

In-House Counsel Committee Newsletter

Vol. 8, No. 1

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WELCOME FROM THE CHAIR

**(as well as a Request for Comments on
Issues Important to In-House Counsel and
Musings on the Intersection of SOx and the
Amended Sentencing Guidelines)**

Jim Moore
Chair, In-House Counsel Committee

It is with pleasure that we release the latest edition of the Newsletter for the In-House Counsel Committee of the ABA Section of Environment, Energy, and Resources. This is the first Newsletter published by our new slate of Committee officers, including our new Newsletter vice chair, David Zoll.

Welcome to new members. We extend a warm welcome to those of you receiving this Newsletter for the first time. We encourage you to learn more about, and to become involved in, our activities. The names of our new members are highlighted in the Member News section below. Tamar Cerifici, our energetic Membership vice chair, has penned a short summary of the advantages of Committee membership for this publication. Please take note of that summary. What is most important, if this Committee is going to bring value to you, is either your active participation in Committee activities or your communicating to us those issues of most interest to you so that we can

tailor our efforts appropriately in this Newsletter and programs.

Committee Officers. We are blessed with a group of experienced and dedicated officers who wish to provide the highest quality service to Committee members. A list of all Committee officers and their contact numbers follows. Please do not hesitate to call or e-mail any of us if you would like to see the Committee address a particular issue or would like to participate in a Committee activity such as the Earth Force public service program co-sponsored by the Committee and Earth Force.

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**In-House Counsel
Committee Newsletter
Vol. 8, No.1, January 2005
David F. Zoll, Editor**

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This newsletter is a publication of the ABA Section of Environment, Energy, and Resources, and reports on the activities of the committee. All persons interested in joining the Section or one of its committees should contact the Section of Environment, Energy, and Resources, American Bar Association, 321 N. Clark St., Chicago, IL 60610.



Public Service. One of the strengths of this Committee has been its Earth Force public service program. Our Public Service vice chair, Raissa Kirk, has worked exceedingly hard this fall to obtain additional funding for the program and is now looking for volunteers to work on the program in selected cities. A description of the program is included in this Newsletter.

Issues of particular interest to Section in-house counsel. In getting started this year, our Committee officers endeavored to identify issues potentially of interest to Committee members. Consequently, our efforts in developing articles for future editions of this Newsletter and in identifying programs that the Committee or Section can sponsor (either in the Spring or Fall Meetings or in conference call brown bags) are currently focused on the following issues. We (and, particularly, Carolyn Covault, Vice Chair, Programs, as well as David Zoll) would like to hear whether this list makes sense to you or, if not, how it should be modified.

- Sarbanes-Oxley/ethics issues important to in-house environmental counsel
 - Adequacy of internal controls to identify environmental issues needing to be reported
 - Reporting contingent liability matters
 - Rule 205 compliance.
- New amendments to the Sentencing Guidelines for Organizations
 - Additional requirements.
 - Effective ways of satisfying the requirements.
- Maintaining the vibrancy and effectiveness of environmental management systems despite corporate change
- Self-reporting violations
 - Is it the way to go and where are the logical limits?
 - Dealing with different jurisdictions.
- Cost-effective use of outside counsel
- Sustainability
 - How has it evolved as it relates to

corporations' and public entities' activities and programs?

- What are the developing expectations for achieving "sustainability"?
- Public Service opportunities
- A tutorial on utilizing the Data Quality Act

Please let one of us know if you have comments on the proposed list or wish to add to it.

Musing on the Intersection of the Amended Sentencing Guidelines for Organizations and Sarbanes-Oxley Internal Control Requirements. As in-house environmental, health and safety counsel, I have (as, I am sure, many of you have) been involved in counseling with regard to the legal implications of both some portions of the Sarbanes-Oxley Act (SOx) and the new Amended Sentencing Guidelines for Organizations. We have included in this Newsletter Chris Bell's fine article on the Amended Guidelines which, we hope, you will find valuable. In addition, I wanted to take this opportunity to comment on a SOx/Amended Guidelines issue that you may have addressed.

Section 404 of SOx concerns internal control reports and auditor attestation of those reports. Internal controls, therefore, are an important focus for SEC-regulated company finance departments as well as external auditors. As I understand the internal controls that are the subject of SOx 404, they are controls pertaining to ensuring that financial statements and other informational disclosures required by SEC rules are accurate. However, since non-compliance of many kinds is the subject of SEC reporting and could have a material adverse effect on the financial success of a company, such "internal controls" may, and probably will in many cases, extend somewhat into traditional regulatory compliance programs.

In parallel, at least temporally, are the Amended Guidelines that seek to provide further assurance that regulatory compliance programs are effective. Their purposes are quite different

than the SOx internal controls. The Guidelines are not primarily focused on ensuring SEC reporting accuracy. They are concerned with ensuring across-the-board compliance with all regulatory requirements. Moreover, the Guidelines are, at least in the first instance, the usual province of legal departments and compliance program managers rather than finance departments and external financial auditors.

In short, SOx internal control assessments are driven by one culture – persons whose professional focus has been on accounting and related financial issues – while most other regulatory programs, including auditing done as an element of those programs, are driven by lawyers and experts (e.g., environmental consultants or technicians) from a different culture.

Coming from different cultures, it is quite possible that company finance departments or external auditors could suggest or even dictate that some elements of an environmental compliance program – which are fully consistent with the Amended Guidelines – are nevertheless inadequate because they do not meet particular internal control requirements. If the focus of the criticism is solely to ensure compliance with reporting requirements, there may be no substantive conflict. If the focus is broader, and goes, for example, to how the compliance program is run more generally, a substantive conflict could result. The finance "folks" might be dictating how the environmental "folks" run their compliance program.

At this early stage of SOx implementation, we may not yet be aware of the full implications of the issue. I would be very interested in hearing from any of you that have had experience in this area. Do you believe that there are no serious potential conflicts between SOx driven internal control reviews and the more traditional environmental compliance programs? Or does your experience suggest otherwise?

