

Challenges in Compliance and Corporate Governance



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CLE Information

This program has been approved for credit in accordance with the requirements of the New York State Continuing Legal Education Board for a maximum of 1 credit hours, of which 1 credit hour may be applied toward the areas of professional practice requirement. This course is NOT approved for transitional credit.

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Overview

➤ **The Current Enhanced Environment: the Financial Crisis and the New Administration**

- The government's response to financial crisis has been to increase enforcement efforts

➤ **Risk Based Approach to Compliance**

➤ **Hot Topics for Compliance Officers**

- Antitrust
- FCPA
- Government Contracts

➤ **A Compliance Monitor's Perspective**

➤ **Compliance in a Time of Financial Constraint**

Regulatory Enforcement Environment

- SEC announced “sweeping expansion of its ongoing investigation of market manipulation,” including investigations into:
 - false rumor mongering
 - abusive short selling
 - possible manipulation of financial stocks

SEC Press Release, September 19, 2008
- TARP Special Inspector General Neil Barofsky is preparing to ask the over 300 firms who have received funds from the financial rescue to provide “a narrative response outlining their use or expected use of TARP funds” and supporting documentation. *Washington Post*, January 23, 2009
- In her January 15th Senate confirmation hearing, newly confirmed SEC Chairman Mary Schapiro promised that she will be “as aggressive an enforcer as anyone has ever been at the SEC” and that she will take the “handcuffs off” the SEC’s Enforcement Division.
- On January 22nd, Senators Schumer and Shelby proposed the Supplemental Anti-Fraud Enforcement (“SAFE”) Markets Act to add \$110 million to FBI, DOJ and SEC budgets to “crack-down” on Wall Street.

2009 SEC Goals

- **Closing Regulatory Gaps** “will be key to financial services regulatory reform.” SEC 2008 Annual Report
- **“In this time of market turmoil, . . . there is an overwhelming need for strong enforcement of the securities laws — by the states, foreign regulators, and the SEC.”** Luis A. Aguilar, Commissioner, January 10, 2009
- **Giving the SEC the authority to undertake criminal prosecutions would “be an effective way to enhance the federal law enforcement of all securities law violations by expanding the [number] of cases that may be brought.”** Luis A. Aguilar, Commissioner, January 10, 2009
- **New SEC Chairman has outlined the following goals:**
 - aggressively reinvigorate enforcement
 - re-engage with investors
 - update, and if necessary, overhaul the regulatory regime
 - increase federal oversight of insurance companies and credit default swaps

Mary Schapiro, SEC Chairman, January 15, 2009



The Prism of Principles Remains Stable

➤ 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

- “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.” COSO, Enterprise Risk Management - Integrated Framework Executive Summary

➤ 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

➤ Caremark Duty

- “[T]o attempt in good faith to assure that a corporate information and reporting system, which the board concludes is adequate, exists . . . [F]ailure to do so . . . may . . . render a director liable for losses caused by non-compliance with applicable legal standards.” *In re Caremark Int’l Inc.*, 698 A.2d 959 (Del. Ch. 1996)
- The Delaware Supreme Court affirmed the Caremark standard for corporate compliance programs in *Stone v. Ritter*, 911 A.2d 362 (Del. 2006)

Big Picture: What are your primary risks?

Assessing the Code of Conduct

- **Public Availability:** Is the Code available and easily accessible to all stakeholders?
- **Tone from the Top:** In today's trying environment, does the CEO's message acknowledge tough times but emphasize company's strong culture of compliance?
- **Readability and Tone:** Is the language of the document easy to read and reflective of its target audience?
- **Non-Retaliation & Reporting:** Is there a stated, explicit non-retaliation commitment and are there clearly available resources dedicated to reporting code violations?
- **Risk Topics:** Does the Code address all the appropriate and key risk areas for a company's industry?
- **Learning Aids:** Does the Code provide hypotheticals and examples?

50 Codes of Conduct Benchmarked, Ethisphere, January 12, 2009

Know and Plan for Your Risks

➤ Enterprise Risk Management

- Identify your company's particular risks and opportunities
 - Risk from lines of business?
 - Products Liability Risk?
 - Financial Risk?
 - Environmental Risk?
 - Antitrust Risk?
 - Reputational Risk?
- Assess each risk's likelihood and magnitude of impact
 - Prioritize Risk
 - Create more comprehensive plans for higher risk areas
 - Penalties are often assessed based on revenue relating to the violation
 - Assure that even less severe risks are monitored
- Determine a response strategy; and
- Monitor progress

➤ Analyze Industry Issues

- When a competitor struggles with a compliance issue, assess your company's performance relating to that issue

