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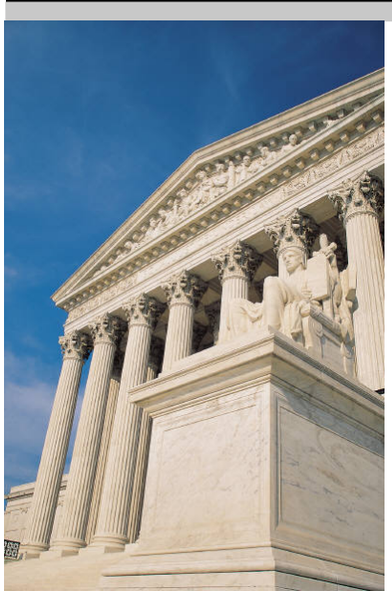

CORPORATE LAW

What the Supreme Court Did NOT Say

Arthur Andersen LLP v. United States

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The Supreme Court's recent decision in *Arthur Andersen LLP v. United States* created headlines and commentary in both the legal and corporate worlds. Hailed by some as a vindication of Arthur Andersen, the case was decided by a unanimous court on narrow, technical grounds. It does not provide a clear road map to companies on how to structure or enforce a document retention policy, it was not a wholesale approval of Arthur Andersen's conduct during the Enron accounting scandal, and it does not give much comfort to corporations planning to shred documents in anticipation of a federal investigation.

The Court's recitation of the facts surrounding Arthur Andersen's prosecution for obstruction of justice provides a reminder of the timeline of events involving Enron and Arthur Andersen. In late August of 2001, Enron's CEO abruptly resigned, and a *Wall Street Journal* article suggested improprieties at Enron. By early September, Arthur Andersen had formed a crisis response team and in October hired outside counsel to represent it in any Enron-related litigation. In-house meetings and emails indicated that Arthur Andersen expected an SEC investigation. On October 10, an in-house training session at Arthur Andersen reminded employees of the firm's document retention policy and urged compliance. This same message was reiterated to employees working on the Enron account by email, at meetings, and on conference calls over the following weeks. On October 16, Enron released its third quarter results, including a $1.01 billion charge to earnings, and the SEC notified Enron the next day that it had opened an investigation in August and requested information and documents. Enron forwarded a copy of the SEC notice to Arthur Andersen on October 19. On October 30, the SEC opened a formal investigation and sent Enron a letter requesting accounting information. Throughout October, "substantial destruction of paper and electronic documents" relating to Enron occurred at Arthur Andersen. On November 8, the SEC served Enron and Arthur Andersen with subpoenas for records, and on November 9, an internal email at Arthur Andersen notified employees that all shredding of Enron documents was to cease. Certain of Arthur Andersen's partners who had worked on the Enron account were later fired, and one pleaded guilty to witness tampering.

In March of 2002, Arthur Andersen was charged with one count of violating a statute dealing with witness tampering. The jury deliberated for ten days before finding Arthur Andersen guilty, and the Fifth Circuit Court of Appeals affirmed. The Supreme Court heard Arthur Andersen's appeal in April of 2005 and reversed the Fifth Circuit.

The focus of Arthur Andersen's appeal was a narrow question involving interpretation of the statute under which it was charged. The Court's opinion did not address whether Arthur Andersen was right in shredding documents although it clearly anticipated an investigation by the SEC, nor did it rule on the propriety of actively enforcing a document retention policy in anticipation of such an investigation. The Court's opinion, and the basis of Arthur Andersen's appeal, turned on the question of what it means to "knowingly . . . corruptly persuade" another person "with intent to . . . cause" that person to "withhold" documents from, or "alter" documents for use in, an "official proceeding," and the jury instructions on how to apply and interpret that phrase in reaching the jury's verdict. The definitions of key words were essential to the Court's decision, including "knowingly" and "corruptly."

Arthur Andersen argued on appeal, and the Court agreed, that the phrase "knowingly . . . corruptly persuade" required that a person committing the act in question must be conscious of wrongdoing. Persuading someone not to cooperate with the government is not inherently unlawful, as there are legitimate reasons, and indeed constitutional guarantees, for refusing to cooperate. The Court held that criminality should be limited to "persuaders conscious of their wrongdoing."