IN-HOUSE COUNSEL COMMITTEE MEMBERSHIP BENEFITS

Tamar Jergensen Cerafici *Membership Vice-Chair*

Ever wondered why you should become a member of the In-House Counsel Committee? Here are a few reasons:

- It's free: That's right – once you're a member of the Section, you can join up to five committees at no additional cost! If you're an attorney serving the environmental needs of a corporation, or if you work for a law firm that provides environmental advice to corporate clients, *you need to join this Committee!*
- Instant access to your colleagues in the Section: The Section has a list serve set up for each committee, giving you instant access to dialogue and problem-solving with in-house counsel throughout the Section.
- Early-bird notification of informative brown-bags: From time to time, the In-House Counsel Committee notifies members of innovations and brown-bags discussions that aren't always sponsored by the Section. For example, In-House Committee members got early notification of an important corporate transparency tool developed by the Global Environmental Management Initiative (GEMI) and a special invitation from GEMI to join in the roll-out teleconference.
- Newsletters: At least three times per year, the Committee produces a newsletter. Committee members receive notification of a newly published newsletter via the Committee's list serve. The newsletter has important information about developing trends, legislation, and case law that may have an effect on your company and clients. Recent newsletters discussed homeland security requirements, disclosure under

Sarbanes-Oxley and corporate sustainable development initiatives. You can also review archived newsletters and find tips on how to manage your practice more effectively.

- Public Service: You get a chance to join with other committee members in an innovative partnership with Earth Force, a program that teaches environmental science to elementary and secondary school kids in areas throughout the country. We are currently working out the 2005 program and support strategy.
- Becoming a member is EASY: Once you join the Section, go to <http://www.abanet.org/environ/committees/signup.html> and select "In-House Counsel."

We hope you see what Committee members know already – Committee membership adds tangible value to your Section membership. If you'd like more information about us, check out our Web site: <http://www.abanet.org/environ/committees/counsel/home.html>.

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IN-HOUSE COUNSEL COMMITTEE NEWSLETTER

We hope you enjoy this issue of the In-House Counsel Committee Newsletter. If you would like to lend a hand by writing, editing, identifying authors, or identifying issues for the Newsletter, please contact the editor David Zoll at (410) 337-2873 or dzollmed8@earthlink.com.

JOIN THE IN-HOUSE COUNSEL COMMITTEE'S PUBLIC SERVICE EFFORT!

Jim Moore

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The Section's In-House Counsel Committee invites you to join our exciting community service project with *Earth Force – Youth for a Change!* This article gives you a brief overview of our efforts to date, and provides information on how you can get involved in our activities. Earth Force is a national non-profit organization created in 1994 by The Pew Charitable Trusts in recognition of two emerging national trends: young people's desire to act on behalf of the environment and their desire to help their communities through voluntary service. Through a variety of programs Earth Force, which serves 35,000 youth a year through 11 offices nationwide, helps young people discover and implement lasting solutions to environmental problems in their communities.

The In-House Counsel Committee's public service project is with Earth Force's GREEN program – the Global Rivers Environmental Education Network. This award-winning program developed nearly a decade ago at the University of Michigan matches middle and high school science classes with private sector sponsors to study and improve water quality in their community. A local watershed group also is involved in each GREEN project. The students and their teacher begin GREEN by doing a watershed assessment that includes physical, chemical and biological monitoring. Using this data and other resources, they identify a problem they would like to address. Students research the problem in a balanced fashion, review applicable legal or community considerations and decide on their preferred

solution. They then design and implement an action plan to address the problem, and conclude by reflecting on what they learned.

The private sector sponsors fund the students' water monitoring and testing equipment, which are kits pre-assembled by Earth Force. Professionals from the private sector sponsors are mentors to the students in the program, and serve as resources for their teachers by assisting in monitoring events, attending a class session, or being available by phone to give input to the class. There is no steadfast time commitment. Mentors can provide just a few hours of their time or more routine support to their host schools. The cost of sponsoring the necessary training, manuals, kits and support for a GREEN school in a city where Earth Force has existing GREEN infrastructure is \$10,000. That sponsorship fee also includes: training and follow-up support for up to 10 mentors, a mini-grant for the local GREEN partner to provide additional support to mentors and educators, \$1,000 for up to three teachers participating in the program to purchase materials. Additional teachers can participate for an additional \$1,000. Of course, this is often an excellent opportunity to meet other corporate leaders and to gain public recognition for your organization or firm. Bottom line, this is a "turn key" project – if we can raise the funds, Earth Force does the work to match the sponsors with schools and a watershed partner, and conducts the training!

By recruiting and pooling sponsors within a geographic area to reach the \$10,000 needed to move forward in a city with pre-existing GREEN activities, the In-House Counsel Committee started two projects during the 2003-2004 school year. Our Indianapolis, Indiana, project was funded and supported by the law firm of Harrison & Moberly, the corporation, Eli Lilly, and the law firm of Krieg DeVault, LLP. Our Baltimore, Maryland, project was supported through funding, mentor assistance, or both, provided by the Section,

Constellation Energy, Quality Environmental Solutions, the law firm of McGuire Woods, LLP and Crown Central Petroleum Corporation. We thank all of these dedicated entities for helping us make the ABA/Earth Force 2003-2004 school year a success. Under the leadership of Vicki Wright, formerly of Harrison and Moberly, and now associated with Krieg DeVault LLP, and Joan Heinz, associate general counsel with Eli Lilly and Company, three Lilly attorneys and several private firm attorneys have been trained in the classroom and the field with Earth Force and non profit partner, Indiana Hoosier Riverwatch. The team worked with five middle school classes talking about the project and doing an outdoor activity on erosion and pollution, spent a day in the field assisting teachers and parents with small group activities in a stream and associated river, and visited each class after the sample results came back. Our Baltimore supporters partnered with Baltimore City Recreation and Parks to conduct water sampling with two elementary schools in the winter and spring, participated in canoe trips and classroom sessions to assist students in analyzing the data and in developing community action plans for addressing problems raised by the data. At an end-of-year, two-day outdoor Celebrations Days picnic, the Baltimore students showcased their action plans, which included implementing a public awareness campaign on litter prevention through a community picnic and cleanup day; making signs and writing a play relating to litter prevention; writing letters to officials over concerns about animal waste and nitrogen in the Gwynns Falls watershed and recommending that buffers be planted to deter goose droppings; and developing a brochure on pollution prevention relating to topics such as salt on roadways, oil and petroleum pollution, and homeowner use of excess fertilizer.