➤ Conduct an assessment of your own risk management and compliance programs

Training: An Ounce of Prevention

- **A comprehensive training program can insulate against violations and provide protection if a violation occurs**
 - *United States v. Merck-Medco Managed Care, L.L.C.*, 336 F. Supp. 2d 430 (E.D. Pa. 2004)
- **Reaching Your Employees, Officers, and Directors**
 - Ongoing Training
 - Vary Teaching Styles
 - Vary Methods of Training
 - E-learning
 - Interactive classes
 - Lectures
 - Director and officer participation

The Government's Mandated Compliance Structure for Bayer

- **In November 2008, Bayer entered into a Corporate Integrity Agreement (CIA) with the OIG of HHS to promote compliance with statutes and regulations of all federal health care programs.**

http://www.oig.hhs.gov/fraud/cia/agreements/fully_executed_bayer_cia_112508.pdf

- **Throughout the 5 year term of the CIA, Bayer must implement and maintain a Compliance Program that includes the following elements:**
 - A compliance officer and compliance committee, comprised of senior management, responsible for ensuring compliance with the CIA;
 - The compliance officer shall make quarterly reports directly to the Board of Directors;
 - A written Code of Conduct that meets certain specifications and *makes adherence to the Code an element of employee evaluations*;
 - Compliance with the Anti-Kickback Statute;
 - Engagement of an independent review organization (i.e. accounting, auditing, consulting, or law firm) to assess compliance with CIA obligations;
 - A disclosure program that enables employees to report potential violations; and
 - Reporting of events that may reasonably be considered violations of laws applicable to any Federal health care program

Hotlines: Now Commonplace but Nonetheless Important

- **Analyze hotlines regularly to determine their effectiveness**
 - **Assess whether and why your call numbers are up or down**
 - Is the line assessable, publicized?
 - Are reports followed up on?
 - Are results of calls publicized?
 - Are there trends in subject matter or location?
- **Consider benchmarking data**
 - *Ethisphere* and *Compliance Week* periodically provide benchmarking data

Whistleblower Update

Crawford v. Metro. Gov't of Nashville and Davidson County, TN, 555 U.S. __ (2009)

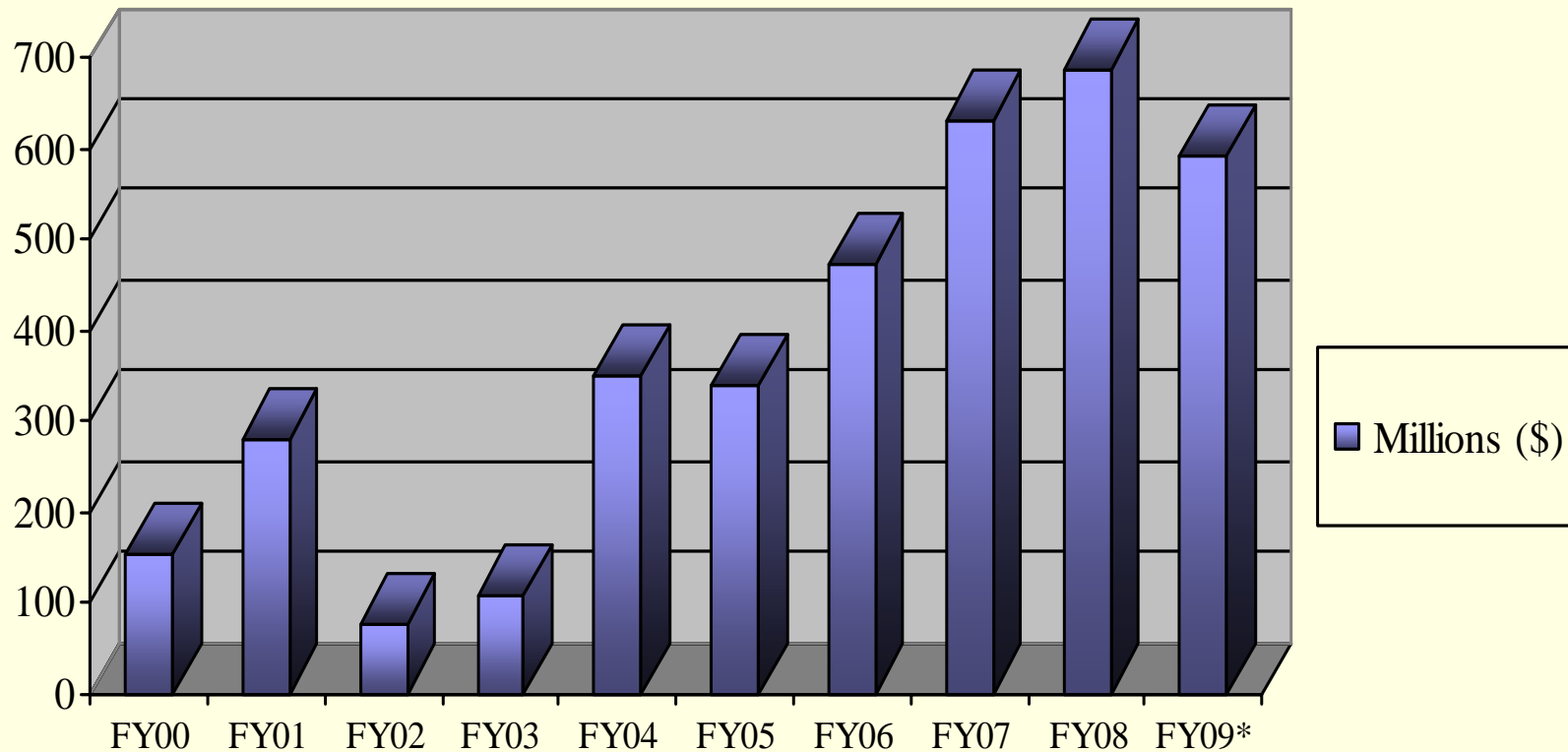
- Under Title VII, it is unlawful “for an employer to discriminate against any . . . employe[e] . . . because he has opposed any practice made . . . unlawful . . . by this subchapter.” 42 U.S.C. §2000e – 3(a)
- In *Crawford*, the Supreme Court held that Title VII whistleblower protection extends to an employee who speaks out about discrimination not on her own initiative, but while answering questions during an employer’s internal investigation
- Now, an employee can be entitled to whistleblower protection even when he is not the original whistleblower

