your excuse. That's the role of the prosecutor in corporate America. To be an excuse. If you get to the prosecutor things have gone so bad they've just gone way bad. The prosecutor's role is to be that father-figure. That back-up. But what is the answer? What is the main lesson of the Enron era? That culture and character matter and that there is such a thing as corporate culture. And that it requires constant care and feeding and attention. That corporate executives need to realize that ethics is not something that you leave for people to get at the church or synagogue or some weekend deal. Ethics is not something you check at the door. Compliance is a fairly narrow thing. Compliance is the boundary on this field. Ethics is how do I behave within those boundaries. Compliance is about people stepping over those boundaries. But ethics is about keeping people away from the sideline at all. And I think for too many corporate executives, ethics made them uneasy as sort of a quasi-religious deal. Huge mistake. I think one of the lessons of the Enron era is that if it makes you feel quasi-religious or not, you must talk to your employees the way we talk to our children. And raise them in a way, yeah, maybe they have that prosecutor as a backup. They don't even think about that prosecutor, because they know what's right and what's wrong. And it is constantly refreshed.

The challenge of culture is, it goes bad like air. Slowly. So the people in the room don't notice it. You've had this happen, right? You're working on something, I don't know whether you're gutting fish or something really disgusting and you're in a room and your spouse or your friend steps into the room and they say, what on earth is that? And you say what are you talking about? They say, that stinks. It doesn't stink. Yes, it does. You know what I'm talking about. Why does that happen? You were in the room when that air went foul. You didn't notice it. When you step into rooms like that and I've stepped into rooms like WorldCom, Adelphia, and Enron it stinks to high heaven. But a lot of good people in the room didn't notice that it got all smelly because it happened

bit by bit by bit. There was never a day at WorldCom when Bernie Evers said, listen, we're going to commit the largest fraud in American history on Wednesday. Is everybody free? Okay. I've had cases where people kill people.

In Mafia cases they say we're going to do it Wednesday. If that's not good, Thursday is a backup for us. In WorldCom, what happened? Thousands of gestures, and e-mails, and signals, and body language, and the air went bad through thousands and thousands of human interactions until people like Betty didn't feel free to say, no, I don't do that. It got stinky as all get out. And it was hard to tell from the inside.

So the primary lesson of the Enron era is that culture matters. And it is incumbent on people who care about their companies to be maniacal about that

culture. And to talk ethics with their employees and to constantly watch that air in which they live, because they will be the last ones to notice it going bad. I think a hopeful lesson of the Enron era is people get that. I went to a company that is maniacal about that in part because the lesson is hard learned by Lockheed but lots of other companies understand how important it, how it is in their self-interest to be maniacal about ethics. And if they do that, there will always be crooks, but there will not be the kind of crooks that generate attention in People Magazine and all across this country in a summer of fraud, in the summer of 2002. And we will not have the situation where people look at people who work in corporate America as a bunch of crooks. And we will not have a situation where the good people of America doubt that the system works. That is the lesson of the Enron era. Thank you.

MR. FRIEDMAN: Thank you. Our next speaker will be Glenn Campbell, a Partner at King & Spalding.

MR. CAMPBELL: I am going to talk today about mergers and acquisitions, particularly in the defense, homeland security, and the government IT services industries. There are a number of issues that I think are of importance to directors and advisors of companies generally in the context of a particular M&A transaction. There also are a number of peculiar issues that I think are either more relevant or more important at times in the context of companies like Lockheed Martin. When you look at the M&A area over the last twenty-five years, there are a number of



developments that have occurred in the M&A world generally that have paralleled some of the developments from a business perspective in the defense, homeland security, and government IT services space.

With regard to corporate M&A law generally the states historically have been the principal architects of our governing law. In Delaware, which has long been the home for many of our largest corporations, over the last twenty-five years there have been numerous cases dealing with the fiduciary duty of directors in an M&A context. And despite the number of cases and the different situations the Delaware courts have had to address, there still is a fair amount of uncertainty at the margin on particular issues. If you go back twenty years to the TransUnion decision, the Delaware courts sent shockwaves through the ranks of corporate directors in this country by concluding that a group of directors who had no personal interest in a transaction, but who the courts ultimately concluded did not avail themselves of all the information that was relevant to a decision to sell the company in fact could be held personally liable for the failure to exercise their fiduciary duty. In the last month, some comfort has been given to directors by the Delaware courts as a result of the *Disney* decision, which has received a great deal of attention. The court concluded that while the Disney directors in hiring a new president didn't do a great job, and certainly didn't meet the highest standards of corporate governance, their actions did not constitute a breach of their fiduciary duty.

The other thing that has happened in the last twenty-five years in the general M&A area is the increased evolution of federal law as a source of the law in M&A

transactions. If you go back to the late 1960s when some abusive takeover tactics received a great deal of attention, the Government stepped in, as Jim has suggested, and passed the Williams Act. To use Jim's phrase, the *Summer of Fraud*, the Government stepped in with both feet in passing Sarbanes-Oxley. I think it is fair to say that it is virtually unprecedented for Congress to move as quickly as it did in 2002, and for something to get passed in Congress by almost unanimous vote, particularly given the political climate in which our Congress acts today. With Sarbanes-Oxley, the federal Government has become a much more active participant, I would suggest, in the boardrooms of America's corporations. Every director has heard of Sarbanes-Oxley, and every director asks about the implications it has for the way the board conducts its business. And that is a good thing. But I also would suggest that it would be a big mistake to focus on Sarbanes-Oxley to the exclusion of other areas of the law that for a long time have been important. I know Jay and others are going to talk about some more specific items in this regard am going to try and highlight at a thirty thousand foot level a number of areas where increased enforcement at the federal level, from both a civil and criminal perspective has had a significant effect on how M&A transactions occur today and, in particular on the way they are conducted within America's defense industry.

During this same twenty-five year period there have been enormous changes in the defense industry generally. If you look at the 1990s, we went through a wave of fairly significant consolidation. A number of very large defense contractors that existed in the 1980s and early 1990s no longer exist. When you look at

Lockheed Martin where Jim is the general counsel, it now includes the businesses of companies like Martin Marietta, Lockheed Corporation, parts of the Loral Corporation and GE Aerospace. Boeing includes the McDonnell Douglas business, Rockwell and Hughes. Northrop Grumman today combines the longstanding aerospace business Northrop and the Grumman business as well as Litton Industries, Westinghouse Electric and now TRW. So there has been a massive consolidation in the industry and at the same time there has been a significant growth of a number of smaller government IT services and systems integration companies. All you have to do is drive around the D.C. area and you can see many of them. The other thing that has happened during this same period is a

you intend it to do. These remedies are used sparingly by the Government, but they exist and as a result they cast a shadow over the diligence and review process that any company goes through in the M&A area. Some of the other speakers today will talk about some of those activities.

In the case of activities that could result in suspension or debarment there are a number of matters that have received publicity lately and are a fallout from some of the things Jim mentioned. The first I would like to touch on is significantly increased enforcement in the area of the Foreign Corrupt Practices Act. There have been a number of M&A transactions in the last several years that have been affected dramatically by FCPA investi-

extended because there was no way to consummate the transactions until the investigation was complete. In the Lockheed Martin/Titan transaction, the FCPA investigation ultimately resulted in the termination of a merger agreement that both parties at its inception thought was in their best interest.

Another area in the international sphere that I want to address is significantly increased enforcement in the export control area. This is an area where the Commerce Department has authority, but most significantly in the defense, homeland security, and government IT services industries, the State Department also has an important role. The International Traffic in Arms Regulations and the

related U.S. Munitions List make it clear that the export of certain defense articles and services is unlawful absent specific licenses and, in some cases is limited or prohibited with respect to individuals or foreign nationals from certain countries. Export control is a critical aspect of any M&A transaction where the target company has significant international operations. And in many cases, companies don't appreciate the scope of the potential risk to the company's business or their potential liability. I also think it is fair to say that with a lot of acquisitions of smaller companies those companies don't have the resources or the robust compliance programs that are needed to address significant export control issues.

In many cases you have individuals, well meaning individuals, who don't appreciate the fact that when they are having a conversation with someone who happens to be a foreign national and they are talking about some technology they are working on, that conversation, in fact, involves an export of technical data, which may violate the U.S. export control laws.