The In-House Committee is excited about continuing this initiative in Baltimore and Indianapolis in the 2004-2005 school year. The enthusiastic response to the program by the

mentors and supporters, as well as the students, teachers and non profit partners is infectious and we are excited to bring this partnership to other cities. We are hoping to start another project soon in one of the following cities with existing GREEN infrastructure: Washington, DC; Lansing, MI; Detroit, MI; Bay City, MI; Pontiac, MI; Ann Arbor, MI; Flint, MI; Rochester Hills, MI; Saginaw, MI; Spring Hill, TN; Shreveport, LA; Houston, TX; Austin, TX; Philadelphia, PA; Erie, PA; Pittsburgh, PA; Tampa/St. Pete, FL; West Palm Beach, FL; Charleston, SC; Portland, OR; Marion, IN; Fort Wayne, IN; Massena, NY; Wilmington, DE; Toledo, OH; Bedford, OH; Dayton, OH; Defiance, OH; Lordstown, OH; Chicago, IL; Denver, CO; Doraville, GA and Atlanta, GA. We are hoping to accomplish this in Houston and Washington, D.C. to start. If your organization, firm or company is interested in committing all or part of the funds needed to start a project in one of these cities, please let us know by e-mail.

What makes GREEN so exciting is that our efforts and time contributions show quick returns. The GREEN program generally is implemented from start to finish during a school year. As you can imagine, GREEN builds essential academic skills including critical thinking, teamwork, problem solving and decision making; teaches students how to assess watershed health with the proper tools; and encourages youth to undertake projects to improve environmental quality based on their findings. Visit their Web site at <http://www.green.org> to learn more about GREEN or check out the Sections' In-House Counsel Committee Web site <http://www.abanet.org/environ/committees/counsel/home.html>. When we work together, young people and attorneys can improve their communities, learn, and have fun at the same time! We hope you join our efforts!

EFFECTIVE COMPLIANCE PROGRAMS UNDER THE NEW SENTENCING GUIDELINES CRITERIA

Christopher Bell
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Introduction

The United States Sentencing Commission, effective Nov. 1, 2004, made far-reaching changes to the Federal Sentencing Guidelines' criteria (Criteria) for what constitutes an effective program to prevent and detect violations of the law. 69 Fed. Reg. 28994-29028 (May 19, 2004). The real impact of the Criteria has been less in the sentencing context itself and more in their influence in shaping prosecutorial, regulatory and private sector policies on compliance programs over the past 15 years. The Criteria have become one of the primary standards against which companies' compliance programs are evaluated. The Criteria will retain their broad impact even after the recent *Booker* and *Fanfan* Supreme Court decisions holding that the Sentencing Guidelines were unconstitutional to the extent that they were mandatory.

The Supreme Court held that sentencing courts must still use the Guidelines in an advisory fashion, signaling their continued viability. Further, prosecutors and regulators will still take compliance programs into account when making enforcement decisions and organizations will still find such programs an essential element when defending themselves against charges of wrongdoing. Finally, as a practical matter of risk management and good corporate governance, a conscious decision not to implement effective compliance programs designed to prevent and detect wrongdoing would increase the likelihood that wrongdoing will occur and might even subject those who would make such a decision to individual liability.

Since the Criteria were first published in 1991, the public (including shareholders), enforcement authorities, regulators and the courts have increased their scrutiny and expectations regarding compliance and ethics systems in evaluating how to regulate companies or respond to alleged violations of law. The new Criteria will significantly change how governmental and private stakeholders will review and evaluate organizations' compliance assurance and ethics programs.

One should also not be surprised by inquiries from boards of directors as to whether a company's compliance system conforms to the new Criteria. Indeed, it is not difficult to imagine a director aiming the following barrage at the general counsel: "Are we in compliance with all of our major legal obligations today, and how do you know? Are there some ticking legal time bombs out there that we won't know about until we read about them in the newspaper? And, by the way, do we really know what all of our legal risks and obligations are, and does everyone know what they need to do to make sure we do the right thing and stay out of trouble?" An effective compliance and ethics system is the foundation for credible answers to these reasonable questions. One should no more attempt to answer the "are we in compliance today?" question without an effective compliance system than one would answer the "what is our financial status?" question without an effective financial system.

Compliance Programs: History and the Existing Landscape

A. The Original Criteria

Commentary in Chapter Eight of the Sentencing Guidelines published in 1991 set forth seven elements of an effective compliance programs.

- Establish compliance standards and procedures reasonably expected to reduce the possibility of criminal conduct if followed.

- Specific high-level personnel must be given responsibility to oversee compliance with the organization’s compliance standards and procedures.
- Use due care not to delegate substantial discretionary authority to individuals with a propensity to engage in criminal conduct.
- Take steps to effectively communicate standards and procedures to employees and agents, including through training programs.
- Take reasonable steps to achieve compliance with standards, including monitoring and auditing programs reasonably likely to detect criminal conduct by employees and agents, and by publicizing a system for employees and agents to report criminal conduct without fear of retribution).
- Enforce standards through appropriate and consistent discipline.
- After an offense has been detected, take reasonable steps to respond to the offense and prevent recurrence.

56 Fed. Reg. 22762, Section 8A1.2, Comment K.

Organizations that have implemented effective compliance programs that meet the Criteria that nonetheless find themselves criminally convicted may benefit from a significant downward adjustment of their criminal penalty. The Criteria may also be used to require organizations, as a condition of probation, to implement a compliance assurance program (an increasingly common phenomenon). Despite the fact that the Guidelines formally apply only in the context of criminal sentencing and the location of the original Criteria as only commentary to the Guidelines, the Criteria have had a significant impact on the governmental policy regarding compliance programs and their implementation in the private sector.

B. The Criteria’s Impact

When the Criteria were first published in 1991, the compliance program landscape was relatively barren. However, due in part to the influence of the Criteria, the situation has since changed radically as both experience and the amount of guidance on compliance programs has broadened and deepened. Therefore, the context in which the new Criteria will be implemented is quite different than when they were first published.

