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Inside

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of the New York State Bar Association

Message from the Chair

First of all, I would like to start by thanking the Section for selecting me as its Chair for the coming year. It is a huge honor and I greatly appreciate it. I would also like to take a moment to thank our immediate past chair, Fawn Horvath, for all of her hard work over the past year. Under her leadership, the Section has been able to achieve great things.

We continued our successful Kenneth G. Standard Diversity Internship Program, where we have placed interns from local, New York law schools in summer internships at the Financial Industry Regulatory Authority (FINRA), Consolidated Edison, Pfizer and the International Institute for Conflict Prevention and Resolution. We capped off the summer with a lovely reception for the students and their host companies, and were joined by previous interns who have gone on to graduate and work at some of the most prestigious law firms in the country.

Through our Membership Committee, we continued to work hard to increase our membership to nearly 2,000. We also, for the second year in a row, reached out to young lawyers by co-sponsoring and attending the Young Lawyers Section's annual boat ride around the Hudson River.

With our CLE Committee, we were able to present stimulating and informative educational events including a CLE on e-discovery at the January 2009 Annual Meeting, and the Third Corporate Counsel Institute in November 2009, which is described in detail in this issue. These programs have provided practical advice to the attendees to implement in their in-house practices.

We also were able to expand and revamp *Inside* to offer theme issues, focusing on privilege, intellectual property and other important topics that in-house counsel face day-to-day, along with adding some fun reading to the publication as well.

Last, I would like to thank our Executive Committee members for all their hard work. Everything that was mentioned above could not have been done without you. And I would like to take a moment to

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Editors: Janice Handler and Allison B. Tomlinson

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introduce two people to our readers. Julie Ko was recently elected to the Executive Committee, and will be leading the Technology Committee with Fawn. Together, they will continue to find innovative ways that we can use technology to communicate with our members and expand our offerings to a larger audience. They have already been working hard to update our website and make it more engaging to our members. And Archena Bhalla has joined us as the Young Lawyers Section Liaison to the Corporate Counsel Section. In that role, she will represent us at the Young Lawyers Section Executive Committee meetings and various events, and ensure that our Section is addressing the concerns of the newest members of the in-house community.

It is an exciting time in the Corporate Counsel Section's history. It's a New Year of a new decade and we are looking forward to growing, adapting and staying on the cutting edge of issues that affect our members. Please remember that the Section is here for you—our members—so feel free to let us know if you have ideas as to program topics, content for *Inside* or our website, or would like to become more active in the Section.

All the best,

Allison B. Tomlinson

Overview of the Third Corporate Counsel Institute

By Mika M. Mooney and Howard S. Shafer

On November 19th and 20th, 2009, the Corporate Counsel Section presented its bi-annual Corporate Counsel Institute.

Corporate Counsel Section members brush up on best practices at the Third Corporate Counsel Institute.

The first day covered the following topic areas: the electronic age, updates in employment law, bankruptcy filing, and intellectual property. The keynote luncheon speaker, Marshall S. Huebner of Davis Polk & Wardwell, lead counsel to the Federal Reserve Bank of New York and the United States Department of Treasury on the financing of American International Group (AIG), spoke about the global impact of AIG and the necessity of financing AIG during that time. On the second day, an Ethics for Corporate Counsel session was held, followed by various workshops providing useful practice tools in the areas of employee privacy, commercial leasing, responding to government subpoenas, investigations by federal and state agencies investigating discrimination, and law department management. Highlights from each of the sessions are presented below.

Advising Corporations in the Electronic Age—The Interplay Between Legal and Public Relations Ramifications

Panelists Amy Binder, Mercedes Colwin, Lolita Lopez, Jay L. Monitz and Mitchell Borger discussed the impact of social media on corporations, the various forms of media that currently exist and the need to embrace the media. Blogs, You Tube, Twitter and social networking sites such as Facebook represent only a few sources of the new era of media.

Employment Law—Reduction in Force, Obama Administration Update, Wage and Hour Collective Issues and Emerging Issues

The employment law session was led by Michael E. Kreitman of Macy's, Vicki R. Walcott-Edin of Jones Day and Gary H. Glaser of Seyfarth Shaw. Employers were advised to carefully implement their reduction in force plan during this economic climate. New legislation was also highlighted including the Forewarn Act and The Lilly Ledbetter Fair Pay Act, which expanded the statute of limitations for compensation discrimination claims to renewal with each discriminatory paycheck. The EEOC also recommended a broadening of the Americans with Disabilities Act—urging that there only be a showing that an impairment "substantially limits" a major life activity as opposed to "significantly" or "severely." The panel also anticipated a rise in litigation over wage and hour issues and greater enforcement of wage and hour laws under the Obama Administration.

Web 2.0—Social Networking in Corporate America SEO, Social Media, Brand Integrity and Legal Issues

Natalie Sulimani of The Sulimani Law Firm and Sarah M. Feingold of Etsy discussed the importance of brands and brand protection in the online world. They encouraged mindfulness of the various nuances that are associated with marketing in the online world along with vigilance of brand protection and monitoring.

Keynote Speaker

The keynote address was given by Marshall S. Huebner of Davis Polk & Wardwell, lead counsel to the Federal Reserve Bank of New York and the United States Department of Treasury on the financing of AIG. He answered many pressing questions involving the United States Government rescue of AIG and made the case for why the rescue was necessary and how taxpayers should ultimately benefit from the government's actions. A poll taken the next day revealed that almost all of the attendees had changed their impression of the Government's rescue of AIG as a result of the presentation.

Bankruptcy—Anticipating and Navigating the Filing

Panelists Karen B. Dine, Rachelle Stern, Kent C. Kolbig and Damian S. Schaible worked hard to make a difficult topic understandable for all. Charles M. Tatelbaum provided a few tricks of the trade: keep track of company addresses and take advantage of the 2005 amendments to the bankruptcy code, which include the right to specify the address to which notices must be sent. Preferred Vendor Status is not always what it seems—someone else may get super preferred vendor status and you may receive cents on the dollar and the Preferred Vendors may also find themselves stuck with unfavorable terms. Obtaining copies of bankruptcy court orders is important and proof of claim should not be filed as a knee-jerk reaction; make an informed decision as to whether one should be filed.

Intellectual Property

Barry I. Slotnick and Chester P. Rothstein provided an overview of the types of intellectual property along with a discussion of how they can be infringed. The defenses that can be offered along with the various factors assessed in litigation over intellectual property were also reviewed.

Responding to Government Subpoenas and Information Requests

Michael L. Koenig of Greenberg Traurig stressed that there is no such thing as an informal government investigation or inquiry. These investigations must be handled delicately. Retaining outside counsel to handle the investigation was encouraged given the serious consequences.

Responding to Investigations—EEOC, NYSDHR and NYCCHR

A tutorial was provided by Dean L. Silverberg of Epstein Becker & Green for attorneys responding to discrimination complaints from the Equal Employment Opportunity Commission (EEOC), New York State Division of Human Rights (NYSDHR) or New York City Commission on Human Rights (NYCCHR). Mr. Silverberg highlighted the differences in the treatment of complaints made to each agency, including varying statutes of limitations and differences in procedure, liability and damages.

Confidentiality of Employee Health Records and Employee Personal Identifying Information

An overview of the laws applicable to private employee health information was given including: Americans with Disabilities Act, New York State Human Rights Law, Family Medical Leave Act, Workers' Compensation Laws, Disability Benefits, The Public Service Act and New York Civil Procedure Laws and Rules. Steven M. Berlin of Martin Clearwater & Bell, LLP provided the nuts and bolts for each of the laws. Linda A. Malek of Moses & Singer discussed the protections under Public Health Law Section 18 (6) followed by Francis J. Serbaroli of Greenberg Traurig who described the liabilities that attach when patient confidentiality is breached and private health information is wrongly distributed. Marcy Wilder of Hogan & Hartson spoke about protecting employees' personal identifying information. Lastly, Wayne A. McNulty of the New York City Health & Hospitals Corporation lectured on the Occupational Safety and Health Act.

Working with Outside Counsel—Litigation Cost Savings and Law Department Management

Maryann W. Lawrence, David A. Kalow, Rachelle Stern, Ilene B. Tannen and Howard S. Shafer comprised a panel of inside and outside counsel. From communicating expectations early to keeping each other informed as the engagement progresses, the word of the day was communication. Inside counsel emphasized the need to always know what is going on and to be prepared to report internally while outside counsel emphasized the need for feedback, timely information and cooperation.

Ethics for Corporate Counsel

Michael S. Ross, Andral N. Bratton, Professor Ellen Yaroshefsky, James Q. Walker and Anthony E. Davis addressed developments in ethics. Some new developments: The Department of Justice has changed its position on disclosure of internal investigations; the importance of having an attorney do the first cut in removing privileged information from internal investigations has grown; Judge Scheindlin changed the relationship between counsel and client with the *Zubulake* decision; attorneys have a duty to ensure litigation holds are placed and enforced; attorneys found themselves in hot water in the *Qualcom v. Broadcom* case after the late disclosure of 46,000 e-mails, and some firms are developing e-discovery SWAT teams to address this issue. Finally the panel noted that New York did not adopt the multi-jurisdictional practice rule whereas 46 or 47 other states say that in-house counsel can practice even if not admitted.

Commercial Leases

Hope K. Plasha and Robert T. Tunis presented a practical guide to any business that rents space in Manhattan. Navigating the Manhattan commercial real estate market can be tricky even for lawyers, and for those who attended this session and are responsible for negotiating their office leases, this was a practical tutorial in navigating commercial leases.

