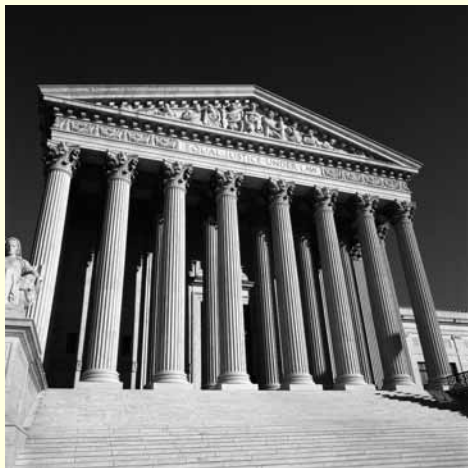


Challenges in Compliance and Corporate Governance



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Thursday, January 17, 2008

CLE Information

This webcast is approved for CLE credit in California, New York (experienced attorneys only) and by the Law Society of England and Wales. Application for approval is pending with the Colorado, Texas and Virginia Bars.

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Overview

- **Increased Exposure for In-House Counsel and Compliance Officers**
- **Risk Based Approach to Compliance**
- **Hot Topics for Compliance Officers**
 - Whistleblowing: Its Role in Compliance and International Developments
 - Anti-Money Laundering
 - FCPA
 - Export Controls
- **Deferred and Non-Prosecution Agreements**
- **A Compliance Monitor's View**

A Dangerous New World for Attorneys

- A record number of corporate general counsels were charged with civil or criminal fraud in federal court in 2007
- While option backdating dominated the news, counsels were charged with other alleged misconduct as well
- Examples:
 - ***U.S. v. Black et al*, No. 05CR727 (N.D. Ill., Dec. 10, 2007)**
 - Mark Kipnis, general counsel for Hollinger International Inc., was convicted of fraud for helping Conrad Black structure fraudulent transactions after a trial in which one government brief argued, “It does not matter that Kipnis was implementing other people's decisions rather than running the show.”
 - ***S.E.C. v. Heinen and Anderson*, No. 07-2214 (N.D. Cal., April 24, 2007)**
 - The SEC accused Apple’s former general counsel Nancy R. Heinen of directing her staff in February 2001 “to prepare documents falsely indicating that Apple's Board had approved the Executive Team grant on [January 17, 2001].”
 - ***U.S. v. Ferguson et al*, 06CR137 (D. Conn., Currently in trial)**
 - Robert Graham, assistant general counsel for General Re, was indicted for allegedly helping to structure a deal which prosecutors claimed in opening statements “appeared to be legitimate, but evidence in reality showed the deal was nothing but a sham transaction to deceive analysts and shareholders.”

Outside Counsel Are Not Immune

- **The government has shown that it will aggressively pursue outside, as well as in-house, counsel**
- ***US v. Collins, 07 CV 11343 (S.D.N.Y. Dec. 18, 2007)***
 - On December 18, 2007, a major law firm partner Joseph P. Collins was indicted for allegedly helping his client, Refco, Inc., hide massive losses from investors
 - “These misrepresentations, omissions, and half-truths – as well as misrepresentations, omissions, and half-truths told by coconspirators that Collins confirmed and furthered – were believed by Refco’s investors and lenders in part because Collins’s status as a partner with a well-known law firm and as Refco’s long-time counsel gave them confidence that such representations were truthful, accurate, and complete.” *Indictment of Joseph P. Collins, S.D.N.Y.*
 - “This indictment should send a chill down the spine of every transactional lawyer who believes he or she is representing an honest client.” *William Schwartz, Attorney for Collins*
 - Prior to his indictment, Collins was set to be recognized by The Best Lawyers in America, 2008

SEC Sanctions Imposed Against Broad Spectrum of Corporate Employees

ConAgra (Summer 2007): The SEC settled a series of civil and administrative actions against ConAgra Foods, Inc., and its former employees, who engaged in various improper and fraudulent accounting practices resulting in material misstatements of the company's financial performance