The U.S. Department of Justice has developed general prosecutorial policies that take into account an organization’s compliance assurance systems and has also developed such policies for particular types of crimes. *Principles of Federal Prosecution of Business Organizations* (U.S. DoJ, Jan. 20, 2003); *Federal Prosecution of Corporations* (U.S. DoJ, June 16, 1999); *Factors in Decisions on Criminal Prosecutions for Environmental Violations in the Context of Significant Voluntary Compliance* (U.S. DoJ, July, 1991). These policies are consistent with the elements set forth in the Criteria. The Justice Department now frequently asks for information about a company’s compliance programs when conducting civil and criminal investigations, and the effectiveness and credibility of these programs can be an important factor in determining the government’s enforcement response. Many organizations invite this inquiry by relying on the “bad apple” defense, in which a company argues that it had good compliance systems and that the alleged violations of law occurred only because of the bad acts of a few individuals.

In addition, many federal agencies have developed policies on compliance assurance systems tailored to specific legislative programs. The most prominent recent example is the effort led by the Securities and Exchange Commission (SEC) to implement Sarbanes-Oxley requirements such as codes of conduct,

internal controls and reporting requirements. Even before Sarbanes-Oxley, the SEC established a list of factors, including the existence of internal compliance programs and procedures, that it would take into account in deciding whether to prosecute a matter. *Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions*, (SEC, Oct. 23, 2001).

The SEC has not been alone in creating criteria for compliance programs. For example, the Department of Health and Human Services, the Food and Drug Administration and the U.S. Customs Service have all developed criteria for effective compliance programs based on or at least consistent with the Criteria.

The importance of compliance programs was highlighted in the seminal *Caremark* case, in which the Delaware Court of Chancery (one of the most influential courts on corporate law) concluded that individual members of Boards of Directors have a fiduciary duty to ensure that a corporation acts in compliance with applicable laws and has a compliance program to meet this obligation. *In re Caremark Inc. Derivative Litigation* 698A.2d 959 (1996). The *Caremark* court expressly discussed the Criteria, noting that “any rational person attempting in good faith to meet an organizational governance responsibility would be bound to take into account this development [the Criteria in the Sentencing Guidelines] and the enhanced penalties and the opportunities for reduced sanctions that it offers.”

C. Environmental Health & Safety Compliance Programs

Though the Sentencing Guidelines do not explicitly apply to environmental crimes, they have influenced the thinking of the U.S. Environmental Protection Agency (EPA) and state environmental agencies on the topic, and

many companies have taken the Criteria into account in designing their environmental, health and safety compliance programs. EPA has provided extensive guidance on what constitutes an effective environmental management system (EMS) aimed in part at complying with the law. See, e.g., *Compliance – Focused Environmental Management Systems – Enforcement Agreement Guidance* (U.S. EPA, Jan. 2000); *Incentives for Self – Policing, Discovery, Correction and Prevention of Violations*, 65 Fed. Reg. 19618 (Apr. 11, 2000); *Code of Environmental Management Principles for Federal Agencies*, 61 Fed. Reg. 54062 (Oct. 16, 1996). EPA, in conjunction with the Department of Justice, has been increasingly including compliance management programs as requirements in consent decrees settling enforcement cases and will consider EMS for supplemental environmental projects as a component of civil settlements. See *Guidance on the Use of Environmental Management Systems in Enforcement Settlements as Injunctive Relief and Supplemental Environmental Projects* (EPA, June 12, 2003).

Beyond the enforcement context, EPA and many states have launched strategies to link effective EMS and compliance programs with regulatory programs. See, e.g., *EPA’s Strategy for Determining the Role of Environmental Management Systems in Regulatory Programs* (EPA, Apr. 12, 2004); *Position Statement on Environmental Management Systems* (EPA, May 15, 2002). In addition to specific EMS-related statutory provisions in almost a dozen states, state interest in environmental compliance programs is also evidenced by the very active Multi-State Working Group (MSWG) which, among other projects, has published guidance on effective EMS. *External Value Environmental Management System Voluntary Guidance* (MSWG, Mar. 2004). EPA has also encouraged voluntary efforts to implement effective systems through initiatives such as the *National*

Environmental Performance Track Program, designed to reward organizations with good environmental performance, which has at its foundation an EMS that is aimed at compliance and improving environmental performance.

The government has also been applying these concepts to its own operations. Executive Order 13,148, *Greening the Government Through Leadership in Environmental Management*, established the goal of making EMS a “fundamental and integral component” of federal government policies, requiring all federal facilities to have EMS in place by the end of 2005, based on U.S. EPA’s Code of Environmental Management Principles for Federal Agencies (1997) or similar frameworks. 65 Fed. Reg. 24,593 (Apr. 26, 2000). The importance of implementing EO 13148 was emphasized in a joint memorandum from the chairman of the Council on Environmental Quality and the director of the Office of Budget and Management on Apr. 1, 2002. The United States has also been promoting EMS at the international level, as reflected in a 2000 guidance document on EMS generated by the Commission for Environmental Cooperation, an arm of the North American Free Trade Agreement (NAFTA). *Improving Environmental Performance and Compliance: 10 Elements of Effective Environmental Management Systems*, Commission for Environmental Cooperation, June 2000.

The private sector has also produced prodigious guidance on designing, evaluating and implementing compliance assurance and ethics systems. The past decade has seen an explosion of literature, trade press, conferences, guidance and educational material on not only compliance assurance systems, but also on the more general topic of ethics and integrity programs. A number of sector-specific programs such as the American Chemistry Council’s Responsible Care® program (including the Responsible Care® Management System and Responsible Care® 14001) and the

American Forest & Paper Association’s Sustainable Forestry Initiative have also increased the uptake of environmental, health and safety compliance and performance management programs.

The increased interest in compliance assurance systems and ethics programs has not been limited to the United States. The most prominent example in the environmental arena is ISO 14001, the EMS standard published by the International Organization on Standardization in 1996 and to which over 50,000 organizations world-wide have been third-party certified (over 7,000 in the United States). The international initiatives have been characterized by broader forays into general topics such as social responsibility and sustainable development. For example, in 2000, the Organization of Economic Cooperation and Development (OECD) published its revised *OECD Guidelines for Multinational Organizations*, which establish a “code of conduct” on a range of issues, including labor, bribery, occupational safety and environment. A coalition of private sector and non-governmental organizations has created *Social Accountability 8000*, which applies management systems principles to labor and social issues and is typically implemented in conjunction with accredited third-party auditors to verify conformance. Even ISO has recently decided to launch a standards writing work item on organizational social responsibility. This brief review reveals that organizations implementing effective compliance and ethics programs today face a very different set of circumstances than in 1991 when the Criteria were first published.

