305 Why It's Important for the Law Department to be Involved with the Compliance Function

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Karl L. Chen is counsel for Watson Wyatt Worldwide in Arlington, Virginia. His responsibilities principally include providing securities and compliance counsel to the company and its investment adviser subsidiary, Watson Wyatt Investment Consulting.

Prior to joining Watson Wyatt, Mr. Chen served as associate general counsel for Fannie Mae in Washington, DC. While at Fannie Mae, he provided counsel to several business units regarding the implementation of the company's corporate compliance program. Prior to his joining Fannie Mae, Mr. Chen served in various capacities at Nextel Communications, Inc. as SEC Counsel and special counsel compliance and marketing. Mr. Chen began his legal career as an attorney-advisor with the SEC in the division of corporation finance.

He currently serves as a co-chair for the corporate and securities committee for ACC's Washington Metropolitan chapter and he is a member of the board of governors of The Washington Latin School and is a cubmaster for Pack 544 in Washington, DC.

Mr. Chen received a B.B.A. from Ohio University and is a graduate of the University Of Baltimore School Of Law.

John W. Jones

John W. Jones is vice president and general counsel of Radio One in Lanham, Maryland.

Prior to assuming his current position, Mr. Jones was the senior vice president and general counsel of TV One, LLC, an African-American focused cable network. Prior to joining TV One, Mr. Jones was an associate general counsel at Radio One. Before joining Radio One, Mr. Jones was an associate with Cooley Godward LLP in Reston, Virginia, where he was involved in multiple transactions, including financing for public and private companies, mergers and acquisitions, and venture capital financings. Early in his legal career, he served as an attorney in the Securities and Exchange Commission's division of corporation finance.

A graduate of the U.S. Naval Academy, Mr. Jones served as an officer in the U.S. Marine Corps, where he attained the rank of captain. He also holds a J.D. from the University of Maryland and an M.B.A. from Webster University.

Jane Sherburne

Jane Sherburne is senior deputy general counsel of Citigroup and a member of the Citigroup management committee and maintains offices in New York and Washington. She manages the company's response to legal disputes or controversies at the group level, including the management of congressional and regulatory investigations. Ms. Sherburne also oversees the company's litigation globally, its U.S. bank regulatory matters, global anti-money laundering, and legal support for corporate finance activities.

Prior to joining Citigroup, Ms. Sherburne was a partner at Wilmer, Cutler & Pickering, where she had a litigation practice, representing clients in matters requiring crisis management, including media relations and matters involving Congressional investigations, internal government and corporate investigations, as well as complex civil litigation. She was co-lead counsel for the University of Michigan in the Gratz v. Bollinger affirmative action case. Ms. Sherburne interrupted her practice at WCP to serve as special counsel to the President. In that capacity she assembled and managed a team of lawyers, including congressional and public relations specialists, to conduct internal inquiries, respond to the ongoing activities of the independent counsel, and develop and implement congressional and public relations strategies in response to Clinton White House ethics investigations. Before entering law school, Ms. Sherburne served as chief of staff to the Commissioner of Social Security in the Carter Administration. Prior to that, she was a legislative assistant to Congressman Donald Fraser (D-MN).

Ms. Sherburne is a fellow of the American Bar Foundation and a member of the boards of trustees of the National Women's Law Center and the Lawyers' Committee for Civil Rights Under Law.

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2004 Federal Sentencing Guidelines

Chapter 8 - PART B - REMEDYING HARM FROM CRIMINAL CONDUCT, AND EFFECTIVE COMPLIANCE AND ETHICS PROGRAM

2. EFFECTIVE COMPLIANCE AND ETHICS PROGRAM

§8B2.1. Effective Compliance and Ethics Program

(a) To have an effective compliance and ethics program, for purposes of subsection (f) of §8C2.5 (Culpability Score) and subsection (c)(1) of §8D1.4 (Recommended Conditions of Probation - Organizations), an organization shall—

(1) exercise due diligence to prevent and detect criminal conduct; and

(2) otherwise promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law.

Such compliance and ethics program shall be reasonably designed, implemented, and enforced so that the program is generally effective in preventing and detecting criminal conduct. The failure to prevent or detect the instant offense does not necessarily mean that the program is not generally effective in preventing and detecting criminal conduct.

(b) Due diligence and the promotion of an organizational culture that encourages ethical conduct and a commitment to compliance with the law within the meaning of subsection (a) minimally require the following:

(1) The organization shall establish standards and procedures to prevent and detect criminal conduct.

(2) (A) The organization's governing authority shall be knowledgeable about the content and operation of the compliance and ethics program and shall exercise reasonable oversight with respect to the implementation and effectiveness of the compliance and ethics program.

(B) High-level personnel of the organization shall ensure that the organization has an effective compliance and ethics program, as described in this guideline. Specific individual(s) within high-level personnel shall be assigned overall responsibility for the compliance and ethics program.

(C) Specific individual(s) within the organization shall be delegated day-to-day operational responsibility for the compliance and ethics program. Individual(s) with operational responsibility shall report periodically to high-level personnel and, as appropriate, to the governing authority, or an appropriate subgroup of the governing authority, on the effectiveness of the compliance and ethics program. To carry out such operational responsibility, such individual(s) shall be given adequate resources, appropriate authority, and direct access to the governing authority or an appropriate subgroup of the governing authority.

(3) The organization shall 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.

(4) (A) The organization shall take reasonable steps to communicate periodically and in a practical manner its standards and procedures, and other aspects of the compliance and ethics program, to the individuals referred to in subdivision (B) by conducting effective training programs and otherwise disseminating information appropriate to such individuals' respective roles and responsibilities.

(B) The individuals referred to in subdivision (A) are the members of the governing authority, high-level personnel, substantial authority personnel, the organization's employees, and, as appropriate, the organization's agents.

(5) The organization shall take reasonable steps—

(A) to ensure that the organization's compliance and ethics program is followed, including monitoring and auditing to detect criminal conduct;

(B) to evaluate periodically the effectiveness of the organization's compliance and ethics program; and

(C) to have and publicize a system, which may include mechanisms that allow for anonymity or confidentiality, whereby the organization's employees and agents may report or seek guidance regarding potential or actual criminal conduct without fear of retaliation.

(6) The organization's compliance and ethics program shall be promoted and enforced consistently throughout the organization through (A) appropriate incentives to perform in accordance with the compliance and ethics program; and (B) appropriate disciplinary measures for engaging in criminal conduct and for failing to

take reasonable steps to prevent or detect criminal conduct.

(7) After criminal conduct has been detected, the organization shall take reasonable steps to respond appropriately to the criminal conduct and to prevent further similar criminal conduct, including making any necessary modifications to the organization's compliance and ethics program.

(c) In implementing subsection (b), the organization shall periodically assess the risk of criminal conduct and shall take appropriate steps to design, implement, or modify each requirement set forth in subsection (b) to reduce the risk of criminal conduct identified through this process.

Commentary

Application Notes:

1. Definitions.—For purposes of this guideline:

"Compliance and ethics program" means a program designed to prevent and detect criminal conduct.

"Governing authority" means the (A) the Board of Directors; or (B) if the organization does not have a Board of Directors, the highest-level governing body of the organization.

"High-level personnel of the organization" and "substantial authority personnel" have the meaning given those terms in the Commentary to §8A1.2 (Application Instructions - Organizations).

"Standards and procedures" means standards of conduct and internal controls that are reasonably capable of reducing the likelihood of criminal conduct.

2. Factors to Consider in Meeting Requirements of this Guideline.—

(A) In General.—Each of the requirements set forth in this guideline shall be met by an organization; however, in determining what specific actions are necessary to meet those requirements, factors that shall be considered include: (i) applicable industry practice or the standards called for by any applicable governmental regulation; (ii) the size of the organization; and (iii) similar misconduct.

(B) Applicable Governmental Regulation and Industry Practice.—An organization's failure to incorporate and follow applicable industry practice or the standards called for by any applicable governmental regulation weighs against a finding of an effective compliance and ethics program.

(C) The Size of the Organization.—

(i) In General.—The formality and scope of actions that an organization shall take to meet the requirements of this guideline,

including the necessary features of the organization's standards and procedures, depend on the size of the organization.

(ii) Large Organizations.—A large organization generally shall devote more formal operations and greater resources in meeting the requirements of this guideline than shall a small organization. As appropriate, a large organization should encourage small organizations (especially those that have, or seek to have, a business relationship with the large organization) to implement effective compliance and ethics programs.

(iii) Small Organizations.—In meeting the requirements of this guideline, small organizations shall demonstrate the same degree of commitment to ethical conduct and compliance with the law as large organizations. However, a small organization may meet the requirements of this guideline with less formality and fewer resources than would be expected of large organizations. In appropriate circumstances, reliance on existing resources and simple systems can demonstrate a degree of commitment that, for a large organization, would only be demonstrated through more formally planned and implemented systems.

Examples of the informality and use of fewer resources with which a small organization may meet the requirements of this guideline include the following: (I) the governing authority's discharge of its responsibility for oversight of the compliance and ethics program by directly managing the organization's compliance and ethics efforts; (II) training employees through informal staff meetings, and monitoring through regular "walk-arounds" or continuous observation while managing the organization; (III) using available personnel, rather than employing separate staff, to carry out the compliance and ethics program; and (IV) modeling its own compliance and ethics program on existing, well-regarded compliance and ethics programs and best practices of other similar organizations.