Criminal Antitrust Developments

Significant Ongoing Antitrust Investigations

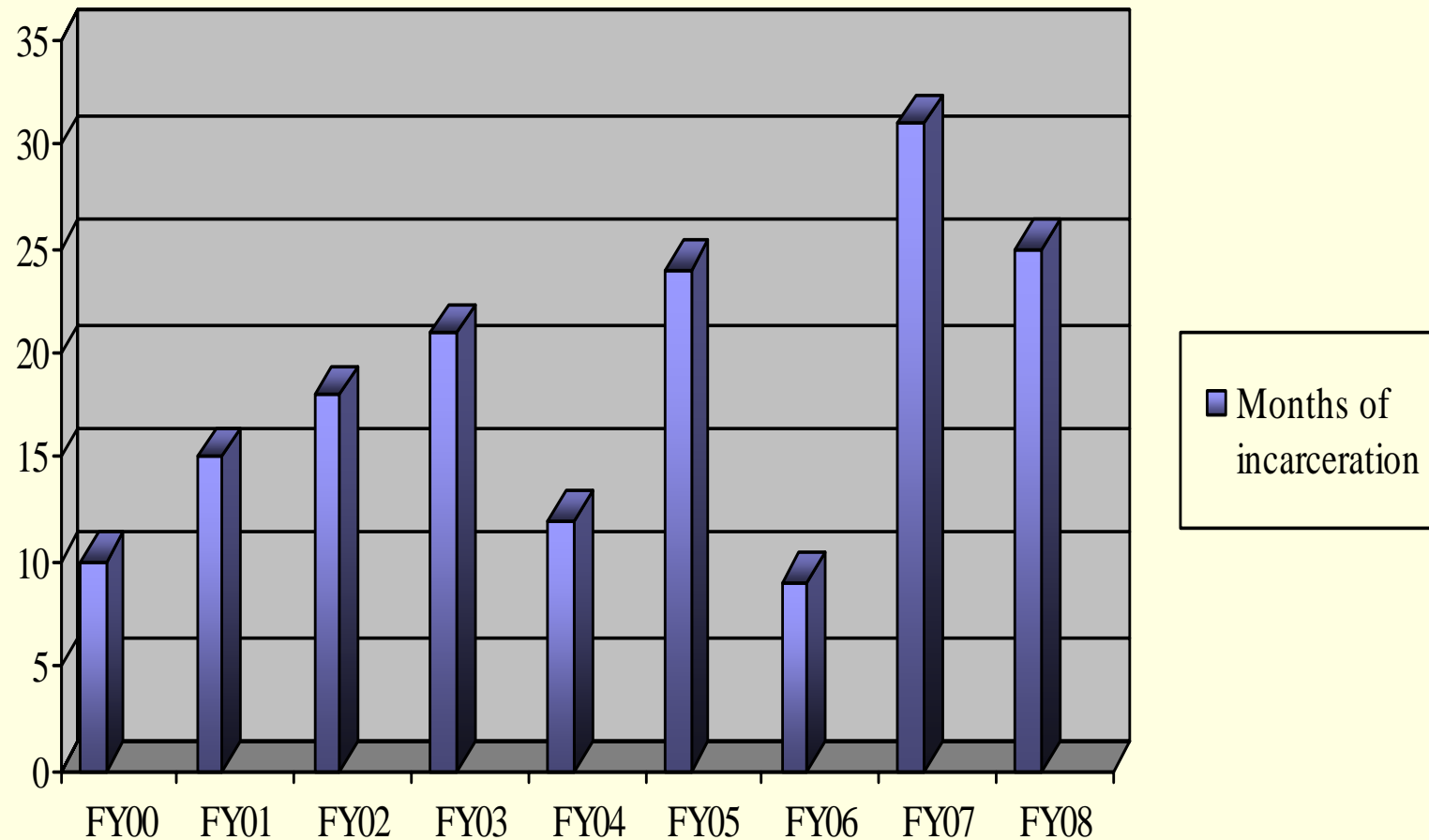
- **Air Cargo**: January 2009 - LAN Cargo S.A. (LAN Cargo), Aerolinhas Brasileiras S.A. (ABSA), and EL AL Israel Airlines Ltd. (EL AL), agreed to plead guilty and pay criminal fines totaling \$124.7 million for their roles in a conspiracy to fix prices in the air cargo industry.
- **Thin Film Transistor-Liquid Crystal Display (TFT-LCD)**: December 2008 - Investigation of price-fixing by all major producers of TFT-LCD panels during the period of 1998 – 2006. LG, Chunghwa, and Sharp, have entered into plea agreements. Combined fines for these defendants total \$585 million. Investigation is ongoing.
- **Marine Hose**: May 2007 - Simultaneous arrests of eight foreign executives for conspiring to rig bids, fix prices, and allocate markets of marine hose. To date, 9 individuals have pled guilty for participation in the cartel.

