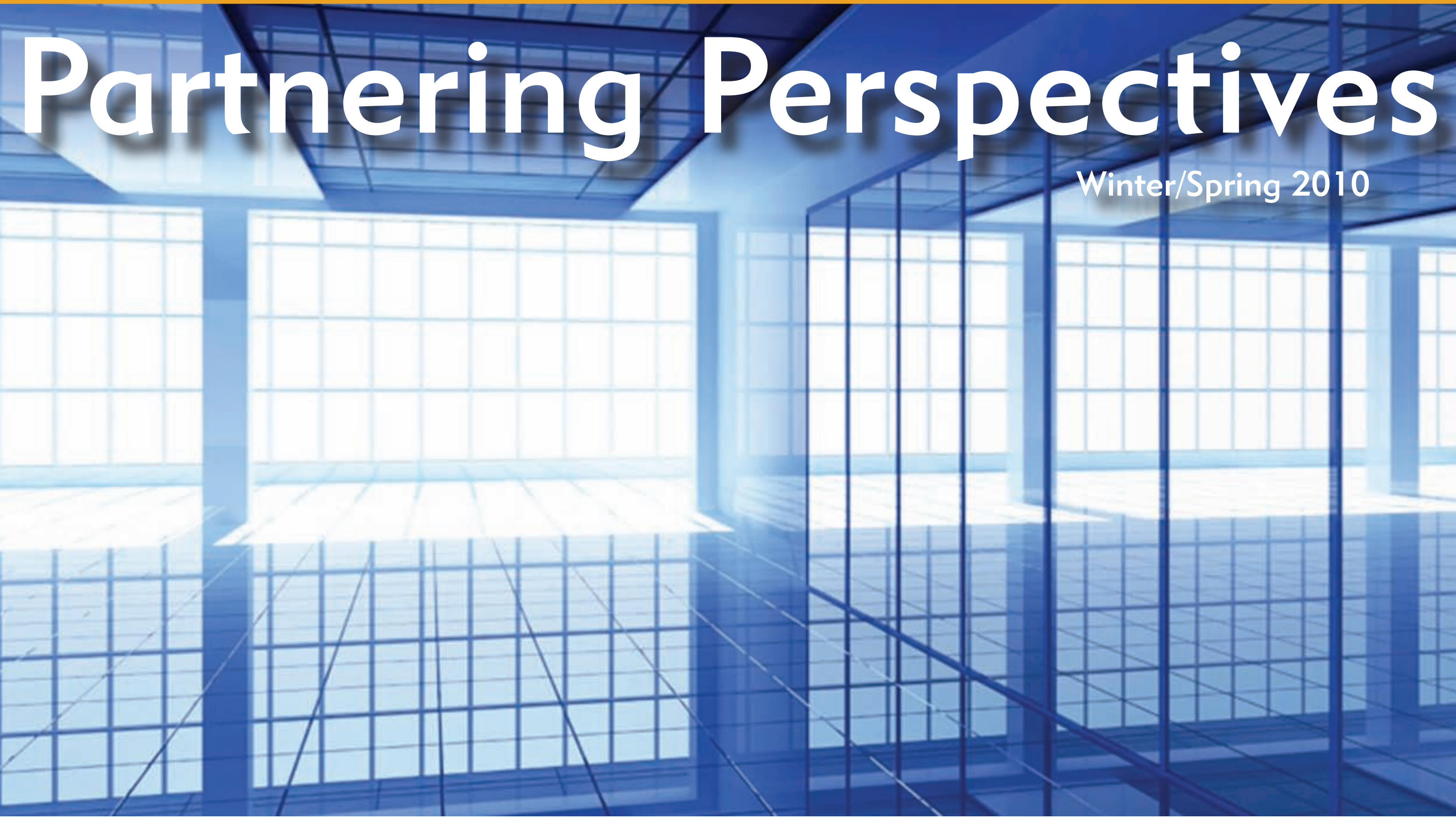
Insights from Inside and Outside the Corporate Law Department

Partnering Perspectives



Winter/Spring 2010

SUTHERLAND

Supplement to *ACC Docket*

From the Editor

Expanding the Discussion

This second issue of Partnering Perspectives continues our editorial goal of providing an exchange of ideas across the inside and outside counsel relationship. We have resumed some conversations started in the first issue and started new conversations. Client service is one topic frequently talked about by both inside and outside counsel. Inside counsel deserves top client service, and outside counsel wants to provide the best possible service.