(D) Recurrence of Similar Misconduct .—Recurrence of similar misconduct creates doubt regarding whether the organization took reasonable steps to meet the requirements of this guideline. For purposes of this subdivision, "similar misconduct" has the meaning given that term in the Commentary to §8A1.2 (Application Instructions - Organizations).

3. Application of Subsection (b)(2).—High-level personnel and substantial authority personnel of the organization shall be knowledgeable about the content and operation of the compliance and ethics program, shall perform their assigned duties consistent with the exercise of due diligence, and shall promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law.

If the specific individual(s) assigned overall responsibility for the compliance and ethics program

does not have day-to-day operational responsibility for the program, then the individual(s) with day-to-day operational responsibility for the program typically should, no less than annually, give the governing authority or an appropriate subgroup thereof information on the implementation and effectiveness of the compliance and ethics program.

4. Application of Subsection (b)(3) .—

(A) Consistency with Other Law .—Nothing in subsection (b)(3) is intended to require conduct inconsistent with any Federal, State, or local law, including any law governing employment or hiring practices.

(B) Implementation .—In implementing subsection (b)(3), the organization shall hire and promote individuals so as to ensure that all individuals within the high-level personnel and substantial authority personnel of the organization will perform their assigned duties in a manner consistent with the exercise of due diligence and the promotion of an organizational culture that encourages ethical conduct and a commitment to compliance with the law under subsection (a). With respect to the hiring or promotion of such individuals, an organization shall consider the relatedness of the individual's illegal activities and other misconduct (i.e., other conduct inconsistent with an effective compliance and ethics program) to the specific responsibilities the individual is anticipated to be assigned and other factors such as: (i) the recency of the individual's illegal activities and other misconduct; and (ii) whether the individual has engaged in other such illegal activities and other such misconduct.

5. Application of Subsection (b)(6).—Adequate discipline of individuals responsible for an offense is a necessary component of enforcement; however, the form of discipline that will be appropriate will be case specific.

6. Application of Subsection (c) .—To meet the requirements of subsection (c), an organization shall:

(A) Assess periodically the risk that criminal conduct will occur, including assessing the following:

(i) The nature and seriousness of such criminal conduct.

(ii) The likelihood that certain criminal conduct may occur because of the nature of the organization's business. If, because of the nature of an organization's business, there is a substantial risk that certain types of criminal conduct may occur, the organization shall take reasonable steps to prevent and detect that type of criminal conduct. For example, an organization that, due to the nature of its business, employs sales personnel who have flexibility to set prices shall establish standards and procedures designed to prevent and detect price-fixing. An organization that, due to the nature of its business, employs sales personnel who have flexibility to represent the material characteristics of a product shall establish standards and

procedures designed to prevent and detect fraud.

(iii) The prior history of the organization. The prior history of an organization may indicate types of criminal conduct that it shall take actions to prevent and detect.

(B) Prioritize periodically, as appropriate, the actions taken pursuant to any requirement set forth in subsection (b), in order to focus on preventing and detecting the criminal conduct identified under subdivision (A) of this note as most serious, and most likely, to occur.

(C) Modify, as appropriate, the actions taken pursuant to any requirement set forth in subsection (b) to reduce the risk of criminal conduct identified under subdivision (A) of this note as most serious, and most likely, to occur.

Background: This section sets forth the requirements for an effective compliance and ethics program. This section responds to section 805(a)(2)(5) of the Sarbanes-Oxley Act of 2002, Public Law 107–204, which directed the Commission to review and amend, as appropriate, the guidelines and related policy statements to ensure that the guidelines that apply to organizations in this chapter "are sufficient to deter and punish organizational criminal misconduct."

The requirements set forth in this guideline are intended to achieve reasonable prevention and detection of criminal conduct for which the organization would be vicariously liable. The prior diligence of an organization in seeking to prevent and detect criminal conduct has a direct bearing on the appropriate penalties and probation terms for the organization if it is convicted and sentenced for a criminal offense.

Historical Note: Effective November 1, 2004 (see Appendix C, amendment 673).

U.S. Department of Justice

Office of the Deputy Attorney General

The Deputy Attorney General

Washington, D.C. 20530

January 20, 2003

MEMORANDUM

TO: Heads of Department Components
United States Attorneys

FROM: Larry D. Thompson
Deputy Attorney General

SUBJECT: Principles of Federal Prosecution of Business Organizations

As the Corporate Fraud Task Force has advanced in its mission, we have confronted certain issues in the principles for the federal prosecution of business organizations that require revision in order to enhance our efforts against corporate fraud. While it will be a minority of cases in which a corporation or partnership is itself subjected to criminal charges, prosecutors and investigators in every matter involving business crimes must assess the merits of seeking the conviction of the business entity itself.

Attached to this memorandum are a revised set of principles to guide Department prosecutors as they make the decision whether to seek charges against a business organization. These revisions draw heavily on the combined efforts of the Corporate Fraud Task Force and the Attorney General's Advisory Committee to put the results of more than three years of experience with the principles into practice.

The main focus of the revisions is increased emphasis on and scrutiny of the authenticity of a corporation's cooperation. Too often business organizations, while purporting to cooperate with a Department investigation, in fact take steps to impede the quick and effective exposure of the complete scope of wrongdoing under investigation. The revisions make clear that such conduct should weigh in favor of a corporate prosecution. The revisions also address the efficacy of the corporate governance mechanisms in place within a corporation, to ensure that these measures are truly effective rather than mere paper programs.

Further experience with these principles may lead to additional adjustments. I look forward to hearing comments about their operation in practice. Please forward any comments to Christopher Wray, the Principal Associate Deputy Attorney General, or to Andrew Hruska, my Senior Counsel.

Federal Prosecution of Business Organizations[1]

I. Charging a Corporation: General

A. General Principle: Corporations should not be treated leniently because of their artificial nature nor should they be subject to harsher treatment. Vigorous enforcement of the criminal laws against corporate wrongdoers, where appropriate results in great benefits for law enforcement and the public, particularly in the area of white collar crime. Indicting corporations for wrongdoing enables the government to address and be a force for positive change of corporate culture, alter corporate behavior, and prevent, discover, and punish white collar crime.

B. Comment: In all cases involving corporate wrongdoing, prosecutors should consider the factors discussed herein. First and foremost, prosecutors should be aware of the important public benefits that may flow from indicting a corporation in appropriate cases. For instance, corporations are likely to take immediate remedial steps when one is indicted for criminal conduct that is pervasive throughout a particular industry, and thus an indictment often provides a unique opportunity for deterrence on a massive scale. In addition, a corporate indictment may result in specific deterrence by changing the culture of the indicted corporation and the behavior of its employees. Finally, certain crimes that carry with them a substantial risk of great public harm, e.g., environmental crimes or financial frauds, are by their nature most likely to be committed by businesses, and there may, therefore, be a substantial federal interest in indicting the corporation.

Charging a corporation, however, does not mean that individual directors, officers, employees, or shareholders should not also be charged. Prosecution of a corporation is not a substitute for the prosecution of criminally culpable individuals within or without the corporation. Because a corporation can act only through individuals, imposition of individual criminal liability may provide the strongest deterrent against future corporate wrongdoing. Only rarely should provable individual culpability not be pursued, even in the face of offers of corporate guilty pleas.

Corporations are "legal persons," capable of suing and being sued, and capable of committing crimes. Under the doctrine of *respondeat superior*, a corporation may be held criminally liable for the illegal acts of its directors, officers, employees, and agents. To hold a corporation liable for these actions, the government must establish that the corporate agent's actions (i) were within the scope of his duties and (ii) were intended, at least in part, to benefit the corporation. In all cases involving wrongdoing by corporate agents, prosecutors should consider the corporation, as well as the responsible individuals, as potential criminal targets.

Agents, however, may act for mixed reasons -- both for self-aggrandizement (both direct and indirect) and for the benefit of the corporation, and a corporation may be held liable as long as one motivation of its agent is to benefit the corporation. In *United States v. Automated Medical Laboratories*, 770 F.2d 399 (4th Cir. 1985), the court affirmed the corporation's conviction for the actions of a subsidiary's employee despite its claim that the employee was acting for his own benefit, namely his "ambitious nature and his desire to ascend the corporate ladder." The court stated, "*Partucci* was clearly acting in part to benefit AML since his advancement within the corporation depended on AML's well-being and its lack of difficulties with the FDA." Similarly, in *United States v. Cincotta*, 689 F.2d 238, 241-42 (1st Cir. 1982), the court held, "criminal liability may be imposed on the corporation only where the agent is acting within the scope of his employment. That, in turn, requires that the agent be performing acts of the kind which he is authorized to perform, and those acts must be motivated -- at least in part -- by an intent to benefit the corporation." Applying this test, the court upheld the corporation's conviction, notwithstanding the substantial personal benefit reaped by its miscreant agents, because the fraudulent scheme required money to pass through the corporation's treasury and the fraudulently obtained goods were resold to the corporation's customers in the corporation's name. As the court concluded, "Mystic--not the individual defendants--was making money by selling oil that it had not paid for."

