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Inside

A publication of the Corporate Counsel Section
of the New York State Bar Association

Message from the Chair

To the Members of the Corporate Counsel Section:

As Chairperson of the Section's Executive Committee, I would like to share with you some of the recent activities the Section has been engaged in, as well as some upcoming events.

On October 29th, the Section conducted its ***Fifth Annual Ethics for Corporate Counsel*** program. Included in this issue of *Inside* are the highlights of this very well-received CLE program, which consisted of an outstanding panel of well-known experts in the area of ethics. Using hypothetical examples and engaging the audience in a discussion of the issues presented, they discussed problems which have specific applicability to in-house practitioners and the businesses and organizations they represent. This was an excellent opportunity for in-house counsel to earn four CLE credits in ethics and professionalism, as well as to meet and socialize with their counterparts from a wide spectrum of in-house settings. This is but one of the many ways in which this Section serves its membership, and I encourage you to take advantage of the CLE programs the Section offers, which are geared specifically to the in-house perspective.

Looking ahead to 2005, I urge you to mark your calendars now so that you can attend the first NYSBA "Corporate Counsel Institute" which will be held on September 22nd and 23rd. A day and a half of CLE programs and break-out sessions specifically geared to the interests and concerns of in-house counsel will take place at the Princeton Club in New York City. Information and updates on this exciting program will be provided in upcoming issues of *Inside*, and at the NYSBA website at http://www.nysba.org/corporate.

As the year draws to a close, we look forward to the Annual Meeting of the NYSBA in January. On January 26th at 9:00 a.m., the Corporate Counsel Section will co-sponsor a program with the International Law and Practice Section which will take a look at "The Impact on International Commerce of the Patriot Act, Sarbanes-Oxley and Other Recent U.S. Laws." Part I of the program will review new developments in employment, immigration and anti-corruption laws, and Part II will present the Canadian perspective on recent developments. CLE credit will be offered, and all are welcome—pre-registration materials will be available shortly.

This issue of *Inside* reflects the many areas of our members' interests. Included is an excellent analysis by Michael Schlanger and Kirk Ruthenberg of Sonnenschein Nath & Rosenthal LLP, of a recent U.S. District

Inside

Court decision in the area of antitrust merger litigation, entitled ***"United States v. Oracle*: A Delphic Guide to the Government's Burden in Antitrust Merger Litigation."** Also included in this issue is an article entitled **"New Risks in Records Management Require New Procedures"** by Lisa J. Sotto, of Hunton & Williams, LLP, which discusses the importance of having an effective records management program along with some practice pointers on how to establish such a program. Another topic which is very relevant today is **Same-Sex Marriage: Employer Benefit Obligations**, authored by Neal Schelberg and Carrie Mitnick of Proskauer Rose LLP.

I am especially pleased to draw your attention to the "Law Department Compensation Survey" article which has been provided by the consulting firm of Altman Weil Inc. This marks a "first" for Altman Weil, which, following a cooperative joint venture with the Corporate Counsel Section, has published a special New York State Report of Law Department Compensation Benchmarking data exclusively for in-house lawyers employed in this state. We hope you find this information helpful and invite you to contact Altmann Weil directly should you wish to receive more detailed survey results.

I hope you enjoy this issue of *Inside*, and that through it, you become more involved in the activities of the Corporate Counsel Section. On behalf of the Executive Committee and officers of the Section, we encourage your interest, and welcome your participation in the activities of the Section and look forward to meeting you at upcoming Section-sponsored events.

Barbara M. Levi

Corporate Counsel Section Sponsors Fifth Annual Ethics Seminar

The Corporate Counsel Section held its Fall Meeting on October 29, 2004 at The Great Hall of The Association of the Bar of the City of New York. The program was organized by Steven G. Nachimson, Program Chair, with the assistance of Steve Mosenson and Barbara Levi, as well as the New York State Bar Association's CLE Department. The meeting featured a seminar titled "Ethics for Corporate Counsel—Emerging Ethical Trends for Corporate Counsel: 2004 Update" and was attended by more than 90 attorneys.

The expert panelists were Michael S. Ross, principal of the Law Offices of Michael S. Ross; Andral N. Bratton, Deputy Chief Counsel of the Departmental Disciplinary Committee of the First Department; and Anthony E. Davis, a partner in the firm Hinshaw & Culbertson. The panel addressed a wide array of ethical issues, including conflicts of interest, the attorney-client privilege, reporting corporate misconduct, corporate investigations, and working with outside counsel, investigators, and public relations firms.

Andral N. Bratton

Steven G. Nachimson

Anthony E. Davis

The speakers presented a series of hypothetical problems, including fact patterns derived from recent corporate scandals, and attendees were encouraged to join in the lively dialogue.