Finally, in the general contract area, I would like to address the nuts and bolts diligence process for reviewing basic Government contracts. It is not particularly glamorous. It is hard work. But embedded in those contracts, embedded in those many pages of references to specific FAR and Government contract provisions, are things like organizational conflicts of interest provisions. When you look at the consolidation in the defense



significant increase in the internationalization of our industry. You look up today and you see large companies like BAE Systems having a very significant role within the U.S. defense industry, including influence on programs that are highly sensitive. These changes in the defense industry, homeland security, and government IT services businesses raise a number of considerations that are very important in the context of an M&A transaction. The first is the fact that, in many cases, particularly with smaller companies, the companies have a single customer. So a failure to comply with the rules and the complexity that exists within the Government contracting arena can have fairly dramatic effects on a company. It can have the ultimate effect of suspension and debarment in which the company that you acquire can't do the business that

gations. You can look at the GE acquisition of InVision Technologies and Lockheed Martin's proposed acquisition of The Titan Corporation as two examples. In both of these cases I think it is fair to say that the acquisition itself was one of the reasons why the activity actually came to light. And, in fact, the desire to close the transaction was the impetus for reporting the possible criminal activity to the Government and conducting extensive diligence. The other aspect of these transactions to remember is that the Government, no matter how fast it moves, does not resolve an FCPA investigation on a timetable that is consistent with a typical M&A transaction. In both the InVision and Titan merger transactions, the merger agreement termination provisions had to be

industry in which major platform or weapons systems companies are acquiring companies in the government IT services space, what you frequently find is provisions in contracts which provide that a company cannot both evaluate a contractor's performance at the same time its affiliate is performing the contract. In the M&A context, these issues frequently arise and can only be addressed if people are very careful in reviewing the stacks and stacks of documents made available during the diligence process.

In closing, one additional consideration I would mention that is fairly unique to the defense industry is the fact that the Department of Defense has a very significant role to play in the antitrust review process. We saw it during the 1990s with both horizontal and vertical restraint analysis when a number of the larger companies in the industry were consolidating and competition was reduced from three to two players for a particular product or in a specific market. We also see it today as the Defense Department is actively considering issues involving a company acquiring a supplier that provides a vital component in a larger product or platform that is sold to the Government. It is important to be aware that the Defense Department will play a very significant role in the review process with the traditional antitrust regulatory authorities. In some cases, the Defense Department's opinions will facilitate a transaction that otherwise might appear to result in a significant reduction of competition. In other cases, the Defense Department effectively will have a veto over a particular transaction if the advice to the Justice Department or the FTC is that it raises significant competition or supply concerns.

MR. FRIEDMAN: Thank you. Before we continue with the next speaker, I want to make two acknowledgements. One is that the co-host for this series is the National Law Journal. I think you know how preeminent it is within the legal sphere. After this event, the NLJ will publish a custom magazine based on the transcript of this discussion. It will be sent out to the NLJ readership as well as a select group of legal and corporate professionals. A PDF will also be available via the NLJ website. Secondly, there are many distinguished people here, including someone I've admired for a long time: I'd like to welcome William Coleman, who was Secretary of Transportation under President Ford. Thank you for joining us today.

Returning to our discussion, I want to ask one quick question of Jim. You mentioned how ethics matter in terms of setting the tone in a company, what should be done?

MR. COMEY: Well, not to convince you that all I think about is parenting, but a bit the way you, again, raise your kids. How did you become the way you are? How were you shaped to the character you have today? Do you remember stuff people told you? Maybe some things. But you were shaped by coaches, teacher, parents, siblings, friends, by what they did and how you watched them, again, in thousands of encounters. I mean, there was a day when your mom got too much change from the

cashier at the supermarket. And you were with her. You were seven. You were holding her hand and you saw what she did. I don't know what she did. I hope she gave it back, but whatever she did it shaped you. And you saw how your dad treated somebody of a different race, or creed, or color that came through the neighborhood. That shaped you. So what I say to chief executives is that it's important that you give speeches, it's important that you are maniacal about ethics. And I'll spare you how maniacal Lockheed Martin is. But you can't get away from it. They are whispering it to you while you sleep. But the most important thing for a chief executive to realize is that your employees are like your children. They are like these amazing sensors that we make. You can't ever turn them off. I mean, I'm sure there are times when you as a parent want to say, look I want to drink beer out of a bottle and scratch my stomach. Move away from me. You know, I don't want to be bothered with this. You can't with a kid. It's always on. Employees are always on. They watch you. They see you. They listen for gestures. They look for signals. And so the way you reinforce that is you recognize that actually what you do is much, much more important than what you say. You got to say stuff but too many people focus on saying stuff and then forget that ninety percent of it is them watching what you do and modeling it. And now I'll shut up.

MR. FRIEDMAN: Thank you very much. Our next speaker is Jay DeVecchio, a partner at Jenner & Block.

MR. DEVECCHIO: I'm fascinated by Jim's last comment about parenting. I have a twenty-one year old. And he now drinks beer and scratches his stomach and wants me to get out of the way. I'm also here to defend the honor of those of us who participate in the "mind-numbing practice" of contract law.

One of the things I think has become apparent is that culture is important, and that Congress has attempted to influence the culture of corporations by passing Sarbanes-Oxley. I also think probably everyone in this room has had some exposure to Sarbanes-Oxley one way or another. We have seen the people in the high executive ranks who now have to sign certificates saying: "Let's see, we have to have internal controls over financial reporting, and we have to have disclosure controls to support the certificates. But what do those mean?" Well, we're not exactly sure, but one of the things we think it means, and that most companies have concluded, is that not only do we need to figure out what internal controls and disclosure controls are, but also to sort out how in this process we are going to attend to our procedures for complying with laws and regulations. My concern is that a number of entities, Lockheed Martin perhaps, that have in place basic, sound, and longstanding systems for ethics and compliance, may be deflected away from them in ways they haven't been in the past; deflected by Sarbanes-Oxley. People pay attention at a higher level in the company to Sarbanes-Oxley issues and, in doing so, may tend to forget the fundamental compliance and

W. JAY DEVECCHIO



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Mr. DeVecchio represents clients in all facets of government procurement law, from bid protests, to complex claims and disputes, through suspension and debarment. He also represents clients in related issues such as criminal and civil fraud, *qui tam* actions, and internal investigations. His litigation practice has encompassed the largest defective pricing appeal tried to date, the leading case on latent defects, and the Eleventh Circuit's decision on false claims immunity for Medicare contractors. His clients are primarily from the aerospace, health care, and technology sectors. In 2005 and 2006, he was named a leading national practitioner in Government Contracts by Chambers USA.

// Does your internal audit staff include supplier issues on its annual audit plan? No? If not, who does? "I'm not exactly sure," you say. Who audits and assures that your suppliers meet your quality control standards and meet your specifications? "I don't know." Do you rotate your buyers to make sure they don't get too cozy with suppliers? . . . Ask yourselves these questions. Doing these things is not mandatory, but it is prudent. //

ethics measures that got them into a safe place to begin with.

I also think it's sort of the perfect storm, because if you look in companies (and I think most of us have seen this) and ask: "Who in companies gets the assignment to go do this kind of compliance work?" It is the upcoming, rising stars — the more junior people. I'm concerned about that because the compliance issues that gave rise to Jim's "memory cycle" those things that got government contractors in trouble — happened over twenty years ago. As far as your mid-level managers are concerned the dinosaurs roamed the earth then. My twenty-one year old son thinks that. They don't appreciate, and they don't have the context to understand, what the reasons were that got us there, so when they are looking at focusing on compliance and internal controls, they don't have the ability, I don't think, to discern well enough the underlying problems. I think we ought to focus on that. And I have a few suggestions I'd like to talk about.

Before that, though, compounding this perfect storm is another issue that we see a lot of these days, which is a heightened level of focus by the Department of Justice, imposing a duty of care on companies that is different than before. It is requiring almost a level of perfection, or of vicarious liability, that didn't exist, it seems to me, four or five years ago. Let me give you some examples to think about, and then let's tie it in to the culture of Sarbanes-Oxley and Generation X.