Final Remarks

The Third Corporate Counsel Institute was a great success. Every session was both interesting and easy for all to understand even if the topic was on an area of law that was not one's particular area of practice. Useful and practical information was given and we look forward to many more successful Corporate Counsel Institutes in the future and hope that more section members and in-house counsel will take advantage of the Institute.

Howard S. Shafer is a Partner in the law firm of Shafer Glazer, LLP and Mika M. Mooney is an Associate of the firm. The firm concentrates its practice in representing businesses in negligence, employment, insurance coverage and related matters and provides Corporate Counsel to companies. Howard or Mika can be reached through the firm's web site at http://www.shaferglazer.com.

Recent Efforts to Rein In Excessive Executive Compensation

By Allen Major and Stephanie L. Soondar
Collaborator: Candace Hines

As the U.S. government cleans up the mess precipitated by the financial crisis and attempts to prevent further crises by modifying and strengthening regulation of the financial system, corporate counsel are advised to track these efforts to determine the potential impact on companies. In addition to Congress, which is negotiating and debating numerous reform bills, the Securities and Exchange Commission (SEC) and the Federal Reserve ("Fed") have strengthened guidance and oversight for listed companies and financial institutions. Some of the reforms, if implemented, could have far-reaching effects on many companies. While the media have discussed the potential consequences of certain reforms, such as the proposal to create a consumer financial protection unit, few have focused on the coming changes in corporate governance standards.

This article focuses on executive compensation issues raised in various recent regulatory efforts and proposals, and specifically the issues which are most relevant to corporate counsel. The SEC issued a final rule in December 2009 requiring issuers to make certain proxy disclosure enhancements as of February 28, 2010. Disclosures required by the new rule and discussed in this article involve: compensation programs that present material risks to companies, board leadership structure, and fees paid to compensation consultants. Additionally, in October 2009, the Fed issued guidance on incentive compensation policies, and requested immediate compliance. Issues addressed in pending legislation in Congress and discussed in this article include: the shareholder say-on-pay vote, the alignment of incentive compensation with risk management, the clawback of incentive pay upon a restatement for noncompliance, the separation of the chief executive position from the chairman of the board position, and heightened standards for compensation committee independence.

Narrative Disclosure of Compensation Programs Posing Material Risks

The SEC staff noted the importance of companies keeping investors informed of compensation programs, and enacted a rule that requires companies to discuss and analyze their compensation policies and practices for *all* employees (not just regarding the executive officers) if the compensation policies and practices create risks that are *reasonably likely* to have a *material adverse effect* on the company.[1] The rule contains a non-exclusive list of situations where a compensation plan may pose material risks to a company and provides examples of the sort of issues a company should discuss. Situations where a compensation plan could potentially trigger discussion include if compensation at one business unit is structured significantly differently than at the company's other units, if compensation expense is a significant percentage of a business unit's revenue, or if bonuses are awarded upon accomplishment of a task while the risk to the company from the task extends over a significantly longer time period. In deciding whether disclosure is required under the rule, the SEC staff noted that companies may consider policies and practices that balance incentives or mitigate risks that might otherwise arise from the compensation programs. Many companies will likely have to comprehensively assess the risks posed by their compensation arrangements to determine whether disclosure is required under this new rule.

For companies that are required to make a disclosure, the rule contains examples of compensation-related issues that companies may need to discuss. These examples include the company's risk assessment or incentive considerations in structuring its compensation policies or in awarding compensation, and the company's policies regarding adjustments to its compensation policies to address changes in its risk profile.

This compensation disclosure will not be included in the Compensation Discussion & Analysis; rather, it will be in a separate paragraph. Additionally, smaller reporting companies will not be required to provide this disclosure.

Divorcing the Positions of CEO and Chairman

A significant responsibility of any board of directors is to choose, compensate, and evaluate the company's executive management. On this theme then, general counsel should be aware of recent regulatory efforts regarding a board's leadership.

The SEC amended its rules to require a company to disclose whether the positions of chief executive officer (CEO) and chairman of the board are occupied by the same person, and why such arrangement is appropriate for the company.[2] In the instance where one person serves as both CEO and chairman, but an independent director is appointed to chair board meetings, the SEC requires a disclosure explaining why that director was so appointed and the role that director plays in the company's leadership. The SEC also requires disclosure regarding how the board manages its risk oversight function, including an explanation of if and how management and the board interact as regards risk.

Legislatively, the Shareholder Bill of Rights contains provisions mandating a separation of the two positions.[3] The bill requires director independence, defined by "not hav[ing] previously served as an executive officer." The bill was introduced in May 2009, but is currently sitting without discussion in the Senate Committee on Banking, Housing, and Urban Affairs. Separately, the Shareholder Empowerment Act also contains a provision requiring separation of the two positions, as well as public disclosure of the separation.[4] That bill is currently in the House Committee on Financial Services.

Enhanced Disclosure of Fees Paid to Compensation Consultants

The new SEC rule also enhances the required disclosure of fees a company pays to compensation consultants that provide advice to the board of directors or compensation committee regarding executive or director compensation in addition to providing additional consulting services to the company.[5] The other services that compensation consultants often provide companies include benefits administration, human resources consulting and actuarial services. The SEC staff expressed concern that, because of the incentive to seek revenue from these additional services, compensation consultants may accede to management's preferences when proposing compensation packages.

If a board or compensation committee hires a compensation consultant to provide advice on the amount or form of executive and director compensation, the consultant or its affiliates provide non-executive compensation consulting services to the company ("additional services") and the fees for the additional services exceed $120,000 during the fiscal year, the SEC requires fee and other disclosure. If a company must make a disclosure, it must communicate the aggregate fees paid for the compensation consulting services and for the additional services, whether the decision to hire the consultant or its affiliates for additional services was made or recommended by management and whether the board approved the additional services. The company need not disclose the extent and nature of the additional services that the compensation consultant and its affiliates provided.

If the board does not hire its own compensation consultant, but management hires a consultant to advise on compensation and to provide additional services which exceed $120,000 during the fiscal year, the company must disclose the aggregate fees paid for the compensation consulting services and other services. If both the board and management hire their own compensation consultants, management does not need to disclose the fees it pays its consultant (but the board must make its disclosures). Consulting services which involve only broad-based non-discriminatory plans or surveys that are not customized for the company (or are customized based on parameters that are not set by the consultant) are not subject to these disclosure rules.

Incentive Compensation

Unknown quantities of government ink have been spilled over the issue of institutional and systemic risk-taking. Incentive compensation that promoted short-term risk-taking at the cost of long-term stability has been identified as one boogeyman to eliminate. Several legislative and administrative proposals attempt to do just that.

The Fed issued Proposed Guidance on Sound Incentive Compensation Policies in October 2009 ("Guidance").[6] The Guidance is mandatory for all banking organizations under the Fed's supervision, and addresses the incentive compensation policies for all employees whose work activity exposes the banking organization to risk. The Guidance instructs banking organizations to devise internal incentive pay practices that promote appropriate risk-taking within an organization's ability to identify, control and manage the risk. As a dual means of monitoring compliance and collecting best practices, the Fed created a supervisory program for both large complex banking organizations (LCBOs) and smaller banking organizations. LCBOs must submit to the Fed a proposal identifying current incentive pay practices, identifying any weaknesses, and proposing remedies and a timeline for full compliance. Smaller banking organizations will have their incentive compensation policies reviewed as part of their annual review. Both organizations, however, will have compliance with this Guidance considered as part of their advisory rating. The Fed requested immediate compliance, and threatened lower supervisory ratings and enforcement actions for failure to do so.

In contrast, the Corporate and Financial Institution Compensation Fairness Act of 2009 directs federal regulators to collaborate to create new incentive-based compensation rules and disclosure requirements.[7] The federal regulators are directed to align risk management with pay, prohibiting any practice encouraging risk-taking that threatens the stability of the company or greater financial system. The bill was successfully voted out of the House in 2009 and is currently awaiting discussion in the Senate Committee on Banking, Housing and Urban Affairs.

There are also a variety of bills in Congress that contain windfall taxes on incentive compensation. The Taxpayer Fairness Act exempts the first $400,000 of 2009 bonus compensation, but then taxes the remaining bonus at 50%.[8] The tax is applicable to financial firms that took federal financing of $5 billion or more in 2008 and 2009. The tax also covers retention bonuses paid in 2009 and 2010. A rival bill in the House of Representatives taxes 50% of 2010 bonus compensation of $50,000 or more for any employee of firms that received Troubled Asset Relief Program (TARP) funds.[9] The Senate companion bill proposes a 50% tax on bonus compensation of $25,000 or more for executives of companies that received federal monies under the Emergency Economic Stabilization Act of 2008.[10] Each of the bills is awaiting discussion in committee.

Say-on-Pay

It is nearly certain that general counsel of publicly listed companies will face a nonbinding shareholder advisory vote on executive compensation practices ("say-on-pay").

The House bill, the Corporate and Financial Institutional Compensation Fairness Act, requires a nonbinding shareholder advisory vote on all matters of executive compensation.[11] Institutional investment managers who cast such advisory votes are required to disclose how they voted each year. The bill was successfully voted out of the House and is currently awaiting discussion in the Senate Committee on Banking, Housing, and Urban Affairs.