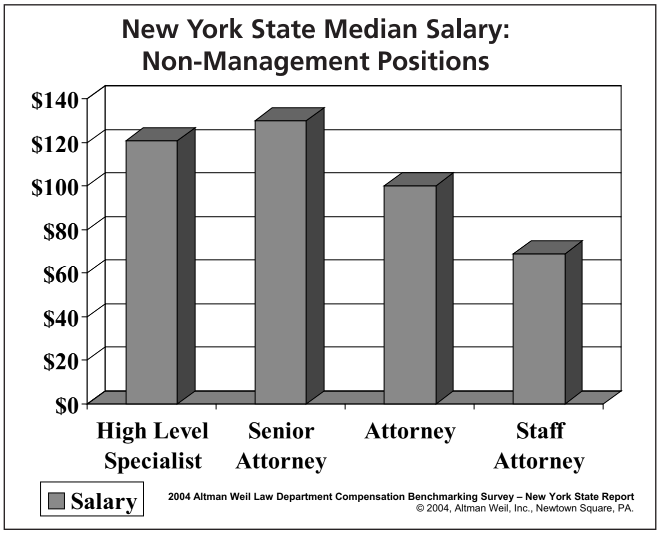
Other topics of discussion included differences between the Standards for Professional Conduct of Attorneys under the Sarbanes-Oxley Act and the requirements of the Lawyer's Code of Professional Responsibility, prohibitions against utilizing deceptive tactics in negotiations, and recent developments in the use of secret tape recordings. The meeting concluded with a discussion of trends in multi-jurisdictional practice.

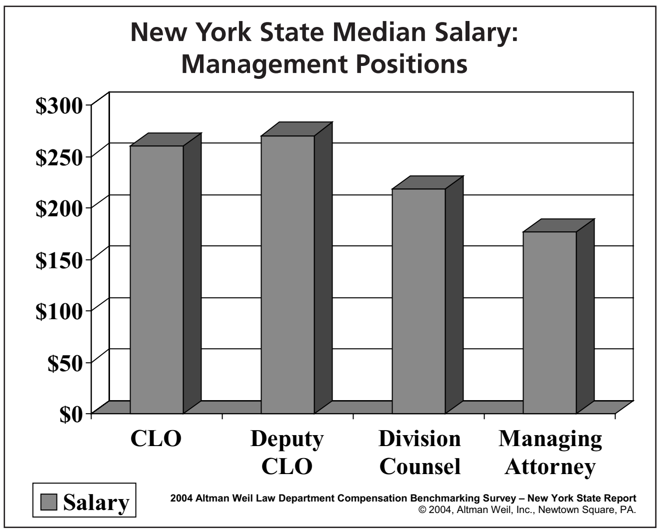
This was the fifth consecutive Fall Meeting at which the Section has sponsored a legal ethics program focusing on the unique role of in-house counsel.

New York attorneys who attended the program were eligible to receive four hours of New York CLE credit in the area of ethics and professionalism.

Michael S. Ross

Law Department Compensation Survey Released





As an extra service to our members, the Corporate Counsel Section this year undertook a cooperative joint venture with the consulting firm of Altman Weil, Inc. under which Altman Weil for the first time has published, in addition to its annual **Law Department Compensation Benchmarking Survey**, a special **New York State Report** with compensation data exclusively for corporate lawyers employed within the state of New York.

The New York State Report shows that the 2003 median salary for Chief Legal Officers in New York was $260,000. Mid-level Managing Attorneys earned $176,500, while Attorneys (those with four or more years of experience) earned $100,000 in 2003. (See accompanying charts for more New York highlights.)

The national survey reports healthy increases in total cash compensation for most in-house lawyers. Nationally, salaries for senior positions in law departments were up between 5.3% and 7.8% this year. In-house lawyers in most non-management positions also saw increases from 3.9% to 5.2%. All positions reported increases in annual bonuses. Stock option values were also up across the board.

The New York State Report is available to New York State Bar Association members for just $295. Bar members also qualify for a 10% discount off the national survey price of $650—which includes a *free* copy of the New York State Report. To order, contact Altman Weil Publications toll-free at (888) 782-7297, via e-mail at info@altmanweil.com or go to http://www.altmanweil.com.

New York State Salary: All Positions

Position		Number of Employers	Salary: Number of Positions Reported	Average $ (000)	Lower Quartile $(000)	Median $(000)	Upper Quartile $(000)	Ninth Decile $(000)
Position	Chief Legal Officer	12	12	253.0	--	260.0	--	--
	Deputy CLO	5	11	269.3	--	270.0	--	--
	Division Counsel	11	24	220.9	185.2	218.5	261.2	286.3
	Managing Attorney	13	84	181.3	135.2	176.5	201.6	259.6
	High Level Specialist	15	140	132.3	100.0	120.9	152.9	184.2
	Senior Attorney	20	236	136.1	99.4	130.0	169.8	197.3
	Attorney	17	118	108.3	81.2	100.0	134.4	156.0
	Staff Attorney	6	95	69.9	65.5	68.9	71.1	81.0
	Recent Graduate	4	49	--	--	--	--	--

2004 Altman Weil Law Department Compensation Benchmarking Survey – New York State Report

Same-Sex Marriage: Employer Benefit Obligations

By Neal Schelberg and Carrie Mitnick

Same-sex couples can now legally marry in the Commonwealth of Massachusetts, leading many employers to question whether, and how, the existence of same-sex spouses will, and should, affect their benefit obligations to their lesbian and gay employees and their partners. In this article we discuss employers' obligations to recognize the existence of a same-sex marriage, and how that affects their health benefit obligations.