- ConAgra paid \$45 million to settle a civil action
- Eight former employees of ConAgra and a subsidiary also settled:
 - Chief Financial Officer
 - Executive VP for Operations
 - Three Corporate Controllers
 - Director of Corporate Accounting
 - Vice President for Taxes
 - President and COO

Prism of Principles

➤ Federal Sentencing Guidelines

- “The organization shall periodically assess the risk of criminal conduct and shall take appropriate steps to . . . reduce the risk of criminal conduct identified through this process.” Federal Sentencing Guidelines § 8.B.2.1.(c)

➤ COSO and Enterprise Risk Management

- “Process designed to identify potential events that may affect the entity, and manage risk to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives.”

➤ Auditing Standard No. 5

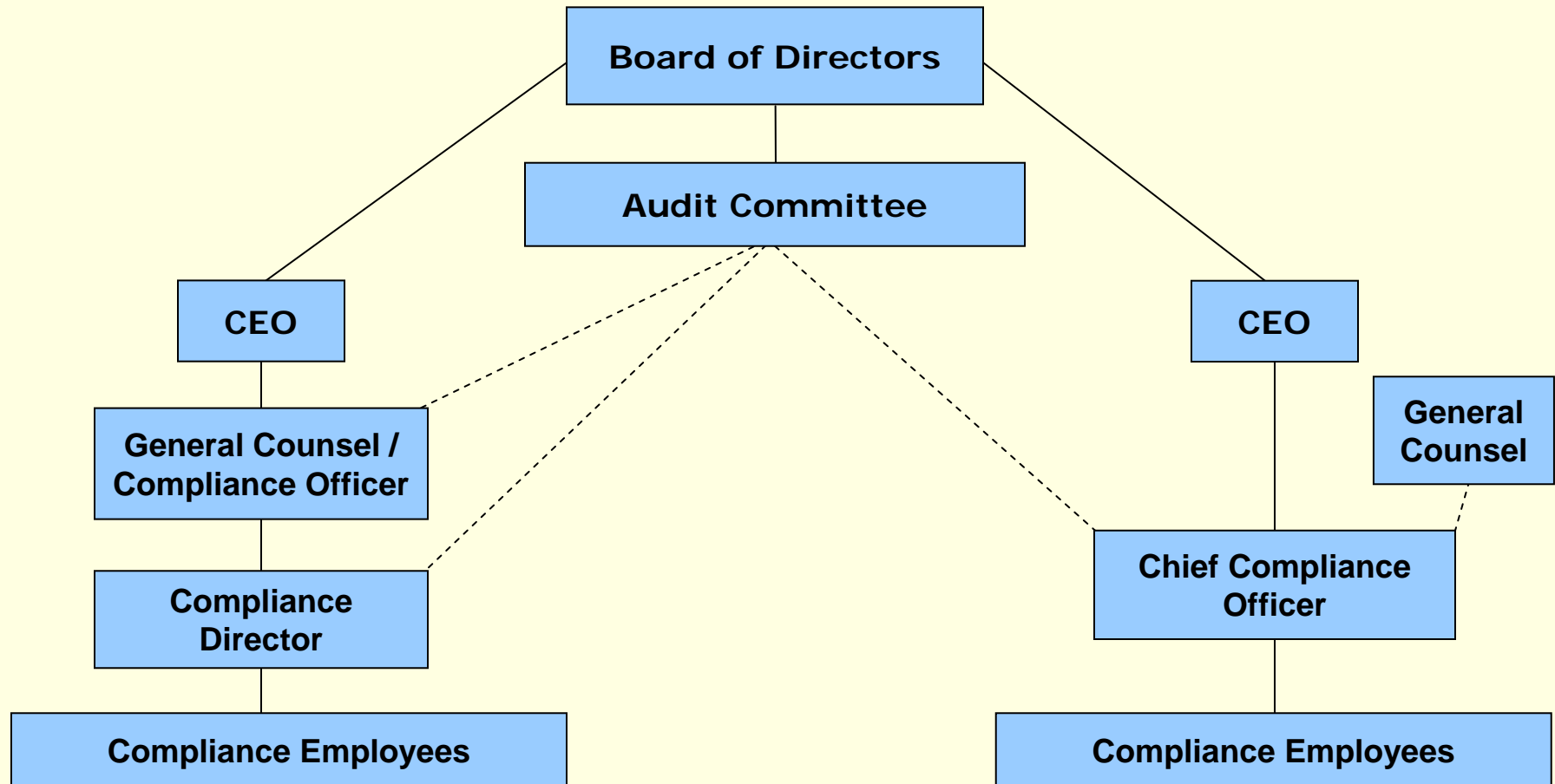
- “At the same time, we and the Public Company Accounting Oversight Board completely replaced the existing auditing standard under 404 with a much shorter, **risk-based and principles-based approach** that will make compliance more rational and efficient, while at the same time better focusing the internal control assessment and auditing effort on what is truly material to the integrity of the financial statements.” Christopher Cox, SEC Chairman, October 9, 2007