The Shareholder Bill of Rights also requires a nonbinding shareholder advisory vote on all matters of executive compensation that are disclosed in the company's public filings.[12] The bill further requires any proxy solicitation material regarding an "acquisition, merger, consolidation, or proposed sale or other disposition of substantially all of the assets of an issuer" to disclose "in a clear and simple form" any compensation agreements involved. This includes any compensation paid to executives who are dismissed as a result of the acquisition or merger. If the compensation agreements in the proxy solicitation materials were not disclosed as part of the company's public filings, those compensation agreements are still subject to a nonbinding shareholder advisory vote. Similarly, the Shareholder Empowerment Act requires a nonbinding shareholder advisory vote on senior executive compensation that is disclosed in the company's public filings.[13] Both bills are in committee.

Separately, the SEC amended its rules in early 2009 to require say-on-pay votes at companies receiving money from TARP.[14] The SEC recently stated an interest in investigating whether say-on-pay should be more broadly required.[15]

Clawback Provisions

The draft legislation introduced by Senator Chris Dodd, Restoring American Financial Stability Act ("Dodd bill"), covers a broad array of systemic and corporate reforms.[16] Uniquely among those reforms is the requirement upon publicly listed companies to create and enforce an internal clawback mechanism. Where the issuer company is forced to file a restatement for any noncompliance, the clawback would disgorge any incentive compensation paid to current or former executive officers. The reach-back would be three years; the compensation subject to clawback would include stock options granted as compensation, and any compensation already paid that would be in excess of what was restated. The draft legislation has been discussed in the Senate Committee on Banking, Housing, and Urban Affairs.

The Shareholder Empowerment Act also provides a clawback function, although more vaguely written.[17] The bill requires publicly listed companies to create and disclose a policy for "reviewing" incentive, equity and other bonus pay that was paid to executives by reason of "fraud, financial results that require[d a] restatement, or some other cause." The bill provides recovery of "unearned" monies where "feasible and practical." The bill also prevents boards from entering into compensation agreements that provide severance payments upon dismissal for cause. The bill includes "poor performance" among the possible causes. The bill is currently in the House Committee on Financial Services.

Heightened Compensation Committee Independence Standards

The Wall Street Reform and Consumer Protection Act ("Wall Street Reform Act"), passed by the House in December 2009, requires the SEC to issue rules directing the national securities exchanges to prohibit the listing of securities of an issuer that does not comply with certain new requirements.[18] One requirement concerns a stricter independence standard for compensation committee members of listed companies than the standard currently required by the securities exchanges. Under this House bill, a member of a compensation committee of an issuer may not, other than in his capacity as a director, accept any consulting, advisory or other compensatory fee from the issuer. The companion Senate bill, the Dodd bill, goes beyond the House bill and, in addition to the provisions in the House bill, requires that compensation committee members meet the same independence standard required of audit committee members under Section 301 of Sarbanes-Oxley—that a director not be affiliated with the issuer or any of its subsidiaries.[19] Both the Wall Street Reform Act and the Dodd bill require that any adviser to the compensation committee, including a compensation consultant, meet the SEC's independence standards.

Another requirement of listed companies under the Wall Street Reform Act and the Dodd bill is that the compensation committee must have the authority to retain an independent compensation consultant, independent counsel and other independent advisers. The compensation committee would hold direct responsibility for the appointment, compensation and oversight of these consultants and advisers, and the issuer would have to provide appropriate funding for compensating such consultants and advisers. An issuer would also be required to disclose in its annual proxy statement whether the compensation committee retained a compensation consultant.

Conclusion

In this age of heightened scrutiny of executive compensation, regulators seem willing to be more aggressive in enforcing compliance. The Fed's threat to lower supervisory ratings and take enforcement action against banks that do not immediately comply with its Guidance is one example of regulators' renewed focus on compliance. Additionally, in November 2009, Shelley Parratt, Deputy Director of the SEC Division of Corporation Finance, said that the SEC staff will now require companies with materially deficient executive compensation disclosure to amend current filings rather than allow the revisions to be made in future submissions.[20] Corporate counsel should take note of the increased scrutiny and the potential for significant governance changes.

Endnotes

1. Proxy Disclosure Enhancements, Securities Act Release No. 33,9089, Exchange Act Release No. 34,61175, Investment Company Act Release No. 29092 (Dec. 16, 2009).
2. Proxy Disclosure Enhancements, Securities Act Release No. 33,9089, Exchange Act Release No. 34,61175, Investment Company Act Release No. 29092 (Dec. 16, 2009).
3. Shareholder Bill of Rights Act of 2009, S. 1074, 111th Cong. (May 19, 2009).
4. Shareholder Empowerment Act of 2009, H.R. 2861, 111th Cong. (June 12, 2009).
5. Proxy Disclosure Enhancements, Securities Act Release No. 33,9089, Exchange Act Release No. 34,61175, Investment Company Act Release No. 29092 (Dec. 16, 2009).
6. Proposed Guidance on Sound Incentive Compensation Policies, 74 Fed. Reg. 55227 (Oct. 27, 2009).
7. Corporate and Financial Institution Compensation Fairness Act of 2009, H.R. 3269, 111th Cong. (July 21, 2009). Federal regulators are specified as the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Board of Directors of the Federal Deposit Insurance Corporation, the Director of the Office of Thrift Supervision, the National Credit Union Administration Board, the Securities and Exchange Commission, and the Federal Housing Finance Agency.
8. Taxpayer Fairness Act, S. 2994, 111th Cong. (Feb. 4, 2010).
9. Wall Street Bonus Tax Act, H.R. 4426, 111th Cong. (Jan. 12, 2010).
10. Press Release, United States Senator Sherrod Brown, Brown Announces Bill to Tax Wall Street Bonuses to Help Main Street Businesses (Feb. 11, 2010).
11. Corporate and Financial Institution Compensation Fairness Act of 2009, H.R. 3269, 111th Cong. (July 21, 2009).
12. Shareholder Bill of Rights Act of 2009, S. 1074, 111th Cong. (May 19, 2009).
13. Shareholder Empowerment Act of 2009, H.R. 2861, 111th Cong. (June 12, 2009).
14. Shareholder Approval of Executive Compensation of TARP Recipients, Exchange Act Release No. 60218 (Sept. 8, 2009).
15. Dealbook, *S.E.C. Commissioner Backs 'Say on Pay,'* N.Y. Times, Feb. 19, 2009.
16. Restoring American Financial Stability Act of 2009, S. __ , 111th Cong. (Nov. 19, 2009).
17. Shareholder Empowerment Act of 2009, H.R. 2861, 111th Cong. (June 12, 2009).
18. Wall Street Reform and Consumer Protection Act of 2009, H.R. 4173, 111th Cong. § 2003(a) (2009).
19. Restoring American Financial Stability Act of 2009, S.__, 111th Cong. § 953 (Nov. 19, 2009).
20. Shelley Parratt, Address at the 4th Annual Proxy Disclosure Conference: Tackling Your 2010 Compensation Disclosures (Nov. 9, 2009).

Allen Major, Esq., formerly an associate at Heller Ehrman LLP, has experience in corporate transactional law, including securities, M&A and finance. His research interests include executive compensation and corporate governance issues.

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The authors gratefully acknowledge the editorial assistance of Candace Hines, Esq.

Website Reminder

The Corporate Counsel Section wants to feature its members in a new upcoming section "In the News" on our website. We want to hear about news, press releases, promotions, publications, events, pro bono, community involvement and anything else you think might be of interest to the community. So don't be shy, let's hear from you. You can send these items to:

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The New Wave of Regulation— Financial Crisis Focuses Congress and Regulators on Risk

By Peter K. Ingerman

Congress and federal regulators have identified risk and the relationship of risk to compensation as contributing factors to the financial crisis that began in 2007. They have proposed a host of measures to require public companies and regulated financial institutions to provide additional disclosure concerning the risks that they face and to adopt measures to monitor and manage those risks and implement compensation practices that discourage short-term risk taking by tying compensation to long-term performance. These measures are not restricted to the financial industry that is largely thought to have been the source of the financial crisis, but will affect all public companies and many regulated financial institutions. If adopted, these measures will result in increased emphasis on risk management processes and procedures, impose on management and boards of directors increased responsibilities with respect to risk identification, management and monitoring and change the manner in which senior personnel are compensated. Managers and independent directors with expertise and experience in risk management will be in great demand.

Legislative and Regulatory Initiatives

Denunciations of risk taking and calls to rein in compensation are coming from every quarter. Securities and Exchange Commission Chairman Mary L. Schapiro identified "excessive risk-taking" as a factor precipitating the financial crisis. Ms. Schapiro stated "I believe that many of the problems leading to our economic crisis can be laid at the door of poor corporate governance."[1]

In particular, boards of directors did not thoroughly question the decisions of senior management to take on risks. Of equal concern, boards often appeared to misunderstand the gravity of risks taken. Senior management took higher returns at face value, without questioning why such higher returns were possible for supposedly safe investments and strategies.

In the same speech Ms. Schapiro identified the SEC's initiatives to improve corporate governance. These include providing shareholders with the opportunity to include their nominees in the issuer's proxy materials[2] and enhanced proxy disclosure with respect to the relationship between a company's overall compensation policies and the company's risk profile, the qualifications of directors, executive officer and nominees, the board's leadership structure and potential conflicts of interest of compensation consultants.[3]

The New York Stock Exchange already imposes some risk oversight requirements on listed companies. The audit committee of each listed company must "discuss policies with respect to risk assessment and management."[4] The NYSE commentary to this standard states, "while it is the job of the CEO and senior management to assess and manage the listed company's exposure to risk, the audit committee must discuss guidelines and policies to govern the process by which this is handled." If the listed company has a separate risk committee, the risk management processes "should be reviewed in a general manner by the audit committee.…"

"I believe that many of the problems leading to our economic crisis can be laid at the door of poor corporate governance."