An example: A contractor buys specialized circuit cards from a company whose quality control systems have been reviewed and approved by the government. It's a common circumstance. The prime contractor does not have to go out, and, in fact, is not required to go out, to inspect the quality aspects of its supplier because its supplier has been certified. Indeed, the supplier provides a certificate of conformance and test reports on each batch that say: "Yes, we meet all of your specification requirements, Mr. Lockheed Martin or Boeing or UTC." And the prime is entitled to, and does rely on, that certificate. It turns out, however, that those certificates of conformance are bogus. The test results are phony. They are not conducting the tests. Does the Department of Justice go after that entity? Not in this circumstance. The Department of Justice goes after the prime contractor and says, "Hey, where were your systems and controls to make sure that your supplier had the right things in place? Where were your quality control people?" And that ends up as a civil false claims action against the prime contractor.

Here's another one: A prime contractor in an effort to get more efficiencies in its procurement system decides to narrow the field by selecting down to a few suppliers. It holds a competition and picks a company that has done well for it in the past, and who offers competitive prices. The deal is that they are going to get more business if they offer lower prices and higher quality to a prime contractor. And they seemingly do that. But slowly the supplier's prices start to creep up and the prime does what it normally does — it reviews their costing and pricing and it doesn't see anything wrong. Unbeknownst to

the prime contractor this sub-contractor has false invoices, a second set of books. The Department of Justice doesn't go after them on a civil matter. It goes after that supplier criminally. It prosecutes them, as it should, while declaring that the prime contractor is a victim. Then, a few months later, DOJ turns around and pursues the prime contractor under the Civil False Claims Act for failing to catch the problem.

There are lots of other examples, and I suggest to you that these are troublesome in and of themselves. But think about them in the context of your large business. You don't do everything yourself. You rely on your suppliers and your subcontractors. Ask yourself the question: As part of your Sarbanes-Oxley compliance, do you do anything to evaluate your systems and processes for looking at your suppliers who account for an enormous part of your business? Is that part of the internal controls that your CFO and CEO have been looking to? I don't think necessarily so. And who, again, are the people who are going to look at these things? It's going to be your Generation X.

Does your internal audit staff include supplier issues on its annual audit plan? No? If not, who does? "I'm not exactly sure," you say. Who audits and assures that your suppliers meet your quality control standards and meet your specifications? "I don't know." Do you rotate your buyers to make sure they don't get too cozy with suppliers? That's something that was done in the '80s under the Anti-Kickback Act. "Well, I haven't looked recently." Ask yourselves these questions. Doing these things is not mandatory, but it is prudent.

And I guarantee you they are not the high-level, attention-getting, consultant-heavy matters that people have been looking at with respect to Sarbanes-Oxley. I also suggest to you that that's part of the problem with Sarbanes-Oxley. When we start elevating the level of review because of the attention it gets by having our CEOs and our CFOs involved, you might start looking at things that aren't the fundamentals anymore. That concerns me. It concerns me because of the memory cycle. The people who are going to be doing this compliance work weren't there in the '80s.

Think back, if you can — and for those of you who are in that generation that I'm disparaging, trust me on this one. The notable focus on product substitution, for example the bad circuit cards; those cases hit the headlines in the 1980's. The National Semi-conductor case, which was the case that said you have to "burn in" these electronics for the first twenty-four hours, even though everyone on Earth knows it'll work if you only do it for fifteen (and, therefore, we won't do it for the full time) was in 1984 big headlines; big fines; big penalties. That's when people started enhancing their quality control. The Department of Justice had put the fear of God in contractors. Well, the people rising in your organization today have never heard of those things. And if you look, I'm afraid you may start seeing more lapses in quality control. At least I think so: Anecdotally, we seem to be seeing more with respect to product substitution.

What about the Truth in Negotiations Act —

TINA? Great stuff. Again, the heyday of TINA was in the '80s. In fact, they altered the law in 1986 to eliminate all those defenses that we had established to avoid liability. Congress got rid of them. Fine, but where were your rising stars then? If you talk to the people now who are responsible for cost and pricing data in a company and you say "TINA," they think of a pop singer, if they think of anything at all. When you say, "Hey, have you done your post-handshake sweep?" They think sweep means the last time they ran the pool table. They don't know what you're talking about. They don't have the context of knowing that you have to have cost or pricing data as of a specific time; or that doesn't matter what your negotiators know. How are they going to know it? What are your systems and processes? I don't know. That's for you to figure out. But when was the last time you looked at it?

And there is example after example in government contracting. Kickbacks, the heyday of that was 1986, when they passed the Anti-Kickback Act. Now we find renewed Kickback cases. We even have a case in the Court of Federal Claims talking about kickbacks, which is a relatively rare phenomenon.

Then there is Procurement Integrity. People in companies of a certain generation probably think Procurement Integrity means you beat up your suppliers and get a really good price. For them, that's good Procurement Integrity. Some people do pay more attention to it nowadays, to an extent, because of the difficulties posed by Darlene Druyan and the Boeing debacle. And they now understand — they now have a little bit of a memory cycle with respect to — the issue of what you can and can't do to engage in employment discussions with former government personnel. But there is a lot more to Procurement Integrity than that. Procurement Integrity goes to the issue of when you can and can't get other companies' confidential information. When you can and can't get source selection sensitive information. Once again, those issues arose in the '80s out of Operation Ill Wind. I assure you if you ask your mid-level managers what "Ill Wind" means you are going to get a very interesting answer that has nothing to do with those cases and those prosecutions back then. It wasn't part of their memory cycle at all. But I can tell you that right now, today, many companies look to hire people from other competitors, and they're hiring them for their expertise. Well, if as part of that you get proprietary information from one of your competitors, inadvertently or not, you've immediately got a problem. You have a potentially serious issue under the Procurement Integrity rules. And certainly you have a problem if you've improperly gotten information from the government. If your folks don't understand that and recognize it, literally the minute they get the documents, so that the documents aren't copied and aren't circulated, your problem compounds. Do your people understand these issues?

Ask yourselves these questions. When is the last time you evaluated your training about these and other ethics and compliance issues? "Well, we do a lot of training." Really? How do you do it? Has your training become so routine it's become lifeless? "Well, I think it's very effective." Really? How do

you do it? Do you have people that get up there and talk about issues and discuss things that actually happened in real life, like some of those cases I mentioned or things that actually happened to this company, like Lockheed Martin? "Well, no. We have computer-based, web-based training." Is that really the right way to do it? Ironically, it may be for Generation X.

Do you feel entirely comfortable that, when you look at the training you have and at your ethics organization, you're up-to-date? If not, I think you need to ask yourself the question whether you have done enough things to get back to the fundamentals that the companies knew well twenty and twenty-five years ago, but that they might be missing today.

When was the last time you took on the mind-numbing work of taking a look at your policies and procedures? Would they induce a coma in Generation X? If they would, you have something to do and you need to pay attention to it.

So in this post-Enron era, it is important to be sensitive to internal controls. But heightened sensitivity to internal controls can't mean ignoring the fundamentals that first got you into compliance. In fact, it means, I think, getting back and refreshing yourselves and the people who are the upcoming stars in your organization about the things that brought you to the ethics and compliance programs that, by the way, have been an enormous benefit to government contractors. People today in companies that are wrestling with Enron and whether or not this is the right thing to do and what's the cost benefit ratio of it forget this key fact: If you have an organization that preaches and is "maniacal" about ethics and affords a mechanism where anybody in your company Betty in Mississippi can raise a question if they have a concern and get it answered by someone who is not beholden to anybody in line management, who reports directly to the highest levels of the company, then what you're going to find is that you start avoiding all the incipient problems that lead to the things that you are now going to be required so rigorously to disclose under Sarbanes-Oxley. You avoid the civil false claims allegations. You avoid the whistleblowers because the people in your company never get to that point of dissatisfaction. They have a mechanism to resolve their concerns.

And that's what's important about Sarbanes-Oxley. If you want to make sure you avoid an SEC problem, create the culture and the mechanism that you need to get there. You do that in part by going back and evaluating what you did before and to see if you need to do it again. Thank you.

MR. FRIEDMAN: Thank you. I am pleased to introduce Marcia Madsen who is a partner at Mayer Brown Rowe & Maw.