D. Implementing Compliance Programs

The new Criteria must be understood in the context of multiple “pressure points,” requirements and guidance on what constitutes an effective compliance program, and the fact that organizations have now had more than a

decade of experience implementing such programs. Companies must design their programs around a complex and diverse set of instructions, from the wide-ranging policies of the Department of Justice and Sarbanes-Oxley to the numerous sector-specific guidelines or criteria that have been established by regulatory bodies or market pressures. In addition, many companies that are subject to these requirements do not operate in the United States alone, and are looking to implement comprehensive and consistent programs that cover their non-U.S. as well as U.S. operations. Finally, there is increasing pressure to implement more holistic strategies based on ethical considerations or broad concepts such as sustainable development or social responsibility that do not rely solely on formal legal obligations.

The private sector has responded to these pressures in a variety of ways. Thousands of companies have developed high-level compliance programs and codes of conduct modeled after the Criteria, often launched from the general counsel's office. In addition, many companies have implemented subject matter-specific compliance programs, with the design and implementation of the programs varying widely within the same company. These subject-matter specific programs sometimes are not part of the companies' Criteria-based high-level compliance programs and are often not coordinated with or integrated into each other. Thus, companies sometimes have multiple and potentially overlapping or even inconsistent compliance programs. This creates cost and effectiveness challenges and complicates consistent and meaningful oversight by boards of directors and senior management. Internal inconsistencies or different levels of stringency among various compliance programs may also be difficult to explain to enforcers, regulators or shareholders.

The new Criteria may provide an opportunity for companies to review and re-think their

compliance programs and establish comprehensive compliance assurance and ethics programs that incorporate the various sector and statute-specific compliance programs into uniform systems that create consistent processes for effectively identifying and meeting the full range of legal and other obligations.

The New Criteria for Effective Compliance and Ethics Programs

A. Overview of the New Criteria

The changes to the Criteria are largely an outgrowth of the recent spate of financial scandals and the resulting public and regulatory interest in what can be done to increase organizational compliance with the law, particularly at senior management levels. The Sentencing Commission (Commission) launched the initiative to review the Criteria in 2001, announcing its intention to convene an ad hoc committee to review and suggest improvements to the Criteria. 66 Fed. Reg. 48306 (Sept. 19, 2001). Coincidentally, the Commission was directed by Congress, in Section 805 of the Sarbanes-Oxley Act of 2002, to review and, as necessary, revise the Criteria. The Commission empanelled an ad hoc advisory group in February 2002, which after seeking public comment and holding public meetings, submitted a lengthy report to the Sentencing Commission on Oct. 7, 2003 containing a number of recommended changes to the Criteria. The Commission moved rapidly to incorporate a number of those recommendations in proposed changes to the criteria on Dec. 30, 2003 that were sent to Congress in final form on April 30, 2004 and became effective Nov. 1, 2004.

The new Criteria maintain the basic goals of an effective compliance program: (1) reduce the likelihood of illegal conduct occurring in the first place, (2) increase the likelihood of early detection and mitigation should illegal conduct

occur, and (3) improve likelihood of reasonable enforcement response (e.g., possible exercise of enforcement discretion or a decision to proceed civilly rather than criminally). An effective compliance program may also contribute to other but equally important benefits such as improved risk management, morale, productivity, reputation and shareholder confidence

The new Criteria have retained the same seven-element structure of the Criteria published in 1991. Some of the elements of the Criteria are relatively unchanged. For example, the first element of the Criteria still provides that the organization must establish standards and procedures designed to prevent and detect criminal misconduct. These are the standards and procedures providing practical direction to affected personnel that might cover everything from the controls mandated by Sarbanes-Oxley to the detailed procedures necessary to comply with environmental, health and safety requirements. However, there have been significant changes as well. The balance of this article summarizes the key changes to the Criteria, and does not address every provision or go through every element of an effective compliance program.

B. Significant Changes to the Criteria

1. Expanded Prominence and Scope

The Commission increased the prominence of the Criteria by moving them from commentary to a new Guidelines section of their own (§ 8B2.1). The purpose of this change is to emphasize the importance of compliance programs.

The Criteria originally focused solely on effective programs to prevent and detect criminal violations. The new Criteria retain this emphasis, with the definitions of compliance programs, standards and procedures aimed at preventing criminal violations. However, the new Criteria suggest a broader scope in a

number of ways. In addition to preventing and detecting criminal conduct, organizations must now “otherwise promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law.” While the Commission has noted that implementing an effective compliance program will result in an adequate culture of compliance, the change in tone is likely to push companies to increase the emphasis on culture and ethics in their compliance programs.

This shift reflects an increasing belief that simply writing detailed compliance procedures and demanding employee obedience is not enough. Rather, an effective compliance program should be built on a culture and ethic of “doing the right thing” as a matter of course in every aspect of personal and organizational conduct. It is difficult to have a rule for every situation where misconduct could occur. Further, a strictly rule-based program can result in individuals attempting to excuse improper conduct by claiming that there were no rules that explicitly prohibited precisely what they did (adopting the theory of “what is not prohibited is permitted”). Commentary to the Criteria attempt to address this issue by explicitly stating that senior management bears a direct responsibility to foster a culture of ethical and compliant conduct.

Further reflecting the Commission’s expanded view of what constitutes an effective compliance program, the commentary to the new Criteria note that an organization’s “failure to incorporate and follow applicable industry practice or the standards called for in any applicable governmental regulation weighs against the finding of an effective compliance and ethics program.” This signals a potentially significant expansion of compliance programs beyond strict compliance with criminal law to programs that take “industry practice” into account. For example, companies that belong to industrial sectors that have developed “best practices” might find themselves having to explain why such practices have not been

systematically implemented, even if they are not required by law.