—SEC Chairman Mary L. Schapiro

Congress is active on this front as well. The proposed "Shareholder Bill of Rights Act,"[5] introduced by New York Senator Charles Schumer, and "Corporate Governance Reform Act,"[6] introduced by Minnesota Representative Keith Ellison, would require public companies to have risk committees composed of independent directors which would be responsible for the establishment and evaluation of risk management practices of the issuer.

The U.S. Treasury was granted authority under the Emergency Economic Stabilization Act of 2008,[7] as amended by the American Recovery and Reinvestment Act of 2009,[8] to promulgate standards for executive compensation and corporate governance for entities that receive financial assistance under the Troubled Asset Relief Program (TARP). Treasury promulgated an interim final TARP Standard for Compensation and Corporate Governance in June 2009.[9] Special Master Kenneth R. Feinberg released determinations on October 22, 2009 on the compensation packages of the twenty most highly compensated executives at seven firms that received exceptional TARP assistance (AIG, Citigroup, Bank of America, Chrysler, GM, GMAC and Chrysler Financial). The Special Master's determination significantly reduced compensation for the affected employees, required a portion of salaries to be paid in company stock that had to be held for several years at a minimum and required incentive compensation to be paid in the form of restricted stock that was contingent on performance and TARP repayment.[10]

On the same day that Special Master Feinberg issued his initial determinations, the Federal Reserve issued proposed guidance on incentive compensation policies at banking organizations to discourage excessive risk taking and announced two supervisory initiatives to spur the banking industry to develop sound incentive compensation arrangements and identify emerging best practices.[11]

The Group of 20 (G-20) Finance Ministers and Central Bank Governors[12] at their meeting in Pittsburgh in late September 2009 endorsed Implementation Standards for Principles for Sound Compensation Practices for financial institutions that had been developed by the Financial Stability Board.[13] The principles and implementation standards are intended to discourage short-term risk taking by aligning compensation of senior managers with long-term performance. The implementation standards suggest measures such as making a substantial portion of compensation dependent on individual, business-unit and firm-wide measures of performance, deferring a substantial portion of variable compensation over a period of at least three years, awarding a substantial portion of variable compensation in shares or share-linked instruments, and using clawback arrangements if the performance of the business-unit or firm is unsuccessful. The principles and implementation standards are merely recommendations and would have to be adopted by the appropriate regulatory body in order to become effective.

Judicial Developments

The Delaware Chancery Court considered the duty of directors to monitor a company's risk in a decision issued in early 2009. *In re Citigroup Shareholder Derivative Litigation*[14] involved a shareholder derivative suit seeking to recover damages against directors and officers of Citigroup arising from exposure to the subprime lending market. The court dismissed the portion of the action relating to risk oversight for failure to plead adequately the futility of demanding that the directors pursue the purported claim but discussed the duty of directors to monitor risk in considerable detail in order to explain the inadequacy of the pleadings. The plaintiffs argued that the directors failed to heed evidence of worsening conditions in the financial markets and the effects of those worsening conditions. The court noted that Citigroup had procedures and controls in place that were designed to monitor risk. Citigroup had established an Audit and Risk Management Committee several years prior to the events that were the subject of the complaint. The charter of this committee stated that one of its purposes was to assist the board in fulfilling its oversight responsibility relating to policy standards and guidelines for risk assessment and risk management. The committee met eleven times in 2006 and twelve times in 2007, the years that the alleged failures to exercise oversight responsibilities occurred.

The court reviewed the Delaware case law establishing that corporate directors had a duty of oversight. This principle was first enunciated in the case of *In re Caremark International Inc. Derivative Litigation*,[15] which involved a failure properly to monitor or oversee employee misconduct or violations of law. The court distinguished the claims of the plaintiffs in the *Citigroup* case from a typical *Caremark* case. "In a typical Caremark case, plaintiffs argue that the defendants are liable for damages that arise from a failure to properly monitor or oversee employee misconduct or violations of law.… In contrast, plaintiffs' Caremark claims are based on defendants' alleged failure to properly monitor Citigroup's business risk, specifically its exposure to the subprime mortgage market."[16] The court stated that the plaintiff's claims were not truly Caremark claims but a claim that "director defendants should be personally liable to the Company because they failed to fully recognize the risk posed by subprime securities."[17] These claims, the court said, should be examined under the doctrines of the fiduciary duty of care and the business judgment rule.[18]

Citigroup was in the business of taking on and managing investment and other business risks. To impose oversight liability on directors for failure to monitor "excessive" risk would involve courts in conducting hindsight evaluations of decisions at the heart of the business judgment of directors. Oversight duties under Delaware law are not designed to subject directors, even expert directors, to *personal liability* for failure to predict the future and to properly evaluate business risk.[19]

While the court's recognition that risk is inherent in business and its application of the business judgment rule to the directors' oversight of Citigroup's risks should be reassuring to directors, one should not lose sight of the fact that Citigroup had a committee of independent directors that was charged with responsibility for monitoring risk and that such committee held regular meetings. While one can speculate concerning the court's disposition of this case if Citigroup had not had a risk committee, it seems clear that having a risk committee was helpful in showing that the directors discharged their duty of care.

Non-Public Companies Also Affected

The legislative and regulatory proposals discussed above apply directly to SEC registered companies and to regulated financial institutions. However, other companies should not ignore these developments. A number of corporate governance requirements that were initially imposed on public companies have morphed into "best practices" that become the norm for a broader class of companies. Examples are establishment of formal internal financial controls and whistleblower hotlines. In addition, the duty of directors to monitor risk that was raised in the *Citigroup* case is applicable to all Delaware corporations, not just publicly traded corporations. This duty is owed to stockholders. While directors and officers of companies with closely held ownership may be tempted to conclude that their stockholders would prefer not to bureaucratize management by adopting formal policies and controls with respect to risk management, they should recognize that the absence of such policies and procedures could lead to allegations that the directors were remiss in their duties and they should be aware of case law developments permitting creditors to assert stockholder derivative claims if the corporation becomes insolvent.[20]

Creating Risk Management Policies and Procedures

The overarching principle that must be kept in mind when creating risk management policies and procedures is that there is no "one-size-fits-all" solution. Each business must examine its unique risk profile. Different risks require different measures and not all risks can be managed or controlled. The risk that an employee will misappropriate corporate funds can be managed and perhaps controlled through policies and procedures. On the other hand, a company manufacturing and selling a product in a field in which technology changes rapidly faces the constant risk that a competitor will introduce a better or cheaper product. This company can attempt to assess the risk and address it through research and development and product innovation, but it cannot control the risk in the same way that the risk of employee misappropriation of funds can be controlled.

A guide for developing risk management policies and procedures is the Enterprise Risk Management—Integrated Framework report released in September 2004 by the Committee of Sponsoring Organizations of the Treadway Commission.[21] COSO's initial endeavor was its report entitled Internal Control—Integrated Framework that became a popular source for the development of internal financial controls.

COSO states that management has ultimate responsibility for enterprise risk management. The board of directors' responsibility is to provide oversight and to be aware of and concur with the entity's risk appetite.

Compensation Practices

The various proposals for compensation practices have several common themes. These themes are captured by the major principles set out in the Financial Stability Board's Principles for Sound Compensation Practices: compensation must be adjusted for all types of risk; compensation outcomes must be symmetric with risk outcomes; compensation payout schedules must be sensitive to the time horizon of risks; and the mix of cash, equity and other forms of compensation must be consistent with risk alignment.

These themes were at the center of the determinations made by Special Master Kenneth R. Feinberg with respect to compensation at the seven firms that received exceptional TARP assistance. A number of entities have announced that they will voluntarily incorporate some of these principles in their compensation practices.[22] These themes are also the focus of proxy advisory firm RiskMetric Group's 2010 policies and are likely to influence institutional investor voting on matters such as "say on pay" proposals, election of directors who are compensation committee members and incentive compensation plans.[23]

Endnotes

1. SEC Chairman Mary L. Schapiro, Speech to the Transatlantic Corporate Governance Dialogue — 2009 Conference (Sep. 17, 2009), *at* <http://www.sec.gov/news/speech/2009/spch091709mls.htm>.
2. Facilitating Shareholder Director Nominations, Securities Act Release No. 9046 (June 10, 2009), *available at* <http://www.sec.gov/rules/proposed/2009/33-9046.pdf>; Securities Act Release No. 33-9086 (Dec. 14, 2009) (reopening comment period), *available at* <http://www.sec.gov/rules/proposed/2009/33-9086.pdf>.
3. Proxy Disclosure and Solicitation Enhancements, Securities Act Release No. 9089 (Dec. 16, 2009), *available at* <http://www.sec.gov/rules/final/2009/33-9089.pdf>, *corrected in* Securities Act Release No. 33-9089A (Feb. 23, 2010), *available at* <http://www.sec.gov/rules/final/2010/33-9089a.pdf>.
4. NYSE Listed Company Manual § 303A.07(c)(iii)(D).
5. S. 1074, 111th Congress (2009).
6. H.R. 3272, 111th Congress (2009).
7. 12 U.S.C.A. § 5221 (West Supp. 2009).
8. American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5 § 7001, 123 Stat. 516.
9. TARP Standards for Compensation and Corporate Governance; Interim Final Rule, 74 Fed. Reg. 28,394 (June 15, 2009); *corrected at* 74 Fed. Reg. 63,992 (Dec. 7, 2009) (codified at 31 C.F.R. §§ 30.0 to 30.17).
10. Treasury Secretary Tim Geithner, Statement on Compensation (June 10, 2009), *at* <http://www.ustreas.gov/press/releases/tg163.htm>.
11. Proposed Guidance on Sound Incentive Compensation Policies, 74 Fed. Reg. 55,227 (Oct. 27, 2009).
12. The G-20 is made up of the finance ministers and central bank governors of 19 countries: Argentina; Australia; Brazil; Canada; China; France; Germany; India; Indonesia; Italy; Japan; Mexico; Russia; Saudi Arabia; South Africa; South Korea; Turkey; United Kingdom; and United States of America.
13. Financial Stability Forum, FSF Principles for Sound Compensation Practices (Apr. 2, 2009), *at* <http://www.financialstabilityboard.org/publications/r_0904b.pdf>; and Financial Stability Board, FSB Principles for Sound Compensation Practices, Implementation Standards (Sep. 25, 2009), *at* <http://www.financialstabilityboard.org/publications/r_090925c.pdf>. The group was re-established and changed its name from "Financial Stability Forum" to "Financial Stability Board" between the release of the two

reports. The group's website states that it is composed of senior representatives of national financial authorities (central banks, regulatory and supervisory authorities and ministries of finance), international financial institutions, standard setting bodies, and committees of central bank experts.