MS. MADSEN: Good morning. We have talked a lot about internal controls in the post-Enron era. And I want to talk a little bit about internal controls in a little different context – from a different angle. And that is internal controls within the government relating to government contracting and government contractors. Just as in private industry when we're

dealing with shareholder confidence, the public's perception and confidence in the integrity of the federal procurement system plays an important role. The trust that we place in government officials to make prudent and disinterested decisions is critical to the public's confidence in the procurement process and the government's ability to handle taxpayer funds wisely. The government's procurement budget today is about three hundred sixty billion dollars. It's about a billion dollars a day. Just sitting here you can just hear it go click, click, click. It's a lot larger than any private enterprise. So it's reasonable for one to ask, particularly if you're a private company doing business with the government, what type of internal controls are in place for handling all of that money, the taxpayer's money.

As many of you know, the acquisition community was surprised to learn in October 2004 that a very senior Air Force acquisition official, Darleen Druyun had admitted that her government decisions and matters affecting a certain contractor, which was Boeing, were influenced by actions that that contractor took on behalf of her family. She specifically acknowledged that she was influenced by her perceived indebtedness to that contractor in selecting Boeing for the C-130 Avionics Modernization Program (C-130 AMP). After she made those admissions during her sentencing, there were bid protests filed at the Government Accountability Office (GAO) regarding contracts that were awarded to Boeing for two programs, C-130 AMP and the Small Diameter Bomb (SDB). C-130 AMP is an extensive avionics upgrade for the C-130 aircraft. The small diameter bomb is a miniature, two hundred fifty pound, bomb that is intended to be dropped from an F-15 or an F/A-22.

We at Mayer Brown were fortunate to handle both of these protests on behalf of Lockheed Martin. Both of them were successful — the protests were sustained. Both cases involved production of documents that reflected Druyun's role and activities, as well as hearings with testimony from people who knew and worked with her. Based on her long experience, her reputation, and her understanding of the acquisition system, Druyun was in a prime position to influence those procurements to suit her own objectives. The cases were fascinating for what they revealed about the extent of Druyun's power; the way in which she was able to exploit the acquisition system to her own ends; And, most importantly, the lack of internal controls in the procurement process inside the government. For example, GAO found in the C-130 AMP case that Druyun made herself the Source Selection Authority. GAO found that she employed a forceful management style and that she left no doubt as to who was in control from the outset. Surprisingly, despite a very voluminous documentary record that made her actions quite clear, the government took the position in these cases that Druyun did not significantly affect the actions of other agency personnel involved in these acquisitions. We referred to that as the 'Darlene who defense'. GAO did not accept the government's position. GAO said that the record was replete with documentation showing her influence. I can give you a couple of quick examples. In the C-130 AMP

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// . . . [T]he government lacks a good regime of internal controls with disclosure requirements that are similar to Sarbanes-Oxley. It means the companies dealing with the government are faced with a very unequal regulatory regime. It places a huge burden on the company to have a highly disciplined ethics compliance and disclosure program that requires a heightened level of attentiveness to whether the governments' actions are legal. //



case, GAO found, and this is all from the public decision, that she drove the evaluators to downgrade their ratings of Lockheed Martin and other contractors and to improve the ratings of her favored offeror. Now, there were a number of people involved in this procurement; -- probably close to a hundred people involved in this procurement. All of them could see what was going on. Where were the internal controls? Where was the ethics training? Why did no one raise his or her hand and say, "You know, this doesn't look right to me"?

GAO also found that the contracting officer in this case expressly directed the destruction of documents, so GAO said it had no confidence that GAO had received the complete record. Again, where were the internal controls inside the government? Where is the ability of that contracting officer to say, "I don't think that's such a good idea"?

In the SDB case, there was an issue regarding whether Druyun had a role in adjusting the program requirements to the detriment of Lockheed Martin. Despite the government's denial, GAO found significant involvement by Druyun in that process. There was testimony of Druyun's boss, the Assistant Secretary of the Air Force, that he had removed her from the position of Source Selection Authority (SSA) for the SDB procurement. In fact, he thought he had appointed another person, Druyun's deputy, as the Source Selection Authority. And in one of the more troubling moments and in some ways incredible, I guess, moments of the case, there was testimony that showed that each of these people, the assistant secretary and Druyun's deputy each thought that the other was functioning as the SSA.

"I thought you were doing it. Oh, I thought you were doing it." And neither of them performed that role. Rather, Druyun just forged ahead with her own agenda.

As you can see, both of these cases raise significant concerns about the internal controls within the government in the management of the procurement process at very, very high levels. Now, since this happened, DOD and the Air Force have undertaken various studies and assessments regarding how the Druyun situation occurred. They've learned that she acquired considerable power without the types of checks and balances that might have helped to avoid the misuse of that power. They have learned that some of the emphasis on efficiency and streamlining the procurement process in the mid-90s may have actually contributed to her consolidation of power. Given the power that she held, and the length of her tenure as a senior Air Force official, her case is probably an exceptional one, but the lessons remain valid. Checks and balances, internal controls are important to any large complex organization. And Darleen Druyun didn't obtain her power and position overnight. A lot of us in the room have encountered her for many years in many different contexts and were well aware of the strong personality — and that was visible even from the outside. So internal controls are a big issue in the Druyun saga.

There are some other issues in the procurement system right now that are under review that also raise questions about internal controls and expenditure of government funds. In my current extracurricular activity I am chairing a Federal Advisory Commission called the Acquisition Advisory Panel,

which is looking at some of the streamlining measures and so-called acquisition reform measures that were put in place in the 1990s. The panel is supposed to report back to Congress and the Administration, and it's taking a look at a number of issues that have been put in place that are supposed to increase the discretion of contracting officials and make it easier to spend the taxpayer's money. I can tell you that it's premature to talk about the findings of the panel. They'll be public in a few months. But we've heard some very, very interesting testimony. Time doesn't permit me to talk about it all in detail, but I wanted to talk about a couple of important issues. Two key issues that the panel is examining are interagency contracting and the combined workforce.

Let me talk about interagency contracting for a second. Interagency contracts are contract vehicles that allow one agency to buy from another agency's contract without going through a formal, competitive procurement process to establish a new contract.

It really features the ability of an agency to move money directly from the program side of the agency onto another agency's contract and obtain the goods and services that it needs without going through a competitive procurement. It's an attractive, expedited acquisition vehicle. It's supposed to give agencies the ability to leverage the government's buying power and provide a simplified and expedited method of acquiring goods and services — and it does that. The panel has heard some very interesting testimony about these contracts. For example, we learned that for 2004, over \$140 billion was spent through interagency transactions on these kinds of vehicles. Testimony and reports by the GAO and the DOD Office of Inspector General (DODIG) have indicated in reviews they have undertaken that there are serious issues regarding the use of these contracts to direct work to specific contractors. Studies and audits by the DODIG and the GAO indicate that a significant portion of awards, close to fifty percent in some of their studies, under these vehicles are being directed to a particular source without any type of competition. Obviously, these questions raise serious issues of internal controls.

GAO has found in one of its reports that ordering under interagency contracts is often handled by entrepreneurial fee-for-service government organizations. One of the things government did in the mid-90s was set up entities called assisting entities or franchise funds that operate like a business and provide contracting assistants to other agencies for a fee. This gives the contracting unit a financial incentive for placing the order. Managing the finan-

cial incentives can be a challenge. GAO is concerned that it might lead the contracting activity to emphasize revenue generation as opposed to good contracting practices that are in the best interest of the government. The acquisition of interrogators for the Abu Ghraib prison in Iraq was the product of one of these contracts. It was an order placed by one of these assisting entities called GovWorks at the Department of the Interior. In that case, none of the parties to that transaction stopped to look at whether the contract applied to those services, whether it was appropriate to place the order in that way, or whether it was permissible to use those services in that manner. And that's the contractor, the government "owner" of the contract vehicle, and the party that placed the order — no internal controls. There's a big gap in accountability between the owner of the contract vehicle, the user, and in some cases, the contractor in these vehicles.

The second issue that the Panel is taking a hard look at, which also has significant internal controls implications, is the question of the combined workforce. In the 90s, as many of you know, the size of the government was reduced substantially, particularly the number of people working in the acquisition function. In many agencies, the work that those people formerly performed is being performed today by someone who actually is an employee of a private sector contractor. The contractor personnel work side-by-side with agency employees in the same offices — on the same projects and programs — particularly if it involves IT related services or management consulting related services. So those people are working at a government office. They are participating in decisions that that government office is making.