Big Picture: What are your primary risks?

Navigating the Mine Field: Know Your Business Risks

- **Recognize that areas of risk vary by company**
 - Know your individualized risk factors
 - What do we sell and what can go wrong with it?
 - Operating in high risk countries?
 - Investigations involving your industry?
 - Joint ventures? Agents? Third-party contractors? Mergers? Acquisitions?
- **Prioritize Risk**
 - Focus on primary sources of revenue
 - The more activity in an area, the greater likelihood of a violation
 - Penalties are often assessed based on revenue relating to the violation
- **Keep abreast of all violations, no matter how minor**
 - Seemingly small problems can indicate more serious issues
- **Deal with problems as they arise**
 - Lingering violations can create an atmosphere of noncompliance
 - The perception that a company is ignoring problems or attempting to cover them up can be more devastating than the violation itself

Structure and Organization of Compliance Functions



*Note: Presence of Chief Risk Officer at some financial institutions

An Ounce of Prevention: Training

- **The lack of an effective compliance program can become a source of liability.**
 - “Plaintiffs have sufficiently alleged that Medco submitted its false claims knowingly under this definition. At the very least, the Government has claimed that Medco's compliance programs were either non-existent or insufficient, in satisfaction of the "reckless" requirements of § 3729(b).” *Merck-Medco Managed Care, L.L.C.*, 336 F. Supp. 2d 430, 440-41 (E.D. Pa. 2004)
 - Medco settled with the government for \$155 million
- **An effective compliance structure must include a training program designed to instruct employees in the principles and procedures necessary to avoid violations**
- **How can you avoid Medco liability?**
 - Training must occur at all levels of the company, including the Board of Directors
 - Keep detailed records of all training activities, including statistics of participants
 - Bathe new employees and those from newly acquired companies in your culture of compliance through early training programs
 - Provide refresher training at regular intervals

Benchmarking Hotlines

- **Analyze hotlines regularly to determine their effectiveness**
- **Statistics show:**
 - 71% of callers have not reported the issue to management
 - 65% of hotline reports were serious enough to warrant an investigation
 - 45% of hotline reports resulted in corrective action
 - 34% of callers learned of the hotline from a poster or sign in the workplace
 - Only a slim majority (53%) of callers chose to remain anonymous
 - 66% of reports involving corruption or fraud were by named individuals

Security Executive Council, 2007 Corporate Governance and Compliance Hotline Benchmarking Report, November 15, 2007

When the Whistle Blows: Hotlines

- If the reports generated by your whistleblower mechanism total only a fraction of the industry average, revisit your training and communications program
- Employee reporting can allow you to discover and neutralize potential compliance issues before they become a problem

Industry Category	Annual Report Frequency per 1000 Employees
Construction	4.3
Finance	7.6
Manufacturing	12.9
Mining	5.9
Retail Trade	20.6
Service Industries	11.3
Transportation, Communication & Utilities	19.3
Wholesale Trade	15.0
Overall	14.9