14. 964 A.2d 106 (Del. Ch. 2009).
15. 698 A.2d 959 (Del. Ch. 1996).
16. *Citigroup* at 123.
17. *Id*. at 124.
18. "The business judgment rule 'is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.'" *Id*. at 124 (citation omitted). Unless that presumption is rebutted, the court will not second guess the decision of the directors.
19. *Id*. at 131 (emphasis in original).
20. *See, North American Catholic Educational Programming Foundation Inc. v. Gheewalla*, 930 A.2d 92 (Del. 2007).
21. Committee on Sponsoring Organizations of the Treadway Commission, Enterprise Risk Management-Integrated Framework (Sep. 2004). An Executive Summary may be obtained free of charge from COSO's website, <http://www.coso.org>. *See also*, COSO, Effective Enterprise Risk Oversight, the Role of the Board of Directors (2009), *at* <http://www.coso.org/documents;COSOBoardsERM4pager-FINALRELEASEVERSION82409.pdf>.
22. *See*, Graham Bowley, *Credit Suisse Overhauls Compensation*, N.Y. Times, October 21, 2009, at B1; *Range of Firms Alter Executive-Pay Policies*, The Wall St. J., October 24-25, 2009, at A4.
23. *See*, RiskMetrics Group, 2010 U.S. Proxy Voting Guidelines Summary, *at* <http://www.riskmetrics.com/sites/default/files/RMG_2010_US_SummaryGuidelines20100225.pdf>.

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For Goodness Sake: Legal Regulation and Best Practices in the Field of Cause-Related Marketing

By Edward B. Chansky

The marketing department sends you the following ad copy to review: "Buy our product and a portion of the proceeds will go to charity." What do you do?

You have just entered the world of "cause-related marketing," the technique of linking marketing with a social cause. This article provides an overview of cause-related marketing, the regulatory framework for this fast-growing field, and practical suggestions for compliance and best practices (including how and why you should change the ad copy proposed above).

Background

Modern cause-related marketing started in 1983 when American Express offered to support the Statue of Liberty Restoration project with one cent for every card transaction and $1.00 for every new card issued. The program was a huge success. Over a period of 4 months, the company donated almost $2 million, consumer card usage grew by 27%, and new applications increased 45%.[1]

Since 1983, cause-related marketing has grown into a popular strategic marketing and public relations tool for corporations and charities alike. A leading nonprofit example is Susan G. Komen for the Cure, the breast cancer awareness organization whose pink-themed messages accompany products nationwide. Among businesses, notable examples abound: Paul Newman built his "Newman's Own" food company around the idea of donating profits to charity; "Project Red" has become a global brand licensed by major companies such as Apple, Giorgio Armani, the Gap, and many others to help fight AIDS in Africa; and Coke and Pepsi both launched major cause-related initiatives to coincide with the 2010 Super Bowl.[2]

Today, economic and social realities demand that companies and brands act as good corporate citizens. Cause-related marketing supports that goal. It's also good business. Studies show that sizable numbers of consumers may change purchasing behavior to select products and services associated with causes they care about.[3]

Contemporary cause-related marketing takes many forms, such as requesting customer donations at checkout, auctioning special items online, walkathons, inviting consumers to "vote" for charities to receive grants, and more. The primary technique, however, remains selling a product or service with a promise to make a donation. This technique is the focus of the discussion below.

Regulatory Framework

Cause-related marketing triggers issues under state commercial co-venturer ("CCV") laws, federal tax laws, Better Business Bureau ("BBB") Standards, and federal and state laws governing false or misleading advertising.

Commercial Co-venturer Laws. Approximately 20 states have CCV laws. New York's statute is fairly representative of the majority definition of a CCV:

> Any person who for profit is regularly and primarily engaged in trade or commerce other than in connection with the raising of funds or any other thing of value for a charitable organization and who advertises that the purchase or use of goods, services, entertainment, or any other thing of value will benefit a charitable organization.[4]

The two key elements are: (a) the offer for sale of a product or service, (b) based on a representation that the purchase will benefit a charity. Some states' laws can apply where the advertiser promises to support a cause (*e.g.*, "cancer research") without naming a specific charitable organization.[5] At least one state does not even expressly require sale of a product or service in its definition, but rather only that a company use the name of the charity in connection with advertising a product or service.[6] Regardless of specific wording, CCV laws generally share a common purpose to protect consumers and charities against fraudulent or misleading advertising, and to help assure that promised donations get delivered to the proper place.

Requirements for Commercial Co-venturers. The CCV laws are triggered by representation made to the public—*i.e.*, advertising that a purchase will benefit a charitable organization or purpose. As with most regulation of advertising, local laws apply in each state where the offer is made to the public. Nationwide cause-related marketing campaigns therefore must comply with the laws in all 50 states.[7]

The basic requirements are as follows:

- *Written contract with the charitable organization*. Approximately 20 states require a contract. Some specify certain provisions for the contract. A partial list of such provisions includes: accurate description of the offer to be made to the public, the charity's right to an accounting of the program results, termination rights for the charity, citation to the state's laws, an estimate of the total donation, and signature by two officers of the charity.[8]

- *Per-Unit Disclosure of Donation Amount*. Approximately 11 states require ads to disclose the amount of the donation, on a per-unit basis, typically either "as a dollar amount or as a percentage of the value of the goods or services purchased or used."[9]
- *Disclosure of Beneficiary*. If applicable, the name of any benefiting charity, contact information for that organization, and the purpose for which the donated funds will be used are required disclosures.[10]
- *Registration and Bonding*. A CCV has a duty to register, post a bond, and file an annual report in Maine, Massachusetts and Alabama; Illinois requires registration and annual reporting as a "charitable trust"; South Carolina and Hawaii require a simple notice of the promotion.[11] The charity has a separate duty to file a copy of the contract in a few states, and also to be registered for general fundraising purposes in all states with general charitable solicitation registration laws (there are approximately 40).[12]

While the requirements may sound daunting, compliance is not difficult. A contract would be desirable even without the CCV laws. Clear disclosure of the actual amount going to the charity is desirable as a matter of truthful advertising. And state CCV registrations, while awkward, can often be handled by knowledgeable counsel for a cost of about $5,000 for a national program.

Professional Fundraiser Laws. In addition to CCV laws, many states also have statutes regulating "professional fundraisers." Again, the New York statute is representative of the general definition:

> Any person who directly or indirectly… for compensation or other consideration plans, manages, conducts, carries on, or assists in connection with a charitable solicitation or individually solicits or who employs or otherwise engages on any basis another person to solicit in this state for or on behalf of any charitable organization….[13]

The primary distinction from a CCV is that a professional fundraiser solicits contributions separate and apart from the regular retail price of a product or service, and does so for compensation.

Most cause-related marketing programs normally will not be deemed covered by the professional fundraiser statutes. If not designed carefully, however, a cause-related marketing program could invite such regulation. A theoretical example arises if a company invites consumers to make donations, but the company accepts those donations only with a required purchase. In such a case, a regulator could argue that the company is soliciting (asking for a donation separate from the regular price of the product) for compensation (only accepting donations when making a sale).

In the common case of a retailer inviting consumers to make voluntary donations at checkout *without* any purchase required, the retailer typically will be viewed as a non-regulated volunteer, *provided* that (a) the retailer is not compensated in any way, and (b) 100% of the donated funds are given to the charity. If either of these two conditions is not satisfied, then the risk of being deemed a professional fundraiser increases. In addition, if the retailer handles the money (as distinguished from consumers depositing donations in locked boxes opened only by the charity), the states of Illinois and Massachusetts could apply their "charitable trust" or CCV laws even though no product is being sold.[14]

A company should avoid being deemed a professional fundraiser. The laws are much stricter than for CCVs, including much more extensive contracting, registration, bonding and disclosure requirements in several states.[15]

Better Business Bureau Standards. BBB Standard 19 establishes disclosure guidelines similar to those under the CCV laws, including disclosure of the per-unit amount of the donation as "the actual or anticipated portion of the purchase price that will benefit the charity (*e.g.*, 5 cents will be contributed to abc charity for every xyz company product sold)," the time period during which the offer is valid, and whether any overall maximum or minimum applies to the contribution (*e.g.*, up to a maximum of $200,000).[16]

Proposed Multistate Consumer Law Guidance Principles. In 1999, the Attorneys General in 16 states plus the District of Columbia proposed guidelines for cause-related marketing. The proposals were made largely in response to perceived abuses of charity names in advertisements for commercial products, particularly where the charitable organization (often a health-related group) appeared to be endorsing or approving a commercial product when such endorsement or approval was not true. Key concepts under the guidelines include disclosing the financial relationship between the advertiser and the charity, avoiding misrepresentation of endorsement by the charity, and not misleading consumers as to the effect purchases will have on any donation.[17]

The proposed guidelines do not have the force of law. However, they provide insight into the types of practices likely to trigger concern under general laws governing false and deceptive advertising. The most important guideline for traditional cause-related marketing is to avoid misleading consumers as to the effect a purchase will have on any donation, which is discussed in the next section.