U.S. Criminal Antitrust Fines (2000 – 2009)



***The number for 2009 reflects only the first quarter. Air Cargo investigation fines of \$124.7 million in January 2009 ensure that FY09 fines will far exceed those of FY08.**

Average Jail Sentence for Incarcerated Defendants Charged by the Antitrust Division



Notable Foreign Prosecutions and Developments: Increased Risk of Prosecution in Multiple Jurisdictions

- **French Metal Producers Hit with Record Fine:** In December 2008, the French Competition Authority imposed a \$798 million penalty against 10 steel brokers and sellers that conspired to fix prices in the French steel market from 1999-2004.
- **Australia Proposed New Cartel Legislation:** The new legislation would criminalize "serious" cartel conduct. The maximum penalty for a cartel violation under the new law is 10 years in prison plus a AU\$220,000 fine for individuals and the *greater* of AU\$10 million, three times the benefit gained by the corporation, or ten percent of the corporation's annual turnover.
- **China Adopts First Antitrust Law in Its History:** In August 2008, China's Anti-Monopoly Law became effective. Initial analysis suggests that the only criminal components to the law relate to obstruction of investigations and official corruption.

Antitrust Enforcement and the New Administration

On January 22, 2008, President Obama nominated Christine Varney as Assistant Attorney General in charge of the Antitrust Division. Varney served former president Bill Clinton as a senior White House adviser and was one of five members of the Federal Trade Commission from 1994 to 1997.



The Obama administration appears primed to continue aggressive enforcement of the criminal antitrust laws. Indeed, during the campaign, President-elect Obama said repeatedly that he would direct his administration to reinvigorate antitrust enforcement.

5 Antitrust Compliance Tips

- 1. Scrutinize trade association and industry meetings**
- 2. Evaluate product sales pricing in concentrated markets**
- 3. Bolster training**
 - role playing
 - handshake agreement is not necessary
- 4. Circulate recent enforcement efforts, reminding employees of obligation to report problematic behavior**
- 5. Complete annual/periodic certifications**