Recently, a number of in-house counsel graciously took the time to discuss with outside lawyers what they consider most important in client service. The findings are shared in the article, "Insights from a Panel Discussion on Client Service." As a former in-house lawyer, I found the discussion to be a helpful reminder of how we can best ensure that clients get the superlative service they deserve. The points on client service can also be applied by inside counsel to interactions with internal clients. We can see their application in the article, "SOX Certifications: 10 Tips for Good Housekeeping."

We are interested in knowing what is on your mind and addressing your questions. A newly added section, Vantage Viewpoints, provides a forum for outside and inside counsel to answer readers' questions. If you need some information from both sides of the legal world, send your question to partneringperspectives@sutherland.com.

I welcome your feedback and suggestions at deb.heilizer@sutherland.com.

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Partnering Perspectives is published quarterly by Sutherland Asbill & Brennan LLP to provide an exchange of ideas across the inside and outside counsel relationship. To receive a complimentary subscription, send name and mailing address to partneringperspectives@sutherland.com.

ABOUT SUTHERLAND

Sutherland Asbill & Brennan LLP is a law firm with global reach known for solving challenging business problems and resolving sophisticated legal issues for many of the world's largest companies. Founded in 1924, the firm handles matters throughout the United States and worldwide. Seven major practice areas—corporate, energy and environmental, financial services, intellectual property, litigation, real estate, and tax—provide the framework for an extensive range of focus areas, allowing Sutherland attorneys to serve a diverse client base that ranges from small and medium-sized start-up businesses to a significant number of Fortune 100 companies.

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SOX Certifications

10 Tips for Good Housekeeping

By Cynthia Krus and Amelia Toy Rudolph

SOX certifications continue to become more rather than less important to companies and the executives who sign them. If a material weakness must be disclosed, the company may be required to engage in budget-busting corrective measures. Executives and the companies they serve face potential financial, regulatory and litigation exposure resulting from "signing on the dotted line." Finally, SOX certification procedures and controls have become a critical part of standard due diligence measures. For example, companies are commonly asked to represent and warrant satisfaction of SOX requirements in a securities offering, lending arrangement or a business combination.

How then does a company ensure that its SOX certification procedures are fresh, well documented and consistently followed? Here are 10 tips to facilitate a vigorous and effective SOX certification process. These considerations should be tailored to a company's particular facts and circumstances; there is no "one size fits all" process for SOX certifications.

1. Don't rush the process.

Taking enough time for meaningful engagement, oversight and input from the certifying executives is critical. The certifying executives are personally responsible for the certified reports, and they should be afforded enough time to read the reports, understand what they are certifying, and be comfortable with the process. Among other things, they should

- Receive regular reports from those within the company most closely involved in preparing the report;
- Have a meaningful opportunity to ask questions of those individuals;
- Consult legal counsel, external auditors and other professionals; and
- Make revisions to the report as appropriate.

Legal or other personnel can assist the certifying executives in these efforts by arranging for disclosure committee meetings with the certifying executives to outline the process, to review any issues that may have arisen during the process, and, at the end, to conclude and evaluate the process.

2. Build on current best practices.

It is not necessary to reinvent the wheel. The SOX certification process, however, has been in place for over five years. Companies need to avoid complacency and thoroughly review their process to ensure that it still reflects the company's business. If lines of business have been acquired or disposed of, or if planned expansions or product areas have been successful, the review process may need to be adjusted. Ideally, a review of existing processes will enable companies to decide whether particular practices have worked or not.

SOX Certifications

Sections 302 and 906 of the Sarbanes-Oxley Act of 2002 (SOX) require certain executives—at a minimum, the CEO and CFO—to certify that the annual or quarterly report has been reviewed by the executive, is accurate in all material respects, and that the financial information is fairly presented, among other things. The topics covered by these certifications include:

- The certifying executives' review of the report;
- Material accuracy of the report;
- Fair presentation of the financial information contained in the report;
- Effective disclosure controls and procedures; and
- Significant deficiencies or changes in internal controls over accounting and financial reporting.

The format of and language to be included in these certifications must comply with SEC rules and regulations and may not be varied.

In addition, the review process may be enhanced by taking note of industry developments. Companies can use such a review to augment existing, effective procedures or to integrate existing procedures into a new process.

3. Stick to a schedule.

In establishing a schedule, it is helpful to work backwards from the filing date to determine which actions will need to be taken, by when and by whom. Once the schedule has been established, stick to it. Companies should build in time for potential follow-up work and internal and external quality control, which should include review and input by outside professionals. To enhance a meaningful process, allow enough time for real input. In this regard, the coordinator for the process should have the authority to manage the process and to ensure compliance with the process and timeline.

