Knoxville Bar Association

THE CONSIGLIERE

Fall 2015 Vol. 10, No. 1

Let us know your ideas and suggestions for *THE CONSIGLIERE:*

- Call or email Paul E. Wehmeier at 546-7000 or Marsha Wilson at 522-6522 or mwilson@knoxbar.org.
- Submit an article for consideration.
- Give us your feedback on this newsletter.
- Tell us about CLE topics or networking events you would like the Section to sponsor.

From the Co-Chairs

FROM THE CO-CHAIRS

By: David Headrick
LandAir Surveying Company, Inc.
Corporate Counsel Co-Chair

U.S. DOJ's New Policy:
Individual Accountability for Corporate Wrongdoing

The U.S. Department of Justice is getting serious about fighting corporate fraud and misconduct by announcing a new policy whereby they intend to hold individuals in companies personally accountable for their actions. Federal Deputy Attorney General Sally Yates issued a memorandum on September 9, 2015 entitled, "Individual Accountability for Corporate Wrongdoing." The Memorandum is addressed to numerous government agencies and divisions, including the FBI, Civil and Criminal Attorneys General, and Antitrust and Tax Divisions.

The Memorandum cites numerous reasons for this new policy, including that: it deters future illegal activity, it incentivizes changes in corporate behavior, it ensures that the proper parties are held responsible for their actions, and it promotes the public's confidence in our justice system.

Here are the main points of the policy:

1. To be eligible for any cooperation credit, corporations must provide to the Department all relevant facts about the individuals involved in corporate misconduct.

2. Both criminal and civil corporate investigations should focus on individuals from the inception of the investigation.

3. Criminal and civil attorneys handling corporate investigations should be in routine communication with one another.

4. Absent extraordinary circumstances, no corporate resolution will provide protection from criminal or civil liability for any individuals.

5. Corporate cases should not be resolved without a clear plan to resolve related individual cases before the statute of limitations expires and declinations as to individuals in such cases must be memorialized.

6. Civil attorneys should consistently focus on individuals as well as the company and evaluate whether to bring suit against an individual based on considerations beyond that individual's ability to pay.

Internal, independent investigations by the company are strongly encouraged by this new policy. Since the Department will be looking at the nature and scope of the company's investigation, it behooves the company to be diligent and thorough. Conditional agreements between the company and the Department could be jeopardized, if they determine that the company did not provide all relevant information.

This also begs the question: What evidence is reasonably within a company's control? Often, evidence of culpability is not set forth in writing or communicated to corporate counsel. There will certainly be a new standard formed about what must be done to obtain all relevant information that is reasonably available.

There is also the matter of attorney-client privilege. No reference to the attorney-client privilege appears in the policy. However, it stands to reason that ethical issues may become more frequent as corporate counsel dispense advice to corporate officers who may have subsequent individual culpability. Certainly, subject matter relevant to good or bad faith will be part of that privilege, but can all such information be withheld from the initial disclosure of relevant fact to the Department?

All major companies will want to visit their insurance policies and limits. As the Department undertakes additional investigations into individual culpability, the need for insurance defense will also rise. Thus, companies will want to look at their policy limits in light of perceived risk.

Also, insurance policies often contain exclusions that preclude coverage for criminal and fraudulent conduct. The Department's new policy will ensure that these determinations will more frequently be made. So, the company will be at greater risk and should visit this language to determine how to minimize the risk. Similarly, the officers themselves will be denied insurance defense by the company, so they should consider Side A/DIC policies in light of perceived risk.

At any rate, practical enforcement of this new policy may be difficult, but it still certainly brings up new issues for the corporate counsel to consider.