A. Introductory Questions

1. What typical employer-provided benefits governed by federal law are available to an employee's spouse and dependents?

Health Care Coverage. It is typical for an employer to provide health care coverage to its employees' spouses and children. The cost of providing such coverage is tax-deductible for an employer, and the cost of such coverage and the amount of benefits received are excluded from an employee's income. If coverage is extended to an individual who does not qualify as a "spouse" or "dependent" under the Internal Revenue Code (the "Code"), the benefit would be treated as taxable income of the employee (although still deductible by the employer).

COBRA. If an employer chooses to provide health care coverage to its employees' spouses and dependent children, then the employer will be required, pursuant to COBRA, to provide such individuals the opportunity to continue their health coverage (on a self-pay basis) for a prescribed period upon the occurrence of certain events which would otherwise result in their loss of coverage under the health plan.

FMLA. FMLA requires an employer to provide an employee with up to twelve weeks of unpaid leave in order to care for his or her sick spouse, child or parent.

2. Under these programs, who can qualify as a "spouse"?

The Internal Revenue Service ("IRS") has consistently stated that an individual is considered to be a "spouse" if the applicable state law recognizes the relationship as a spousal relationship. Currently, no state recognizes a "domestic partner" as a "spouse." Moreover, the Defense of Marriage Act ("DOMA") provides that, in determining the meaning of any federal statute, ruling or regulation, the term "spouse" can only refer to married persons of the opposite sex.

3. Under these programs, who can qualify as a "dependent"?

The Code was recently amended. Effective January 1, 2005, the Code will provide that an individual, other than a qualifying child, qualifies as a dependent only if the individual: (a) bears a specific familial-like relationship to the taxpayer; (b) has gross income for the year that is less than the exemption amount under section 151(d) of the Code (currently $3,100); (c) is not a qualifying child of any other taxpayer for the taxable year; and (d) receives over 50% of his or her support from the taxpayer (employee) for the taxpayer's taxable year. (Unofficially, we understand that the U.S. Treasury is considering deleting this provision for purposes of the income exclusion available for health care coverage provided by an employer to its employee and to his/her spouse and dependents under Code section 106 and the Treasury Regulations issued thereunder.) A domestic partner's relationship could only satisfy the family-type relationship criteria if such individual has as his or her principal abode the same principal abode as the taxpayer for the taxpayer's taxable year and is a member of the taxpayer's household.

B. Employer Obligations With Respect to Same-Sex Marriage

1. Should an employer recognize a same-sex marriage as a legal marriage?

In this subsection, we distinguish between the "legalization" of same-sex marriage and the "recognition" of same-sex marriage. When discussing legalization of same-sex marriage, we refer to Massachusetts and any state in which a same-sex couple may in the future legally enter into a same-sex marriage. When discussing the recognition of same-sex marriage, we refer to a state which, while not permitting same-sex marriage in that state, will nevertheless recognize a same-sex marriage that is legally entered into in another state.

a. In general, if a same-sex marriage is legally entered into in the Commonwealth of Massachusetts, will it be recognized in all states?

Not necessarily. Although state legislatures may pass legislation on this subject, it ultimately is the role of a state's judiciary to determine whether its state is legally required to recognize a marital union legalized in another state. Based on the Full Faith and Credit Clause of Article IV of the U.S. Constitution, a state would be required to recognize a marriage legalized in another state, even if the marriage would not be legal in its own state, unless such marriage violated the strong public policy of the state. For example, New York will not legally permit a marriage between an aunt and her nephew, but New York courts will recognize the validity of such a marriage if it is entered into in a state that allows such marriages. In contrast, New York State considers polygamy to violate a strong public policy of the state. Thus, if another state were to permit polygamy, a New York court would not recognize the polygamist's marriage.

At this point, no state judiciary has ruled on whether it will recognize a same-sex marriage legally entered into in the Commonwealth of Massachusetts.

b. May an employer recognize the same-sex marriages legalized in other states, such as New York or California?

The law in this area is not clearly developed. Although the courts in many states have not yet ruled on whether same-sex marriage can legally be entered into, other legal developments in these states may provide some guidance for employers.

For example, New York State Attorney General Elliott Spitzer issued an advisory opinion on March 3, 2004 in which he indicated that current New York State law does *not* provide for the legalization of same-sex marriage. Also, on August 12, 2004, the California Supreme Court voided all same-sex marriages that had been sanctioned by local officials in the state. According to the California Supreme Court, because California law provides that a marriage license can only be issued to a couple comprised of a man and woman, local officials lacked the authority to issue marriage licenses to same-sex couples and these "marriages" have no legal effect. Accordingly, in the state of California, employers cannot recognize partners in these California "marriages" as spouses. It should be noted that the Supreme Court of California explicitly cautioned that it was not ruling on the constitutional validity of the California law itself.

However, while a New York or California court might not recognize a same-sex marriage "legalized" in, for example, New Paltz, New York, or San Francisco, California, because those states' laws do not provide for legalization of same-sex marriage, such courts might nevertheless recognize a same-sex marriage legally entered into in the Commonwealth of Massachusetts. In fact, New York State Attorney General Spitzer advised in the advisory opinion discussed above that he believed that New York courts would be required to recognize a same-sex marriage legally entered into in Massachusetts. Accordingly, a New York or California employer might be required to recognize an employee's same-sex marriage legally entered into in Massachusetts, but would be prohibited from acknowledging another employee's same-sex marriage if it was "legalized" in New York or California.