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Update

Michigan Business Corporation Act Amendments

In our spring issue we reported on amendments to the Michigan Business Corporation Act recommended by the Michigan Business Corporation Act Subcommittee of the State Bar Business Law Section. The Legislative Services Bureau has drafted a series of bills to implement the proposed amendments, and they are now awaiting introduction. The legislature may act on them as early as this fall.

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However, the question of whether Arthur Andersen was conscious of its own wrongdoing in destroying documents was not actually decided by the Supreme Court. Instead, the Court focused on the jury instructions that told the jury what it must consider in determining Arthur Andersen's guilt or innocence, specifically whether the instructions clearly told the jury what level of intent to commit a crime was required. The jury instructions at issue did not do so; in fact, according to the Court, the judge told the jury that even if Arthur Andersen believed its conduct was lawful, the jury must find it guilty. No dishonesty was required. A further argument made by Arthur Andersen, and followed by the Court, was that the jury instructions did not require that "corruptly . . . knowingly" persuading someone to destroy documents or otherwise hinder an investigation had to be linked to a particular proceeding. The Court has held in the past that obstructive acts must be connected in some way to the proceeding they are supposed to have obstructed. In short, the jury instructions did not accurately reflect the elements of the crime that Arthur Andersen was supposed to have committed, and the jury's decision was therefore not consistent with the law.

Thus this case, while useful for Arthur Andersen and its ongoing legal struggles, does not provide much substantive guidance for companies trying to determine whether the actions taken by Arthur Andersen are models to be followed in the event of potential investigation, or how far to push their document retention policies. The *Arthur Andersen* case was a narrow, technical decision based on faulty instructions to the jury. The Court stated that it did not need to address broader issues because the jury instructions were so clearly flawed. The decision's impact is further weakened by the fact that the statute at issue was amended in the post-Enron Sarbanes-Oxley legislation. As part of Sarbanes-Oxley, Congress also passed a broader and less concrete provision that specifically addresses document destruction, does not include the concept of "corruptly," includes merely "impeding" an actual or contemplated government investigation, and appears to be targeted at the sort of document destruction that Arthur Andersen engaged in once it knew the SEC would investigate. Future destruction of documents in situations similar to Enron and Arthur Andersen could be charged under this statute.

A further reason why this decision will have less practical impact than one might initially think is that this was a criminal case. The burden of proof is high in criminal cases, and the jury must address each element of the crime for which the person is being tried. Companies are far more likely to be sued than prosecuted for a crime, and for this reason also the case provides little guidance to executives trying to decide what to do about document retention when the possibility of investigation looms.

There was much that the Supreme Court did not say in *Arthur Andersen LLP v. United States*. It did not say that shredding documents when a company is expecting and planning for the SEC to launch an investigation is legal. It did not say that aggressively enforcing a document retention policy until the day the subpoena arrives is legal. It also did not say that any of these actions were illegal. It merely said that the jury that found Arthur Andersen guilty was wrongly instructed in what to consider in its deliberations, and therefore the jury verdict could not stand.

So what practice should a company pursue with regard to document retention? The best advice remains unchanged by the Supreme Court's decision. Establish a reasonable policy, follow it as a matter of good business practice, and consult with experienced counsel if there are questions about how to act or react in the face of a pending investigation.

Do You Have an Enforceable Supply Agreement?

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A manufacturer of steel products sends an award letter to a steel supplier with the approximate volume of steel expected to be purchased over the term of the arrangement. The manufacturer then submits purchase orders to the steel supplier, and the supplier supplies the ordered steel, but when the price of steel increases, the supplier will no longer provide steel at the price reflected in the letter. Instead, the supplier says that it will supply steel products at higher, market prices on an order-by-order basis depending on product availability. The parties reach an impasse as to price, and the supplier refuses to ship. This was the case in *General Motors Corporation vs. Steel Dynamics, Inc.* Faced with a possible interruption in production, GM paid the steel supplier, Steel Dynamics, the increased price under protest. GM then sued the supplier in the Circuit Court of Oakland County, Michigan, seeking damages and an injunction to enforce the contract and prevent the supplier from stopping shipment. The court dismissed GM's complaint, holding that there was no enforceable contract between GM and Steel Dynamics.