One of the issues the Panel is looking at is what kinds of standards these people are observing when they are in very closely connected government decision-making space. What kinds of ethical constraints are they subject to? What's the impact of all of this for contractors?

I think it's threefold. First, the government lacks a good regime of internal controls with disclosure requirements that are similar to Sarbanes-Oxley. It means the companies dealing with the government are faced with a very unequal regulatory regime. It places a huge burden on the company to have a highly disciplined ethics compliance and disclosure program that requires a heightened level of attentiveness to whether the governments' actions are legal. Not just whether your company's actions are appropriate, but whether governments actions are appropriate. Second, it may place a company in a very difficult position if the company has determined an action that its government customer has taken, or wants the contractor to take, is undesirable or impermissible. You know you shouldn't do it but, you have got a government customer on the other side who may be perfectly willing to go ahead with the transaction and who is not sensitive to the ethical issues. The government's lack of internal controls may place the contractor in a very awkward position. In essence, the contractor has to monitor the government's behavior. And third, with respect to the combined workforce, it's very important to

understand that if you're a contractor and you're providing services, where are your people? What are they doing? Which offices are they working in? Who is giving them direction? What kind of standards are they subject to? Are the ethical standards that your company imposes enough or do they need additional guidance and direction particular to the specific work they are performing? Many government agencies including DOD and GSA are working hard to address these issues as we speak. There is quite a bit of discussion in the press about some of these topics. They don't have this problem solved. The challenge they face is maintaining enough discretion to accomplish their mission, balanced with a need for accountability. Maybe we should apply Sarbanes-Oxley to the government?

MR. FRIEDMAN: Thank you. I would now like to introduce Mr. A. B. Culvahouse, the Chairman of O'Melveny & Myers.

MR. CULVAHOUSE: Good Morning. I'm going to talk very briefly about the role of independent directors, and investigations conducted or overseen by independent directors, in the post-Enron world. After listening to my fellow panelists I think I've probably been at this work longer than anybody at the table. I first came to Washington in to stay eighteen months to work for Howard Baker on the Senate Watergate Committee on the least sexy part of that investigation, which was the very many U.S. and in some cases foreign corporations who made illegal corporate contributions to both major presidential candidates in the 1972 election. I was thinking about those issues because the first special report voluntarily publicizing corporate wrongdoing, including unlawful political contributions, that I recall seeing, was authored by John McCoy of the Milbank firm for Gulf Oil, which then became a paradigm for the next stage of my career working for my then senior partner and still senior partner Bill Coleman, investigating payments by U.S. corporations to foreign government officials.

For some of you who are as old as I am will recall Stanley Sporkin, the then Securities and Exchange Commission's Director of Enforcement, essentially said in the late 1970's to corporate America that if you have paid foreign officials, and if you will hire independent counsel and do an independent investigation to disclose to the SEC all you know, the SEC will forebear enforcement. Many of our clients at the time were outraged by Sporkin's policy, but I can tell you they would love to have that same enforcement forbearance extant today, where we now find ourselves with a number of prominent independent counsel and independent committee investigations, including those done in connection with Enron and related cases. Examples of independent investigations include Enron itself, with the Powers report; obviously WorldCom; David Boise in Tyco; Hollinger where our firm worked with Richard Breeden; Warren Rudman and Paul, Weiss for Boeing, and for Fannie Mae; and Jim Doty and Baker Botts for Freddie Mac.

Similarly, if you look at the "backdating" issues which are now in the financial press, of the sixty or

so public companies that have announced that they have stock options backdating issues, it appears that at least thirty of those have entered into some sort of treaty with the SEC and the Department of Justice where the Government will forebear an active investigation while an independent committee of directors and an independent counsel of stature does a full blown investigation and report, finds facts, and keeps the SEC and the Justice Department informed. That is a very good policy for lawyers who work as independent counsel. I think it also is quite a good policy for companies, but it's fraught with difficulty. Now, I will talk a little bit about some of that difficulty.

First, sitting independent directors, while independent under the New York Stock Exchange standards, almost always were on the Board of Directors when some of the bad conduct occurred. Those directors, by the time a committee of independent directors is created by a resolution of the full Board of Directors to review those allegations, likely have already been named in civil security actions as defendants. So the question is, are those directors sufficiently independent? Having tried recently to convince people of stature to join Boards of Directors who are under current investigation by the SEC and Justice Department, one finds that the possible solution of going out and finding new directors who are purely independent, who were not on the board at the time of the bad conduct allegedly occurred, is a very difficult task, particularly with all of the other pressures on public company directors occasioned by Sarbanes-Oxley and otherwise. The substantive corporate law in some states does allow non-directors to serve on independent committees, and that is an alternative where you might have a little more luck in convincing someone of stature to serve temporarily as a member of an independent committee, without having to be a full-fledged Director. There also are interesting issues about corporate indemnities, the cost of "D&O" insurance and so forth, but it is the independence requirement and time commitment that are the big hurdles in creating an independent review committee.

The independent committee and its counsel are "deputized," as I mentioned before, by the SEC and the Department of Justice. That is a fact that has to be remembered because, as the former General Counsel of Computer Associates found out, obstructing an inquiry by an independent committee and its counsel is tantamount, in the eyes of the Department of Justice, to obstructing the Government's inquiry, because that committee and its counsel are reporting its information and findings to the Government. In the case of the backdated stock options issues, independent committees are reporting on the results of their investigations virtually every week to the SEC and the Southern District of New York, the Northern District of California and other United States Attorneys.

The Board of Directors itself faces some very tough issues on what to do once its investigation is completed, and resolving those issues is becoming increasingly more complicated in the world in which we live. The Board is under considerable

pressure by shareholders, regulators, customers, and the press. If you are representing companies involved with alleged backdated stock option issues, these are front page stories, you and your clients receive calls everyday to take prompt, aggressive remedial action, such as terminating responsible executives for cause, holding back compensation, and suing executives for damages. Of course, your partners who are handling the shareholders derivative cases will advise that a Board's showing that type of independence from company management also helps substantiate that the Board and its independent committee is sufficiently independent, disinterested and motivated to protect the shareholders' interests, that they can be trusted to protect the shareholders. Conversely, personal counsel for management will tell company counsel and counsel for the independent committee, quite properly that if the Board takes such action, if executives are terminated, if they are terminated for cause, if the Board holds back executive compensation, that the Directors are substantially increasing the likelihood in today's environment that the SEC will bring a fraud charge not only against management, but also against the company. And as we all know too well, if the company consents to an SEC fraud charge, or is found by a court to have committed securities fraud, that fraud violation will substantially increase the costs of settling the civil securities cases filed against the company. A study that we commissioned recently indicates that the cost of settling civil securities cases, where there is a parallel SEC consent decree consenting to a Section 10-b fraud violation, is increased six to ten times compared to civil settlements where there is no parallel SEC fraud violation.

So the Board is sitting there saying we have found bad conduct by management. It's conduct that in Temple or Sunday School is objectively bad. On the other hand, if you take aggressive remedial action against management, you could cost the company additional money in settling its way out of the civil cases and the enforcement proceedings. It is easier to resolve these issues in extreme cases like WorldCom, I believe, where revenues were made up. Or in a company where the reported new factory in Iowa did not exist, but it gets much more difficult when you're talking about conduct that the directors and independent counsel believe to be



objectively unacceptable, but may not be so material or clear cut that the Board and counsel believes that the SEC and DOJ will bring fraud charges against the company in any event. That is the dilemma facing Boards of Directors today in these backdated stock option cases, as they work their way through trying to do the right thing from a corporate governance point of view, protecting the shareholders' interest, sending the message that needs to be sent throughout the company and to corporate America that this cannot and will not be tolerated; and yet, when taking remedial action against responsible management, not give the SEC, the Justice Department and worse yet the plaintiff's lawyers such advantages that you're spending company money for fines and civil settlements that otherwise would not have been spent. You now have counsel for individual executives suggesting that the directors themselves could be liable to a receiver if they take disciplinary action against their clients that the increases geometrically the cost of civil cases and SEC fines. There really are interesting

issues, fun issues, and I don't think they are going to get any easier. Hopefully the government will begin to show some degree of forbearance for companies that take action against those responsible, but have the temerity, if you will, to say "this is not an admission to securities fraud, we are going to resist spending our shareholder's money when it's not justifiable.