Moreover, the corporation need not even necessarily profit from its agent's actions for it to be held liable. In *Automated Medical Laboratories*, the Fourth Circuit stated:

> [B]enefit is not a "touchstone of criminal corporate liability; benefit at best is an evidential, not an operative, fact." Thus, whether the agent's actions ultimately redounded to the benefit of the corporation is less significant than whether the agent acted with the intent to benefit the corporation. The basic purpose of requiring that an agent have acted with the intent to benefit the corporation, however, is to insulate the corporation from criminal liability for actions of its agents which be inimical to the interests of the corporation or which may have been undertaken solely to advance the interests of that agent or of a party other than the corporation.

770 F.2d at 407 (emphasis added; quoting *Old Monastery Co. v. United States*, 147 F.2d 905, 908 (4th Cir.), cert. denied, 326 U.S. 734 (1945)).

II. Charging a Corporation: Factors to Be Considered

A. General Principle: Generally, prosecutors should apply the same factors in determining whether to charge a corporation as they do with respect to individuals. *See* USAM § 9-27.220, *et seq.* Thus, the prosecutor should weigh all of the factors normally considered in the sound exercise of prosecutorial judgment: the sufficiency of the evidence; the likelihood of success at trial,; the probable deterrent, rehabilitative, and other consequences of conviction; and the adequacy of noncriminal approaches. *See* id. However, due to the nature of the corporate "person," some additional factors are present. In conducting an investigation, determining whether to bring charges, and negotiating plea agreements, prosecutors should consider the following factors in reaching a decision as to the proper treatment of a corporate target:

1. the nature and seriousness of the offense, including the risk of harm to the public, and applicable policies and priorities, if any, governing the prosecution of corporations for particular categories of crime (*see* section III, *infra*);

2. the pervasiveness of wrongdoing within the corporation, including the complicity in, or condonation of, the wrongdoing by corporate management (*see* section IV, *infra*);

3. the corporation's history of similar conduct, including prior criminal, civil, and regulatory enforcement actions against it (*see* section V, *infra*);

4. the corporation's timely and voluntary disclosure of wrongdoing and its willingness to cooperate in the investigation of its agents, including, if necessary, the waiver of corporate attorney-client and work product protection (*see* section VI, *infra*);

5. the existence and adequacy of the corporation's compliance program (*see* section VII, *infra*);

6. the corporation's remedial actions, including any efforts to implement an effective corporate compliance program or to improve an existing one, to replace responsible management, to discipline or terminate wrongdoers, to pay restitution, and to cooperate with the relevant government agencies (*see* section VIII, *infra*);

7. collateral consequences, including disproportionate harm to shareholders, pension holders and employees not proven personally culpable and impact on the public arising from the prosecution (*see* section IX, *infra*); and

8. the adequacy of the prosecution of individuals responsible for the corporation's malfeasance;

9. the adequacy of remedies such as civil or regulatory enforcement actions (*see section X, infra*).

B. Comment: As with the factors relevant to charging natural persons, the foregoing factors are intended to provide guidance rather than to mandate a particular result. The factors listed in this section are intended to be illustrative of those that should be considered and not a complete or exhaustive list. Some or all of these factors may or may not apply to specific cases, and in some cases one factor may override all others. The nature and seriousness of the offense may be such as to warrant prosecution regardless of the other factors. Further, national law enforcement policies in various enforcement areas may require that more or less weight be given to certain of these factors than to others.

In making a decision to charge a corporation, the prosecutor generally has wide latitude in determining when, whom, how, and even whether to prosecute for violations of Federal criminal law. In exercising that discretion, prosecutors should consider the following general statements of principles that summarize appropriate considerations to be weighed and desirable practices to be followed in discharging their prosecutorial responsibilities. In doing so, prosecutors should ensure that the general purposes of the criminal law -- assurance of warranted punishment, deterrence of further criminal conduct, protection of the public from dangerous and fraudulent conduct, rehabilitation of offenders, and restitution for victims and affected communities -- are adequately met, taking into account the special nature of the corporate "person."

III. Charging a Corporation: Special Policy Concerns

A. General Principle: The nature and seriousness of the crime, including the risk of harm to the public from the criminal conduct, are obviously primary factors in determining whether to charge a corporation. In addition, corporate conduct, particularly that of national and multi-national corporations, necessarily intersects with federal economic, taxation, and criminal law enforcement policies. In applying these principles, prosecutors must consider the practices and policies of the appropriate Division of the Department, and must comply with those policies to the extent required.

B. Comment: In determining whether to charge a corporation, prosecutors should take into account federal law enforcement priorities as discussed above. *See* USAM § 9-27-230. In addition, however, prosecutors must be aware of the specific policy goals and incentive programs established by the respective Divisions and regulatory agencies. Thus, whereas natural persons may be given incremental degrees of credit (ranging from immunity to lesser charges to sentencing considerations) for turning themselves in, making statements against their penal interest, and cooperating in the government's investigation of their own and others' wrongdoing, the same approach may not be appropriate in all circumstances with respect to corporations. As an example, it is entirely proper in many investigations for a prosecutor to consider the corporation's pre-indictment conduct, *e.g.*,voluntary disclosure, cooperation, remediation or restitution, in determining whether to seek an indictment. However, this would not necessarily be appropriate in an antitrust investigation, in which antitrust violations, by definition, go to the heart of the corporation's business and for which the Antitrust Division has therefore established a firm policy, understood in the business community, that credit should not be given at the charging stage for a compliance program and that amnesty is available only to the first corporation to make full disclosure to the government. As another example, the Tax Division has a strong preference for prosecuting responsible individuals, rather than entities, for corporate tax offenses. Thus, in determining whether or not to charge a corporation, prosecutors should consult with the Criminal, Antitrust, Tax, and Environmental and Natural Resources Divisions, if appropriate or required.

IV. Charging a Corporation: Pervasiveness of Wrongdoing Within the Corporation

A. General Principle: A corporation can only act through natural persons, and it is therefore held responsible for the acts of such persons fairly attributable to it. Charging a corporation for even minor misconduct may be appropriate where the wrongdoing was pervasive and was undertaken by a large number of employees or by all the employees in a particular role within the corporation, *e.g.*, salesmen or procurement officers, or was condoned by upper management. On the other hand, in certain limited circumstances, it may not be appropriate to impose liability upon a corporation, particularly one with a compliance program in place, under a strict *respondeat superior* theory for the single isolated act of a rogue employee. There is, of course, a wide spectrum between these two extremes, and a prosecutor should exercise sound discretion in evaluating the pervasiveness of wrongdoing within a corporation.

B. Comment: Of these factors, the most important is the role of management. Although acts of even low-level employees may result in criminal liability, a corporation is directed by its management and management is responsible for a corporate culture in which criminal conduct is either discouraged or tacitly encouraged. As stated in commentary to the Sentencing Guidelines:

> Pervasiveness [is] case specific and [will] depend on the number, and degree of responsibility, of individuals [with] substantial authority ... who participated in, condoned, or were willfully ignorant of the offense. Fewer individuals need to be involved for a finding of pervasiveness if those individuals exercised a relatively high degree of authority. Pervasiveness can occur either within an organization as a whole or within a unit of an organization.

USSG §8C2.5, comment. (n. 4).

V. Charging a Corporation: The Corporation's Past History

A. General Principle: Prosecutors may consider a corporation's history of similar conduct, including prior criminal, civil, and regulatory enforcement actions against it, in determining whether to bring criminal charges.

B. Comment: A corporation, like a natural person, is expected to learn from its mistakes. A history of similar conduct may be probative of a corporate culture that encouraged, or at least condoned, such conduct, regardless of any compliance programs. Criminal prosecution of a corporation may be particularly appropriate where the corporation previously had been subject to non-criminal guidance, warnings, or sanctions, or previous criminal charges, and yet it either had not taken adequate action to prevent future unlawful conduct or had continued to engage in the conduct in spite of the warnings or enforcement actions taken against it. In making this determination, the corporate structure itself, *e.g.*, subsidiaries or operating divisions, should be ignored, and enforcement actions taken against the corporation or any of its divisions, subsidiaries, and affiliates should be considered. *See* USSG § 8C2.5(c) & comment. (n. 6).

VI. Charging a Corporation: Cooperation and Voluntary Disclosure

A. General Principle: In determining whether to charge a corporation, that corporation's timely and voluntary disclosure of wrongdoing and its willingness to cooperate with the government's investigation may be relevant factors. In gauging the extent of the corporation's cooperation, the prosecutor may consider the corporation's willingness to identify the culprits within the corporation, including senior executives; to make witnesses available; to disclose the complete results of its internal investigation; and to waive attorney-client and work product protection.

B. Comment: In investigating wrongdoing by or within a corporation, a prosecutor is likely to encounter several obstacles resulting from the nature of the corporation itself. It will often be difficult to determine which individual took which action on behalf of the corporation. Lines of authority and responsibility may be shared among operating divisions or departments, and records and personnel may be spread throughout the United States or even among several countries. Where the criminal conduct continued over an extended period of time, the culpable or knowledgeable personnel may have been promoted, transferred, or fired, or they may have quit or retired. Accordingly, a corporation's cooperation may be critical in identifying the culprits and locating relevant evidence.