2. Must an employer extend health care benefits to a same-sex spouse recognized as a "spouse" under state law?

In addition to determining whether it must extend health care coverage to same-sex spouses, an employer must determine how to treat same-sex spouses for federal income tax purposes. We address each of these issues below. Of course, an employer must determine how to treat same-sex spouses for state income tax purposes as well. However, as the focus of this article is on federal income tax benefits, we will confine our comments to an employer's federal tax obligations.

a. Must an employer extend health care coverage to a same-sex spouse recognized as a "spouse" under state law?

It depends on whether an employer provides health care coverage through an insured or through a self-funded plan.

An employer providing health care coverage under a self-funded (non-insured) plan likely will not be required to extend health care coverage to a same-sex spouse. Indeed, even where such spouse is recognized as a "spouse" under a state law, such law will probably be preempted by federal law. The Employee Retirement Income Security Act of 1974, as amended ("ERISA") preempts any state law that "relates to" any employee benefit plan covered by ERISA. The U.S. Supreme Court has broadly interpreted this section to preempt state laws of general application.

However, an employer providing health care coverage through an insured plan may arguably be required to extend health benefits to a same-sex spouse. Under ERISA, a state law that "relates to" an employee benefit plan will be saved from preemption if the law regulates insurance. Since insured ERISA health plans are subject to state insurance laws, a state law legalizing or recognizing same-sex marriage likely would require a conforming change to be made to such state's insurance law. In such event, the state insurance law recognizing a same-sex spouse in its definition of "spouse" would arguably be saved from preemption by virtue of its being a law regulating insurance. Accordingly, it appears that an employer providing health care coverage to opposite sex spouses under an insured plan would be required to provide health benefits to same-sex spouses.

b. If a state recognizes or legalizes same-sex marriage, can an employee receiving employer-provided health care coverage receive the federal tax benefits for the same-sex spouse?

No. DOMA provides that, in determining the meaning of any federal statute, ruling or regulation, the term "spouse" can only refer to married persons of the opposite sex. As a result, an employee covered under a health plan would not receive the associated federal income tax benefits with respect to his or her same-sex spouse. Specifically, if the same-sex spouse does not qualify as a "dependent" under the Code, employer-provided coverage under a health plan on behalf of the same-sex spouse will constitute income to the employee, subject to applicable income tax withholding and federal employment taxes, *even if the provision of such health care coverage is required by state law* (as discussed above). The amount of the benefit included in an employee's gross income is the excess of the fair market value of the employer-provided group medical coverage over the amount paid (if any) by the employee for such coverage. The health benefits likely will be taxed even if the employee already is provided family coverage under the health plan at no additional cost.

3. Can an employer choose to make benefit coverage available to same-sex spouses?

It appears that an employer could voluntarily *choose* to treat a same-sex spouse as a "spouse" for benefit purposes. In fact, plan sponsors should consider amending their plans to clarify whether same-sex spouses are intended to be covered, in order to avoid confusion among participants and to avoid any argument that coverage was intended.

Health Care Coverage. The IRS has previously ruled that an employer can extend health care coverage to a domestic partner but the employee cannot receive the favorable federal tax benefits afforded to spouses or dependents under the employer's health plan. Given this IRS position, it seems likely that the IRS would likewise allow an employer to extend health care coverage to an employee's same-sex spouse, but the employee would not receive the associated federal tax benefits (as described above) with respect to his or her same-sex spouse, unless such individual qualifies as a "dependent" under the Code.

COBRA. An employer may choose, but is not required, to extend COBRA-like benefits to a same-sex spouse. If an employer does provide health care coverage for same-sex spouses, it should consider whether it wishes to extend continuation rights to same-sex spouses as well, and whether to treat separating same-sex spouses similar to divorced spouses. Before extending such coverage, however, an employer providing health care coverage through an insured plan must determine whether the health insurer is willing to extend such continuation rights to same-sex spouses.

FMLA. An employer may choose, but is not required, to provide this benefit to an employee in order to care for a sick same-sex spouse. However, an employer extending this benefit should be aware that if an employee takes a leave to care for his or her same-sex spouse, such leave will not count against the employee's twelve weeks under FMLA, and the employee would nevertheless be entitled to subsequently take FMLA leave to care for a sick child or parent.

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Notes: *The focus of this article is primarily addressed to health benefits provided under federal law. However, same-sex marriage also has significant implications for other types of employee benefits, such as pension benefits or benefits governed primarily by state law. We would welcome any questions on the implications of same-sex marriage for health benefits as well as for other types of employee benefit programs.*

The employee benefits landscape relating to same-sex marriage is rapidly evolving. Courts and state legislatures are actively wrestling with these very complex issues. Our analysis above is based on the current state of the law and is subject to change as developments warrant.

For further information relating to this subject, please feel free to contact: ***Neal Schelberg—nschelberg@proskauer.com; or at (212)969-3085; or Carrie Mitnick—cmitnick@proskauer.com or at (212)969-3883.***

New Risks in Records Management Require New Procedures

By Lisa J. Sotto

Recent scandals involving the shredding of corporate documents highlight the importance of having an effective records management program. In response to questionable document destruction activities, Congress enacted the Sarbanes-Oxley Act of 2002, which dramatically broadened the crime of obstruction of justice.