As someone who has criticized SOX in public, let me just say the one odd and unexpected result of SOX is that there are very few companies that have backdated options issues after SOX was passed. Because of the prompt reporting required by SOX of the grant of stock options, it appears that virtually every company that has made disclosures of backdated options issues treats it as events that occurred prior to the passage of SOX. So that is one totally unexpected benefit of SOX, and a good one.

MR. FRIEDMAN: Thank you. A very dominant issue for many companies is the question of how much should they cooperate with the government in terms of the attorney-client privilege. Also some boards feel that they should just give up and do whatever the government tells them to do to save the company. They believe that such cooperative behavior might get the company better treatment under sentencing guidelines, et cetera. Jim, maybe you'd like to try that.

MR. COMEY: My view of this has not changed as much as you think it would. It's a different animal when you're in an industry as regulated as the one Lockheed Martin is in. It is not a someone said to me, how do you grapple with questions about what to disclose to the government. And I said, well given that there are thousands of government auditors in our offices, it is a very different calculus than someone who is in the, you know, soft drink business deciding whether or not to tell the government something. We have a relationship with the government that's close to symbiotic. So it's not as hard a call to make in our world as in others. But I spent a lot of time, obviously, on this issue of attorney-client privilege wavering. Whether it was the touchstone of effective cooperation by a company. And I'm very pleased, as I told my fellow panelists this morning, that I resisted the temptation to fix a couple things in the Thompson memo because it would have led to it being called the Comey memo. And I've told Larry Thompson I'm pleased to leave it to him. Let me just offer the government perspective on some of

the issues on attorney-client privilege waivers. I met quite often, as often as they wanted to with representatives of very different bar groups to talk about this issue. And folks would come in and say, look, it's terrible out there. All of your prosecutors are reflexively asking us to waive privilege and it's awful. You've created a culture of waiver. And I would say, look, help me here. Because I cannot for the life of me as deputy attorney general get my arms around this. I've heard this complaint. I heard it when I was U.S. attorney in Manhattan. And what I did there was to try to put in place a trip wire is I announced a policy that no assistant U.S. attorney could ask for material that was covered by any colorable assertion any assertion really, I didn't even put colorable any assertion of work product protection, or attorney client privilege without going to the chief of the criminal decision, who was then a woman named Karen Seymour. And that was a tripwire that I had in place for eighteen months before I became deputy attorney general. And nobody came and asked. And so that told me offered a couple of possibilities to me. One, my assistants are just disobeying me, which I had a hard time believing. Second, nobody's asking, companies are coming in for a waiver. Or companies are coming in kind of with an understanding of what's expected so no one addresses the issue head on. It's a bit of a dance going on. There is never a request made, so the assistant never has to take it up the chain. And that's entirely possible. What I've said to the bar groups is look, you've got to give the policy makers at the Department of Justice examples because there are a lot of people inside the government who think, and I'm not just trying to be funny, but a lot of them think that the private bar has a case of the vapors. That this has become an issue where everybody knows it happened, it's never happened to me, but I've heard about it from so and so. So these surveys show everybody knows about waivers of attorney-client privilege that were inappropriate, but the Department of Justice has precious few examples. I never got any when I was Deputy attorney general and I would say to the defense bar, look, God knows you know how to complain. That's your job. Bump it up the chain. Bump it up to the U.S. attorneys. Let's get these surfaced. And the response would be, well, companies are reluctant to do that because they don't want to be the squeaky wheel. They just want to get it taken care of and move on. And I'm not saying that's not a reasonable explanation. But I'm just trying to offer you some of the frustration from inside the Department of Justice. Robert McCallum when he was acting deputy attorney general as you know, I think, announced a policy that each U.S. attorney had to create the kind of tripwire that I created in the Southern District of New York and that was a decision I didn't take part in because I already knew I was going to Lockheed Martin and I thought my involvement might taint that. Someone might say that I took a punch or threw a punch that I shouldn't. So I gave it to Robert and Robert made that call in an effort to try to gather some of the information to raise it up to the U.S. attorneys. And I'm sure that's still a work in progress. What the private bar has to understand is this though, the

government is not going to sacrifice the core value that it clings to and should cling to. If you want credit for leniency, you want leniency in a charging decision, you have to cooperate. Cooperation means helping us get the bad guys. If it comes to a point where you have to turn over work product protected material or privileged protected material to help us get the bad guys and you don't do that, don't complain to us and say you need leniency in the charging decision. I think as citizens of the United States it is not an unreasonable thing for the government to say. How you get there is much more complicated. I've seen very sophisticated lawyers go into the government and say, look, I'm very worried about the plaintiff's class action bar. Let's work together. I will help you get the bad guys and you will help me get you claims of waiver. Let me first suggest you interview the following five people and let me also suggest you look in the following five filing cabinets. After you've done that, talk to me. And sometimes that works. Now, you're sitting there thinking, well, the plaintiff's lawyer can still make a claim of waiver there, but it's a little bit harder. Sophisticated lawyers know how to get this done and sophisticated U.S. attorneys should know how to work with them. But again, my message is, the Department of Justice is having a hard time seeing and touching this issue. If you find yourself with an example you have to find a way to raise it up, even if you strip out details and give somebody like Paul McNulty, my successor a sanitized version of a specific example where there was an abusive request for waiver. And the last thing people need to remember is that the Department of Justice looks at this and hears a lot of crying about attorney-client privilege. What their thinking is, we don't want privileged communications in the core sense of that. We don't want advice that lawyers gave companies. What we want is facts gathered by lawyers working for companies. Yes, that's privileged. It's also work product, but the department thinks of it really as work product and they have respect for the work that the lawyers at this table do for me and protection for the facts they gather, protections for their opinions, their advice to me. I care passionately about that. All I'm trying to tell you is from the government's perspective and this is a perspective I'd like the ABA to get because I think it would make it much easier to discuss it with the government is that if the following situation happens: Company XYZ discovers a multibillion dollar fraud and their CFO is implicated. The interview of the CFO he gives it all up and they go to the government and say, we've discovered a four billion dollar fraud. We want to report that to you, we don't want to waive privileges. We'll cooperate with you in any way we can. We'd like not to be prosecuted. And the agents for the government then go out and approach the CFO and he takes five. The government is going to come back to the company and say, okay, we need the notes of your interview. And if Jay did that interview, we need Jay to testify against the CFO in the grand jury and maybe at his trial, if he's silly enough to go forward after that kind of compelling credible testimony, Jay. And the company is certainly within its rights going to say, no we don't want to do

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that, we don't want to expose that, we don't want to waive that. The government is going to say, that is not cooperation. You did not help us get the bad guy. You will not get leniency in the charging decision. And I don't think that's shocking to the people in this audience. What I have told to private lawyers, and I am now a member of a lot of general counsel organizations. One in particular, I had a meeting, it's general counsel for the Fortune 100 and there were about 50 of us in the room and I was alone with a whip and a chair on this issue, and what I said is you've got to look for common ground with the government that balances what you have to recognize as an important value of getting the bad guys with important values that we as in-house counsel care about. You need to think about things like, say, Farbers. You need to think about ways to create selective waiver doctrines so that the public policy interest of getting the bad guys can be served and you don't serve yourself up to plaintiff's class action lawyers. There has got to be a way to cut this knot that doesn't involve people from the defense bar screaming that the government's out of control, and the government saying you've got a case of the vapors. There is a way to work this out. Some of the steam has to be taken out of the debate, but I think there is a way to work it out.

MR. FRIEDMAN: Over the years the Directors Roundtable has hosted SEC officials many times. An issue is whether in today's disclosure environment and securities markets any public company can avoid sharing some information about alleged misdeeds.

MR. COMEY: Yeah, I think there are ways. And I offer an example of kind of doing a dance that walks close to the line, but balances the competing interest of getting the government the information they want while avoiding the slam dunk claim of

sake. And if it does, those are people we need to straighten. Now, the response I get when I talk to my colleagues, general counsel, and say okay, who has actually had an abusive situation with the Department of Justice? Very few hands go up. And what they say, which, again, is a reasonable thing to say, and I'm not in a position to say it's not right, is to say, okay, it's not so much the Department of Justice, it's a culture that's been created. We see it from regulators of all stripes and we see it from state AGs because they think this is the cool thing to do. That may be so. Again, you notice I was confining myself talking about what the U.S. attorneys were doing. That was something that I tried very hard to control and get my arms around. But if there is a broader culture of waiver out there, that's not something I'm qualified to address. It may well be so. And the answer may well lie in some of the things I talked about.