The Commission even hints that, at least for larger organizations, the scope of their compliance and ethics program should extend beyond organizational boundaries. The Commission, in commentary, suggests that larger organizations, where appropriate, should encourage smaller organizations, particularly those that seek to have a business relationship with the larger organization, to implement effective programs. This is a more general statement of the concept of “greening the supply chain” that is well-established in the environmental arena, as well as burgeoning arena of “social responsibility,” where some multinational organizations are taking steps to address a wide range of issues (*e.g.*, working conditions, wages, bribery and corruption) in their relationships with suppliers and contractors. This is not solely an issue of “doing good”: an organization may suffer significant economic and reputational harm and possibly incur legal liability for the misdeeds of suppliers or contractors thousands of miles away. Of course, getting involved in the design or implementation of the compliance programs of third parties is fraught with its own legal challenges, as organizations seek to avoid taking actions that could unnecessarily expose them to liability for the actions of their suppliers and contractors. Prudent organizations seek to achieve the delicate balance between decreasing risk through reasonable controls (or directions to) aimed at suppliers and contractors while not stepping over the line that might significantly increase exposure to liability from those entities.

2. Increased Emphasis on Board of Directors and Senior Management Responsibility

The old Criteria required that specific high-level personnel in the organization be assigned responsibility to oversee compliance. The new Criteria amplify on this requirement in several

important ways, reflecting the current interest in enhancing compliance assurance and oversight at the highest management levels.

The new Criteria establish three senior levels of responsibility for compliance programs: (1) “governing authority,” (2) “high-level personnel,” and (3) “substantial authority personnel.” The “governing authority” is the board of directors (with provisions for organizations that do not have a board). The organization’s “governing authority shall be knowledgeable about the content and operation of the program to prevent and detect violations of the law and shall exercise reasonable oversight with respect to the implementation and effectiveness of the program.” The “governing authority” (or some subgroup thereof) is expected to periodically receive information on the implementation and effectiveness of the program. Therefore, the Criteria impose an explicit responsibility on the board of directors to know how the compliance assurance system works (*i.e.*, training) and to oversee its implementation. An example of an application of this change to the Criteria would be on the requirement in ISO 14001 for regular “management review” of the effectiveness of the EMS. Companies that implement ISO 14001 often do not include the board of directors in their management review procedures. An ISO 14001 organization that wants to also conform with the Criteria should review its management review procedures to determine if they include effective participation and oversight by the board.

The Criteria also expand the responsibilities of senior management. All management, not just those formally charged with compliance, must be knowledgeable on the operation of the compliance assurance system and perform their duties in a manner designed to prevent and detect violations of the law and promote an organizational culture that is committed to compliance and ethical conduct. “High-level personnel” (*i.e.*, senior management) must

ensure that the organization has an effective compliance and ethics program, and specific individual(s) within high-level personnel must be assigned overall responsibility for the compliance and ethics program. When it released the new Criteria, the Commission emphasized that while various duties may be delegated, ultimate responsibility for the effectiveness of the compliance program must reside in senior management.

The new Criteria replace the previous requirement that “substantial authority personnel” be screened for their “propensity to engage in violations of law” with the requirement that the organization “use reasonable efforts not to include within the substantial authority personnel of the organization any individual whom the organization knew, or should have known through the exercise of due diligence, has engaged in illegal activities or other conduct inconsistent with an effective compliance and ethics program.” “Substantial authority personnel” include “high-level personnel” (who are senior executives and other senior managers), as well as individuals who exercise substantial supervisory authority (e.g., a plant manager or a sales manager). There is not an absolute bar on hiring individuals with a history of misconduct in positions of responsibility. The organization should take into account how the individual’s record of misconduct relates to the specific responsibilities the individual will be assigned to, how recent the misconduct was, and the nature of other misconduct that might not be directly related to the individual’s anticipated duties.

The Criteria set forth conditions for delegating responsibilities for the compliance program. Persons to whom such responsibilities have been delegated must report periodically to high-level personnel (*i.e.*, senior management) and, as appropriate, the governing authority (*i.e.*, the board or an appropriate subgroup of the board) on the effectiveness of the program. To carry out this responsibility, individual(s) to whom

such authority has been delegated shall be given adequate resources, appropriate authority and direct access to the governing authority (or an appropriate subgroup of the governing authority). The Commission commented that if the high-level person with overall responsibility for the compliance program does not have day-to-day responsibility, then the person with day-to-day responsibility should report directly to the governing authority at least annually on the effectiveness of the program.

Finally, the Criteria’s training requirements explicitly include, in addition to employees, the organization’s governing authority, high-level personnel and substantial authority personnel. This common-sense provision may cause significant changes in many organizations’ training programs. Training is often thought of as something that production workers or contractors must go through, not managers. Even in companies that have extensive new-employee training and qualification procedures at the production level, it is common to find relatively little training at most levels of management, particularly on compliance-related issues. Indeed, the further up the management chain one goes, the weaker the training programs often become, with even less at the board of directors level. This situation makes it challenging for managers, particularly senior managers, to understand and meet their specific legal obligations (e.g., sign Sarbanes-Oxley or Clean Air Act Title V permit certifications) and to adequately oversee the implementation of an effective compliance assurance program. The new Criteria hope to overcome this gap by including the governing authority (*i.e.*, the board) and management in the training provision.

Taken together, these provisions significantly enhance the explicit responsibilities for boards of directors, and senior and mid-level management for effective compliance programs. They must be directly involved in the programs’ implementation and oversight,

understand how the programs work and cannot simply shift these responsibilities to staff.

3. New Requirement For Ongoing Assessments of Risks of Violating the Law

The Criteria provide that organizations “shall periodically assess the risk of criminal conduct and shall take appropriate steps to design, implement or modify each requirement . . . [in the balance of the Criteria] . . . to reduce the risk of criminal conduct identified through this process.” In the commentary, the Commission states that organizations will have to assess the nature and seriousness of potential violations of the law, the likelihood that certain violations of the law may occur because of the nature of the organization’s business, and the prior history of the organization. Assessments of legal risk are not a one-time event; they must be conducted on an ongoing or periodic basis so that the assessment is kept current and violations of the law are prevented.