The award letter from GM included a pricing matrix and a "Volume Award," which stated in part:

> The General Motors award for calendar years 2003-2004 will be on a part number basis and will be approximately 70,000 Metric Tonnes of General Motors flat rolled product….

The letter also included the following disclaimer:

> This is not guaranteed tonnage nor guaranteed percentage of General Motor's *[sic]* business.

In support of its later demand for market (instead of matrix) prices, Steel Dynamics explained in correspondence to GM that because GM had refused to provide tonnage commitments in its letter, the parties "were operating strictly on a purchase order by purchase order basis …" Steel Dynamics also told GM that it would supply steel at matrix prices under purchase orders it had previously acknowledged, but that it would only supply at market prices under forecasts and releases it had received but not yet acknowledged. Steel Dynamics went on to state: "Henceforth, any forecasts and/or releases received from GM that are not based on market pricing will be deemed automatically rejected." GM responded by stating that "GM's position has consistently been that Steel Dynamics is required to comply with the contracts and supply steel to GM at the contractually agreed-upon prices."

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The court found that the award letter to Steel Dynamics did not contain a quantity term. The court specifically noted the disclaimer confirming that there was no guaranteed tonnage or percentage of business. Accordingly, GM had no commitment to purchase any amount of steel, and absent such commitment, there was no mutuality of obligation. Accordingly, there was no enforceable contract. Although GM presented evidence of the course of performance between the parties, including the submission and acceptance of purchase orders over almost 14 months, the court found that "it only applied on specific orders, and it did not apply in this particular circumstance." GM has appealed the case to the Michigan Court of Appeals.

More recently, in the unpublished opinion of *Dedoes Industries, Inc. v. Target Steel, Inc.*, the Michigan Court of Appeals similarly held that there was no enforceable contract where a purchase order failed to contain a quantity term. In *Dedoes Industries*, a manufacturer of steel products submitted a purchase order in response to a price quote from a supplier of steel stock. The price quote indicated that the supplier would satisfy the purchaser's steel needs and that the quote was good "for all of 2001 and the next two years." The court found that this did not constitute a quantity term nor was any quantity term contained in the purchase order submitted by the purchaser. Accordingly, there was no enforceable contract.

Under § 2-201 of the Michigan Uniform Commercial Code, a contract for the sale of goods for $1,000 or more must be in writing and signed. A writing is not insufficient because it omits or incorrectly states a term agreed upon by the parties. In fact, the Code provides several gap-fillers to cover omitted terms. But § 2-201 specifically provides that "the contract is not enforceable under this subsection beyond the quantity of goods shown in the writing." In 1984, the Michigan Supreme Court explained in *Lorenz Supply Company v. American Standard, Inc.*, that the "only term which must appear is the quantity term which need not be accurately stated but recovery is limited to the amount stated." The Michigan Supreme Court further recognized that a "requirements or output term of a contract, although general in language, nonetheless is, *if stated in the writing*, specific as to quantity, and in compliance with § 2-201." In 1983, the Michigan Court of Appeals found in *In re Frost* that the term "all" referred to quantity. However, a party relying on the use of the term "blanket" in a supply agreement to satisfy the requirement of a quantity term may be disappointed by the recent unpublished decision of the Michigan Court of Appeals in Acemco, Inc. d/b/a Acemco Automotive vs. Olympic Steel Lafayette, Inc.

Once the basic requirement of a quantity term is met, additional evidence may be introduced to explain the writing, including the quantity term. However, as illustrated by the two recent cases discussed above, the failure to include any quantity term in the operative documents may be fatal to enforceability. Where one party has an obligation to perform and the other has no obligation to perform, a court may find that the alleged contract lacks mutuality of obligation and is thus void for lack of consideration. While this may not necessarily apply to individual purchase orders or releases that contain a quantity and are effectively accepted, a party relying on a supply agreement totally silent as to quantity but that instead anticipates the submission of future purchase orders or releases containing a quantity term may be disappointed in attempts to enforce the obligation of the other party to accept future purchase orders.

The rise of raw material costs and increased general economic hardships have burdened purchasers and suppliers alike, and no company wants to learn that a supply agreement or purchase order it has relied on is unenforceable. We recommend consulting with experienced counsel about supply agreements, purchase orders, and related practices and procedures. It's true what they say–an ounce of prevention is worth a pound of cure.

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