Sources:

- U.S. Department of Justice Memorandum "Individual Accountability for Corporate Wrongdoing," Issued Sep. 9, 2015 (located at http://www.justice.gov/dag/file/769036/download).
- Thinking About the Justice Department's New Policy Directive Targeting Corporate Executives by Kevin LaCroix on September 13, 2015 (located at http://www.dandodiary.com/2015/09/articles/director-and-officer-liability/thinking-about-the-justice-departments-new-policy-directive-targeting-corporate-executives/).
- DOJ Outlines New Policy Regarding White Collar Cases Against Individuals by Boyd M. Johnson III et al on September 10, 2015 (located at https://www.wilmerhale.com/pages/publicationsandnewsdetail.aspx?NewsPubId=17179879356).

Section Events

UPCOMING SECTION EVENTS

The Natural Laws and Consequences for Cyber Insecurity

Thursday, November 5, 2015
5:30 p.m. – 6:30 p.m.
Blackhorse Pub & Brewery - 4429 Kingston Pike
Matt Smith, Sword & Shield Enterprise Security
Approved for 1 Hour of Dual CLE Credit
Cost: $20 KBA Members; $30 Non-KBA Members

Our speaker will cover the common, underlying vulnerability issues and solutions found after performing numerous assessments for a range of different types of clients. The issues include those of both human and technical failings.

Register Online

Sponsored by the Corporate Counsel Section

News and Notes

NEWS AND NOTES

Special Thanks!

Thanks to all those who contributed this year to *The Consigliere*. I would like to take this opportunity to thank our regular contributors. The quality of the articles never ceases to impress. Looking toward 2016, we will certainly have room for more regular columns. If you or your firm would be interested in contributing a regular column in 2016, or if you would like to contribute an in-house counsel guest column, please let me know. Also, if there is an area of the law that you would like to see covered in 2016, we will do our best to make it happen.

The success of this section depends upon the support and participation of local corporate counsel. We are indebted to the strong leadership of our Section Chairs, Marcia Kilby and David Headrick. We are also fortunate to have Peter Brewer coordinate CLE programs and Paul Wehmeier for serving as Editor for *The Consigliere*. For 2016, I'd like to challenge you to get involved and to let us know what you want for this section. What types of CLE programs would you like to see the section sponsor? Are there specific topics and speakers you would find interesting? Please contact Marsha Wilson at mwilson@knoxbar.org (522-6522) to share your ideas.

CORPORATE COUNSEL SPOTLIGHT

By: Paul E. Wehmeier
Arnett, Draper & Hagood, LLP

Cynthia Gibson brings "business lens" approach to representation of Scripps Network Interactive, Inc.

In 2009,[1] Cynthia Gibson left a successful legal practice to become a leader in the cable industry, serving as the executive vice president and chief legal officer of Scripps Network Interactive, Inc. Upon returning to the southeast, Gibson put legal acumen and common sense business approach to work managing the legal department of one of the leading lifestyle media companies in the world. She now manages Scripps' global business

[1] Certain background information for this article was obtained from Carly Harrington, *Scripps powerhouse: Corporate attorney Gibson has business bona fides*, KNOXVILLE NEWS SENTINEL, Mar. 9, 2014, available at http://www.knoxnews.com/business/scripps-powerhouse-corporate-attorney-gibson-has.

Corporate Counsel Spotlight

and legal affairs, government affairs, external relations and internal audit departments, with staff in Knoxville, New York City, Chevy Chase, Cincinnati, London and Singapore.[2]

Gibson grew up in North Carolina, approximately 90 miles from Knoxville. She obtained her undergraduate degree from Wake Forest and received her juris doctor degree from the University of Virginia, School of Law. Thereafter, she went to work for a law firm in Cincinnati, Ohio and rose to managing partner. She attributes much of her success in the practice of law and as a corporate executive to her ability to look at legal problems through a business lens. She acquired this unique perspective from her work in litigation and her experience being a child of parents who operated a family owned businesses.

Gibson encourages in-house and outside counsel to consider the business goal when positing legal advice. She acknowledges that particular business solutions to legal problems may require an attorney to say "no." The client, however, is best served when the lawyer follows the "no" answer with the question, "what is the result you are trying to achieve?" Gibson also points out that it is important for legal counsel to present both the range of options and risk, as well as the suggested course to follow.