FCPA Developments

Aggressive FCPA Enforcement Activity

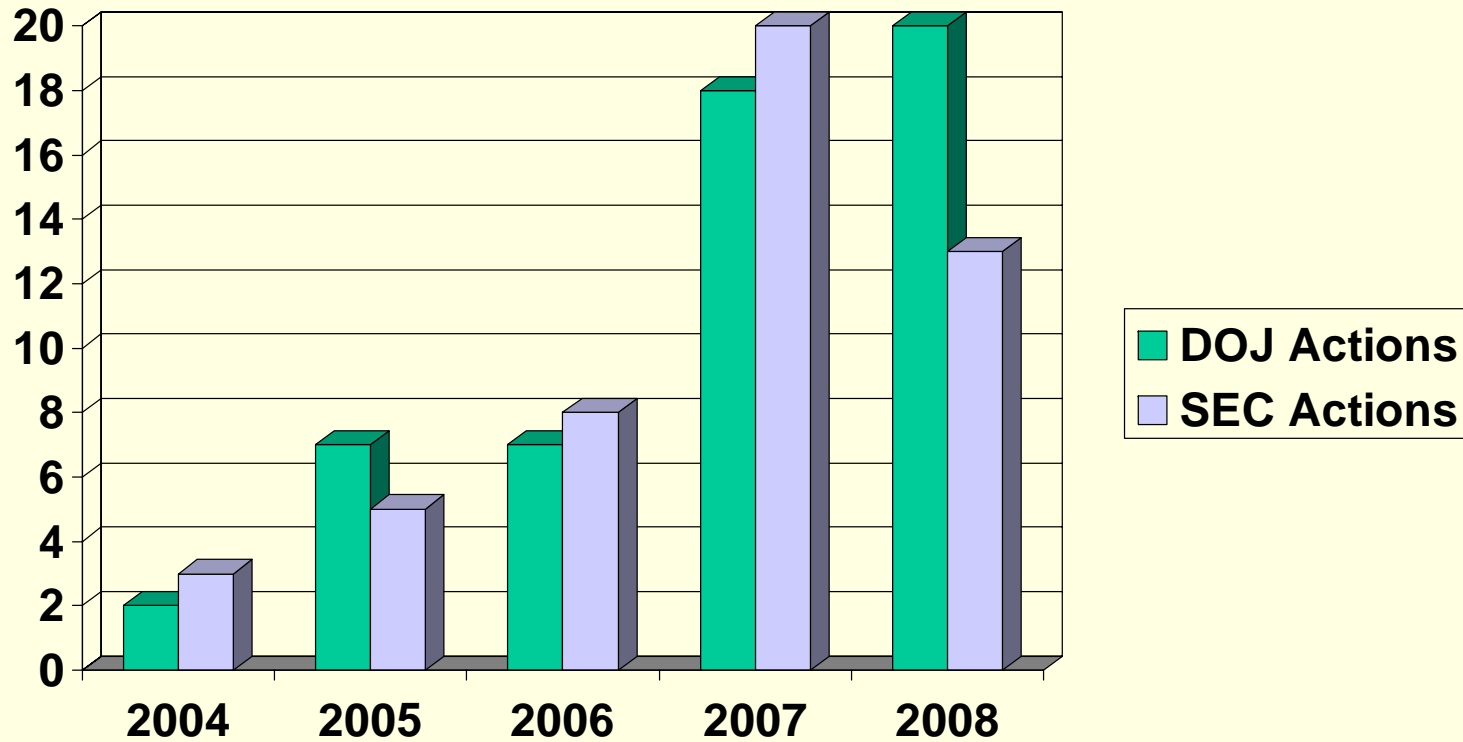


- **In 2008, the FCPA enforcement explosion continued with 33 new enforcements**
 - Twenty new enforcement actions by the DOJ
 - Thirteen new enforcement actions by the SEC

- **Approximately 100 other companies currently have open FCPA investigations**
- **“Corporations both domestic and foreign should expect [that DOJ] and our international colleagues will continue our efforts to level the business playing field, making it free from corruption and open to all who seek to participate within it.”** Matthew Friedrich, Acting Assistant Attorney General, December 2008
- **Director of SEC’s Division of Enforcement Linda Chatman Thomsen affirmed that SEC is “committed to holding violators accountable when they engage in illegal conduct to obtain business in foreign countries.”** September 2008



Recent FCPA Enforcement Efforts



	2004	2005	2006	2007	2008
DOJ Actions	2	7	7	18	20
SEC Actions	3	5	8	20	13

Escalating Corporate Financial Penalties

“The dollar amounts in the [FCPA] cases that will be coming within the next short while will dwarf the disgorgement and penalty amounts that have been obtained in prior cases.”