Toby Bishop and Deborah Temkin, *Benchmarking Your Whistleblower Hotline*, ALM Business Crimes Bulletin, Volume 14, Number 8, April 2007

Whistleblowing and the Global Workplace

- **Establish hotlines in every office and in every language your employees speak**
- **Publish examples of information gathered from hotlines leading to positive change**
- **Ensure that your employees know that retaliation will not result from reporting violations**
- **Advertise hotlines in multiple media, including through emails, handouts, signs, banners, and on the company webpage**
- **Expect cultural variation in hotline participation**
- **Identify offices where hotlines are underused. Offices in countries with strong cultural traditions against whistleblowing may require additional training**
- **European Union privacy laws also may affect the process**
 - Germany and France have specific rules for the implementation of hotlines

Anti-Money Laundering

➤ What is Money Laundering?

- The process that conceals existence, nature or source of the proceeds of illegal activity and disguises them to make them appear legitimate
 - ***Not limited to drug trafficking:*** Can involve any crime that generates proceeds, e.g., bribery, corruption, embezzlement, and all types of fraud
 - ***Not limited to cash transactions:*** Can involve wire transfers, checks, and money orders
 - ***Not limited to the movements of funds:*** Can involve purchases of goods, loans, and investments domestically or internationally
 - ***Not limited to financial institutions:*** Can include a financial transaction with any business, including a manufacturer, distributor or seller of goods

Government Response to the Money Laundering Problem

- **Criminal Laws:** Prohibit knowingly conducting financial transactions with knowledge that the proceeds are from specified unlawful activity
 - Government must prove the proceeds came from one of over 200 U.S. crimes (e.g., drug trafficking, racketeering, FCPA violations, and mail and wire fraud) and certain foreign crimes (e.g., official corruption, terrorist acts, and bank fraud)
 - **U.S. v. Pasquantino, 544 U.S. 349 (2005):** A scheme to defraud a foreign government of taxes can constitute a wire fraud, which can be the basis for money laundering
 - **Knowledge:** Actual knowledge; includes “willful blindness”
- **Regulatory Requirements:** Impose compliance program, reporting and recordkeeping requirements to prevent and detect money laundering and terrorist financing
 - Primarily apply to financial institutions (e.g., banks, broker-dealers, mutual funds, insurance companies, and money service businesses) *but* cash and certain other reporting requirements apply to *all* businesses

U.S. Sentencing Guidelines consider an effective compliance program a mitigating factor in sentencing (and could be a disincentive to prosecution)

Elements of an Effective Anti-Money Laundering Program

- A designated qualified Compliance Officer with adequate authority and sufficient resources to oversee and monitor compliance with the AML Program
- Initial and periodic assessments of the AML risks posed by the business' customers, products and services, distribution channels, and geographic locations and markets
- Risk-based policies, procedures and internal controls to prevent and detect possible money laundering and comply with regulatory requirements that are periodically refreshed, *including*:
 - Customer due diligence policies and procedures, *e.g.*, prohibitions or enhanced procedures for high-risk customers
 - Payment policies that restrict cash and other forms of payment, *e.g.*, money orders, travelers checks and third-party payments
 - Procedures and systems for identifying, escalating, investigating and, where required or appropriate, reporting cash transactions and suspicious activity and taking other action, *e.g.*, severing customer relationships
 - Procedures for retaining customer and transaction records, reports, and other documentation

Elements of an Effective Anti-Money Laundering Program

- **Procedures for complying with criminal subpoenas and other law enforcement information requests**
- **Initial and periodic education and training for the Board of Directors, senior management and all appropriate employees**
- **Compliance incentives and discipline for employees**
- **Independent audits to test compliance with and the effectiveness of the Program**