With respect to budding legal issues, Gibson believes that cyber security is a growing concern for businesses functioning on the internet. She notes that the cyber security threat to business is more than a simple financial threat. Companies are forced to consider how to protect customers from individuals with moral or political goals that are beyond simply gaining access to customers' personal information.

Finally, since she became chief legal officer for Scripps, Gibson has become an active member of the local bar and sought to enhance Scripps' engagement in the Knoxville Bar by hosting CLE[3] programs and engaging local, outside counsel where appropriate.

LABOR HAPPENINGS

By: Ben D. Cunningham
Kennerly Montgomery

What The NLRB Thinks About Your Employee Handbook

Do you see anything wrong with including the following provision in an employee handbook:

[2] Additional information was obtained from an interview with Ms. Gibson on August 26, 2015 and from the following pages of Scripps Network Interactive Website: *available at* (1) http://www.scrippsnetworksinteractive.com/our-company/about-us/; and (2) http://www.scrippsnetworksinteractive.com/our-company/leaders/cynthia-gibson/.

[3] Scripps Networks Interactive, Inc. hosted the Corporate Ethics & Updates: The 2015 KBA Corporate Counsel Section Annual CLE in August of this year.

"Be respectful to the company, other employees, customers, partners and competitors."

How about:

"Do not make insulting, embarrassing, hurtful or abusive comments about other company employees online and avoid the use of offensive, derogatory or prejudicial comments."

Or:

"Do not send unwanted, offensive or inappropriate e-mails."

If you did not find anything objectionable about these provisions then you are certainly not alone. However, Richard F. Griffin, Jr., General Counsel of the National Labor Relations Board, disagrees.

According to a recently released report from Mr. Griffin, all three of the above provisions are unlawful rules which an employee could "reasonably construe" to prohibit protected Section 7 activity under the National Labor Relations Act (the "Act").[4] This report is important to all employers because the Office of the General Counsel investigates unfair labor practice charges and the NLRB's Regional Directors receive their marching orders from the General Counsel when they are investigating whether a charge has merit. Thus, the report offers important guidance as to what language and policies will be viewed suspiciously and are likely to be found to interfere with employees' rights under the Act.[5] The reason the report is meaningful to all employers, not just "union shops," is that the latest trend from the NLRB has been an aggressive application of unfair labor practice charges to non-union employers based on the employer's handbook provisions.[6]

In particular, the report addresses handbook provisions on the following topics, which Mr. Griffin notes "are frequently at issue":

- Confidentiality

[4] Employees have a Section 7 right to discuss wages, hours and other terms and conditions of employment with fellow employees, as well as nonemployees.

[5] While much of the report and this article discuss handbooks, unlawful provisions can arise in any policy, rule, contract or agreement that the employer enforces or might enforce.

[6] The National Labor Relations Act covers most private-sector employers. Excluded from coverage under the NLRA are public-sector employees, agricultural and domestic workers, independent contractors, workers employed by a parent or spouse, employees of air and rail carriers covered by the Railway Labor Act and supervisors (although supervisors that have been discriminated against for refusing to violate the NLRA may be covered).

Labor Happenings:

What the NLRB Thinks About Your Employee Handbook

- Employee Conduct Toward the Company and Supervisors
- Employee Conduct Towards Fellow Employees
- Employee Interaction with Third Parties
- Rules Restricting Use of Company Logos, Copyrights and Trademarks
- Rules Restricting Photography and Recording
- Restrictions on Employees Leaving Work
- Employer Conflict of Interest Rules

The problem with the General Counsel's position regarding these topics is that, while Mr. Griffin recognizes in his memo that "most employers do not draft their employee handbooks with the object of prohibiting or restricting [protected conduct]," the NLRB's actions do not reflect this commonsense approach. Rather, the NLRB and General Counsel have taken an expansive view as to what an employee "would reasonably construe" as violating their Section 7 rights.