Before Sarbanes-Oxley, the government had to show that an individual destroyed evidence with knowledge that the evidence was wanted in an official proceeding. Today, an individual can be charged with obstruction—and risk 20 years imprisonment—for destroying evidence if the person should have known to preserve the documents for future government inquiries.

The act creates the potential for criminal liability for the destruction of a record even if done pursuant to an otherwise appropriate records management policy and even if there was no federal proceeding or investigation underway at the time the record was destroyed.

The risk created by Sarbanes-Oxley would argue in favor of retaining huge numbers of records because some future reviewer otherwise might conclude that, at the time of the destruction, it was contemplated that the records might be of interest in a then non-existent government inquiry.

These legal developments vividly underscore the need for every business to have an effective records management program.

Objectives

A good records management program provides a cost-effective way to manage risks associated with records and achieve records-related efficiencies. A formal records management program consists of a comprehensive policy with a record retention schedule, procedures to implement the policy, employee training, and audit and oversight mechanisms. The program should establish consistent standards for managing, retaining, storing and disposing of all records, regardless of the media in which they exist.

When developing a records management policy, companies should consider:

- Ensuring efficient maintenance of, and ready access to, records required for company operations;
- Complying with all applicable legal retention requirements;
- Effectively identifying, preserving and ensuring easy access to records that may be relevant in litigation or a government investigation;
- Providing appropriate and orderly document storage processes; and
- Reducing records maintenance costs by disposing of records no longer needed by the company.

Companies should retain all documents that are currently in effect, necessary to operate the company or required by law to be retained. The legal requirement to retain records stems from either (i) statutory or regulatory recordkeeping requirements or (ii) the requirement to retain records in connection with litigation or a government investigation.

A record retention schedule helps ensure that records are maintained for the time period they generally are needed to satisfy legal recordkeeping requirements. The key to an effective record retention schedule is ease of use. A record retention schedule may be broken down into logical, user-friendly categories. For example, it might separately list human resources, environmental and tax records, then indicate next to each type of record listed in a particular category the requisite time period for retention. At the end of the specified retention period, the relevant records usually can be destroyed.

The time periods in the schedule should not apply when the company's legal department has indicated that certain documents or types of records should be retained. Records that are considered in any way relevant to any current or future legal action, proceeding or government investigation should not, under any circumstances, be altered or destroyed without specific authorization from the legal department.

A records management program must be applied consistently and even-handedly. Selective or sudden destruction of records, even when they had been previously slated for disposal but disposal had not occurred, creates a host of risks and can impugn the credibility of the program—and the company—as a whole.

The most effective way to ensure compliance with a records management program is to designate one or more employees as program coordinators with responsibility for overseeing and implementing the program. These employees would be responsible for communicating the program's requirements to other employees, supervising the program's implementation and overseeing the company's records review process.

Records management policies should be evaluated annually to ensure that legal requirements have not changed. At least once a year, each department should examine records maintained by its employees, and index and label records to be retained for transfer to an appropriate format and storage location. Records that have exceeded their required retention period should be identified and, in the absence of any evidentiary reason to retain them, destroyed.

Storage requirements should be incorporated into a records management program. In general, records being retained should be stored in a secure storage area that is reasonably safeguarded against theft, inappropriate access, misuse and damage (including events such as fire, flood and technological failures).

Electronic Messages

E-mail presents unique challenges that must be addressed in a comprehensive records management program. Because of the colloquial nature of e-mail, e-mail communications often present the greatest liability risk to a company when produced during litigation or an investigation.

In addition, the sheer volume of internal and external e-mail can overwhelm a company's data storage capacity. One way to minimize the risk related to e-mail is to require employees to electronically file or print e-mails that must be retained beyond a given time period (based on the company's record retention schedule).

All other e-mails and back-up e-mails can then be routinely destroyed within a time period appropriate to the company's needs. For example, the company's procedures might require that any e-mail residing in an employee's inbox or "sent items" folder be destroyed 60 days after the date on which the e-mail was created or received. Before the end of the 60-day period, a hard copy would be printed out and retained, or the e-mail would be filed in an electronic subject file if the e-mail needs to be retained pursuant to the company's records management policy and retention schedule.

Any e-mails remaining past 60 days in the employee's inbox or "sent items" folder would then be destroyed using a method by which e-mail is permanently expunged, such as multiple overwrites.

A few industries now have record retention requirements that apply to instant messaging (IM). For example, the NASD recently mandated that brokers and dealers that use IM to contact clients and other employees must save the communications for three years. The NASD indicated that regardless of the extreme informality of IM communications, they are still subject to the same requirements as e-mail communications. The Securities and Exchange Commission's position is that all business-related communications (including IM) must be preserved according to the SEC's recordkeeping requirements, regardless of the form of the record.

Privacy issues also must be addressed so employees know whether to expect their personal e-mails to remain private. These issues may be managed separately in a company e-mail and computer use policy. A well-crafted and clear policy should serve to increase employee awareness that anything put in an e-mail may subsequently appear in the CEO's inbox or the local newspaper.