In some circumstances, therefore, granting a corporation immunity or amnesty or pretrial diversion may be considered in the course of the government's investigation. In such circumstances, prosecutors should refer to the principles governing non-prosecution agreements generally. *See* USAM § 9-27.600-650. These principles permit a non prosecution agreement in exchange for cooperation when a corporation's "timely cooperation appears to be necessary to the public interest and other means of obtaining the desired cooperation are unavailable or would not be effective." Prosecutors should note that in the case of national or multi-national corporations, multi-district or global agreements may be necessary. Such agreements may only be entered into with the approval of each affected district or the appropriate Department official. *See* USAM §9-27.641.

In addition, the Department, in conjunction with regulatory agencies and other executive branch departments, encourages corporations, as part of their compliance programs, to conduct internal investigations and to disclose their findings to the appropriate authorities. Some agencies, such as the SEC and the EPA, as well as the Department's

Environmental and Natural Resources Division, have formal voluntary disclosure programs in which self-reporting, coupled with remediation and additional criteria, may qualify the corporation for amnesty or reduced sanctions.[2] Even in the absence of a formal program, prosecutors may consider a corporation's timely and voluntary disclosure in evaluating the adequacy of the corporation's compliance program and its management's commitment to the compliance program. However, prosecution and economic policies specific to the industry or statute may require prosecution notwithstanding a corporation's willingness to cooperate. For example, the Antitrust Division offers amnesty only to the first corporation to agree to cooperate. This creates a strong incentive for corporations participating in anti-competitive conduct to be the first to cooperate. In addition, amnesty, immunity, or reduced sanctions may not be appropriate where the corporation's business is permeated with fraud or other crimes.

One factor the prosecutor may weigh in assessing the adequacy of a corporation's cooperation is the completeness of its disclosure including, if necessary, a waiver of the attorney-client and work product protections, both with respect to its internal investigation and with respect to communications between specific officers, directors and employees and counsel. Such waivers permit the government to obtain statements of possible witnesses, subjects, and targets, without having to negotiate individual cooperation or immunity agreements. In addition, they are often critical in enabling the government to evaluate the completeness of a corporation's voluntary disclosure and cooperation. Prosecutors may, therefore, request a waiver in appropriate circumstances.[3] The Department does not, however, consider waiver of a corporation's attorney-client and work product protection an absolute requirement, and prosecutors should consider the willingness of a corporation to waive such protection when necessary to provide timely and complete information as one factor in evaluating the corporation's cooperation.

Another factor to be weighed by the prosecutor is whether the corporation appears to be protecting its culpable employees and agents. Thus, while cases will differ depending on the circumstances, a corporation's promise of support to culpable employees and agents, either through the advancing of attorneys fees,[4] through retaining the employees without sanction for their misconduct, or through providing information to the employees about the government's investigation pursuant to a joint defense agreement, may be considered by the prosecutor in weighing the extent and value of a corporation's cooperation. By the same token, the prosecutor should be wary of attempts to shield corporate officers and employees from liability by a willingness of the corporation to plead guilty.

Another factor to be weighed by the prosecutor is whether the corporation, while purporting to cooperate, has engaged in conduct that impedes the investigation (whether or not rising to the level of criminal obstruction). Examples of such conduct include: overly broad assertions of corporate representation of employees or former employees; inappropriate directions to employees or their counsel, such as directions not to cooperate openly and fully with the investigation including, for example, the direction to decline to be interviewed; making presentations or submissions that contain misleading assertions or omissions; incomplete or delayed production of records; and failure to promptly disclose illegal conduct known to the corporation.

Finally, a corporation's offer of cooperation does not automatically entitle it to immunity from prosecution. A corporation should not be able to escape liability merely by offering up its directors, officers, employees, or agents as in lieu of its own prosecution. Thus, a corporation's willingness to cooperate is merely one relevant factor, that needs to be considered in conjunction with the other factors, particularly those relating to the corporation's past history and the role of management in the wrongdoing.

VII. Charging a Corporation: Corporate Compliance Programs

A. General Principle: Compliance programs are established by corporate management to prevent and to detect misconduct and to ensure that corporate activities are conducted in accordance with all applicable criminal and civil laws, regulations, and rules. The Department encourages such corporate self-policing, including voluntary disclosures to the government of any problems that a corporation discovers on its own. However, the existence of a compliance program is not sufficient, in and of itself, to justify not charging a corporation for criminal conduct undertaken by its officers, directors, employees, or agents. Indeed, the commission of such crimes in the face of a compliance program may suggest that the corporate management is not adequately enforcing its program. In addition, the nature of some crimes, *e.g.*, antitrust violations, may be such that national law enforcement policies mandate prosecutions of corporations notwithstanding the existence of a compliance program.

B. Comment: A corporate compliance program, even one specifically prohibiting the very conduct in question, does not absolve the corporation from criminal liability under the doctrine of *respondeat superior. See United States v. Basic Construction Co.*, 711 F.2d 570 (4th Cir. 1983) ("a corporation may be held criminally responsible for antitrust violations committed by its employees if they were acting within the scope of their authority, or apparent authority, and for the benefit of the corporation, even if... such acts were against corporate policy or express instructions."). In *United States v. Hilton Hotels Corp.,* 467 F.2d 1000 (9th Cir. 1972), *cert. denied,* 409 U.S. 1125 (1973), the Ninth Circuit affirmed antitrust liability based upon a purchasing agent for a single hotel threatening a single supplier with a boycott unless it paid dues to a local marketing association, even though the agent's actions were contrary to corporate policy and directly against express instructions from his superiors. The court reasoned that Congress, in enacting the Sherman Antitrust Act, "intended to impose liability upon business entities for the acts of those to whom they choose to delegate the conduct of their affairs, thus stimulating a maximum effort by owners and managers to assure adherence by such agents to the requirements of the Act."[5] It concluded that "general policy statements" and even direct instructions from the agent's superiors were not sufficient; "Appellant could not gain exculpation by issuing general instructions without undertaking to enforce those instructions by means commensurate with the obvious risks." *See also United States v. Beusch,* 596 F.2d 871, 878 (9th Cir. 1979) ("[A] corporation may be liable for the acts of its employees done contrary to express instructions and policies, but ... the existence of such instructions and policies may be considered in determining whether the employee in fact acted to benefit the corporation."); *United States v. American Radiator & Standard Sanitary Corp.,* 433 F.2d 174 (3rd Cir. 1970) (affirming conviction of corporation based upon its officer's participation in price-fixing scheme, despite corporation's defense that officer's conduct violated its "rigid anti-fraternization policy" against any socialization (and exchange of price information) with its competitors; "When the act of the agent is within the scope of his employment or his apparent authority, the corporation is held legally responsible for it, although what he did may be contrary to his actual instructions and may be unlawful.").

While the Department recognizes that no compliance program can ever prevent all criminal activity by a corporation's employees, the critical factors in evaluating any program are whether the program is adequately designed for maximum effectiveness in preventing and detecting wrongdoing by employees and whether corporate management is enforcing the program or is tacitly encouraging or pressuring employees to engage in misconduct to achieve business objectives. The Department has no formal guidelines for corporate compliance programs. The fundamental questions any prosecutor should ask are: "Is the corporation's compliance program well designed?" and "Does the corporation's compliance program work?" In answering these questions, the prosecutor should consider the comprehensiveness of the compliance program; the extent and pervasiveness of the criminal conduct; the number and level of the corporate employees involved; the seriousness, duration, and frequency of the misconduct; and any remedial actions taken by the corporation, including restitution, disciplinary action, and revisions to corporate compliance programs.[6] Prosecutors should also consider the promptness of any disclosure of wrongdoing to the government and the corporation's cooperation in the government's investigation. In evaluating compliance programs, prosecutors may consider whether the corporation has established corporate governance mechanisms that can effectively detect and prevent misconduct. For example, do the corporation's directors exercise independent review over proposed corporate actions rather than unquestioningly ratifying officers' recommendations; are the directors provided with information sufficient to enable the exercise of independent judgment, are internal audit functions conducted at a level sufficient to ensure their independence and accuracy and have the directors established an information and reporting system in the organization reasonable designed to provide management and the board of directors with timely and accurate information sufficient to allow them to reach an informed decision regarding the organization's compliance with the law. *In re: Caremark,* 698 A.2d 959 (Del. Ct. Chan. 1996).

Prosecutors should therefore attempt to determine whether a corporation's compliance program is merely a "paper program" or whether it was designed and implemented in an effective manner. In addition, prosecutors should determine whether the corporation has provided for a staff sufficient to audit, document, analyze, and utilize the results of the corporation's compliance efforts. In addition, prosecutors should determine whether the corporation's employees are adequately informed about the compliance program and are convinced of the corporation's commitment to it. This will enable the prosecutor to make an informed decision as to whether the corporation has adopted and implemented a truly effective compliance program that, when consistent with other federal law enforcement policies, may result in a decision to charge only the corporation's employees and agents.