As an example, the NLRB has taken the position that the first provision above is "unlawfully overbroad" because employees "would reasonably construe" it to ban protected criticism or protests regarding their supervisors, management or the employer in general. According to the NLRB, "a rule that prohibits employees from engaging in disrespectful, negative, inappropriate or rude conduct towards the employer or management, absent sufficient clarification or context, will usually be found unlawful."

So what about the second provision above? On its face, this provision only applies to "other company employees" and not supervisors, managers or the employer in general; so how is it unlawful? According to the NLRB, "employees also have a right under the Act to argue and debate with each other" and the employees' speech will not lose its Section 7 protection "even if it includes intemperate, abusive and inaccurate statements." Thus, the NLRB struck down this provision as unlawful because "debate about unionization and other protected activity is often contentious and controversial" and, as a result, employees would "reasonably read a rule that bans offensive, derogatory, insulting or embarrassing comments as limiting their ability to honestly discuss such subjects." The NLRB's rationale for the two provisions above is concerning primarily because it will have a direct impact on how broadly employers draft anti-harassment/ employee conduct provisions in the future.

Additional highlights (or lowlights depending on your point of view) that should be noted include:

- Rules Regarding Confidentiality: The report recognizes that employers have a substantial and legitimate interest in maintaining the privacy of certain business information. However, "broad prohibitions on disclosing confidential information are lawful" only as long as "they do not reference information regarding employees or anything that would reasonably be considered a term or condition of employment." As an example, a rule prohibiting employees from discussing their compensation would likely be found unlawful.

- Rules Regarding Employee Conduct toward the Company/Supervisors: While the report places special emphasis on rules which were illegal due to the fact that they prohibit employees "from engaging in disrespectful, negative, inappropriate or rude conduct towards the employer or management," the report further notes that an employee's criticism of the employer does not lose the protection of the Act because the criticism is false or defamatory. Thus, according to the General Counsel, a rule is unlawful unless it specifies that only maliciously false statements are prohibited.

- Rules Regarding Employee Interaction with Third Parties: Mr. Griffin makes clear that employees have a right under the Act to communicate with news media, government agencies and other third parties about the terms and conditions of employment and rules "that reasonably would be read to restrict such communications are unlawful."

- Rules Restricting Use of Company Logos, Trademarks and Copyrights: The NLRB's position is that an "employer's proprietary interests are not implicated by employees' non-commercial use of a name, logo or other trademark to identify the employer in the course of Section 7 activity." Thus, a broad ban on employee use of company logos, trademarks and copyrights will generally be found overbroad.

- Also insightful, the report offers examples of lawful rules and provisions as well as a comprehensive discussion of certain handbook provisions which were drafted pursuant to an informal, bilateral NLRB settlement agreement with Wendy's International LLC.

In sum, it is worth reviewing the report and reviewing your handbook to make sure you do not have any provisions similar to the unlawful ones in the report. You may wish to rework potentially problematic provisions with the "model language" of the lawful provisions in the report. One particular takeaway from the report should be to pay attention to overly broad provisions. Any provision that is drafted broadly could be construed as applying to Section 7 activities.

Also important are the matters not discussed in the report. Reading between the lines, it appears that the General Counsel does not take issue with workplace rules regarding unlawful acts, rules prohibiting knowingly false statements, rules prohibiting disclosures of trade secrets and rules requiring employees to work during working time.[7] Also absent from the report is any clarification or guidance on what position the General Counsel will take regarding "savings language" in employee handbooks. Whether a statement in a handbook that no rules are meant or intended to violate an employees' rights under the Act

[7] Do not confuse working time with "on-duty time," "company time" or "time on the clock." Working time is the time an employee is engaged (or should be engaged) in performing their work tasks for their employer.

will protect an employer is an issue that has yet to be determined by the NLRB.