Training

Proper employee training is critical to a successful records management program. The company's policy should be distributed to all personnel, and relevant employees should be trained so they understand the policy and its procedures.

Equally important is training employees on document creation so records that contain half-truths or inappropriate statements are not created in the first place.

A records "retention" program applies only to the second half of a comprehensive records management program. "Retention" addresses records that already exist—how long the records must be kept, when they can be discarded, and in what format they should be retained. Before records can be retained, however, they must be created. If unnecessary records are not created, issues of management and retention do not arise. Thus, a comprehensive records management program should, to the extent practicable, include efforts to encourage employees to take care in how and whether they create records to avoid potential misunderstandings or future misinterpretation. This can best be achieved through employee training.

Areas to be covered in a training session on document creation include record copying, distribution, retention of drafts, and attention to word choice (i.e., avoiding conjecture, speculation, exaggeration and over-generalization).

Training should be conducted on an ongoing basis for new hires and annually for all other employees. It might be useful to consider online training that can be completed at the convenience of the employee. Training not only maximizes the likelihood that the policy will be followed as intended, but also is useful in combating charges of obstruction or spoliation of evidence.

Audits and Oversight

As with any well-conceived company program, it is critical to build an audit component into a records management program. The frequency and nature of the audits should be determined based on the level of anticipated risk to the program's effectiveness.

Audits can uncover problems in the operation of a program such as the failure of a department to implement the record retention schedule appropriately as to a certain media or particular platform. An audit can address misunderstandings as to procedures or the application of the retention schedule.

Moreover, audits can provide incentives for compliance, especially if the audit reports are provided to senior management.

A regularly conducted audit should, at a minimum, focus on whether:

- Employees are aware of the company's records management program, understand it and are able to apply it to all their records;
- The retention schedule has indeed been applied to company records and retention periods are being followed; and
- Records management procedures as to transfer, disposal and disposal suspension are understood and followed.

Such an audit need not be extensive. Audits of one or two areas within a department and across several subsidiaries, may suffice to promote compliance throughout the company. Off-site storage facilities also should be audited from time to time. It is often useful to have audits conducted or reviewed by independent third parties or staff members independent of those primarily responsible for maintaining the program.

In addition, employees should be encouraged to report any concerns regarding compliance with the company's records management policy. Companies should consider a means by which employees could anonymously make such reports to company management. It is critical that management diligently pursue any such reports and fix any problems that are identified.

Conclusion

A sound records management program should contain certain hallmarks that will help defeat an argument that records were destroyed with the intent to impede a future government inquiry. These include high-level company involvement and support for the program, training, clear direction on disposal suspension, and encouraging staff to report any concerns regarding compliance with the company's records management policy.

Lisa J. Sotto is a partner in the New York office of Hunton & Williams LLP. Ms. Sotto heads the firm's Regulatory Privacy and Information Management Practice.

United States v. Oracle: A Delphic Guide to the Government's Burden in Antitrust Merger Litigation

By Michael Schlanger and Kirk Ruthenberg

In the wake of a September 9 decision by Judge Vaughn Walker of the U.S. District Court for the Northern District of California, *United States v. Oracle Corp.*,[1] Oracle Corp. is now free to resume its quest to acquire competitor PeopleSoft, Inc. The Justice Department's Antitrust Division had brought the case, along with several state attorneys general, contending that the proposed merger would be anticompetitive and violate Clayton Act § 7. Judge Walker's scholarly opinion exhaustively detailed the requirements of a modern section 7 case, but rested, at the end of the day, on the simple fact that, in the court's view, the government plaintiffs failed to meet their burden of proving a relevant product market. The court's holding is noteworthy as a case study in litigation tactics, and for the stringency with which it judged the plaintiffs' use of customer evidence—typically a cornerstone of the government's case. The opinion further demonstrates that many federal judges will strictly hold the government to its own guidelines for prosecuting merger cases.

The Factual Background

The plaintiffs' case to stop the proposed Oracle/PeopleSoft merger honed in on a small but significant part of the vast universe that is the computer software market. Within the constellation of "enterprise application software" (EAS) products, and the EAS subcategory of "enterprise planning software" (ERP), the plaintiffs focused their sights on only those ERP products developed to handle "human relations" and financial management systems. The plaintiffs further narrowed their focus to only those human relations/financial management ERP products "able to meet the needs of large and complex enterprises with 'high functional needs.'" Finally, the plaintiffs alleged that the market they defined was limited to the United States.

Plaintiffs sought to distinguish such "high function" software from "mid market" offerings. They contended that the only vendors of "high function" human relations/financial management ERP software products were Oracle, PeopleSoft, and SAP, a German company that does extensive business in the United States. They claimed that none of the alternatives to these three firms—"mid-market" products, various Microsoft business software offerings, "Best of Breed" software modules, or outsourcing—were adequate substitutes, and that all should be excluded from the product market. Plaintiffs relied heavily on evidence from large ERP software customers to make their case.

Oracle was a "unilateral effects" case. That is, the "anticompetitive effects" the plaintiffs alleged were based on the notion that Oracle and PeopleSoft are in "a 'localized' competition sphere" within the "high function" ERP software market. According to the plaintiffs, that sphere "does not include SAP or any other vendors, and a merger of Oracle and PeopleSoft would, therefore, adversely affect competition in this localized market."