Hot Topics: Increasing FCPA Enforcement Activity

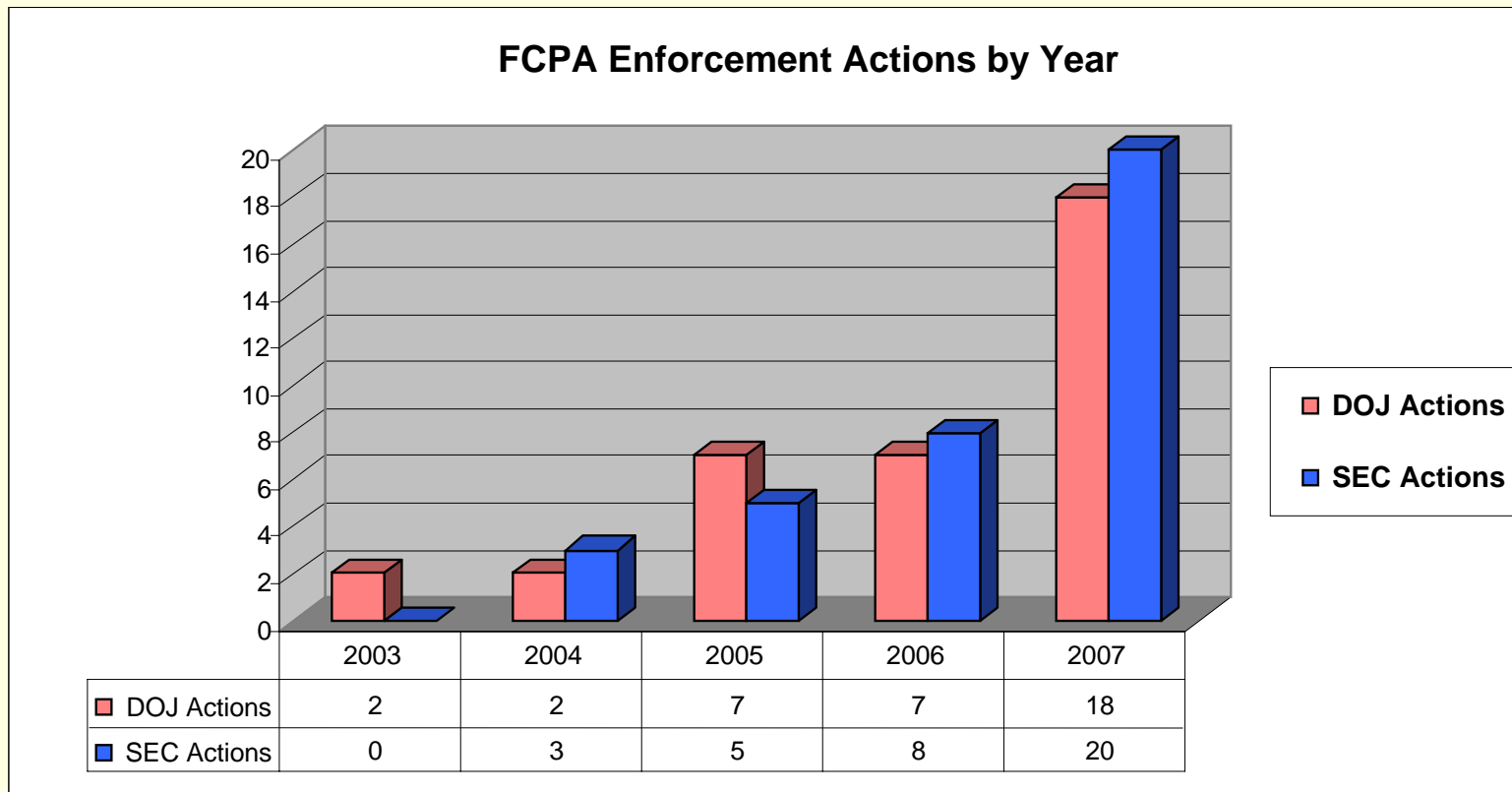


- **There has been a recent explosion of enforcement activity by both the SEC and the DOJ, 38 in 2007 alone**
 - Eighteen new enforcement actions by the DOJ
 - Twenty new enforcement actions by the SEC