Finally, all employers are now on notice that the NLRB is actively looking at and investigating workplace rules and employee handbooks that may have a chilling effect on an employees' exercise of rights protected under the Act. Any rule-based discipline, including termination, of an employee based on a company handbook needs to be scrutinized in the context of whether the rule or provision could be construed as unlawfully broad. Employers found to be in violation can be ordered to strike any unlawful rules and to reverse any disciplinary action based upon the offending rule.[8]

TAX TIDBIT

By: Eric Butler
Woolf, McClane, Bright, Allen & Carpenter, PLLC

Third-Party Payroll Providers: Proceed with Caution

An April 2012 survey conducted by the National Small Business Association revealed that approximately 40 percent of small businesses use a third-party payroll provider for tasks ranging from handling payroll to payment of Federal employment taxes. The percentage of businesses utilizing the services of a third-party payroll provider is expected to rise exponentially in the next few years. The use of third-party payroll providers has become so popular with businesses that on March 2, 2015, the Treasury Inspector General for Tax Administration (TIGTA) issued a report entitled "*Processes Are Needed to Link Third-Party Payers and Employers to Reduce Risks Related to Employment Tax Fraud*."

Employers are required by law to withhold employment taxes from an employee's wages and submit those withheld employment taxes to the Internal Revenue Service. Many employers outsource this function by entering into a contract to authorize a third-party provider to assume some or all of the employer's Federal employment tax withholding and payment obligations. Depending on the nature of the agreement, the employer / client can essentially hire the third-party provider to withhold the employment taxes, remit the employment tax deposits to the IRS, handle the administration of benefits, and/or handle the filing of the quarterly and annual employment tax returns. The services offered by the third-party provider largely depend on the type of provider the employer / client selects.

There are four (4) basic types of third-party arrangements most commonly used by

[8] For those employers dealing with actual union activity, an unlawful rule could also be grounds for the NLRB to invalidate an election and order a re-run election giving the union another chance to unionize the workforce.

employers: (1) Payroll Service Provider (PSP); (2) Reporting Agent; (3) Section 3504 Agent; and (4) Professional Employer Organization (PEO). Of the four most common types of third-party provider arrangements, the IRS only requires Reporting Agents and Section 3504 Agents to submit an authorization form disclosing the relationship between the employer / client and the third-party provider. The IRS does not require a similar authorization to be filed for employers that use a PSP or a PEO. Further, the IRS does not require a PSP or PEO to identify the employers / clients for whom the provider is filing returns or paying employment taxes, nor does the IRS track or document the relationships between a PSP or PEO and the employer's they represent.

TIGTA performed the audit to test the IRS's effectiveness in dealing with third-party payroll providers who handle millions of dollars in employment taxes for various employers nationwide. The results of the audit are alarming to say the least. TIGTA found the IRS continues to have insufficient processes in place to combat abuses in this industry. The uptick in the PEO industry in recent years[9] has created a serious risk for many small businesses that outsource their employment tax obligations. The risk to an employer lies in the fact the employer may not be aware of filing or payment improprieties on the part of the third-party provider. This risk is much smaller when the employer uses a PSP or Reporting Agent, because the returns are filed and the employment tax paid under the employer's tax identification number. Thus, it is much easier for the employer / client to verify the tax filing and payment obligations are being met.

With the PEO arrangement, however, TIGTA noted the employer is at much greater risk of not being aware of filing or payment improprieties because the PEO aggregates the employees of multiple employers / clients and often files a single return under the PEO's tax identification number. Likewise, the PEO typically aggregates multiple payroll tax deposits for multiple employers / clients in a single bank account and remits aggregated tax deposits to the IRS for multiple employers / clients, making it impossible to trace tax deposits to a particular employer / client. TIGTA found that when a PEO fails to remit employment tax deposits to the IRS, it can be next to impossible for the Service to trace and identify which specific employer / client failed to remit its employment taxes to the IRS.