Compliance programs should be designed to detect the particular types of misconduct most likely to occur in a particular corporation's line of business. Many corporations operate in complex regulatory environments outside the normal experience of criminal prosecutors. Accordingly, prosecutors should consult with relevant federal and state agencies with the expertise to evaluate the adequacy of a program's design and implementation. For instance, state and federal banking, insurance, and medical boards, the Department of Defense, the Department of Health and Human Services, the Environmental Protection Agency, and the Securities and Exchange Commission have considerable experience with compliance programs and can be very helpful to a prosecutor in evaluating such programs. In addition, the Fraud Section of the Criminal Division, the Commercial Litigation Branch of the Civil Division, and the Environmental Crimes Section of the Environment and Natural Resources Division can assist U.S. Attorneys' Offices in finding the appropriate agency office and in providing copies of compliance programs that were developed in previous cases.

VIII. Charging a Corporation: Restitution and Remediation

A. General Principle: Although neither a corporation nor an individual target may avoid prosecution merely by paying a sum of money, a prosecutor may consider the corporation's willingness to make restitution and steps already taken to do so. A prosecutor may also consider other remedial actions, such as implementing an effective corporate compliance program, improving an existing compliance program, and disciplining wrongdoers, in determining whether to charge the corporation.

B. Comment: In determining whether or not a corporation should be prosecuted, a prosecutor may consider whether meaningful remedial measures have been taken, including employee discipline and full restitution.[7] A corporation's response to misconduct says much about its willingness to ensure that such misconduct does not recur. Thus, corporations that fully recognize the seriousness of their misconduct and accept responsibility for it should be taking steps to implement the personnel, operational, and organizational changes necessary to establish an awareness among employees that criminal conduct will not be tolerated. Among the factors prosecutors should consider and weigh are whether the corporation appropriately disciplined the wrongdoers and disclosed information concerning their illegal conduct to the government.

Employee discipline is a difficult task for many corporations because of the human element involved and sometimes because of the seniority of the employees concerned. While corporations need to be fair to their employees, they must also be unequivocally committed, at all levels of the corporation, to the highest standards of legal and ethical behavior. Effective internal discipline can be a powerful deterrent against improper behavior by a corporation's employees. In evaluating a corporation's response to wrongdoing, prosecutors may evaluate the willingness of the corporation to discipline culpable employees of all ranks and the adequacy of the discipline imposed. The prosecutor should be satisfied that the corporation's focus is on the integrity and credibility of its remedial and disciplinary measures rather than on the protection of the wrongdoers.

In addition to employee discipline, two other factors used in evaluating a corporation's remedial efforts are restitution and reform. As with natural persons, the decision whether or not to prosecute should not depend upon the target's ability to pay restitution. A corporation's efforts to pay restitution even in advance of any court order is, however, evidence of its "acceptance of responsibility" and, consistent with the practices and policies of the appropriate Division of the Department entrusted with enforcing specific criminal laws, may be considered in determining whether to bring criminal charges. Similarly, although the inadequacy of a corporate compliance program is a factor to consider when deciding whether to charge a corporation, that corporation's quick recognition of the flaws in the program and its efforts to improve the program are also factors to consider.

IX. Charging a Corporation: Collateral Consequences

A. General Principle: Prosecutors may consider the collateral consequences of a corporate criminal conviction in determining whether to charge the corporation with a criminal offense.

B. Comment: One of the factors in determining whether to charge a natural person or a corporation is whether the likely punishment is appropriate given the nature and seriousness of the crime. In the corporate context, prosecutors may take into account the possibly substantial consequences to a corporation's officers, directors, employees, and shareholders, many of whom may, depending on the size and nature (e.g., publicly vs. closely held) of the corporation and their role in its operations, have played no role in the criminal conduct, have been completely unaware of it, or have been wholly unable to prevent it. Prosecutors should also be aware of non-penal sanctions that may accompany a criminal charge, such as potential suspension or debarment from eligibility for government contracts or federal funded programs such as health care. Whether or not such non-penal sanctions are appropriate or required in a particular case is the responsibility of the relevant agency, a decision that will be made based on the applicable statutes, regulations, and policies.

Virtually every conviction of a corporation, like virtually every conviction of an individual, will have an impact on innocent third parties, and the mere existence of such an effect is not sufficient to preclude prosecution of the corporation. Therefore, in evaluating the severity of collateral consequences, various factors already discussed, such as the pervasiveness of the criminal conduct and the adequacy of the corporation's compliance programs, should be considered in determining the weight to be given to this factor. For instance, the balance may tip in favor of prosecuting corporations in situations where the scope of the misconduct in a case is widespread and sustained within a corporate division (or spread throughout pockets of the corporate organization). In such cases, the possible unfairness of visiting punishment for the corporation's crimes upon shareholders may be of much less concern where those shareholders have substantially profited, even unknowingly, from widespread or pervasive criminal activity. Similarly, where the top layers of the corporation's management or the shareholders of a closely-held corporation were engaged in or aware of the wrongdoing and the conduct at issue was accepted as a way of doing business for an extended period, debarment may be deemed not collateral, but a direct and entirely appropriate consequence of the corporation's wrongdoing.

The appropriateness of considering such collateral consequences and the weight to be given them may depend on the special policy concerns discussed in section III, *supra*.

X. Charging a Corporation: Non-Criminal Alternatives

A. General Principle: Although non-criminal alternatives to prosecution often exist, prosecutors may consider whether such sanctions would adequately deter, punish, and rehabilitate a corporation that has engaged in wrongful conduct. In evaluating the adequacy of non-criminal alternatives to prosecution, *e.g.*, civil or regulatory enforcement actions, the prosecutor may consider all relevant factors, including:

1. the sanctions available under the alternative means of disposition;

2. the likelihood that an effective sanction will be imposed; and

3. the effect of non-criminal disposition on Federal law enforcement interests.

B. Comment: The primary goals of criminal law are deterrence, punishment, and rehabilitation. Non-criminal sanctions may not be an appropriate response to an egregious violation, a pattern of wrongdoing, or a history of non-criminal sanctions without proper remediation. In other cases, however, these goals may be satisfied without the necessity of instituting criminal proceedings. In determining whether federal criminal charges are appropriate, the prosecutor should consider the same factors (modified appropriately for the regulatory context) considered when determining whether to leave prosecution of a natural person to another jurisdiction or to seek non-criminal alternatives to prosecution. These factors include: the strength of the regulatory authority's interest; the regulatory authority's ability and willingness to take effective enforcement action; the probable sanction if the regulatory authority's enforcement action is upheld; and the effect of a non-criminal disposition on Federal law enforcement interests. *See* USAM §§ 9-27.240, 9-27.250.

XI. Charging a Corporation: Selecting Charges

A. General Principle: Once a prosecutor has decided to charge a corporation, the prosecutor should charge, or should recommend that the grand jury charge, the most serious offense that is consistent with the nature of the defendant's conduct and that is likely to result in a sustainable conviction.

B. Comment: Once the decision to charge is made, the same rules as govern charging natural persons apply. These rules require "a faithful and honest application of the Sentencing Guidelines" and an "individualized assessment of the extent to which particular charges fit the specific circumstances of the case, are consistent with the purposes of the Federal criminal code, and maximize the impact of Federal resources on crime." *See* USAM § 9-27.300. In making this determination, "it is appropriate that the attorney for the government consider, *inter alia*, such factors as the sentencing guideline range yielded by the charge, whether the penalty yielded by such sentencing range ... is proportional to the seriousness of the defendant's conduct, and whether the charge achieves such purposes of the criminal law as punishment, protection of the public, specific and general deterrence, and rehabilitation." *See* Attorney General's Memorandum, dated October 12, 1993.

XII. Plea Agreements with Corporations

A. General Principle: In negotiating plea agreements with corporations, prosecutors should seek a plea to the most serious, readily provable offense charged. In addition, the terms of the plea agreement should contain appropriate provisions to ensure punishment, deterrence, rehabilitation, and compliance with the plea agreement in the corporate context. Although special circumstances may mandate a different conclusion, prosecutors generally should not agree to accept a corporate guilty plea in exchange for non-prosecution or dismissal of charges against individual officers and employees.

B. Comment: Prosecutors may enter into plea agreements with corporations for the same reasons and under the same constraints as apply to plea agreements with natural persons. *See* USAM §§ 9-27.400-500. This means, *inter alia*, that the corporation should be required to plead guilty to the most serious, readily provable offense charged. As is the case with individuals, the attorney making this determination should do so "on the basis of an individualized assessment of the extent to which particular charges fit the specific circumstances of the case, are consistent with the purposes of the federal criminal code, and maximize the impact of federal resources on crime. In making this determination, the attorney for the government considers, inter alia, such factors as the sentencing guideline range yielded by the charge, whether the penalty yielded by such sentencing range ... is proportional to the seriousness of the defendant's conduct, and whether the charge achieves such purposes of the criminal law as punishment, protection of the public, specific and general deterrence, and rehabilitation." *See* Attorney General's Memorandum, dated October 12, 1993. In addition, any negotiated departures from the Sentencing Guidelines must be justifiable under the Guidelines and must be disclosed to the sentencing court. A corporation should be made to realize that pleading guilty to criminal charges constitutes an admission of guilt and not merely a resolution of an inconvenient distraction from its business. As with natural persons, pleas should be structured so that the corporation may not later "proclaim lack of culpability or even complete innocence." *See* USAM §§ 9-27.420(b)(4), 9-27.440, 9-27.500. Thus, for instance, there should be placed upon the record a sufficient factual basis for the plea to prevent later corporate assertions of innocence.