- **Approximately 100 other companies currently have open FCPA investigations**
- **Mark Mendelsohn, Deputy Chief of the Fraud Section at the DOJ, recently noted that the recent flurry of enforcement actions is “just the tip of the iceberg” and that the DOJ has “many more matters under investigation.” (Sept. 27, 2007)**



Increasing FCPA Enforcement Activity



- **Since 1990, twice as many individuals as corporations have been prosecuted for FCPA violations**
- **ABB**: Regional Sales Manager for West Africa; Senior Vice President of Operations; Vice President of Finance; Former Vice President of Sales
 - **Faheem Salem**: Civilian Translator in Iraq
 - **InVision**: Senior Vice President for Sales and Marketing and Board Member
 - **Schnitzer Steel**: Former Chairman and CEO; Executive Vice President of Sales
 - **Syncor International Corp.**: Chairman
 - **Titan**: Titan's Africa President
 - **Willbros Group**: Two Regional Managers

Three Silos of Exposure

1. Department of Justice: Criminal enforcement against issuers, domestic concerns, foreign companies listed on U.S. exchanges, U.S. citizens, and other persons
2. Securities & Exchange Commission: Civil enforcement against issuers and individuals
3. Private Litigants/Shareholders: Trend to allow securities class actions against issuers based upon FCPA violations
 - Immucor
 - Nature's Sunshine Products
 - FARO Technologies

Typical Settlement Components

SEC:

- Injunction
- Fine
- Disgorgement
- Pre-judgment Interest
- Compliance Monitor and/or Compliance Undertakings

DOJ:

- Plea of Guilty
- Deferred Prosecution Agreement or Non-Prosecution Agreement
- Fine
- Monitor and/or Compliance Undertaking

Aggressive FCPA Enforcement

➤ Failure to Comply with the FCPA can lead to the imposition of Large Penalties:

- Chevron (November 2007): \$30 Million fine related to Oil-for-Food (\$3 million civil penalty, \$25 million in disgorgement of profits, and \$2 million penalty to the Office of Foreign Asset Controls)
- Baker Hughes (April 2007): Largest total fine to date – \$44 million (\$11 million criminal fine, \$10 million civil penalty, and \$23 million in disgorgement of profits) and requirement to retain a compliance monitor
- Vetco Gray (February 2007): Largest criminal fine to date – \$26 million in combined criminal fines paid by three Vetco subsidiaries and requirement to retain a compliance monitor
- Statoil (October 2006): \$21 million criminal penalty, disgorgement of profits, and requirement to retain a compliance monitor
- Schnitzer Steel (October 2006): \$15.2 million criminal penalty, disgorgement of profits, and requirement to retain a compliance monitor
- Titan (March 2005): \$28.5 million fine (\$13 million criminal fine and \$15.5 million civil penalty), in addition to disgorgement of profits

Disproportionate Penalties

- **Immucor Inc.**

- SEC accused Immucor of paying Italian doctor in Milan \$16,000 in exchange for preferential treatment in selection of contracts for supplies and equipment
- *In re Immucor Inc.* (N.D. Ga. Oct. 4, 2006): Federal district court refused to dismiss a § 10(b) action based on Immucor's allegedly false and misleading statements in financial statements regarding FCPA violations because the plaintiffs met the heightened pleading requirement for fraud under the PSLRA. Immucor settled the class action for \$2.5 million in May 2007
- On September 27, 2007, Immucor entered into administrative settlements with SEC charging them with violating FCPA's anti-bribery, books-and-records, and internal controls provisions and ordering them to cease-and-desist from future violations of same

\$16,000 in improper payments v. \$2.5 million settlement

- **Paradigm B.V.**

- \$22,000 paid to consultant who appeared to provided no actual service
- Payments to Chinese gas companies to influence employee's procurement process
- \$12,000 vacation in Napa Valley for the brother of PEMEX official
- On September 21, 2007, Paradigm entered non-prosecution agreement and paid \$1 million fine