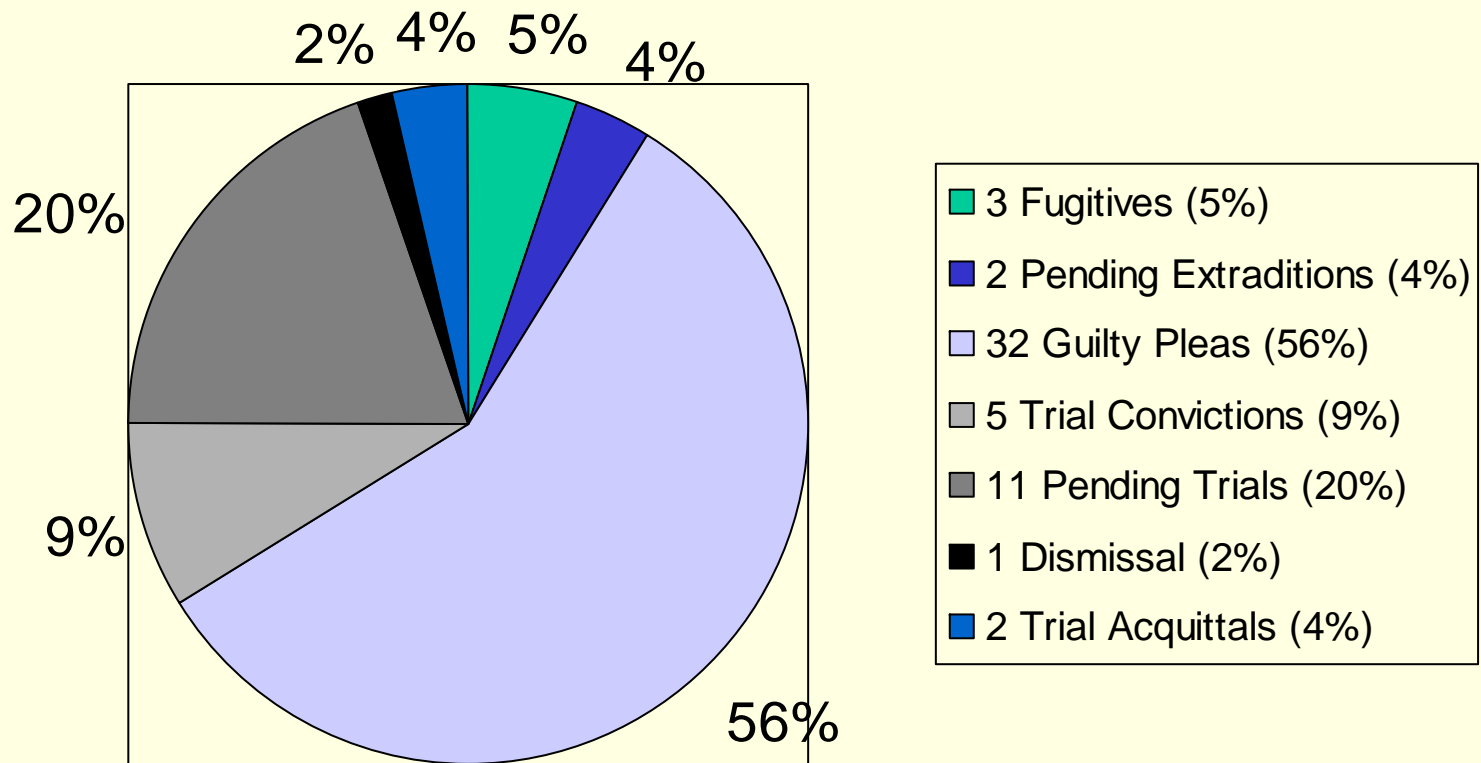
Scott Friestad, Deputy Director of Enforcement for the SEC, November 24, 2008

- **Halliburton (January 2009):** Has reserved \$559 million for settlement of charges that a unit bribed Nigerian officials during construction of a gas plant. Awaiting DOJ final approval
- **Siemens (December 2008):** Record breaking penalties – criminal fine of \$450 million and disgorgement of \$350 million in illicit profits to the SEC. Siemens also settled liabilities with the Munich Public Prosecutor for approx. \$569 million
- **ABB Ltd. (December 2008):** Announced it had reserved \$850 million for potential costs related to U.S. and European investigations concerning suspect payments and alleged anti-competitive practices
- **Aibel Group (November 2008):** DOJ revoked the 2007 deferred prosecution agreement. Aibel Group paid a \$4.2 million criminal fine and will serve a two-year term of organizational probation
- **Willbros Group (May 2008):** \$10.3 million in disgorgement. Also entered into a deferred prosecution agreement with DOJ, paying a \$22 million criminal fine
- **Volvo (March 2008):** \$19.6 million fine related to Oil-for-Food (\$4 million civil penalty, \$7 million criminal fine, and \$8.6 million disgorgement of profits)