The design and implementation of compliance programs must take into account the risks identified in the assessment. The commentary to the Criteria provides examples on how this is expected to work. For example, organizations that employ sales personnel who have flexibility to set prices “shall establish compliance standards and procedures designed to prevent and detect price fixing,” while organizations whose sales employees have the flexibility to “represent the material characteristics of products shall establish compliance standards and procedures to prevent fraud.” Applying this reasoning to the health, safety and environmental area, companies that due to the nature of their business have employees whose decisions could have environmental or safety consequences would be expected to have compliance standards or procedures to prevent violations of safety or environmental laws.

This new element adds a nuance to the step of identifying risks or hazards in environmental, health and safety management systems (known

as “aspects” in ISO 14001). While those are typically technically-oriented inquiries, this element of the Criteria adds a legal component. In addition to the risk of injury or environmental harm of a particular activity, what is the risk of noncompliance? From another perspective, this new element in the Criteria might be addressed through so-called “enterprise risk” assessments that are growing increasingly popular, such as those being conducted consistent with the COSO elements. No matter what approach is adopted, it would be prudent to involve counsel in this process, not simply for purposes of cloaking the inquiry in attorney-client privilege, but because counsel has professional expertise in evaluating the applicability of legal requirements to organizational activity and understanding the likelihood and risks of non-compliance.

This provision on assessing legal risks should push organizations to take a close and realistic look at how they do business, the laws that apply to them and the risks of non-compliance. Then, organizations must develop and implement compliance programs that effectively address those risks (including practical procedures that direct employees, in language that they can understand that is relevant to their responsibilities, what they must do to comply). Compliance programs that simply generate detailed memoranda formally describing generic legal requirements without reference to the company’s particular risks and activities are not likely to satisfy this requirement.

4. Incentives and Internal Reporting

The old Criteria directed that the compliance program include discipline for those that violate the organization’s standards or procedures. The new Criteria arguably balance this provision by requiring the program to also include incentives to promote desired behaviors.

The old Criteria requiring procedures to allow employees to report violations without fear of retribution have been replaced with a more

specific requirement calling for internal reporting mechanisms that allow for “anonymity or confidentiality” while still protecting against retaliation. Therefore, a company could establish a “whistleblower” system consistent with the Criteria that provides for confidential, but not anonymous, reporting. Further, the proposal expands internal reporting to cover potential as well criminal misconduct, and also directs that this be a mechanism for those seeking guidance on compliance issues. This is an element of the Criteria that might be implemented in conjunction with the whistleblower provisions of Sarbanes-Oxley.

5. Auditing

The auditing and monitoring provisions have been revised to require “periodic evaluations of the effectiveness” of the compliance program. Thus, in addition to the traditional compliance auditing and measuring functions, organizations must also evaluate the effectiveness of the compliance system itself. This encourages organizations to identify and correct systems deficiencies before they are manifested in performance problems (e.g., noncompliance) and, where noncompliance is detected, to prevent recurrence by finding and fixing the systemic root cause of the problem. This concept of management systems evaluation is common in most major systems standards such as ISO 14001, and is also reflected in the Sarbanes-Oxley requirement to evaluate the effectiveness of controls related to financial reporting.

6. Cooperation, Reducing the Culpability Score and Attorney-Client Privilege

A major issue throughout the process of revising the Criteria was the relationship between obtaining “credit” (*i.e.*, lowering the culpability score) for “fully cooperating” with government authorities investigating the alleged wrongdoing and waiving the attorney-client privilege and work product doctrine. To qualify for a

reduction, an organization must “fully cooperate” in government investigations of wrongdoing. “Credit” would also be lost if, after becoming aware of an offense, the organization “unreasonably delays” notifying the appropriate governmental authorities. Further, the downward adjustment would also not apply if high-level personnel were either involved in the misconduct, condoned it or were willfully ignorant of it, and there is a presumption against the downward adjustment if substantial authority personnel were involved in the misconduct, condoned it or were willfully ignorant of it.

The original Criteria did not suggest a relationship between cooperation and privilege. However, certain elements in the Department of Justice advocated waiver of attorney-client privilege as a condition for a determination of full cooperation. The private sector argued that the Commission should either be silent on the issue or explicitly state that waiver of attorney-client privilege was not necessary to get credit for an effective compliance program. Attempting to reach middle ground on this issue, the Commission in commentary stated that waiver is not a prerequisite for full cooperation “unless such waiver is necessary in order to provide timely and thorough disclosure of all pertinent information known by the organization.” Though the Commission notes that it expects that waivers “will be required on a limited basis,” many in the private sector legal community are skeptical that prosecutors will be so reticent.

Conclusion

Effective compliance assurance systems are now a well-established fixture in the legal landscape.

The Sentencing Commission’s new Criteria establish an overall compliance system “umbrella” under which the various other programs applicable to an organization, ranging

from Sarbanes-Oxley to environmental, health and safety, may be implemented. Compliance systems can also be integrated with broader management systems aimed at quality, efficiency (e.g., six-sigma), sustainable development or social responsibility.

As with all management systems, perhaps the most important variable in determining success or failure is the direct, frequent and visible participation and leadership by management and, pursuant to the new Criteria, meaningful oversight by the board of directors. Further, counsel should play a direct role in the design, implementation and ongoing oversight of compliance assurance systems. Identifying and understanding legal risks and obligations, evaluating programs and procedures to manage those risks and meet those obligations, and evaluating compliance performance are all core competencies of the legal function.

Regulators, enforcers and courts expect effective compliance systems, and prudent companies implement them, not merely to satisfy some formal provision of the Sentencing Guidelines' Criteria, but rather to improve performance and prevent and detect non-compliance. The most important measure of an effective compliance system is whether it actually works, not whether it meets the Criteria "on paper." In other words, will your system increase the likelihood that your people will consistently do the right thing?