TIGTA's investigation also revealed that between fiscal years 2007 and 2012, the Department of Justice criminally prosecuted at least 24 owners of different types of third-party payers,[10] which in the aggregate had collected approximately $300 million in employment taxes from thousands of employers / clients and did not remit those funds to the IRS. Because of the impact this loss of tax revenue can have on the ever-widening tax

[9] The PEO industry has grown so rapidly there is now an organization, the National Association of Professional Employer Organizations, to represent and lobby for PEOs.

[10] A search of the Department of Justice's website for the various types of third-party payers will produce news releases discussing the multitude of ways these third-party payroll providers abuse the contractual relationship with their clients, resulting in millions of dollars in lost revenue once the schemes are uncovered.

TAX TIDBIT: Third-Party Payroll Providers: Proceed with Caution

gap, the IRS and the Department of Justice continue to place great emphasis on identifying PEOs involved in the diversion of employment taxes.

Most states, including Tennessee, have legislation to regulate third-party payroll providers. However, Congress thus far has not required the bonding of PEOs to help ensure against the massive financial losses caused when a PEO fails to remit millions of dollars in employment taxes for several tax periods. TIGTA recommended Congress enact legislation requiring PEOs to satisfy certain standards, to include producing financial statements to the IRS, requiring the owners of the PEO to submit to a background check, and requiring the PEO to post a bond of up to $1 million to cover tax losses. TIGTA also recommended the IRS implement a system to track the employers / clients using a particular PEO, which would enable the IRS to ensure each employment tax deposit can be traced to a specific employer / client. At present, the IRS does not have systems in place to make this connection, which allows unscrupulous PEOs to underreport employment taxes for several periods or years before the tax losses are discovered by the Service or the employer / client.

In response to the TIGTA audit, the IRS argued it has no authority to require certification or to further regulate PEOs. The IRS also cited to recent budgetary constraints as prohibiting the Service from establishing a compliance program to regulate and oversee third-party payroll providers. The IRS further noted in its response that in every year since 2007, it has made legislative proposals to Congress seeking to implement legislation allowing the IRS to better regulate PEOs. Recognizing the massive financial harm PEOs can cause to the U.S. tax system, Congress introduced legislation in 2011[11] to amend the Internal Revenue Code to regulate the handling of employment taxes by PEOs. The bill was re-introduced in November 2013.[12] The 2013 legislation provided for IRS certification requirements for PEOs, including financial review and reporting requirements. The proposed legislation also requires a PEO to post a bond each year, up to $1 million, to guarantee payment of employment taxes for the employer / client. To date, these legislative proposals have not been enacted by Congress.

In the recent past, there have been several instances where PEOs and other third-party payers have received funds from the employer / client to be paid over to the IRS, but the third-party provider failed to remit those employment taxes to the Service. When this occurs, it can result in millions of dollars in unpaid employment taxes being owed by multiple employers. Oftentimes the IRS is unable to detect the underpayment of the employment taxes by the third-party provider until the employment tax liabilities have risen to astronomical levels. Once the unpaid taxes are discovered, the PEOs typically shut down operations leaving the employer / client as the only source of collection for the unpaid employment taxes. With the ever increasing use of third-party payroll providers, sound business judgment now dictates companies implement a procedure for carefully monitoring third-party payroll providers to ensure employment taxes are timely and fully paid to the IRS.

Knoxville Bar Association
505 Main Street
Suite 50
Knoxville, TN 37902

Phone:
(865) 522-6522

Fax:
(865) 523-5662

E-mail Addresses:
dheadrick@lasurveying.com
mkilby@deroyal.com
ccf@lyblaw.net
mwilson@knoxbar.org
http://www.knoxbar.org

[11] H.R. 2466, *Small Business Efficiency Act of 2011*.

[12] H.R. 3581, *Small Business Efficiency Act*.