Common Problems in Cause-Related Marketing

The Flat Donation. The company agrees to give a fixed amount to the charity. The amount does not depend on the number of sales. Yet the advertising tells consumers that each purchase results in a donation. This situation should be avoided. It misleads consumers as to the effect a purchase will have on the donation. A more appropriate form of advertising would be to simply say that the company is a proud sponsor of the charity and to disclose the gross amount of the donation. Consumers can then decide whether they think the fact of the donation is a reason to purchase the advertiser's product. A further advantage of this approach is that it generally avoids the need to comply with CCV laws.

Caps and Minimums. The accurate, per-unit donation amount is disclosed in the advertising, but the total donation is subject to either a cap (*e.g.*, "up to $200,000"), a guaranteed minimum, or both. Common sense and BBB Standard 19 both dictate disclosure of any applicable maximum or minimum. But is such disclosure enough? It depends. For a cap, if the offer continues to be communicated for a substantial time after the cap is reached, anyone purchasing later may be misled as to the effect his or her purchase may have on the donation. For a minimum, if the threshold is well above anticipated sales, consumer action may be irrelevant to the donation.

This is not to say caps and minimums are prohibited. Instead, the advertiser should seek to establish a reasonable fit between the scope of the offer and the disclosed maximum or minimum. For a maximum donation, the fit might involve controlling inventory to create only a limited number of qualifying, specially marked packages so that the maximum cannot be exceeded, or using historical sales information to make the offer valid only for a limited time period in which an appropriate sales level is likely to occur. For a minimum donation, the floor should not exceed anticipated sales. Such precautions—together with transparent disclosure to the consumer—can generally avoid problems with a maximum or minimum donation.

Vague Disclosure. A typical reason to promise a donation with purchase is to induce a purchase. As noted above, many consumer purchase decisions are likely to be influenced by such promises.[18] Given these facts, a regulator can credibly argue that the public is entitled to know exactly how much money goes to the charity for each purchase. For example, a consumer likely cares if the donation is $1.00 vs. one-ten-thousandth of a penny. Were it the latter amount (and if the consumer knew), the consumer might not make the purchase. For all these reasons, disclosure of the donation amount in terms the consumer can easily discern or calculate is the recommended way to comply with the CCV laws and BBB Standard 19.

Advertisers, however, sometimes want to use vague disclosures, such as "a portion of the purchase price," "a portion of proceeds," or a designated percentage of "profits" or "net profits." Occasionally a vague disclosure is proposed because the actual per-unit donation amount can't be calculated accurately in advance. Other times the actual amount is known, but the advertiser worries that the amount sounds too low to induce purchases. Regardless of the motive, the fundamental problem with a vague disclosure is that it lacks transparency. "A portion of the proceeds" could mean anything between zero and the full purchase price of the product. Even more troubling is where the advertising trumpets a generous-sounding percentage of profits (*e.g.*, "50 percent of net profits") when the actual donation is a relatively or extremely small percentage of the purchase price. While such disclosure may be literally true, it further increases the risk that consumers may be misled as to the actual amount donated.

Practical advice for a "percentage" disclosure is to base the percentage on the retail purchase price of the product rather than on "proceeds" or "profits." If a profits-based formula must be used, then an additional disclosure should be added to disclose a minimum, per-unit amount to be donated for each purchase. Such disclosure establishes a baseline for consumer expectations. If the actual per-unit donation exceeds the disclosed baseline, no harm occurs to either the consumer or the charity.

The Charity's Perspective

When considering cause-related marketing, a company should bear in mind certain tax-related issues that affect the charity. Without an awareness of these issues, the company might not understand why a charity typically cannot agree to actively promote the sale of the advertised product or service, or the company may unknowingly lead the charity to engage in activity that could jeopardize the charity's tax-exempt status.

Unrelated Business Taxable Income. The major issue for charities is unrelated business taxable income ("UBTI"). UBTI arises when a tax-exempt organization engages on a regular basis in business activity unrelated to its charitable purpose. Actively promoting the sale of a commercial sponsor's goods or services—even if such sales help generate donations to the charity—is not normally considered part of a tax-exempt organization's charitable purpose, but rather rendering of advertising services that can potentially become taxable at standard corporate tax rates.[19] Too much UBTI can result in loss of tax-exempt status.[20]

An exception to UBTI allows a charity to publicly "acknowledge" a sponsor's support. Acknowledgement is typically a thank-you message that also may include a general reference to the sponsor's business and products, as well as contact information for the sponsor.[21] Unfortunately, the line between "acknowledgement" and "advertising" is not always clear. The major earmarks of advertising include qualitative or comparative statements about a product, price information, indications of savings or value, or "*an endorsement, or inducement to purchase, sell, or use any company, service, facility or product*."[22] A thank-you message mentioning that each purchase of the sponsor's product benefits the charity can be viewed as an inducement to purchase, and thus a form of advertising. For this reason, sophisticated tax-exempt organizations often will not agree to actively promote an advertiser's product or service in a cause-related marketing program. A conscientious advertiser may wish to consider whether the charity is aware of this risk when negotiating the terms of a cause-related marketing agreement to help avoid later misunderstandings or bitterness if the charity is subsequently audited by the IRS.

Self-Dealing. "Self-dealing" is an additional concern if the benefiting organization is the advertiser's own private charitable foundation. Stated simply, self-dealing occurs when a private foundation's assets are improperly used to benefit "disqualified persons," who include substantial contributors and their officers and directors, as well as officers and directors of the foundation. Ordinary cause-related marketing programs where the foundation merely allows the company to use the foundation's name on commercially reasonable terms, and the foundation receives donations passively without promoting or advertising the company's business, are unlikely to cause a problem. But the more active the foundation becomes in promoting the company's business, the greater the risk of a self-dealing problem. In addition, the terms of the relationship must be arm's-length, and preferably should be approved by independent board members of the foundation unrelated to the CCV. Penalties for self-dealing can include individual liability for the corporate officers involved in the transactions.[23] As a result, great care should be taken when implementing a cause-related marketing program between a company and its own charitable foundation.

What Should a Company Do?

To date, enforcement of the CCV laws has been lax. With the rapid growth of cause-related marketing, however, increased regulatory attention can be expected. The following are best practices to help minimize the legal risks in typical cause-related marketing programs:

- Sign a written contract with the charity, including any statutorily mandated provisions.
- Structure the promotion to avoid misleading consumers as to the effect purchases will have on any charitable donation.
- Review advertising carefully for transparent disclosure of the per-unit donation amount and compliance with applicable state disclosure laws and BBB Standard 19.
- Register and bond the program in any applicable jurisdictions.
- Confirm that the benefiting charity is registered for general fundraising purposes in all states where the offer will be made.
- Be sensitive to UBTI issues for the charity.
- Take care in structuring programs with your own corporate foundation to avoid return benefits that could be construed as "self-dealing" in the eyes of the IRS.

Cause-related marketing is here to stay. It is popular. It is growing. The legal regulation of this powerful advertising tool is not yet widely understood. With a little effort—and some help from experienced counsel—companies can safely engage in cause-related marketing for the mutual benefit of business and charity alike with minimal risk and cost. In short, you can do good while you do well.

Endnotes

1. See *Past. Present. Future. The 25th Anniversary of Cause Marketing*, Cone, Inc. http://www.coneinc.com/research/index.php.
2. See news report at http://causeintegration.wordpress.com/2010/01/28/coke-launches-cause-marketing-campaign-to-rival-pepsi/.
3. See *Past. Present. Future. The 25th Anniversary of Cause Marketing*, *supra*, note 1, and studies cited therein.
4. NY Executive Law § 171-a.
5. See, e.g., Conn. Gen. Stat. § 21a-190a (9) (defining "charitable sales promotion" as benefiting a "charitable organization or purpose").
6. See Mass. Gen. Laws, ch. 68, Section 18.
7. While international laws are beyond the scope of this article, it is worth noting that, apart from a few Canadian provinces, most foreign countries generally do not have specific "commercial co-venturer laws" but instead regulate CCV-style offers primarily under laws governing false or misleading advertising.
8. See, e.g., NY Exec. Law § 174-a; Georgia Code § 43-17-6(a); Mass. Gen. Laws, ch. 68, Section 22.
9. See, e.g., Arkansas Code § 4-28-408(c)(2); Conn. Gen. Stat. § 21a-190g(c). NY Exec. Law § 174-c requires disclosure of "the anticipated portion of the sales price, anticipated percentage of the gross proceeds, anticipated dollar amount per purchase, or other consideration or benefit the charitable organization is to receive."
10. Mass. Gen. Laws, ch. 68, Section 23.
11. Alabama Code § 13A-9-71(h); Hawaii Stat. § 467B-5.5; 760 Illinois Compiled Stat. 55/6; 9 Maine Rev. Stat. § 5008; Mass. Gen. Laws, ch. 68, Section 24; S.C. Code § 33-56-70.
12. See list of states at http://www.multistatefiling.org/index.html.
13. NY Exec. Law § 171-a.
14. See 760 Illinois Stat. 55/3; Mass. Gen. Laws, ch. 68, Section 18.
15. See, e.g., NY Exec. Law § 173, *et seq.*
16. BBB Wise Giving Alliance for Charity Accountability, Standard 19.
17. "What's In A Nonprofit's Name?," Public Trust, Profit and the Potential for Public Deception, a Preliminary Multistate Report on Commercial/Nonprofit Product Marketing, April 1999.
18. See note 3, *supra,* and sources cited therein.
19. See 26 U.S.C. § 511 *et seq*.
20. See 26 CFR § 501(c)(3)-1(e)(1).
21. 26 CFR § 1.513-4(c)(iv).
22. 26 CFR § 1.513-4(c)(v) (emphasis added).
23. 26 U.S.C. § 4941.