IN-HOUSE COUNSEL COMMITTEE

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<http://www.abanet.org/environ/committees/counsel/home.html>

KEYSTONE 2005 WILL FOCUS ON ISSUES FOR IN-HOUSE COUNSEL

Alexandra Dunn
Keystone Program Chair
Vice Chair, In-House Counsel Committee

If the 34th Annual Conference on Environmental Law is not already on your calendar of "must attends" in 2005, I hope you will consider making room for this dynamic program. The conference will be held March 10-13, 2005 at the beautiful Keystone Resort and Conference Center, Colorado. This year's meeting kicks off with what promises to be a dynamic *Keynote Address* by nationally-recognized author and Georgetown University Professor, J.R. McNeill. Basing his remarks on his recent book, *Something New Under the Sun: An Environmental History of the Twentieth-Century World*, Professor McNeill will discuss with Keystone attendees the ecological dangers of our fossil fuel-based civilization. His remarks will focus on how our demand for cheap energy and rapid economic growth has strained our world's air, water, and soil. At the same time, he will outline the successes of environmental policy in reversing pollution. Professor McNeill's unique blend of history and science will challenge us all to reflect on our role as the environmental experts and counselors of the future.

Keystone is known for its high-level plenary sessions and this year is no exception. On Friday morning, we will bring together some of our nation's top experts to hold a dialogue on climate change. The speakers will cover the prospects for a meaningful response to climate change through legislation, policy initiatives, litigation, stakeholder pressure, and economic drivers. This discussion is sure to be a high-profile starting point for future discussions and ideas on climate change, particularly in the wake of the recent elections.

Of particular interest to in-house counsel also will be a Friday breakout session entitled

“Environmental Law & the Journey Toward Sustainable Development: Insights from Corporate Counsel.” This session will focus on the ongoing debate over the role of companies in fostering sustainable development, and how mechanisms such as pollution banking and emissions trading, bolstered by accountability measures to assure performance of environmental goals, transparency, and stakeholder engagement may be used in the future. Leading in-house practitioners, drawn from companies that have publicly espoused a commitment to sustainability and been rated favorably for their efforts (e.g., by the Dow Jones Sustainability Indices), will shed light on this topic and describe how sustainable development is gradually beginning to impact the practice of environmental law with observations on the implications of these trends for outside counsel. Featured speakers include Peter Etienne, Baxter International Inc., Deerfield, IL; Carol A. Casazza Herman, Pfizer, Inc., New York, NY; Vail T. Thorne, The Coca Cola Co., Atlanta, GA; and Peter C. Wright, Dow Chemical, Midland, MI.

A unique Friday afternoon program entitled *Taking Control of Your Practice: Developing Business for the Next Ten Years* will explore business trends and growth, and critically evaluate where the practice of environmental law is headed – including for in-house counsel.

A Saturday plenary session will focus on lawyering techniques for advanced environmental litigators. A terrific assembly of speakers will explain – and even contradict – commonly held beliefs and theories about which tactics work, and which do not, in the courtroom during environmental, natural resources, and toxic tort cases.

Bottom line, this is bound to be a program that you’ll remember for a long time. We hope to see you there!

MEMBER AND OTHER NEWS

Bonnie Harrington recently moved from her role as Counsel, Northeast-Midwest Region at GE Corporate Environmental Programs in Albany, N.Y. to a new position as Senior Counsel, Environment, Health & Safety at GE Consumer & Industrial located in Louisville, Ky.

Committee member and Vice Chair for Technology *James R. Arnold*, of the Arnold Law Practice, was named to the inaugural list of the international Who’s Who of Environmental Lawyers published by Law Business Research Limited of London.

After eight years in-house as assistant general counsel at Echo Bay Mines and then at Duke Energy, *Anne Weber* has returned to private practice and formed the Weber Law Firm (303-893-20004).

Michael Bramnick has left Millenium Chemical Company, a Lyondell Co subsidiary, as of Dec. 15, 2004, and has joined NRG Energy Company in West Windsor, New Jersey. Mr. Bramnick was formerly with Lucent Technologies in Morristown, N.J. and can be reached at: Michael.bramnick.nrgenergy.com.

Shirley Edwards, previously with the Bay Area Air Quality Management District and before that with the regional environmental prosecutors program of the State Attorney General’s Office has opened her own firm in the East Bay Area: 2754 Del Monte Ave., El Cerrito, CA 94530, (510) 236-7700; ShirleyREdwards@msn.com.

The EPA has awarded \$660,000 to 66 teams of college students in the current academic year for work on cost-effective solutions which encourage sustainable development. A panel of judges of the National Academy of Engineering will review the project designs and winners will receive funding for their projects. The agency is accepting applications for the next competition in 2005. A list of the current teams is available at

<http://es.epa.gov/ncer/p3/projects/index.html>.
Information on the 2005 competition can be
obtained at: <http://www.epa.gov/p3>.

Thanks to Walter James for the following
update:

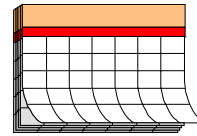
EPA - No corporate officer responsibility existed
for CWA administrative violation.
In re Smith (7/15/04) Full Summary Decision

The EPA filed a complaint against C.W. Smith,
Grady Smith, and Smith's Lake Corporation
(SLC) for discharging pollutants in violation of
the Clean Water Act (CWA). Findings that
pollutants were added through a point source in
the lake bed were not sufficient alone to impose
liability for a CWA violation on Grady Smith
individually. The CWA did not provide for civil or
administrative aiding and abetting liability. Thus,
the aiding and abetting theory could not be used
to hold Grady Smith responsible under the
CWA. Congress did not provide for
"responsible corporate officer" liability for civil or
administrative CWA violations. The fact that
Grady Smith was an officer and shareholder of
SLC and that he acquiesced in C.W. Smith's
sidecasting, participated in meetings and
inspections, and was aware of the alleged CWA
violations, was not sufficient to impose liability
on him for SLC's discharge of pollutants.

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AMERICAN BAR ASSOCIATION SECTION OF ENVIRONMENT, ENERGY, AND RESOURCES

Calendar of Section Events



23rd Annual Water Law Conference

Feb. 24-25, 2005

San Diego

34th Annual Conference on Environmental Law

March 10-13, 2005

Keystone, Colorado

Key Environmental Issues in Region 4

April 22, 2005

Atlanta

Key Environmental Issues in Region 6

May 26, 2005

Dallas

Wetlands Law and Regulation

June 8-10, 2005

Washington, D.C.

(Cospponsored with ALI-ABA and ELI, for
information see www.ali-aba.org.)

13th Section Fall Meeting

Sept. 21-25, 2005

Nashville, Tennessee

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