4. Engage and involve the certifying executives.

Provide for a regular flow of information to the certifying executives, including regular meetings with lower level officers to engage the certifying executives in the report preparation process and to educate the certifying executives with respect to the key judgments being made.

5. Engage the audit committee and board of directors.

The board of directors and audit committee should be informed about the main decisions involving the report being certified, should be given an opportunity to review the contents of the report, and should have oversight of the effectiveness of the company's internal controls and confirm their adequacy. The audit committee also should be given an opportunity to decide how to have information presented in the certified reports, including the form of the information (such as graphs or tables) and the amount of detail included. Companies should ensure that the audit committee receives reports throughout the course of the year on issues that arise and how the issues were resolved. In addition, time should be set aside at each audit committee meeting to discuss the review of internal controls. As a result, to the extent that issues arise, the audit committee already should be up to speed, which is essential to a swift resolution of the issues.

6. Review disclosure committee process.

The U.S. Securities and Exchange Commission (SEC) expects companies to develop a process for reviewing and evaluating their disclosure controls and procedures according to their particular business and internal management and supervisory practices. A disclosure committee is now a standard component of this process. Such a committee may be formal or informal, but its purpose should be to consider disclosure obligations and evaluate the materiality of potential disclosures on a timely basis. At least once per quarter, the disclosure committee should report to senior management, including the certifying executives. In this regard, the disclosure committee and disclosure coordinator can serve as "air traffic controller" for the process. If issues arise, the committee or coordinator can help drive the process and solutions in a timely manner. Without an "air traffic controller," the process may go off kilter.

7. Consider supplemental or subcertifications.

Many companies have implemented a subcertification process, calling upon lower level employees providing information for the reports to certify up the chain of command that they have assessed the disclosure controls and/or internal controls within their area of responsibility and that those controls for which they are responsible are operating effectively. In turn, the certifying executives rely upon these subcertifications as part of their own certification process. Subcertifications, if used, should be carefully crafted—not merely cookie-cutter reproductions of the ultimate SOX certifications.

To be meaningful, subcertifications should be narrow in scope and tailored to the lower level employee's area of personal knowledge and accountability. It may also be prudent to educate the employees being asked to sign these subcertifications how they fit into the company's public reporting obligations, how they will be relied upon, what repercussions could follow from a false subcertification signed in bad faith, and the importance of speaking up promptly if the employee believes that a disclosure or internal control is not operating effectively. If the employee does not understand the process or his or her specific function within the process, the employee may overreach and assume a greater role in the subcertifications than is appropriate for his or her specific area of responsibility, possibly disrupting the certification process rather than streamlining it.

8. Document the process.

A careful and thorough process, once established and followed, should be documented for the record. In the unfortunate event that a misstatement or omission is identified in a report for which SOX certifications have been provided, the existence of a solid certification process can prove very beneficial. To the extent that issues arise in the process, there should be a documented process for addressing the issues, including a process for reporting issues to senior executives and the audit committee and a process for resolving issues.

9. Review the certification process at least annually.

A process may work well on paper but fail in practice. Changing circumstances may also call for adjustments to the process. Companies should evaluate their certification processes regularly to ensure that they continue to be effective, identify areas for possible improvement and provide a solid foundation for the certifications. The certification process must remain fluid to match the changing business and operations of the company and market environment.

10. If there is a problem, elevate it quickly.

If a problem is discovered during the preparation of the periodic report, it should be elevated quickly to the certifying executives and, depending upon the facts and circumstances, to the audit committee, legal counsel and/or external auditors. The most significant issues should be elevated to the board of directors. The resolution of the problem should also be documented.

A careful, thorough and diligent certification process, if followed consistently for each periodic report, can play an important role in establishing the necessary "tone at the top" for a corporate culture of transparency and accurate public reporting.

Cynthia Krus serves as the Co-Practice Group Leader of Sutherland's Corporate Practice Group. She advises public company clients on a broad range of corporate and securities matters, such as SOX, corporate governance, disclosure, executive compensation and shareholder matters. She is also the author of the Corporate Secretary's Answer Book. Amelia Toy Rudolph is a member of Sutherland's Litigation Practice Group and has more than 15 years of trial experience in complex business litigation, with particular emphasis on accounting and financial issues.