A corporate plea agreement should also contain provisions that recognize the nature of the corporate "person" and ensure that the principles of punishment, deterrence, and rehabilitation are met. In the corporate context, punishment and deterrence are generally accomplished by substantial fines, mandatory restitution, and institution of appropriate compliance measures, including, if necessary, continued judicial oversight or the use of special masters. *See* USSG §§ 8B1.1, 8C2.1, *et seq.* In addition, where the corporation is a government contractor, permanent or temporary debarment may be appropriate. Where the corporation was engaged in government contracting fraud, a prosecutor may not negotiate away an agency's right to debar or to list the corporate defendant.

In negotiating a plea agreement, prosecutors should also consider the deterrent value of prosecutions of individuals within the corporation. Therefore, one factor that a prosecutor may consider in determining whether to enter into a plea agreement is whether the corporation is seeking immunity for its employees and officers or whether the corporation is willing to cooperate in the investigation of culpable individuals. Prosecutors should rarely negotiate away individual criminal liability in a corporate plea.

Rehabilitation, of course, requires that the corporation undertake to be law-abiding in the future. It is, therefore, appropriate to require the corporation, as a condition of probation, to implement a compliance program or to reform an existing one. As discussed above, prosecutors may consult with the appropriate state and federal agencies and components of the Justice Department to ensure that a proposed compliance program is adequate and meets industry standards and best practices. *See* section VII, *supra*.

In plea agreements in which the corporation agrees to cooperate, the prosecutor should ensure that the cooperation is complete and truthful. To do so, the prosecutor may request that the corporation waive attorney-client and work product protection, make employees and agents available for debriefing, disclose the results of its internal investigation, file appropriate certified financial statements, agree to governmental or third-party audits, and take whatever other steps are necessary to ensure that the full scope of the corporate wrongdoing is disclosed and that the responsible culprits are identified and, if appropriate, prosecuted. *See* generally section VIII, *supra*.

Footnotes:

1. While these guidelines refer to corporations, they apply to the consideration of the prosecution of all types of business organizations, including partnerships, sole proprietorships, government entities, and unincorporated associations.

2. In addition, the Sentencing Guidelines reward voluntary disclosure and cooperation with a reduction in the corporation's offense level. *See* USSG §8C2.5)g).

3. This waiver should ordinarily be limited to the factual internal investigation and any contemporaneous advice given to the corporation concerning the conduct at issue. Except in unusual circumstances, prosecutors should not seek a waiver with respect to communications and work product related to advice concerning the government's criminal investigation.

4. Some states require corporations to pay the legal fees of officers under investigation prior to a formal determination of their guilt. Obviously, a corporation's compliance with governing law should not be considered a failure to cooperate.

5. Although this case and *Basic Construction* are both antitrust cases, their reasoning applies to other criminal violations. In the Hilton case, for instance, the Ninth Circuit noted that Sherman Act violations are commercial offenses "usually motivated by a desire to enhance profits," thus, bringing the case within the normal rule that a "purpose to benefit the corporation is necessary to bring the agent's acts within the scope of his employment." 467 F.2d at 1006 & n4. In addition, in *United States v. Automated Medical Laboratories*, 770 F.2d 399, 406 n.5 (4th Cir. 1985), the Fourth Circuit stated "that Basic Construction states a generally applicable rule on corporate criminal liability despite the fact that it addresses violations of the antitrust laws."

6. For a detailed review of these and other factors concerning corporate compliance programs, see United States Sentencing Commission, GUIDELINES MANUAL, §8A1.2, comment. (n.3(k)) (Nov. 1997). *See* also USSG §8C2.5(f)

7. For example, the Antitrust Division's amnesty policy requires that "[w]here possible, the corporation [make] restitution to injured parties...."

SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 44969 / October 23, 2001

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 1470 / October 23, 2001

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

Today, we commence and settle a cease-and-desist proceeding against Gisela de Leon-Meredith, former controller of a public company's subsidiary.[1] Our order finds that Meredith caused the parent company's books and records to be inaccurate and its periodic reports misstated, and then covered up those facts.

We are not taking action against the parent company, given the nature of the conduct and the company's responses. Within a week of learning about the apparent misconduct, the company's internal auditors had conducted a preliminary review and had advised company management who, in turn, advised the Board's audit committee, that Meredith had caused the company's books and records to be inaccurate and its financial reports to be misstated. The full Board was advised and authorized the company to hire an outside law firm to conduct a thorough inquiry. Four days later, Meredith was dismissed, as were two other employees who, in the company's view, had inadequately supervised Meredith; a day later, the company disclosed publicly and to us that its financial statements would be restated. The price of the company's shares did not decline after the announcement or after the restatement was published. The company pledged and gave complete cooperation to our staff. It provided the staff with all information relevant to the underlying violations. Among other things, the company produced the details of its internal investigation, including notes and transcripts of interviews of Meredith and others; and it did not invoke the attorney-client privilege, work product protection or other privileges or protections with respect to any facts uncovered in the investigation.

The company also strengthened its financial reporting processes to address Meredith's conduct -- developing a detailed closing process for the subsidiary's accounting personnel, consolidating subsidiary accounting functions under a parent company CPA, hiring three new CPAs for the accounting department responsible for preparing the subsidiary's financial statements, redesigning the subsidiary's minimum annual audit requirements, and requiring the parent company's controller to interview and approve all senior accounting personnel in its subsidiaries' reporting processes.

Our willingness to credit such behavior in deciding whether and how to take enforcement action benefits investors as well as our enforcement program.

When businesses seek out, self-report and rectify illegal conduct, and otherwise cooperate with Commission staff, large expenditures of government and shareholder resources can be avoided and investors can benefit more promptly.[2] In setting forth the criteria listed below, we think a few caveats are in order:

First, the paramount issue in every enforcement judgment is, and must be, what best protects investors. There is no single, or constant, answer to that question. Self-policing, self-reporting, remediation and cooperation with law enforcement authorities, among other things, are unquestionably important in promoting investors' best interests. But, so too are vigorous enforcement and the imposition of appropriate sanctions where the law has been violated. Indeed, there may be circumstances where conduct is so egregious, and harm so great, that no amount of cooperation or other mitigating conduct can justify a decision not to bring any enforcement action at all. In the end, no set of criteria can, or should, be strictly applied in every situation to which they may be applicable.

Second, we are not adopting any rule or making any commitment or promise about any specific case; nor are we in any way limiting our broad discretion to evaluate every case individually, on its own particular facts and circumstances. Conversely, we are not conferring any "rights" on any person or entity. We seek only to convey an understanding of the factors that may influence our decisions.

Third, we do not limit ourselves to the criteria we discuss below. By definition, enforcement judgments are just that -- judgments. Our failure to mention a specific criterion in one context does not preclude us from relying on that criterion in another. Further, the fact that a company has satisfied all the criteria we list below will not foreclose us from bringing enforcement proceedings that we believe are necessary or appropriate, for the benefit of investors.

In brief form, we set forth below some of the criteria we will consider in determining whether, and how much, to credit self-policing, self-reporting, remediation and cooperation -- from the extraordinary step of taking no enforcement action to bringing reduced charges, seeking lighter sanctions, or including mitigating language in documents we use to announce and resolve enforcement actions.

1. What is the nature of the misconduct involved? Did it result from inadvertence, honest mistake, simple negligence, reckless or deliberate indifference to indicia of wrongful conduct, willful misconduct or unadorned venality? Were the company's auditors misled?

2. How did the misconduct arise? Is it the result of pressure placed on employees to achieve specific results, or a tone of lawlessness set by those in control of the company? What compliance procedures were in place to prevent the misconduct now uncovered? Why did those procedures fail to stop or inhibit the wrongful conduct?

3. Where in the organization did the misconduct occur? How high up in the chain of command was knowledge of, or participation in, the misconduct? Did senior personnel participate in, or turn a blind eye toward, obvious indicia of misconduct? How systemic was the behavior? Is it symptomatic of the way the entity does business, or was it isolated?

4. How long did the misconduct last? Was it a one-quarter, or one-time, event, or did it last several years? In the case of a public company, did the misconduct occur before the company went public? Did it facilitate the company's ability to go public?

5. How much harm has the misconduct inflicted upon investors and other corporate constituencies? Did the share price of the company's stock drop significantly upon its discovery and disclosure?

6. How was the misconduct detected and who uncovered it?

7. How long after discovery of the misconduct did it take to implement an effective response?

8. What steps did the company take upon learning of the misconduct? Did the company immediately stop the misconduct? Are persons responsible for any misconduct still with the company? If so, are they still in the same positions? Did the company promptly, completely and effectively disclose the existence of the misconduct to the public, to regulators and to self-regulators? Did the company cooperate completely with appropriate regulatory and law enforcement bodies? Did the company identify what additional related misconduct is likely to have occurred? Did the company take steps to identify the extent of damage to investors and other corporate constituencies? Did the company appropriately recompense those adversely affected by the conduct?

9. What processes did the company follow to resolve many of these issues and ferret out necessary information? Were the Audit Committee and the Board of Directors fully informed? If so, when?

10. Did the company commit to learn the truth, fully and expeditiously? Did it do a thorough review of the nature, extent, origins and consequences of the conduct and related behavior? Did management, the Board or committees consisting solely of outside directors oversee the review? Did company employees or outside persons perform the review? If outside persons, had they done other work for the company? Where the review was conducted by outside counsel, had management previously engaged such counsel? Were scope limitations placed on the review? If so, what were they?