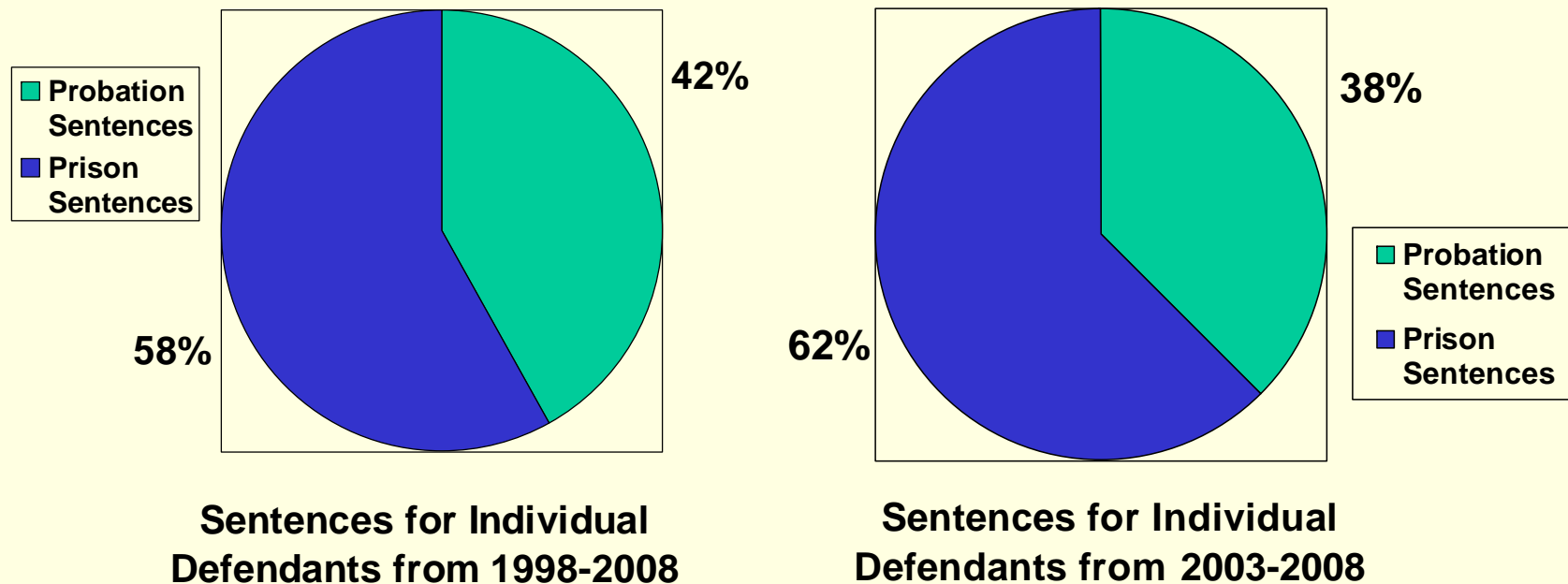
Focus on Individual Prosecutions

- **Prosecution of individuals is “part of a very concerted effort to supplement our prosecution of corporations . . . with our prosecution of natural persons.”** Mark Mendelsohn, Deputy Chief Fraud Section DOJ, October, 2007
- **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
 - **Kellogg, Brown & Root (KBR)**: Albert Stanley, former Chairman and CEO of the former Halliburton subsidiary
 - **Willbros International**: a former President, a consultant and four employees
 - **Pacific Consolidated Industries**: a former President and part owner
 - **Schnitzer Steel**: Executive Vice President of Sales; former Chairman and CEO already settled civil enforcement action
 - **Syncor International Corp.**: Chairman
 - **Yet unnamed California valve company**: Mario Covino, worldwide sales director

56 individuals have been prosecuted under the FCPA since 1998



Majority of defendants who have pleaded guilty or been found guilty at trial between 1998 and 2008 have gone to prison



Corporate Executives Will Go to Jail if Convicted

A Fourth Silo 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; and Faro Technologies*
4. **Foreign prosecutors**: Anti-corruption prosecutors are not only assisting U.S. authorities but are also increasing enforcement efforts
 - “We are now working with our foreign law enforcement colleagues in bribery investigations to a degree that we never have previously.”
Matthew Friedrich, DOJ Acting Assistant Attorney General, December 15, 2008
 - Countries involved in anti-corruption investigations include: Brazil, China, Germany, Greece, Ireland, Italy, Japan, Netherlands, Norway, Switzerland, and United Kingdom

Continuing Upswing in FCPA Litigation

➤ **FCPA investigations have increasingly spurred collateral civil suits**

- securities fraud actions (e.g. Faro Tech)
- shareholder derivative suits (e.g. BAE Systems and Chevron Corp.)
- lawsuits initiated by foreign governments or business partners (e.g. Jack Grynberg suit against BP, Statoil, and British Gas; Bahrain suit against Alcoa Corp.)

➤ **Majority of companies that exhibited statistically significant price reactions (at the 5% level) to FCPA-related news subsequently had 10b-5 actions filed against them.**

NERA, *FCPA Settlements: It's a Small World After All* (January 28, 2009).