After a June 2004 bench trial, the district court issued extensive, detailed findings and conclusions, which ultimately held that the plaintiffs failed to prove the fundament of their case: a credible and accurate definition of the relevant market. The court found there was no such "market" for "high function" human relations/financial management ERP products; by the court's lights, plaintiffs' result-driven market definition had "no recognized meaning in the industry." Nor was there any basis for finding "that Oracle and PeopleSoft engage in competition to which SAP is simply not a party"—which was the whole premise for the unilateral anticompetitive effects plaintiffs alleged.

Judge Walker's fact intensive opinion meticulously picked apart the plaintiffs' case, witness by witness. The result is a virtually unreviewable opinion, so "bulletproof" that the plaintiffs apparently felt an appeal was futile, and ended up abandoning the case.

Merger Analysis: The Legal Landscape

The Supreme Court's decision in *United States v. Philadelphia Nat'l Bank*[2] codified a legal presumption of anticompetitive effect from a horizontal merger that would increase market concentration. The 1960s vintage cases generally deferred to the government's expertise in antitrust matters. The apotheosis of such deference is generally considered to be *United States v. Von's Grocery Co.*[3] There, the Supreme Court halted a grocery chain merger based on its observation that the "grocery business was being concentrated into the hands of fewer and fewer owners"— even though defendant possessed only a 4.7% market share, and the merged companies would have 7.5%. In the memorable words of the dissenting Justice Stewart, the "sole consistency" in the Court's jurisprudence was that "in litigation under section 7, the Government always wins."

In 1982, the Justice Department adopted its Horizontal Merger Guidelines. The current version of these Guidelines, in which the FTC joined, was issued in 1992. The Guidelines set forth a systematic approach for analyzing merger cases; the fear of industry concentration and loss of small businesses that informed the 1960s cases has given way to a more hard-nosed economic analysis focusing on the market power of the merged entity. As Judge Walker observed, "[t]he trend . . . away from the 'very strict merger decisions of the 1960s,'" is "reflected in the Guidelines," which "define market power as 'the ability profitably to maintain prices above competitive levels for a significant period of time.'"[4] The Guidelines were intended to guide the government's prosecutorial discretion; they were not intended to be binding on the courts. Nevertheless, the courts have increasingly used the Guidelines as a restatement of the law, and they have now become the *de facto*, established framework for analyzing mergers. *Oracle* further establishes the transition to this new mode of adjudication. Cases like *Philadelphia Nat'l Bank* are cited more for historical background now.

The *Oracle* decision demonstrates that a demanding federal judge will not reflexively defer to the government. Cases like *Oracle*, and the D.C. District Court's recent decision in *Federal Trade Comm'n v. Arch Coal, Inc.*[5] have strictly held the government to its own Guidelines.

Defining the Market

The Guidelines' market power analysis depends, as a threshold matter, on establishing a credible and accurate definition of the relevant market. This is the *sine qua non* of the plaintiffs' case, as it was under *Philadelphia Nat'l Bank*.

> In determining whether a transaction will create or enhance market power, courts historically have first defined the relevant product and geographic markets within which the competitive effects of the transaction are to be assessed. This is a 'necessary predicate' to finding anticompetitive effects.[6]

Having rejected the plaintiffs' market definition, it would have been difficult, if not impossible, for the plaintiffs to prove that the merger would have *any* competitive effect. Without a market definition, there is no way to assess any effects.

Why did the plaintiffs' market definition fail? Principally, it was a matter of the quality of the evidence (or, as the court saw it, the lack thereof), and the court's willingness to decide the case as it would any other commercial dispute—digging into the facts and aggressively questioning the weight and credibility of the evidence.

Customer Evidence

The most significant aspect of the *Oracle* decision was the court's rejection *in toto* of the plaintiffs' customer evidence—a mainstay of antitrust litigation. As Judge Walker himself noted, "[i]n defining the market, the Guidelines rely on consumer responses."[7] Such analysis is necessarily predictive. The question, as framed by the Guidelines, is what customers' behavior would be in the event of a "small but significant"—the Guidelines say 5%—"nontransitory price increase" by the merged firm. That is, would they look for substitute products that could force the merged firm to lower its prices? "The product market must be expanded to encompass those substitute products that constrain the monopolist's pricing."

"The test of market definition turns on reasonable substitutability."[8] The plaintiffs put on a significant number of customer witnesses—more than in the usual case. They all testified they would not go beyond Oracle/PeopleSoft and SAP for the particular enterprise software solution at issue—even in response to a hypothesized *10%* post-merger price hike. The customers' basic rationale was not an unreasonable one: the alternatives (e.g., mid-market vendors, outsourcing, "best of breed") were simply too much of a hassle.