11. Did the company promptly make available to our staff the results of its review and provide sufficient documentation reflecting its response to the situation? Did the company identify possible violative conduct and evidence with sufficient precision to facilitate prompt enforcement actions against those who violated the law? Did the company produce a thorough and probing written report detailing the findings of its review? Did the company voluntarily disclose information our staff did not directly request and otherwise might not have uncovered? Did the company ask its employees to cooperate with our staff and make all reasonable efforts to secure such cooperation?[3]

12. What assurances are there that the conduct is unlikely to recur? Did the company adopt and ensure enforcement of new and more effective internal controls and procedures designed to prevent a recurrence of the misconduct? Did the company provide our staff with sufficient information for it to evaluate the company's measures to correct the situation and ensure that the conduct does not recur?

13. Is the company the same company in which the misconduct occurred,

or has it changed through a merger or bankruptcy reorganization?

We hope that this Report of Investigation and Commission Statement will further encourage self-policing efforts and will promote more self-reporting, remediation and cooperation with the Commission staff. We welcome the constructive input of all interested persons. We urge those who have contributions to make to direct them to our Division of Enforcement. The public can be confident that all such communications will be fairly evaluated not only by our staff, but also by us. We continue to reassess our enforcement approaches with the aim of maximizing the benefits of our program to investors and the marketplace.

By the Commission (Chairman Pitt, Commissioner Hunt, Commissioner Unger).

Footnotes

[1] *In the Matter of Gisela de Leon-Meredith*, Exchange Act Release No. 44970 (October 23, 2001).

[2] We note that the federal securities laws and other legal requirements and guidance also promote and even require a certain measure of self-policing, self-reporting and remediation. *See, e.g.*, Section 10A of the Securities Exchange Act of 1934, 15 U.S.C. § 78j-1 (requiring issuers and auditors to report certain illegal conduct to the Commission); *In the Matter of W.R. Grace & Co.,* Exchange Act Release No. 39157 (Sept. 30, 1997) (emphasizing the affirmative responsibilities of corporate officers and directors to ensure that shareholders receive accurate and complete disclosure of information required by the proxy solicitation and periodic reporting provisions of the federal securities laws); *In the Matter of Cooper Companies, Inc.,* Exchange Act Release No. 35082 (Dec. 12, 1994) (emphasizing responsibility of corporate directors in safeguarding the integrity of a company's public statements and the interests of investors when evidence of fraudulent conduct by corporate management comes to their attention); *In the Matter of John Gutfreund,* Exchange Act Release No. 31554 (Dec. 3, 1992) (sanctions imposed against supervisors at broker-dealer for failing promptly to bring misconduct to attention of the government). *See also Federal Sentencing Guidelines* § 8C2.5(f) & (g) (organization's "culpability score" decreases if organization has an effective program to prevent and detect violations of law or if organization reports offense to governmental authorities prior to imminent threat of disclosure or government investigation and within reasonably prompt time after becoming aware of the offense); *New York Stock Exchange Rules* 342.21 & 351(e) (members and member organizations required to review certain trades for compliance with rules against insider trading and manipulation, to conduct prompt internal investigations of any potentially violative trades, and to report the status and/or results of such internal investigations).

[3] In some cases, the desire to provide information to the Commission staff may cause companies to consider choosing not to assert the attorney-client privilege, the work product protection and other privileges, protections and exemptions with respect to the Commission. The Commission recognizes that these privileges, protections and exemptions serve important social interests. In this regard, the Commission does not view a company's waiver of a privilege as an end in itself, but only as a means (where necessary) to provide relevant and sometimes critical information to the Commission staff. Thus, the Commission recently filed an *amicus* brief arguing that the provision of privileged information to the Commission staff pursuant to a confidentiality agreement did not necessarily waive the privilege as to third parties. *Brief of SEC as Amicus Curiae, McKesson HBOC, Inc.*, No. 99-C-7980-3 (Ga. Ct. App. Filed May 13, 2001). Moreover, in certain circumstances, the Commission staff has agreed that a witness' production of privileged information would not constitute a subject matter waiver that would entitle the staff to receive further privileged information.

http://www.sec.gov/litigation/investreport/34-44969.htm

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ACC'S CLO THINKTANK EXECUTIVE REPORT

THE CLO'S ROLE IN CORPORATE GOVERNANCE AND COMPLIANCE: WHAT'S NEXT?

This Executive Report provides an overview of discussion results from ACC's CLO ThinkTank session titled "The CLO's Role in Corporate Governance and Compliance: What's Next?" and held on September 9, 2005 in San Francisco, California. ACC's CLO ThinkTank sessions are designed to provide a forum for CLOs who wish to exert greater leadership at the bar, in the courts, and in the halls of government on emerging issues of greatest concern. Following is summary information on key topics, discussion point highlights, and takeaways and follow-up initiatives identified by these CLO thought leaders.

ThinkTank participants included the following Fortune 500 company thought leaders:

- Chris Campbell, Senior Vice President, General Counsel, Secretary and Chief Franchise Policy Officer, Yum! Brands, Inc.;
- Dan Cooperman, Senior Vice President, General Counsel and Secretary, Oracle USA, Inc.;
- Nancy Heinen, Senior Vice President, General Counsel, Apple Computer, Inc.;
- Muzette Hill, ACC Board Member & Incoming Advocacy Committee Chair, Counsel, Ford Motor Credit Corporation
- Craig Nordlund, Senior Vice President, General Counsel and Secretary, Agilent Technologies;
- Mike Roster, Executive Vice President and General Counsel, Golden West Financial Corporation; and
- Laura Stein, Senior Vice president and General Counsel, The Clorox Company.

KEY TOPICS

Below is a list of key discussion topics covered during this CLO ThinkTank session:

- **Compliance**
- **Governance Rating Agencies**
- **Role of CLO/Confidentiality/Privilege**
- **Executive Compensation**
- **Director Education**
- **Relationships with External Auditors**

KEY TAKEAWAYS

Thought leaders participating in this session described a number of ideas and practices. Listed below are the top five key themes and takeaways. Ideas on additional issues are described in the Discussion Highlights section below, and thoughts on action items are summarized in the final section titled Conclusions.

- Compliance programs and practices will continue to receive strong scrutiny by the government and others, and this scrutiny more than other factors will drive changes in the process and practical responses of companies--and not necessarily in the most positive way.
- Actions taken by governance rating agencies to set standards that are sometimes unpublished and decided upon without public input are problematic and should be addressed. Also problematic are conflicts of interest inherent in the "sale" of consulting services by these agencies to those they purport to review.
- The role of the CLO, in at least some companies, has fundamentally changed due to a convergence of factors: the CLO increasingly is forced into the role of deputized policeman and this impacts relationships with executives decreasing candor in discussions and increasing exposure to risks.

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- Relationships with auditors are changing, and protecting privilege in the audit context is a challenge that every company faces every year regardless of their success in ensuring corporate compliance.
- The internal relationship between business compliance leaders and legal compliance leaders is crucial, changing, and poses some challenges. Questions that are emerging as compliance becomes a "cultural" issue within the company will not be ironed out easily or quickly, as different actors with different processes and perspectives all seek to define how compliance roles and responsibilities are assigned and proper outcomes are assured.

DISCUSSION HIGHLIGHTS

COMPLIANCE: ORGANIZATIONAL STRUCTURE, GLOBAL CONSIDERATIONS & ROLE OF IN-HOUSE LAWYERS

- Compliance/ Organizational Models: Participants described various organizational models for compliance, including models that designate the CLO as the Chief Compliance Officer (CCO) or have the compliance function reporting organizationally to the CLO and models that identify compliance as a separate business function with no organizational reporting nexus to the CLO. Some organizational models have a centralized compliance function and others have functional groups responsible for compliance in their areas together with a compliance oversight council that includes leader representatives from key functional groups. Also described was a practice that included having regional General Counsel serve as Regional Business Conduct Officers with dual reporting responsibilities: to the CLO for legal matters and to the CCO for compliance matters. Participants described an emerging practice of not having a direct reporting relationship between the CCO and any business unit, and noted that this appears to be an emerging regulatory bias particularly for banking industry regulators.

  For regulated industries, participants described more comfort with an organizational model that includes having the compliance function outside the law department. In this type of model, the CLO is very involved and may host a monthly meeting of all compliance leaders and lawyers, but there is no organizational reporting or formal organizational compliance position for the CLO.

  For other industries, participants discussed practices that include designating as a CCO an experienced lawyer who reports organizationally to the CLO. The lawyer in CCO position would be relieved of other responsibilities and focus entirely on compliance. Qualifications for the CCO position include the need for both business experience and the importance of having the right personality for effectively performing this role (e.g., facilitator not dictator). Roles of the CCO include: responsibility for helpline administration, serving as head of company's compliance council, interviewing global business leaders on compliance issues and performing any needed gap analyses, coordinating and providing oversight on investigations, developing and managing compliance education initiatives, and performing process improvement assessments, post mortems, and follow-up.