Insights from a Panel Discussion

By Jack Minnear and Caroline Placey

As outside counsel, we operate under our own assumptions about what it means to partner with and provide first-rate service to clients. But, the best judges are the clients themselves. To help us understand better what partnership and first-rate client service mean to inside counsel, we asked three in-house lawyers to provide us their perspectives at a panel discussion on December 9, 2009. The participants were Jerry Liu (Senior Patent Counsel at ARRIS Group, Inc.), Cheryl Tubach (Chief Intellectual Property Counsel at J.M. Huber Corporation), and Bernard Zidar (Chief Intellectual Property Counsel at McKesson Provider Technologies). Each participant conveyed a unique perspective drawn from his or her own career experiences, but the panelists shared a common view about three characteristics of an effective and reliable outside counsel partnership: good communication, attention to budget, and timeliness.

Listening and Responding

Good communication is key to any successful business relationship—including the relationship between inside and outside counsel. And, of course, the first key to good communication is listening. Only by listening can outside counsel clearly understand expectations regarding deliverables, deadlines and budgets. As a project progresses, successful outside counsel will initiate conversation to ensure that those expectations are being met and have not changed. This is especially true when the outside lawyer is taking on a project beyond the scope of a previous representation.

While the views of inside counsel vary on a number of subjects, one concern is nearly universal: inside counsel needs to be able to contact outside counsel easily. A clear point of contact for inside counsel should be given. If it is necessary to have multiple points of contact, outside counsel should identify the best contacts for specific issues. Also, outside counsel should make a point of learning the proper contacts at the corporation. In some circumstances, inside counsel may want outside counsel to directly conduct businesspeople at the corporation on issues. In other circumstances, this may be strongly disfavored.

Clients need straightforward advice delivered in a useful format. Outside counsel's advice should be practical and understandable. Effective outside counsel think about issues and risks from the client's perspective and make clear recommendations by identifying and assessing the risks of different approaches. Clients want to understand the recommendations and the reasons for them without having to draw their own conclusions from overly hedged advice.

on Client Service

In other words, outside lawyers should give their in-house contacts confidence that they are "in it together." However, this does not mean outside lawyers should simply parrot back what they think their clients want to hear. If outside counsel thinks the client is going down the wrong path, most inside counsel want the benefit of the outside counsel's opinion. Providing alternative recommendations is particularly helpful. Of course, inside counsel makes the final decision. Outside counsel also should keep in mind that the in-house contacts usually have unique information and a better perspective on corporate goals. Therefore, a decision that may initially seem counterintuitive from the outside may in fact best serve the needs of the client.

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Be Budget Conscious

One of the key metrics by which corporate legal departments are judged by their management is their ability to operate efficiently and within budget. The people to whom in-house lawyers report often are highly focused on the financial bottom line. This requires in-house counsel to spend a significant amount of time forecasting and tracking expenses. Effective outside counsel help the client by keeping an eye on the client's budgetary concerns.

Budget surprises are not good for inside or outside lawyers. It is important for both to be aware of the assumptions that inform the budget for a particular project. If a project is unavoidably going over budget, outside counsel should notify the client as soon as possible. This allows the client to accommodate the overage or refocus outside counsel's priorities.

Time is money, especially in the legal world, and this influences the client's bottom line. Inside lawyers have the best perspective on what initiatives warrant top priority. Inside counsel not only cares about the aggregate amount of a law firm's bills but also that the money is being spent in the right places. Outside counsel should learn how the client prioritizes projects and make sure not to spend excessive time on low priority projects. Good communication can considerably help in this area.

Dealing with law firm bills often consumes a much larger percentage of inside counsel's time than outside lawyers assume. Outside counsel can ease the load of inside counsel by providing invoices that clearly describe the work performed. Outside counsel will benefit as much as the client: clear and detailed invoices usually can be processed more quickly than invoices with vaguely described time entries.

Communicating by E-mail

It is important for outside lawyers to consider what means of communication is the most appropriate for a particular client and for a particular message. In-house lawyers have different preferences in this regard, and it is important for outside lawyers to learn what works best in a given client relationship.

As most clients have a full e-mail inbox, it is important that outside counsel's e-mails are written to convey information as clearly and efficiently as possible. Outside counsel can help inside counsel prioritize the importance of an e-mail message by clearly stating what is needed and by when in the subject line. An empty subject line or "Re: X Corp. v. Y, Inc." may not be helpful.

E-mail may not be the best way to communicate all information. For example, if outside counsel has a difficult message to deliver to inside counsel, it is often better to pick up the telephone. E-mail can read differently than intended by the writer. Additionally, inside counsel may take the e-mail as a sign that the setback is not that important to the outside lawyer.