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Getting the Benefit of Your Bargaining Power: How to Get "Added Value" from Outside Counsel

By Rob Thomas and Melissa Pearlstein

Believe it or not, there is a silver lining in the dark economic cloud hovering over corporate legal departments. With many law firms struggling to attract or retain corporate clients, companies now often have the upper-hand in negotiating new engagements. This increased bargaining power presents a great opportunity for corporate legal departments to re-tool their relationships to ensure that they receive more value from their outside counsel.

Managing for Savings

For the past nine years, the Association of Corporate Counsel (ACC) and Serengeti Law have published the *ACC-Serengeti Managing Outside Counsel Survey*, a report assessing the latest trends in outside counsel management.[1] Some 390 legal departments completed the 2009 survey, in which, for the first time in three years, in-house counsel's top concern was reducing outside counsel spending.[2] For the first time in the history of the survey, there was no increase in annual outside counsel spending, and none predicted for the coming year. And outside counsel rates increased by the lowest percentage (4.7%) since the survey began in 2000.[3] Given higher rates and static budgets, legal departments must get better control over outside legal spending.

The report also indicates that more in-house counsel find that the key to controlling spending is active management. Following are the most effective practices identified by respondents:[4]

- Requiring case/matter budgets (22% savings)
- Re-allocation of work to firms with lower rates (18% savings)
- Discounted/alternative fees (17% savings)
- Billing guidelines/expense reviews (17% savings)
- Evaluations of outside counsel (15% savings)
- Electronic bill review/audit (12% savings)

The challenge in implementing these strategies often lies in getting law firms to cooperate. Approximately 38% of in-house counsel surveyed said that 10% or fewer of their firms implemented their suggestions for increasing value; 21% said that *none* of their firms did.[5] Most cost-saving methods are grounded in the principle that clients want more communication and more participation in the strategic decisions affecting their projects. The following sections describe specific ways that both clients and firms are applying this basic principle to boost the efficiency and effectiveness of their legal teams.

Agree Upon Clear Engagement Terms; Employ a System to Monitor Compliance

Outside counsel may think that clients should agree to their engagement letters, but many corporate clients now set uniform retention terms that they require from all of their firms. Clear retention terms, consistently applied, can be very effective in controlling spending. Companies should begin each project by securing outside counsel's agreement, which may take the form of a simple letter, or a longer document complete with sample forms. Generally, the larger the project, the more likely the client will require a detailed plan and regular updates.

To realize the benefits of engagement terms, companies must have practical ways to hold law firms to their end of the bargain. At a minimum, the lead in-house attorney should calendar reminders to request periodic budgets and status reports. Many legal departments (even small ones with a single lawyer) use online e-billing/matter management systems to automatically monitor outside counsel compliance with their retention terms. For example, the most widely used system (Serengeti Tracker) includes a patented workflow to ensure that law firm requirements are fulfilled. The system allows law departments to require information, such as budgets and initial case assessments, and then checks, whenever a firm submits a bill, to see whether the required information has been entered by outside counsel within the time period established by the client. If any required information is overdue, then the firm is immediately notified that the bill will be held for processing until the requirements are completed. As a result of this systematic workflow, clients are assured that firms promptly comply with the major terms of the engagement.

Electronic systems can also automatically check compliance by auditing legal bills for elements such as the following: (1) no increase in hourly rates nor addition of new timekeepers without client approval; (2) no bills exceeding the budget; and (3) agreed limits on expenses such as copying costs, travel expenses, long-distance charges, and online legal research. The system flags any violations, and the in-house attorney reviewing the bill then decides whether exceptions to the engagement terms are warranted. As a result of this enhanced ability of in-house counsel to monitor compliance with retention guidelines, companies report that such systems result in average savings of 12% (compared with a system cost of generally less than 1%).[6]

Set Realistic Goals with Budgets and Early Case Assessments

According to the ACC-Serengeti Report, budgets reduce total outside counsel spending by an average of 21%.[7] Budgets and early case assessments force attorneys to set realistic strategies early, minimizing false starts down the road. They also require a meeting of the minds between attorney and client regarding expected levels of activity and spending to accomplish the client's goals for each stage of a project. Following are examples of terms:

- Company requires budgets for every matter. The budget should be provided to and discussed with Company before commencement of the engagement and should include, at a minimum, a timetable; personnel; a forecast of hours, fees, and expenses; and, with respect to litigation, a discussion of possible outcomes with cost-benefit analyses and potential exit points. Firm should review project budgets with Company quarterly and after the occurrence of a significant event. The review should include a summary of the work performed and an updated projection of anticipated work.
- Company requires a strategic litigation plan designed to achieve the earliest, most cost-effective resolution consistent with the Company's business objectives. Company and firm should collaborate to evaluate risk and potential exposure and then develop the most appropriate resolution strategy. An initial case assessment allows Company to make informed choices among strategic options at the earliest possible stage in the litigation. The matter should be sufficiently evaluated in the first 90 days to determine whether settlement is efficient, responsible, and prudent before engaging in lengthy discovery, complex motion practice, or other potentially expensive and time-consuming practices.

Maintain Optimal Staffing

There is no one-size-fits-all approach to staffing legal projects. However, the ACC-Serengeti Report found that 62% of companies now require law firm associates to have at least one year of experience.[8] Clients expect that attorneys will have a minimum level of competence so that they aren't paying for training. Yet, for certain tasks such as routine discovery or document review, a summer clerk or first-year associate may be the right person, at the right rate. In other situations, partners may provide the biggest bang for the buck because they can accomplish tasks in much less time, albeit at higher rates. Therefore, terms that offer flexibility, with oversight by the client, are often effective at reducing costs:

- We must approve in advance the staffing of each matter. Once staffing has been agreed upon, consult with us before you make changes or additions. We will pay for only one attendee at depositions, court hearings, and negotiations, unless otherwise pre-approved.
- Company expects an experienced Lead Outside Counsel to remain on the case/transaction from start to finish, unless otherwise requested by Company. Company will not pay for review time if Firm changes lawyers, nor will Company pay for training junior lawyers or support staff. Use of associates and paralegals is encouraged, but Company expects Lead Outside Counsel to maintain responsibility for the entire matter.

This is another area where electronic billing systems help clients, by presenting summaries with each bill that help in-house counsel assess the allocation of work being done by various members of a legal team.

Monitor Periodic Status Updates

Periodic status reports from outside counsel can help companies avoid expensive surprises. By regularly monitoring progress, the client knows if a project is getting off track, not meeting major milestones, or exceeding the budget. They can then work with outside counsel to address such issues before they become much larger. Companies should communicate clear expectations on how and when they expect updates from outside counsel:

- Firms must submit monthly status reports to our online matter management system, as well as whenever there is a development that materially affects the fees, expenses, duration, or likely outcome of the matter. Company will not pay invoices unless status reports have been submitted.
- Firm should discuss strategic direction with Company and inform us of ongoing developments. Send drafts of all documents and significant correspondence sufficiently in advance of filing or mailing to permit time for review.

Evaluate Firms and Assign Work Accordingly

A thorough evaluation of the law firm's performance (including costs incurred as well as results achieved) can reduce future costs by 15%.[9] By systematically evaluating performance, companies can make sure to assign future work to those attorneys who deliver the best value. In addition, by asking firms what steps they took to improve efficiency, companies can apply lessons learned to similar projects in the future.

Build Long-Term Relationships with Your Firms

Every company knows the value of retaining good employees, and it's just as important to build lasting relationships with outside counsel. Solid working relationships ease the way for the cost-saving measures described above, as well as for alternative fee agreements (AFAs), which encourage efficiency. Firms are also more likely to invest time to develop expertise that will be useful to a specific client with which they have a long-term relationship and to provide free CLEs and other substantive support for the law department. One of the central tenets of the ACC's Value Challenge—an initiative to help companies and firms derive more value from their work—is the importance of long-term relationships. The ACC suggests that the company and firm should meet, talk, and act on ideas that will result in a relationship that improves value, protects the client, maintains firm profitability, and reduces attrition rates for both company and outside counsel.[10]

With a strong working relationship between client and outside counsel, firms may feel more comfortable engaging in AFAs (including fixed fees and fees contingent upon success) that can generate significant benefits for both parties.[11] According to one 20-year attorney who has engaged in AFAs extensively since the mid-1990s:

> Under most scenarios, a well-designed alternative fee arrangement will actually strengthen relationships with outside counsel….Communication improves [and] outside counsel truly invests in understanding the client's corporate culture. Additionally, there is incentive for outside counsel to perform a serious and realistic early evaluation of the legal matter, which is exactly what the client wants. Efficiencies and optimum use of technology are realized when outside counsel's rewards are tied to performance. Nickel and dime invoicing issues vanish.[12]

Companies may have the upper hand in negotiating engagements with outside counsel—for now. But the reality is that bargaining power is a pendulum that swings back and forth over time. In-house counsel should leverage their current position to create long-term relationships with outside counsel that focus on increasing the value of the services that they provide. By implementing techniques such as agreeing upon and monitoring clear engagement terms, evaluating outside counsel performance, and building long-term relationships, companies can ensure that their firms will deliver top quality representation at the best possible price—now and in the future.