Seemingly, plaintiffs invested significant time and effort to prove their necessarily prospective and predictive case through customer evidence. Yet, Judge Walker rejected the evidence. He found it expressed, at most, the customers' general "preferences" for Oracle/PeopleSoft and SAP. However, he reasoned, "[c]ustomer preferences towards one product over another do not negate interchangeability. . . . The preferences of these customer witnesses for the functional features of PeopleSoft or Oracle products was evident. But the issue is not what solutions the customers would *like* or *prefer* for their data processing needs; the issue is what they *could* do in the event of an anticompetitive price increase by a post-merger Oracle."[9]

Traditionally, courts are reluctant to question executives' business judgment. But the *Oracle* court displayed no such reluctance; it found the customer evidence had a "rote" quality and had nothing to back it up in terms of economic analysis or historical fact. "[N]one [of the customers] gave testimony about the cost of alternatives to the hypothetical price increase a post-merger Oracle would charge: e.g., how much outsourcing would actually cost, or how much it would cost to adapt other vendors' products to the same functionality that the Oracle and PeopleSoft products afford." Given the sophistication of the customers and the large sums of money at stake, the court found their failure to "present cost/benefit analyses of the type that surely they employ and would employ in assessing an ERP purchase" badly diminished the credibility of their testimony.

Thus, "the full weight of the plaintiffs' product market burden fell at trial upon" their highly regarded expert, Prof. Kenneth Elzinga. But here, too, there was no hard data for positing a "distinction between a high-function product and a mid-market product." Rather, "Elzinga kept telling the court that there is 'something different' about the products sold by Oracle, SAP and PeopleSoft"; the court held that "more is required" to "delineate product boundaries in multi-billion dollar merger suits."[10]

What Market Definition Evidence Will Suffice?

Whether or not Judge Walker's dissatisfaction with the quality of plaintiffs' evidence was fair, one thing is clear: in this new era of section 7 merger litigation—in which the government does not "always win"—evidence of market definition, even if it comes from customers or renowned expert economists, will not necessarily carry the day. Instead, the court may deem such evidence "rote" or conclusionary if customers cannot articulate in some detail why a small but significant price increase would not affect their purchasing decisions. It also helps if plaintiff can back up its customer witnesses with hard data illustrating the historical effects of consolidation on pricing. That is precisely what the plaintiff was able to do, based on documents from defendants' own files, in *Federal Trade Comm'n v. Staples.*[11]

In *Staples*, as in *Oracle*, the "case hinge[d] on the proper definition of the relevant product market," which plaintiff contended was the "submarket" for selling "consumable office supplies through office superstores." Plaintiff successfully argued that "an increase in price by Staples would result in consumers turning to another office superstore, especially Office Depot [the proposed merger partner], if the consumers had that option." It did so by presenting evidence "show[ing] that, in markets where Staples faced no office superstore competition at all, . . . prices are 13% higher." The court found "[t]he data which underl[ie] this conclusion make it compelling evidence."[12] Further, in sharp contrast to *Oracle*, plaintiff "offered abundant evidence" to show "industry or public recognition of the [office superstore] submarket as a separate economic entity."[13] Of course, the kind of showing plaintiff made in *Staples* is far more difficult to make in the software context, because the competition is not geographically constrained as it is in most retail markets.

Finally, Oracle's litigation strategy is worth noting. Oracle opted not to put on evidence of its own market definition. Instead, it decided to hold the plaintiffs to their burden of proof. This is a judgment call in any antitrust defense. Given Judge Walker's ultimate conclusion that the plaintiffs' market definition evidence was weak, Oracle's decision proved wise. It left the company free to poke holes in the plaintiffs' definition—oftentimes, and with greatest effect, through plaintiffs' own witnesses. But, had Oracle decided to present evidence of its own, far more sweeping market definition, that evidence would be subject to a similar credibility assessment, bogging Oracle down with a host of additional issues, and forcing the court to balance the competing definitions.

All in all, whether or not *United States v. Oracle* is a landmark decision of substantive antitrust law, it is certainly an instructive case study in litigation strategy, and illustrates the federal courts' increased assertiveness and expectations in evaluating government antitrust challenges to mergers.

Endnotes

1. 331 F. Supp. 2d 1098 (N.D. Cal. 2004).
2. 374 U.S. 321 (1963).
3. 384 U.S. 270 (1966).
4. *Oracle*, at 1111, quoting Guidelines § 0.1.
5. 329 F. Supp. 2d 109 (D.D.C. 2004).
6. *Oracle*, at 1110, quoting *United States v. E.I. DuPont & Co.*, 353 U.S. 586, 593 (1957).
7. *Oracle*, at 1111.
8. *Oracle*, at 1131.
9. *Oracle*, at 1131.
10. *Oracle*, at 1159.
11. 970 F. Supp. 1066 (D.D.C. 1997).
12. *Id.* at 1075–76.
13. *Id.* at 1079.

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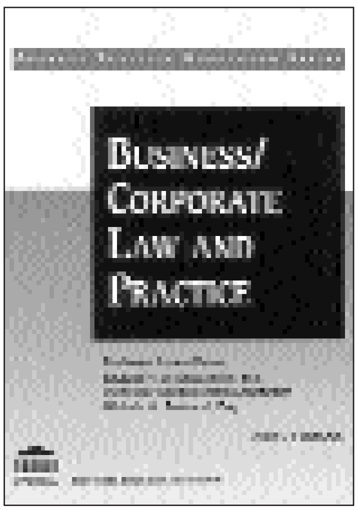

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