Beat the Clock

Lack of timeliness by outside counsel creates enormous headaches for inside counsel. In-house lawyers often seek advice or work product from outside counsel in response to queries they have received from their own internal clients. By delivering on or ahead of schedule, outside counsel helps inside counsel make good on promises. Outside counsel should never assume that inside counsel will be free to drop other work and turn to a project at the last minute.

While the first goal always should be to deliver reliable advice and work product in a timely fashion, deadlines should never pass without explanation. If a project is running late because the scope of the project turned out to be larger than expected, outside counsel should communicate this to inside counsel as early as possible. Outside counsel's communications about deadlines enables the client to make informed judgments and adjust schedules as necessary.

Understand the Client

Outside lawyers are fortunate when inside counsel looks at them as an extension of the corporate legal department, and, as outside counsel, we should work to live up to that. Outside counsel acts as an extension of the department by understanding the client's strategic goals and working hand in hand with inside counsel to achieve them. There are numerous opportunities, formal and informal, through which we can make sure we are living up to expectations. The bottom line is that better understanding of the client equals better client service.

In-house lawyers are sophisticated consumers of legal services who retain outside firms that help them meet the needs and expectations of their own internal clients. Delivering effective and reliable advice and work product is a baseline expectation, not the end of the story. By maintaining clear channels of communication and delivering work product in a timely and efficient way, we can provide the level of service our clients expect and deserve.

Delivering effective and reliable advice and work product is a baseline expectation, not the end of the story.

Jack Minnear is a partner in Sutherland's Intellectual Property Practice Group, where he focuses his practice primarily on patent infringement, trade secret and antitrust matters. Earlier in his career, Jack served as inside counsel at Gemstar-TV Guide International, Inc., where he attained the position of Vice President of Legal Affairs. Caroline Placey is a member of Sutherland's Intellectual Property Practice Group and focuses primarily on IP litigation.

Doing a Deal from the Inside Out

Preparing a Deal from the Seller's Perspective

Second in a Series

By B. Scott Burton

The first article in this series emphasized the need to build an integrated buy-side team of outside and inside counsel early on in a transaction to

- Ensure that adequate and knowledgeable resources are "at the ready" during the transaction process;
- Allow team members to develop their individual roles in the collaborative mission;
- Advise the client with respect to structuring the transaction in accordance with strategic imperatives; and
- Ensure that the client is nimble enough to execute as much of the transaction as possible on the terms.

These needs are even more pronounced when the client intends to engage in sale transactions. Advance planning by the seller gives substantial advantage in managing the sale process and concluding a successful negotiation. Effective collaboration between inside and outside counsel can be a tremendous asset in this endeavor.

Early Preparation and Education

Preparing for the sale of a business or business unit entails a plethora of legal issues that are best identified and dealt with up front. However, because many clients underestimate the scope of the lawyer's job in successfully completing a transaction, lawyers often are brought in late in the process. Alas, many think of the lawyer's job as "papering the deal" after the parties have settled the financial and other basic terms (and sometimes even after confidentiality agreements, banker engagement letters or letters of intent have been executed). By waiting to engage lawyers until these key terms have been decided, the seller forgoes a valuable opportunity to shape the transaction.

Many outside counsel will assist (often at no charge) in presenting a seminar for the internal lawyers and business leaders on the nuts and bolts of the mergers and acquisitions process.

So how does one "prepare to prepare" and educate the internal business client about the role of counsel in the sale process? Unfortunately, there are few shortcuts. The good news is that inside counsel usually can be successful in educating the business client by presenting an internal seminar. Many outside counsel will assist (often at no charge) in presenting seminars for the internal lawyers and business leaders on the nuts and bolts of the mergers and acquisitions process. A successful seminar benefits all involved:

- Inside counsel gains more detailed knowledge about deals and the capabilities of outside counsel;
- Outside counsel learns more about the client's business and the personalities populating the business;
- Business leaders are provided with an educational opportunity on transaction issues;
- Inside and outside counsel demonstrate to the business client that they are invested in the client's success; and
- Inside and outside counsel are given an early exercise in collaboration.

Transaction Mapping

Once a decision to sell a business has been made, the successful marketing and eventual sale of that business will, in large part, turn on the structure of the transaction and available information about the business to be sold. Thoughtful inside/outside counsel collaboration can be critical to produce a superior effort. Outside counsel brings experience with similar transactions to mapping out the structure of the proposed sale, identifying issues with respect to such structures and assisting in developing solutions, identifying tasks and providing resources to complete those tasks that are not handled in-house. Concurrently, inside counsel excels at monitoring compliance with the business goals and identifying precedent transactions.