\$34,000 in improper payments v. \$1 million fine

Ten Essential Elements of an FCPA Compliance Program

1. Clearly articulated policy against violations of the FCPA and foreign anti-bribery laws
2. Appropriate disciplinary procedures to address compliance violations
3. Regular FCPA training for, with mandatory compliance certifications by, employees and third-party representatives
4. Careful pre-retention scrutiny of all third-party representatives
5. Senior management oversight of third-party representatives post-retention
6. Inclusion of anti-corruption representations and undertakings, with audit and termination rights, in all third-party representative agreements
7. Anonymous "Helpline" reporting system
8. Centralization of accounting systems to achieve corporate headquarters-review of all financial transactions (*i.e.*, follow the money)
9. Thorough pre-acquisition due diligence of prospective targets, with a particularized focus on the FCPA and analogous foreign anti-bribery laws
10. Immediate integration of recently acquired subsidiaries to assure that the new entity is effectively bathed in the compliance culture of the acquirer

See Gibson, Dunn & Crutcher [2007 Year-End FCPA Update](http://www.gibsondunn.com/Publications/Pages/2007Year-EndFCPAUpdate.aspx);
<http://www.gibsondunn.com/Publications/Pages/2007Year-EndFCPAUpdate.aspx>

Does Every Violation Have to Be Reported?

“If a company has good controls in place; it trains people; it trains them regularly; it tests its controls regularly so it can be satisfied that they are in place and working; it has appropriate disciplinary policies in place and utilizes them; it thoroughly investigates the matter and gets to the bottom of the issue and is satisfied it has done it; it understands how its controls were circumvented in this case and why it is not a broader problem. If you can say those things – investigate, remediate, properly document all of the things I’ve described – then, yes, I think you can responsibly deal with it and not tell us about it. . . There are only so many hours in the day, and I would like to sleep some of them.”

-- Mark Mendelsohn, Deputy Chief Fraud Section DOJ (Oct. 17, 2007)

FAR Case 2007-006, Contractor Compliance Program and Integrity Reporting

Requirement to establish Code of Ethics and Business Conduct and to establish and maintain specific internal controls to detect and prevent improper conduct relating to government contracts

Requirement to “notify contracting officers without delay whenever they become aware of violations of Federal criminal law with regard to [federal] contracts or subcontracts.”

Decisions on Voluntary Disclosure Are Company and Fact Specific

Consider:

1. Whether the circumstances represent an isolated event or a systemic problem
2. The seniority level of the employee or employees who made, were aware of, and/or authorized the conduct
3. The length of time over which the conduct occurred
4. The amount of improper payment
5. The clarity of the violation
6. The inevitability that the conduct will be revealed to the DOJ through an anonymous report by a whistleblower, activities in a foreign country, or through the actions of foreign governments
7. The likelihood, if it learns of the incident, the government will take enforcement action
8. The existence of prior misconduct
9. Concerns of government discovery of additional improper conduct
10. The willingness to waive attorney-client and work product privileges

Trading Dangers: Export Controls

- Export control laws cover
 - Products and Technology
 - Physically Located in the U.S.
 - Located Abroad But of U.S. Origin
 - Of Foreign Origin But with U.S. Content
- On October 16, 2007, the president signed into law the International Emergency Economic Powers Enhancement Act, increasing civil and criminal penalties for violations of certain export controls
 - Increased civil penalties from \$50,000 to \$250,000 per violation or twice the amount of the violating transaction, whichever is greater
 - Increased penalties for willful and knowing criminal violations from \$50,000 to \$1,000,000
 - Maximum imprisonment term remains 20 years

Export control violations can lead to serious penalties

- In March 2007, ITT pled guilty and was fined \$100 million for illegally exporting night-vision technology to Singapore, China, and the UK and providing false information to the State Department
 - ITT also is subject to an independent monitor and an extensive remedial action program
 - U.S. Attorney John Brownlee stated, "We hope the agreement reached with ITT will send a clear message that any corporation who unlawfully sends classified or export-controlled material overseas will be prosecuted and punished."
- In December 2007, ITT entered into a consent decree with the Army and State's Directorate of Defense Trade Controls in which ITT agreed to pay an additional \$20 million in penalties