MR. CULVAHOUSE: Jack, let me leap in where angels fear to tread. I think the pendulum is swinging back a little bit. I do believe that the SEC, state attorneys general, and Congress, have been much more adamant on privilege waiver issues than perhaps DOJ. But the Department of Justice in many cases is piggy-backing on the SEC investigations, so they aren't in the front line in any waiver requests. And for what I would call eggshell defendants or targets, companies like government contractors, investment banks, banks, and other companies that really rely on good standing with the government or with government agencies -- state, local, or federal -- there is a lot of pressure on them to capitulate. Joe Grundfest, the former SEC commissioner, has a wonderful speech on "egg shell" defendants who must capitulate. His view is that it is only the Exxon Mobils of the world that really could defend a criminal investigation anymore in the way that many

wavering later civil litigation. I've seen it done. I've done it in working with when I was in the government working with outside counsel. As I said, it could be a bit cute because there could still be arguments made by plaintiff's counsel that even telling me as a prosecutor which file cabinets to look in acts as a broader waiver. But I think that companies certainly have a stronger argument to make if they are able to do that. But again, that's the interest. The government's interest is in getting the bad guys. The government does not care about waivers for waivers

companies would wish to defend themselves. I think Joe may be engaging in a bit of hyperbole, but he has a very valid point. I hope the pendulum has come back toward protecting the privilege.

But I must admit that in some cases waiving the privilege is appropriate. It is our fault as lawyers. We've allowed ourselves, instead of being counselors and advising our clients on what is the right thing to do, what is the wise thing to do, we've become masters of advising client of what colorable argument there is to allow the client to do what they want to do, no matter how poor it may look in the clear light of day with the absolute clarity of hindsight. And as Jim said, a lot of the facts and the mindset of what the company and company management had in mind at the time can be revealed in the legal advice they received. So I think it's important for us, particularly those of us responsible for maintaining the ethics and the culture and the professional integrity of our respective institutions to really inculcate that we must not, again, become masters of the technical and forget our obligation as counselors.

MR. CAMPBELL: If I could just add one thing and approach it from a slightly different angle, that ties in to some of the things Jay said. I think the basis of our discussion is the big investigation, the very public investigation, the very large dollar issues when this becomes critical and a big concern for companies. That presumes we already have gotten to the point where there is something very significant that has gone on for a significant amount of time and finally was discovered, after which there was a massive internal investigation. I think part of what companies need to do is learn from industries like the defense industry, and to a degree, the healthcare industry because of some of the problems that it had back in the 1980s, and think about the fact that virtually every government agency has some sort of voluntary compliance program. And to think about a cooperative approach that is consistent with internal training programs that are not the sort of "web-based, ten o'clock at night, while you are watching T.V. at home" training program Jay alluded to, but is consistent with a real program where the company actually has a culture of compliance that addresses hard issues up front. Then, when you have problems that arise because inevitably individuals from time to time stray from where they ought to be going, the problems can be dealt with at a time and in a way that in most cases does not raise these difficult privilege issues involving significant, high dollar, bet the company litigation or government investigations. I would suggest that the more a company does on the front end and the more a company, as Jim suggested, creates a culture that is consistent with doing the right thing, the less often that company actually has to address these harder issues. Then you don't have to go to the Government and say, look, there is a huge problem here, and how are we going to deal with the securities lawsuits?

MR. FRIEDMAN: I am afraid that we might go through this whole session and have the only event in Washington that doesn't mention the word "Congress". Lest we get disoriented when we leave here, let's cover Congress a bit. I'm actually sur-

prised that it didn't come up earlier.

MR. COMEY: I heard it mentioned. Does that cover it?

MR. FRIEDMAN: What's that?

MR. COMEY: I heard someone mention it.

MR. FRIEDMAN: It must be incredibly difficult when you're dealing with the government as a key customer. With political and public opinion shifts; and national securities law for exports. Trying to do long-term corporate activity is challenging when you don't know military spending budgets five or ten years out. Can the panelists comment about your experience with some of the issues you face in terms of Congress intervening on the whole process?

MR. DEVECCHIO: I would say that sometimes when we see Congress involved it is in the sense of an unguided missile. Somebody has a problem, or they are facing a debarment or a suspension, and they want their Congressman to get engaged. Or on the other side someone wants their Congressman to look into what their competitor is doing and raise an issue with the agency. I always caution, you can go to your Congress person but you never know what the consequence of that is going to be. So one needs to be very, very careful about doing that.

But generally, I don't think you see a lot of congressional pressure other than letters that go across the transom; people in government will pay attention to them but not too much, because they are sensitive to the appearance of undue influence.

The other thing I wanted to say, just briefly over this issue of the privilege, is that I think the only rational thing to do when you're dealing with a company and a government contractor is to say to the executives before you commence an internal investigation "Look, you might as well forget about the privilege because if push comes to shove, you are going to be disclosing this to the government." And you don't know, just like you don't know where your congressional unguided missile is going to go, you don't know where this investigation is going to go. The only responsible thing to do is to assume that everything that your lawyers turn up is one way or the other is going to be at the doorstep of the government if you want to continue to do business in your industry, unless you're Exxon Mobile. I think that if lawyers take a different position than that, they're doing a disservice to themselves and certainly to their client.

MR. COMEY: We don't really deal with Congress much. We do plenty but if you think I'm going to say anything about it in a mailing that you say is going to go to tens of thousands of people. I just want to be careful to disassociate myself from the unguided missile remark that Jay made. I love everybody in Congress and find them very supportive.

MR. CAMPBELL: One thing I just want to mention in terms of Congress, and Jack eluded to it is what you are seeing from time to time is that Congress

does weigh in on issues. If you look at the current debate that's going on with the entire Sifius process, which up until recently with the Dubai ports acquisition most people didn't know about. It was something that was done behind closed doors. People thought of national security as something that the CIA and others took care of. Now people walking the streets, and if you listen to talk radio, they're talking about the Sifius process, which in and among itself is fairly remarkable. But in connection with your business, whether you're talking about it in the context of an acquisition or just your ongoing business and relationships you have with other parties because everybody in the government contracting business has significant relationships with other companies both domestically and abroad. I think you always have to think about kind of the front page effect and what are things going to look like if the press gets a hold of or writes an article about what you're doing. I think in many ways if everybody thought of that, it's not that you wouldn't do things, but you would make better decisions at times. I mean, we're going to get out of Congress presumably some amendments to the Sifius process. It's become a very political issue with a number of people, but at the same time we all have to recognize we're operating in an increasingly global world. And the U.S. defense industry is today dependent in significant part on the contributions of many foreign companies both their operations here in the U.S. as well as their operations around the world.

MS. MADSEN: I guess I was well, speaking of where angels fear to tread but having had an earlier career working in Congress. You know at least for government procurement, I mean, Congress is really a partner in the process. They provide the money. Every year when we look in the defense authorization bill there are new provisions that effect the procurement process which results in new regulations. So it's just part of what we do to remember that Congress has a very vital interest in how the Department of Defense and all other federal government agencies operate. What they buy, how they buy it, where they spend their money and that Congress is just going to do oversight. That's just part of what we do and the Constitution gives Congress that role and it's a legitimate role for them to take, you just have to factor it into the way you do business in this area.

AUDIENCE MEMBER: This is directed to Jim Comey more than anyone I suppose. Going back to poor Betty and her non-options. What mechanisms do general counsel set up for in-house complaints when management is in generally such control so as to cause an employee to be fearful to make a complaint? I think of inspector generals or the Office of Professional Responsibilities. I don't see those in corporations. What is the future outlook to avoid the problem of the whistle blower?