Together, inside and outside counsel can work to plan and identify the structure of the proposed sale, the attributes of the sales process that will influence the seller during the process, the internal resources that will be impacted (for example, human resources, information technology, sourcing), the expected timing, and steps to closing. Working in concert, a viable transaction map can be designed to assist management in both executing the deal process and in setting expectations for other constituencies such as the board of directors.

Additional Areas of Collaboration

To increase efficiency, deal management and knowledge management, inside and outside counsel should consider working together on the actions listed below.

- Work out the terms of confidentiality agreements and proposed responses to buyers. Issues to be discussed may include: what is considered confidential information; how long the protections should last; if there should be employee solicitation restrictions and, if so, what should those terms be; and how should the buyer's advisors be covered.
- Negotiate the terms of various engagement letters for investment bankers, accountants and other advisors.
- Put in place retention packages for key personnel in the target or the seller.
- Review "deal books" and other materials prepared to market the target for accuracy and potential legal issues (e.g., issues that could impact any antitrust concerns).
- Prepare and review materials to keep the board and/or other constituencies.
- Negotiate the transaction agreements, and the schedules, exhibits, etc., that are necessary in connection with these agreements.

Presale Self-Diligence

In this author's view, few things are as crucial to the seller as comprehensive sell-side due diligence. Nothing evaporates a seller's leverage and credibility than a "surprise" discovered by the potential buyer. Such information may influence transaction structure, and negative information can significantly erode economic value and waste resources. It is axiomatic that the more the seller knows about the target being sold, the greater advantage the seller possesses. Nevertheless, data rooms often become depositories of information that many sellers first review at the same time as potential buyers. It can be difficult to convince a client to incur the time and expense of a pre-review. But if counsel has previously discussed this issue with the client (perhaps in an internal seminar as discussed above), the client can make an educated decision about data review.

The seller self-assessment process is an exercise where the value of an effective collaboration between inside and outside counsel will almost certainly be realized. When properly executed, this process

- Provides a detailed assessment of the target's condition.
- Diagnoses and corrects problems that can be readily cured.
- Assesses problems that are not readily cured that may be discovered and be of significance to the potential purchaser. (Often, even if a particular issue is not easily remedied, assessing it early and proposing possible solutions for the buyer preempts future areas of potential friction and preserves the seller's credibility.)

- Allows for possible changes in the transaction structure, when compelled by the findings, before such items interrupt the negotiations with a buyer.
- Identifies personnel, contractual relationships, assets or processes that may be crucial to the target or that need to be retained by the buyer post closing.
- Provides an assessment of the services needed and the resources that may be required to provide those services in cases where transition services, integration services or other post-closing relationships with the buyer will continue after closing.

The self-assessment process and (presumably concurrent) transaction structure efforts act as simultaneous equations to produce a successful deal formula. The self-assessment process maximizes the collective efforts of counsel by melding the abundant resources and industry-specific deal experience provided by outside counsel with inside counsel's deep knowledge of the selling organization, the target, the business goals and importantly, the people accountable for those business goals. From the seller's perspective, effective self-assessment collaboration provides a foundation on which to build a strong deal negotiation and execution team. With the organizational knowledge and tactical issues provided by the process, the seller's team can effectively put the target in the best light and be prepared for battle with the buyer.

The self-assessment process maximizes the collective efforts of counsel by melding the abundant resources and industry-specific deal experience provided by outside counsel with inside counsel's deep knowledge of the selling organization, the target, the business goals and importantly, the people accountable for those business goals.

Controlling the Process

The seller's process is a huge undertaking for an entire business. However, assuming a situation where the bid for the target is not a sudden pressurized initiative by an uninvited buyer, the seller can control the process, at least at the early stages. Undertaking efforts to maximize collaboration at the earliest stages maximizes the chances for the seller's success. In essence, early collaboration becomes an important practice and preparation for the "big game."

The next article in this series will discuss the tricks and traps of transition services.

B. Scott Burton is a member of Sutherland's Corporate Practice Group. He was the former Corporate General Counsel for ING America Insurance Holdings, Inc., and has extensive experience handling corporate mergers and acquisitions.

Vantage Viewpoints

Inside and Outside Counsel Answer Readers' Questions

By Michael Lacek and Neil Lang

In this issue's Vantage Viewpoints, Michael Lacek, in-house counsel at MetLife, and Neil Lang, partner in Sutherland's Litigation Practice Group, answer questions about internal investigations. Send your questions for the Vantage Viewpoints section to partneringperspectives@sutherland.com.