Government Contracts Developments

Federal Acquisition Regulation (“FAR”): New Mandatory Disclosure Rule

- Final rule took effect December 12, 2008
- Applies to all government contracts and subcontracts expected to exceed \$5 million and 120 days
- **Contractual Requirement to Disclose:** Requires timely disclosure, in writing, to agency IG with copy to CO, whenever, in connection with the contract containing the clause, or a subcontract, the contractor has *CREDIBLE EVIDENCE* that principal, employee, agent or subcontractor has committed a violation of:
 - Federal criminal law involving fraud, conflict of interest, bribery or gratuities (18 U.S.C.), or
 - Civil False Claims Act
- Failure to comply can be ground for suspension and debarment

FAR: New Mandatory Disclosure Rule

➤ Contractual Requirement for an Internal Control System:

- Contractors must establish and maintain an internal control system that includes timely disclosure to the IG and CO whenever, in connection with *any* contract, or subcontract, the contractor has *credible evidence* that principal, employee, agent or subcontractor has committed a violation of:
 - Federal criminal law involving fraud, conflict of interest, bribery or gratuities (18 U.S.C.), or
 - Civil False Claims Act
- Must implement system within 90 days of contract award
- Does not apply to small businesses or commercial-item acquisitions

General Compliance Issues

Cooperation and Privilege Waiver

- **The McNulty Memo**: In December 2006, the DOJ issued new guidelines that, among other things, require prosecutors to receive approval from high-ranking supervisors before seeking privilege waiver.
- **New DOJ Policy (The Filip Memo)**: The 2008 changes to DOJ policy are found in the United States Attorneys' Manual. Now, cooperation with DOJ is not legally required, and lack of cooperation may not be considered as evidence of wrongdoing, nor will it necessarily affect the government's decision whether to indict.
- **New SEC Enforcement Manual**: According to the 2008 Manual, "[t]he staff should not ask a party to waive the attorney-client or work product privileges and is directed not to do so."
- **Proposed Legislation**: In June 2008, Senator Specter re-introduced the Attorney-Client Privilege Protection Act, designed as a legislative solution to DOC internal policy that may place businesses at an unfair disadvantage by allowing prosecutors to ask that businesses waive privilege during investigation. The Bill has been referred to the Judiciary Committee.

Vicarious Liability

- **An effective compliance program is critical, but ultimately it “does not immunize the corporation from liability when its employees, acting within the scope of their authority, fail to comply with the law.”** *United States v. Ionia Management*, No. 07-5801 (2nd Cir. 2009) (quoting *Twentieth Century Fox Film Corp.*)
- **When deciding whether to charge the corporation, charge employees, or mitigate charges against the corporation, prosecutors will consider whether the corporation has implemented a truly effective compliance program or merely a “paper program.”** DOJ’s Corporate Charging Guidelines
- **If an organization can demonstrate that it has an effective compliance program, the potential fine range may be mitigated by up to 95%.** USSC, An Overview of the Organizational Guidelines

The Role of a Compliance Monitor in Non-prosecution or Deferred Prosecution Agreements

- **Mandate:** Defined by the terms of the agreements that a company enters into with the U.S. government.
- **Providing the assessment:** The monitor is more like an auditor than investigator. The purpose is to assess whether the company's compliance policies and procedures are reasonably designed to detect and prevent FCPA violations.
- **Issuing recommendations:** The monitor should recommend enhancement to the company's compliance policies and procedures to improve their ability to detect and prevent FCPA violations.
- **Tailoring the monitorship:** The monitor should –
 - develop a work plan to reflect the particular corruption risks faced by the company;
 - make recommendations that are consistent with the company's business model and culture; and
 - make recommendations that work within the current size and structure of the existing compliance program, whenever possible.
- **The Monitor is not an investigator, but he evaluates current company policies.**

Choosing a Monitor: DOJ's Guidance

- **The DOJ's Morford Memo standardizes common practices involving monitors by addressing:**
 - the criteria for selecting a monitor;
 - the need for a monitor's independence;
 - restrictions on the scope of a monitor's duties; and
 - the need for procedures to resolve disputes over the monitor's suggestions

- **The process for selecting a corporate monitor should be designed to:**
 1. select a highly qualified and respected person or entity based on suitability for the assignment and all of the circumstances;
 2. avoid potential and actual conflicts of interests; and
 3. otherwise instill public confidence

Compliance Matters Even More Today

Five Reasons to Support Compliance in Difficult Times

- 1. Increased government enforcement necessitates compliance programs**
- 2. Budgetary constraints will fall on deaf ears at DOJ, SEC, and other government agencies**
- 3. As Siemens has demonstrated, investigation and prosecution expenses can dwarf compliance costs**
- 4. Paradigm shift in criminalizing behavior previously viewed as ambiguous**
- 5. Risk of personal liability and reputation for senior executives and directors**

Questions?



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