MR. COMEY: That's a great question and you heard some of my colleagues refer to it I didn't want to brag on Lockheed Martin too much. I was pleased that they did. And I think that my company has one of the best

examples, and it's not unique, but I think it's the gold standard. And that's to have an inspector general who is called the ethics officer that is embedded in each of the business areas. There are hundreds and they report up through an organization that's headed by an ethics official who reports not to me as a general counsel because the concern would be, I'd be trying to shape it somehow for a legal outcome reports directly to the CEO and like the Office of Professional Responsibility, OPR of Justice, keeps an inventory, gets back to people on what the result was. It's a separate mechanism. It conducts investigations. It has a database that's searchable so that if someone is a repeat offender and has moved within the huge company that I work at, you can track it and say, oh, this is the third time that accusation has been made. It's very much like an IG or an OPR at the Department of Justice. It's very effective. Lockheed Martin has very little labor litigation. Very little employment litigation. For those of you who are looking to do more work with Lockheed Martin on labor litigation, I'm pleased to report that there isn't any. And I think one of the reasons for that is I forget who said it, maybe it was Glenn who said it that there is a vent, there is a steam valve within my company for someone that has a concern that their boss is mistreating them and it can be anything: That I saw him stealing; I think he's hostile to women; I think that he is a racist; I think he is working on company time. All of those accusations are reported and they can be reported anonymously to the ethics organization. Every single one of them is run to ground and a written report is kept in a computer system. And if it was not anonymous there is a report back to the complainant about what happened. That is very healthy and creates an environment in which people don't feel the need to go to the outside because they know they're going to get real honest to goodness independence insight. People like Betty, there shouldn't be any Bettys at Lockheed Martin because people should know and we preach this, you got a problem you can talk to someone anonymously, you can slip a note under the door. It will be run to ground what you say. And that's the ultimate, I think, protection. And at the same time reinforces the culture. So anyway, that's more of a bragging on us. But that's the way to do it. And it's been someone said I think you said there is never anything positive in the newspaper. The Wall Street Journal ran a piece on Lockheed Martin's ethics program the second week in June. It was entirely positive. Not for lack of trying, I suspect. But it's a very positive story about this ethics program.

MR. FRIEDMAN: Last question.

AUDIENCE MEMBER: I'm going to ask Mr. Comey to address the issue of backdated options on the assumption that Lockheed Martin does not have this problem and I'm going to . . .

MR. COMEY: I'm pleased to confirm that.

AUDIENCE MEMBER: I would like to ask the panel how a firm might advise companies with this issue. It's clearly unethical. I can't imagine anyone thinking it was okay. It's a personal aggrandizement issue and it goes directly to the board and it's, dare I say, the attor-

JACK FRIEDMAN



Jack Friedman, Chair of the Directors Roundtable, is an executive and attorney active in diverse business and financial matters.

He has appeared on ABC, CBS, NBC, CNN and PBS, authored numerous business articles in the *Wall Street Journal*, *Barron's* and the *New York Times*.

Mr. Friedman has served as an adjunct faculty member of Finance at Columbia University, NYU, US (Berkley), and UCLA. He received his MBA in Finance and Economics from Harvard Business School and a J.D. from the UCLA School of Law.

ABOUT THIS PUBLICATION

The Roundtable Discussion, held July 13th, 2006, at The Decatur House in Washington DC, was co-hosted by the marketing department of *The National Law Journal* and The Directors Roundtable. The text of the panelists' comments, edited for clarity and brevity, follows. This custom publication is included as a special supplement to *The National Law Journal* and was produced independent of the NLJ's editorial staff.

The National Law Journal, an ALM publication, in partnership with The Directors Roundtable, a civic group which organizes events globally on issues relevant to corporate directors and their advisors, organizes these events to create an open dialogue in which to discuss matters affecting the legal and corporate worlds. If you are interested in more information on these events, please contact Brian Corrigan at 212.545.6277 or bcorrigan@alm.com

neys advising the board. If you were at the SEC now, what would you consider an acceptable action on the part of the company? Is it enough for a company to say, well, we looked at this and it was bad and we'll never do it again?

MR. COMEY: I don't think I'm qualified enough to answer that for a good reason. I know enough about this issue to know I've done the due diligence what needs to be done inside my company, and we don't have this problem. And so not to focus on it a whole lot more. I mean, I think A.B. [Culvahouse] may be in a better position to say what companies would suggest to the SEC as a way to keep them from initiating an enforcement issue. So I don't mean to dodge it, but I would just be a dummy making stuff up. So I'll just ask A.B. [Culvahouse] maybe.

MR. FRIEDMAN: Well, I hope you charge a lot for your advice on these matters.

MR. CULVAHOUSE: One has many different fact situations. There are "real" backdated options, or what we're starting to call "white out" backdated options, where three years later someone says, well gee, our options would be a whole lot more valuable if they were dated in February three years ago rather than November three years ago. So the month gets changed. And there have been reports of those people being fired and their options voided, and I think those are very serious issues. You have Commissioner Atkins of the SEC saying that backdating options, or looking back and picking a favorable strike price in the past, is not in and of itself illegal. You have to look at the plan and whether it is allowed by the plan. But what is problematic is the disclosure and tax issues. If you have an executive compensation table in your proxy statement that says all options were granted at fair market value on the date of grant, but the date of grant and the strike price don't match up, then you have a problem. Yes, it is a non-cash charge, and, in some cases you can argue how much were the shareholders really harmed? On the other hand, this practice creates difficult control and integrity issues under Sarbanes-Oxley, and books and records issues under the 34 Act, part of The Foreign Corrupt Practices Act that's often ignored. I don't think we're anywhere close to understanding what the SEC is going to do as a matter of enforcement policy. I think there are many investigations underway, but less is known about what companies may decide to do. I think there are going to be terminations of those people who clearly were involved in the "whiting out" kind of fraudulent activity. I think that's just straight up fraud, as Jim would say.

MR. COMEY: One of my favorite cases in the Southern District of New York when I was U.S. attorney involved we prosecuted three guys who made six million dollars betting on horse races that were over, very much like "The Sting." And one of them was inside guy at an outfit that collected betting information from around the country and then transmitted it to tracks and results information and they took advantage of a few second delay that if they knew the result they could place the bet. The problem is that they got

greedy like a lot of these executives and exposed themselves by winning six races in a row in which five of them were like fifty to one long shots and exposed themselves. So people can't contain themselves and set their hair on fire and run around and then be shocked when the SEC notices them or when they get prosecuted. So I know something about something that sounds very similar. Betting on races that are over.

MR. CAMPBELL: Let me approach it again from a slightly different perspective. We spent a lot of time today talking about controls, ethics, and how companies operate. And I know you suggested that perhaps in the end it really didn't have an affect on the market. Maybe there were some tax issues and there are some technical legal issues. I think there is a much broader issue here, putting aside what the legal analysis ultimately dictates in these cases. In many of these cases, in virtually all these cases, you are talking about the senior most people in the company doing things that fundamentally are unfair, and that involve compensating themselves in a way that is not transparent. And, as Jim suggested before, when you talk about how to establish a culture within a company of good behavior and ethical conduct, it is impossible if what you have going on at the senior most ranks of the company is people backdating options to advantage themselves personally. If they are really worth the compensation, then the board ought to decide that it is going to pay Bob or Mary a very large bonus and just put it out there. But it is impossible to talk out of one side of your mouth about controls and ethics and make people sign certifications, because I as the CEO have to sign these certifications every quarter, and at the same time act in a way that's fundamentally inconsistent. People make a mistake when they assume that information like this, even if it ultimately doesn't show up on the front page of the Washington Post, doesn't become known within the company. People know who is out for themselves, and that plays into the culture and the ethical underpinning that is necessary for a successful compliance program.

MR. FRIEDMAN: I'd like to just finish with a quick question of our Guest of Honor. It's a personal question. In the very little free time that you have, what do you like to do as far as vacations or hobbies or philanthropies? What are your interests besides your work?

MR. COMEY: Again, I spent my entire career in government. Until this point philanthropy has not been a big option. But I have five kids from first grade to a now freshman in college, so most of what I do involves my children and trying to stay in shape. And that leaves me very little time for anything else. So I live a very pedestrian lifestyle and I'm going to keep it that way because my wife keeps saying, I know you're going to screw me over again and go back to the government. And I keep saying no dear, no, I won't dear. So I'm a fairly ordinary suburban dad.

MR. FRIEDMAN: Our thanks to Jim Comey, the distinguished panelists, and especially to our audience. Thank you for joining us. ■

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