Why do I need outside counsel for internal investigations?

The short answer to the question is you don't. As nice as it would be to suggest that outside counsel is an essential part of any internal investigation, the simple fact is that in many, if not most situations, inside counsel can effectively conduct or direct internal inquiries. Indeed, internal investigations that do not involve senior management are often performed better and more economically by in-house personnel.

Many larger companies have well established and highly competent internal audit and compliance examiners who can effectively and efficiently investigate a wide range of issues relating to operations, regulatory matters and certain types of financial issues among others. Other significant advantages of internal investigations conducted by internal counsel are the knowledge and familiarity that company employees have with the business, the persons being interviewed, the recordkeeping system, the institution's culture, access to management, and how these aspects may have impacted any potential issues. Last, but not least, it is generally easier to control out of pocket costs when inquiries are conducted internally.

How does outside counsel add value?

Although in-house counsel may be more cost effective, the exclusive use of company personnel can create disadvantages for a company, particularly if a government investigation or shareholder litigation is involved. Because of their position in the company, in-house attorneys frequently perform both legal and business functions. In-house attorneys may also have been consulted as to the legality of the conduct at issue. And, even if in-house attorneys were not directly involved in the alleged activities at issue, they report to and their performance is evaluated by the executive team whose conduct may be implicated. Internally directed investigations may also require internal auditors to investigate conduct that may have been under their jurisdiction. These potential conflicts are likely to draw skepticism from government agencies and private parties as to the credibility of the investigation's findings.

Although the out of pocket costs of having outside counsel undertake an investigation will be greater initially, if allegations or government investigations involve senior management or serious misconduct, the benefits of retaining outside counsel will usually outweigh the costs.

In addition, there may be practical obstacles to conducting internal investigations in-house. Investigations may involve colleagues and acquaintances within the company and are time consuming and labor intensive. It may also be difficult for inside counsel and auditors to effectively balance their ongoing ordinary responsibilities with the demands of a significant internal inquiry. Furthermore, communications between a special committee and internal auditors likely will not be considered privileged,[1] and the dual responsibilities of in-house counsel can weaken claims of attorney-client privilege for communications between management, a special or other board committee, and in-house counsel.[2]

"Things have been going much more smoothly since we started riding with representation."

In contrast, outside counsel hired to conduct an inquiry will not share in-house counsel's potential conflicts of interest, will most likely have greater experience with internal investigations, and be adept at responding to shareholder claims or agency investigations relating to the subject of the inquiry. Communications with outside counsel also generally receive greater protection as to privilege, particularly when outside counsel is retained in the context of the corporation seeking legal advice.[3] Thus, although the out of pocket costs of having outside counsel undertake an investigation will be greater initially, if allegations or government investigations involve senior management or serious misconduct, the benefits of retaining outside counsel will usually outweigh the costs of retaining outside counsel.

Choosing outside counsel to conduct the investigation, however, does not completely foreclose the involvement of in-house counsel. Because of their experience with the company, in-house lawyers can and ordinarily should play an important role in the investigation. In-house counsel can ensure, for example, that outside counsel has ready access to the documents, personnel, technology, and other resources critical to the completion of the inquiry. In-house counsel can also be invaluable in addressing issues relating to company culture and organizational structure, as well as in saving time and resources by procuring the buy-in from important business and management personnel.

Endnotes

1. The self-evaluative privilege is not widely recognized. States that recognize the privilege via statute generally limit its application to specific situations, such as medical peer reviews.
2. *Se. Penn. Transp. Auth. v. CaremarkPCS Health, L.P.*, 254 F.R.D. 253, 258 (E.D. Pa. 2008). "The 'primary purpose' of the communication at issue must be 'to gain or provide legal assistance' for the privilege to apply due to the fact that 'in-house counsel may play a dual role of legal advisor and business advisor.'" Citation omitted.
3. See, e.g., *United States v. ChevronTexaco Corp.*, 241 F. Supp. 2d 1065, 1073. "Communications between a client and its outside counsel are presumed to be made for the purpose of obtaining legal advice." Citation omitted.

Employment Tax Withholding Compliance

Sorting Through a Patchwork of Laws

By Jeff Friedman and Charlie Kearns

Nearly all large companies have workers traveling throughout the country. These traveling employees create a state and local tax obligation for companies—nonresident personal income tax withholding obligations—with which even the largest and most sophisticated companies struggle to achieve adequate compliance. Because a failure to accurately withhold state income tax on traveling executives will directly impact the employees' personal income tax obligations, companies' executive teams often are directly impacted by this tax compliance challenge.