Endnotes

1. Association of Corporate Counsel and Serengeti Law, *2009 ACC-Serengeti Managing Outside Counsel Survey Report* (2009) (hereafter "ACC-Serengeti Report"); <http://www.serengetilaw.com/survey/>.
2. Reflecting the demographics of the broader in-house profession, the majority of respondents by far—84%—have 10 or fewer attorneys. *Id*. at 33.
3. *Id*. at 119.
4. *Id*. at 130.
5. *Id*. at 113.
6. *Id*. at 130
7. *Id*.
8. *Id*. at 114.
9. *Id*. at 130.
10. Association of Corporate Counsel, *ACC Value Challenge Briefing Package*, 3 (Feb., 2010) <http://www.acc.com/valuechallenge/upload/Value-Challenge-Brief_022510.pdf>.
11. According to the ACC-Serengeti Report, nearly 90% of companies reported that their firms are resistant to AFAs, compared with only 40% who faced internal resistance. *ACC-Serengeti Report*, at 124 (2009).
12. Kevin Young, *Busting the Myths of Alternative Fee Agreements*, ACC South/Central Texas Chapter Focus Newsletter, Second Quarter 2007, at 6.

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Inside-Books

OUR DAILY MEDS

Melody Petersen
Sarah Crichton Books, 2008

Reviewed by Janice Handler

When we re-launched *INSIDE*, we told you that we would write, not only for your lawyer life, but for your real life. This book is for the latter (although there are enough regulatory implications to interest your lawyer lives as well). This is the story of how pharmaceutical companies "medicalize" non-diseases to sell sometimes ineffective and sometimes dangerous drugs to unsuspecting patients. It is an important book and one which will inform your Real Life and your life as a medical consumer.

First the disclaimer. I am the wife of a physician. For many years I enjoyed drug company largesse and thought the role of Big Pharma in the world was to provide me with pens and post-its. Now in freebie recovery, I would gladly write with papyrus rather than continue to fuel the giving and getting loop that runs from drug companies to physicians. In *Our Daily Meds,* Melody Petersen, a former pharmaceutical reporter for the *New York Times*, tells how that loop has hooked our country on prescription drugs.

You don't have to look hard to find Petersen's thesis. Right on the cover page is the banner "How the Pharmaceutical Companies Transformed Themselves into Slick Marketing Machines and Hooked the Nation on Prescription Drugs." Petersen expands on this thesis with riveting anecdotes, scientific data, historical analysis, and first class investigative reporting.

Our Daily Meds starts with some eye-popping statistics, *e.g.*:

- Americans spent over $205 billion on prescription drugs in 2005, more than the combined gross domestic products of Argentina and Peru.
- Americans spend more on drugs than do all the people of Japan, Germany, France, Italy, Spain, U.K. Australia, New Zealand, Canada, Mexico, Brazil, and Argentina combined.
- Almost 65% of US take a drug available only by prescription.
- 1980-2003, amount spent yearly by Americans on prescription drugs rose from $12 billion to $197 billion—(an increase of 17 times).
- 100,000 Americans per year die from complications of prescription drugs.

Having grabbed the reader's attention, Petersen then lays out the history of how drug companies evolved from developing lifesaving cures in the 40's and 50's (penicillin, steroids, antibiotics, tranquilizers) to the "age of the blockbuster" where the emphasis shifted from scientific research to marketing and promotion. After real drug advances fell off, drug companies realized they could sell high volumes of almost any drug by spending more on promotion and focusing on marketing drugs for chronic diseases and non-diseases rather than actually curing them.

Petersen describes the age of the blockbuster as having three components—"medicalizing" non-diseases by prescribing cures for "symptoms" which are not illnesses, seducing doctors with easy money, and hyping off label uses. She tells how what were once considered normal life events—menopause, baldness, erectile dysfunction, irritable bladder, restless legs, even shortness—have become diseases to be treated with expensive, ineffective, and often dangerous meds. Marketers, she says, create their own demand for drugs, broadening the definition of disease to cover more and more people and "disease-ifying" (my word) whole groups of the population—women, seniors, and even children. She tells how some of the normal behaviors of childhood are now called ADD and of the growth of prescriptions for Ritalin and its counterparts (10% of ten year old boys are on it, she says).

To "treat" these diseases and sometimes non-diseases, the pharmaceutical companies have enlisted doctors to their payrolls as speakers, consultants, researchers, advisors and just plain prescribers. A great revelation of this book is its description of the ties that exist between drug companies and academics that run drug trials and the rewards given to physicians who prescribe heavily. Doctors get cash for prescribing drugs. They get frequent flier miles. They get all expense paid vacations and dinners. Drug companies purchase prescription records from pharmacies in order to identify which loyal prescribers to reward with free dinners, gifts, trips, and cash. They pay doctors to attend "seminars" at fancy resorts to discuss (read that "pitch") their products. They pay to "shadow" doctors in their treating rooms and influence their prescribing decisions. In 2004, drug companies paid for 536,734 dinners, retreats, meetings or other events to physicians.

The strategy also includes prescribing for off label uses—uses that have not been approved by FDA but for which physicians can independently prescribe. A compelling chapter discusses Parke Davis's epilepsy drug, neurotonin, which was pushed for every neurological condition the company could think of—an estimated 90% of neurotonin prescriptions were for unapproved uses.

If the only harms of these marketing schemes were economic, it would be bad enough, but we're talking drugs here, people. Some of Petersen's most compelling writing is of ordinary people whose lives became train wrecks after taking the hottest new wonder drug. She details drug recalls such as the cholesterol lowering drug Baycol and the arthritis drug, Vioxx, which were found to be dangerous after being rushed to market. She talks of known adverse reactions to drugs still on the market, such as the relationship of Detrol (irritable bladder) to dementia, Prempro (hormone) to heart attacks, and Ambien (sleeping aid) to hallucinations and sleep walking. She points out that in one study, death from prescription drugs is the 4th leading cause of death in the U.S., and the leading cause of liver failure is not hepatitis but drug poisonings (many from that ubiquitous analgesic, Tylenol). As I wrote this article, the *New York Times* reported the possible relationship between Avandia, a leading diabetes drug, to heart failure.

In addition to adverse effects, more subtle damage to our health and the health of our society is noted, including: the ecological damage caused by prescription drugs dumped in U.S. waters; higher costs for new drugs—(cancer drugs can cost $100,000 year)—; the growth of drug resistant germs because of over prescribed antibiotics; the rising incidence of prescription drug abuse (the number of Americans admitting to abusing prescription drugs nearly doubled from 1992-2003); and more auto crashes by patients under influence of prescription drugs. And these risks are incurred for drugs which can be unnecessary and ineffective! (*Meds* presents impressive data on how often drugs don't work in large numbers of people.)

Like most such books, *Med*s ends with a chapter on what we can do—as a society and as individual medical consumers. Our lawyer brains can engage with her suggestions for reforming the system—legislation to prevent physicians from taking drug money, creation of an impartial government agency to really review drug science, requirement of full disclosure of drug side effects before a prescription is written, strengthening of FDA, prevention of covert drug marketing by celebrities and others. But it is her suggestions for individual action that inform our real lives as patients and medical consumers. Quiz your doctors about their relationships with drug companies. Challenge whether you really need a drug. Review labeling information and risks before taking a drug. Be skeptical of taking drugs for "diseases" such as "pre diabetes" and "sub clinical thyroid disease." Be suspicious of drugs that are heavily promoted and sampled.

This book is clearly one sided. Does Petersen know what she's talking about? Perhaps. Is there another side of the story? Maybe. But the material resonates with me. For years I took hormones because they were supposed to prevent everything from heart attacks to bad hair days. They didn't. Now statins are claimed to do the same things. Let's not get taken in again. Ask Petersen's suggested questions. Not for your lawyer life but for your real life. Your real life might depend on it!

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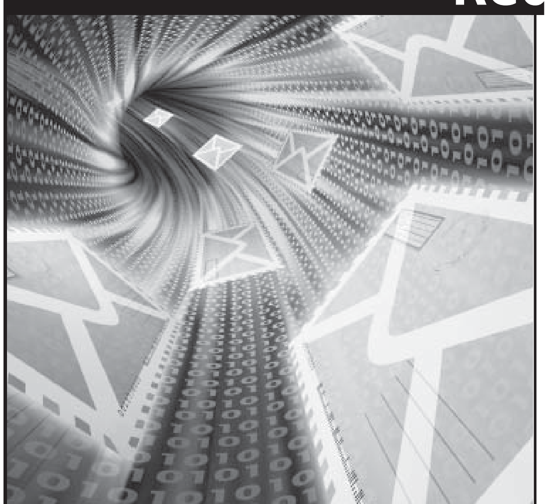

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