The DOJ prosecuted at least 21 major export-related cases in 2007

Export Compliance Checklist

- **Classify the product or technology**
 - U.S. Munitions List
 - Commerce Control List
- **Check the country of destination**
 - National security restrictions for China, some former Soviet Republics, and others
 - Export prohibitions on Cuba, Iran, North Korea, Sudan, and Syria
- **Check the end-user and end use**
 - Legal responsibility to know your customer
 - Check government lists for prohibited persons or entities
 - Look for red flags such as payment in cash, evasiveness about end use, products not appropriate for customers business, and the country of destination does not have industries that use the product

The Rise of Deferred (DPA) and Non-Prosecution Agreements (NPA)

- In 2002, the government issued 2 DPAs and 0 NPAs
- In 2007, that number skyrocketed to 34: 19 DPAs and 15 NPAs
- DOJ uses these agreements when cooperation is deemed “authentic”
- Advantages to DPAs and NPAs
 - Government: Gets compliance results similar to those expected after a full scale prosecution
 - Company: Avoid the expense and negative publicity inherent with a trial
- Obtaining a DPA or NPA:
 - Cooperation is key
 - “You’ll get a lot of credit if you cooperate, and that credit can make the difference between life and death for a corporation. . . . You have to get all the way on board and do your best to help the government.”
Christopher Wray, Assistant Attorney General,
Speech, February 25, 2005

Deferred and Non-Prosecution Agreements Defined

- **Deferred Prosecution Agreement:** Contract between the government and a defendant, executed contemporaneously with the government's filing of a criminal charge against the defendant. The government agrees to "defer" its prosecution of the charge if the defendant adheres to various obligations outlined in the DPA. If the defendant satisfies these obligations, the government will move to dismiss the charge.
- **Non-prosecution Agreement:** Contract in which the government agrees not to file charges against the company at all in exchange for certain promises from the defendant
- **Common Features:**
 - Fines
 - Adjustments in Compliance Programs
 - Compliance monitor

A Compliance Monitor's View

- **A monitoring program generally consists of three phases**
 1. Implementation – The company implements new standards and practices
 2. Monitoring – The monitor records how the company meets the newly implemented standards and evaluates their effectiveness
 3. Assessment – The monitor makes an overall assessment of the company's new standards and practices

- **The monitor evaluates compliance practices and suggests areas for improvement, it does not create the policies**

- "The Justice Department's criminal division launched a policy review of [monitor selection], meeting with business executives, former prosecutors and defense lawyers last year to evaluate how the monitorships are working and whether a process for selecting them should be centralized, in part to avoid appearance problems." *Washington Post, Jan. 15, 2008*

Keys to a Successful Monitorship

- **A compliance agreement is between the company and the regulator, not the monitor**
- **Draft a comprehensive Administrative Agreement that clearly outlines the responsibilities and limitations of the monitor**
- **Expect an outline of the monitors plan, including resource planning and expected costs**
- **Maintain the independence of the monitor**
 - The monitored company is not the client of the monitor
- **The monitor is not a regulator, company's ombudsman, or policy maker**

Managing Risks Associated with Monitors

➤ Things to Remember

- There is no attorney-client privilege between the company and monitor
- Keep dialogue open between the company and monitor
- Share information such as internal reviews and corporate data
- Self report violations and maintain a full disclosure policy
- Have a plan for every stage of the monitoring program
- Continuously review monitoring reports

It's A Dangerous World

Five Ways to Make it Safer

1. Regular compliance messaging from senior executives
 - Banners and posters in conference rooms and elevators
 - Internet messaging
 - Open forums, townhall meetings
2. Incorporate compliance goals as a component of compensation
3. Don't segregate compliance; integrate into business units
4. Bifurcate whistleblower claims from personnel issues, e.g. passed over for promotion v. legitimacy of allegations
5. If compliance failure, assess and remediate immediately

Questions?



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