Compliance Obstacles

States' withholding tax laws are a patchwork of laws, making full compliance difficult for multistate companies. Many states have low thresholds for determining when a company must begin withholding income tax on a traveling employee. For example, New York State requires employers to withhold tax from the wages of nonresident employees that work in the state after only 14 work days.

Ambiguous rules are another obstacle to companies trying to comply with nonresident withholding tax laws. For example, many states adopt a dollar threshold as opposed to a days worked threshold. Dollar thresholds create uncertainty for employers. It may be difficult for employees to estimate the amount of income that will be earned in a year, a necessary metric in determining whether to activate withholding in a state, much less attribute that income to a particular day. Companies struggle with creating systems and processes that can accurately capture and record the necessary data to report nonresident withholding tax.

Proposals to Simplify

To modernize and simplify state withholding tax compliance and enforcement, two competing proposals are being offered. Last year, with the support of various employers and trade groups, federal legislation H.R. 2110, the Mobile Workforce State Income Tax Fairness and Simplification Act, was introduced. If signed into law, H.R. 2110 would establish a national framework for states to require an employer to withhold tax from a nonresident employee's wage or nonwage payments attributable to service performed in a state. Partially in response to this legislation, the states, working through the Multistate Tax Commission (MTC), are developing a model withholding state statute. The model statute is an attempt to encourage states to voluntarily adopt uniform withholding tax rules.

Multistate Tax Commission

MTC is an intergovernmental state tax agency that, among other things, drafts model state tax laws. For more information on the MTC, visit www.mtc.gov.

Although the MTC draft and H.R. 2110 are topically similar, they contain very different provisions. Each proposal adopts a threshold number of days that a nonresident employee must work in a state before the employer must withhold personal income tax. Wages earned for service below the respective thresholds are excluded from withholding. H.R. 2110 requires in-state service of 30 days during a calendar year. The MTC draft requires only 20 days before withholding is required.

Both proposals provide the same significant benefit—nonresident wages excluded from withholding are also excluded from the nonresident employee's personal income tax. As such, not only is the employer relieved of withholding obligations, but also the employee is relieved from filing income tax returns in potentially numerous states. Although the employee's tax liability may not increase due to credits for taxes paid on the resident state's return, the employee is spared the administrative headache of filing returns in numerous states. For this reason, making employees' income tax filing thresholds identical to employers' withholding tax thresholds is a crucial element in crafting a national framework for taxing mobile employees.

Matters for Consideration

Because H.R. 2110 and the MTC proposal both necessitate counting days for each involved employee, it is important to determine what constitutes a "day" for purposes of the respective thresholds. The MTC draft provides that any portion of a day worked in a state equals a full day towards the 20-day threshold. In contrast, the federal legislation adopts a much more reasonable "preponderance" of a day test to allocate wages to a state.

Finally, it is notable that the current MTC draft contains a number of exceptions to the 20-day safe harbor. Most notably, its coverage excludes certain "highly compensated employees" and "key employees." Although the exclusions reduce the number of employees obligated to withhold nonresident income tax, these carve-outs significantly undermine the simplification of the MTC proposal. H.R. 2110 does not contain any similar limitations and, therefore, may ultimately be simpler to implement.

The MTC draft will likely be expedited for approval in light of the looming federal bill and could be finalized as early as March 2010 for consideration at the MTC's July 2010 meeting. The passage of H.R. 2110 is difficult to predict. In the meantime, employers may wish to consider developing and putting in place withholding tax policies and communicating those policies to employees.

H.R. 2110	MTC Proposal
Supported by various employers and trade groups	Developed by the states working through MTC
National framework for states to require an employer to withhold tax from a nonresident employee's wage or nonwage payments attributable to service performed in a state	Model withholding state statute to encourage states to voluntarily adopt uniform withholding tax rules
Nonresident wages excluded from withholding are also excluded from the nonresident employee's personal income tax	Nonresident wages excluded from withholding are also excluded from the nonresident employee's personal income tax
30 day threshold	20 day threshold
Preponderance of a day test to allocate wages to a state	Any portion of a day worked in a state equals a full day toward the threshold
No similar exclusions	Contains exceptions for highly compensated employees and key employees to the 20-day safe harbor
Difficult to predict passage	Likely to be expedited for approval and could be finalized as early as March 2010

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