  Business case for CCO: participants described a number of factors that help support the business case for creating a CCO dedicated solely to performing that role. Depending on the industry, these factors may include the concept of incorporating compliance into the front-end of business strategy, the ability to free-up capacity within the legal department by centralizing the role of the CCO, and the concept of compliance metrics and negative impacts to profit-centers for lack of compliance (discussions also noted rapid personnel movement as a challenge in implementing this latter factor).
- Compliance/ Global Considerations & Challenges: Having a global code of business conduct modified for local customs, blending local customs with global policies, establishing the role of the in-house lawyer, and communicating disciplinary actions taken as a result of compliance weaknesses or omissions (privacy law concerns) are all challenges identified in connection with compliance in the global context.

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Challenges: For in-house lawyers in countries outside of corporate headquarters, challenges include finding ways to reconcile their role serving on business teams with their emerging role as traffic cops. Participants noted the pressures of sitting with the local business teams and/or on executive business teams, and issues relating to lawyers sitting on boards of company businesses. They also discussed practices for selecting the investigation team for performing internal investigations.

Possible Solutions: Solutions may include: having all lawyers report organizationally to the CLO as part of a global legal department, a 'general' rule against having 1-lawyer offices in the field, and CLOs on the road reinforcing the importance of the in-house lawyers' role by meeting with the lawyers and then also in combined meetings with the clients to send the message that in-house lawyers in the field have the CLO's full-backing. On ideas for how to handle investigations, solutions include educating in-house lawyers and selected staff on do's and don'ts of conducting internal investigations, the differences between conducting a factual investigation and performing a legal analysis, and the practice of including a headquarters lawyer on the investigation team to provide support to local lawyers in the field.

- Compliance/ Key Topic Takeaways: Compliance is here to stay. It is common practice, and -- in the minds of the majority of participants -- desirable, to have compliance reporting organizationally into the legal department. The Chief Compliance Officer (CCO) role is/can be a full-time responsibility with accountability. 'Choking impacts' of compliance in today's regulatory environment- both in terms of cost and on impact on role of the Board—present concerns.

GOVERNANCE RATING AGENCIES: 'LEGISLATING' & SELLING SERVICES; CONFLICTS AND BURDENS; NEED FOR PUSHBACK

- Governance Rating Agencies/ 'Legislating': Examples of situations where rating agencies are creating separate standards without accountability:

  Number of Independent Directors: SEC says majority; some rating agencies press for supermajority

  Limiting Boards Director may sit on: rating agencies say 4 (2 for CEO)

  Anti-takeover Devices: rating agency position against these; however state law may require at least some of these provisions

  Best practice concepts regarding use of outside counsel rather than consulting CLOs- seeking to drive where and how business leaders and Directors seek counsel

  Voting recommendations against audit committee members re: tax-related work

  Potential of D&O Insurers reviewing rating agency information to determine whether a company is insurable and to set premiums

- Governance Rating Agencies/ Conflicts: Participants discussed notion of an apparent conflict of interest in having the rating agencies sell consulting services that in turn influence governance ratings, and in the need to buy consulting services to determine how to adjust practices to eliminate the penalty/upward adjust ratings.
- Governance Rating Agencies/ Key Takeaways & Pushback Initiatives: Possible strategies for addressing challenges in this area and achieving 'pushback' include:

  Legislation (may need something outside of the proxy rules);

  Lobbying the SEC to ask them to take back ownership;

  Administrative procedural requirements for governance ratings agency 'standards' (e.g., require governance rating agencies go through an administrative procedure to publish, hold hearings, and accept comment on proposed standards); and

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Publish 'standards': require governance rating agencies to publish their standards to eliminate the concept of 'secret standards' as a hook for consulting fees to decipher, remedy and upward adjust ratings.

CLO'S ROLE: MULTIPLE CONSTITUENTS; INTERNAL INVESTIGATIONS; INCREASED RISK PROFILE

- CLOs Role/ Investigations: Participants described a variety of different roles and approaches for involving CLOs in performing internal investigations, including: having 3-5 outside law firms on a list of 'independent' law firms to use if situation arises rather than having the CLO conduct the investigation, having the CLO lead (or outside counsel lead) the investigation with a shadow law firm to perform a 'gut check,' and having the audit committee or Board appoint independent counsel with the CLO playing a supporting role. Participants also discussed concepts of creating and using QLCCs.
- CLOs Role/ Counsel on Engagement Partners: Discussions on engagement partner issues included implications of the non-retaliation provisions of Sarbanes-Oxley if a company needs to remove an engagement partner and the positive role the CLO can play in helping to select the right engagement partner. One participant described a practice of speaking annually with General Counsel of the company's outside auditor.
- CLOs Role/ Investment Committee: Participants described CLO movement off of investment committees (for some, other executive officers are also moving off of these committees). In addition, they discussed the evolving role of the CLO as a committee advisor rather than committee member, and the practice of having professional management firms/ independent fiduciaries/outside advisors provide advice on 401k plans. The emerging need for outside advisors in this area was cited as expensive and another example of a governance-related cost.
- CLOs Role/ Certifications: Participants queried whether company practices involving CEO and CFO certifications include a requirement for the CLO to provide a supporting certification, and client responses to reluctance to provide (e.g., the CEO and CFO may not be experts in GAAP or FAS 5 either- if they need to sign why won't you?). One possible approach included provide a legal assessment on the litigation reserve but not on GAAP or on compliance with FAS 5. Another view on the CLO certification and the rationale for not providing it is the difficulty in providing legal advice to CFO on her certification if the CLO is providing her/his own certification.
- CLOs Role/ Board Minutes: Discussions addressed the desire for minutes to reflect robust discussions and dialogue of Board on issues of importance, but not be anything like a transcript, and requests from auditors to review draft minutes. One participant described the practice of periodically sending minutes to an in-house securities litigator for guidance on the approach to preparing minutes. Participants also described requests from internal Section 404 committees to review Board minutes, and providing access to the same.
- CLOs Role/ Miranda Warning: Using streamlined versions and suggestions on how to respond when asked if there is a need for separate counsel were discussed among the group (one option described: informing can't advise on this question and if there are any questions whatsoever, suggesting they get counsel and be comfortable; another described option: stating that from the company's perspective, the company has investigated the matter and believes it can represent the individual because of the community of interest- case-specific application).
- CLOs Role/ Seats on Company Boards: Participants expressed a general view that it is probably better for in-house lawyers not to sit on company boards (example of assertion against sitting on Boards: can't give legal advice to the Board if sitting on the Board). They also described challenges of Director liability in countries around the world.
- CLOs Role/ End-of-Quarter Pressure on In-House Lawyers: The issue of peak work to complete contracts at end-of-quarter, and a solution describing use of contract lawyers during the last 3 weeks of each quarter were discussed.
- CLOs Role/ Disclosure Committee: 4 CLOs sit on these committees (2 have designated other lawyers who advise the committee), 3 do not sit on the committee. Participants discussed issues relating to sitting on vs advising the Disclosure

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Committee, and theories of CLO liability if the CLO sits on Disclosure Committee (or should have) and didn't insist on disclosing an event (often coupled with stock trading that occurs before event is disclosed).

- CLOs Role/ Emerging Liability; Increased Risk Profile: The increased risk profile of CLOs, and allegations of CLO liability for cases involving omissions (e.g., failure to advise on problem that later arose—not because CLO knew about the problem but on theory that CLO should have known) were discussed. Among the ideas on solutions to counter the omissions theory are enhanced education for lawyers, and Sarbox reporting-up policies. Participants expressed concerns regarding imputed knowledge if listed on string of cc's in emails, CLO offices as a place the government is increasingly beginning investigations, and emerging cases with CLOs and in-house lawyers as targets. Additional discussions included issue of investment committee exposure and trends for CLOs to get off of these committees, and concerns regarding possible erosion of ability of CLO to rely on outside expert advice and concept of legal business judgment rule.
- CLOs Role/ Policing Function and Impacts on Relationship with C-Suite: Idea that with new governance practices, CLOs have assumed a prominent policing role that has fundamentally changed the relationship between the CLO and the CEO or other C-Suite executives. Participants described concerns regarding impacts of this role and the erosion of confidence and trust in the CLO. They also expressed increased skepticism regarding the quality of information they receive, and question whether CLOs will receive the 'unvarnished truth.' Issues regarding whistleblower procedures on financial matters and perception of the CLO as going around management by directly reporting these matters to the Board were also discussed.
- CLOs Role/ Organizational Structure for Tax Counsel & Impacts: Participants identified tax as a specialized practice area, and described organizational structures that may place tax lawyers outside of the law department. In these situations, questions arose regarding whether the CLO would be considered "responsible for/to possess imputed knowledge of" advice provided on tax matters. Participants also discussed the scope of Sarbox 307 reporting-up policies and the definition of who is covered by the policy, and noted the issue of whether including tax lawyers creates a possible nexus for CLO responsibility.
- CLOs Role/ Key Takeaways: There is a fundamental change in the role of CLOs as a result of governance initiatives. The CLO risks being viewed as a 'corporate policeman,' and this impacts relationships with executives, candor in discussions, and the ability to provide legal advice. Concerns regarding participation as committee members or Board members of company subsidiary entities and the increased risk profile for CLOs were also key takeaways. Participants suggested considering action at the executive or business-level regarding affecting governance reform (perhaps through NACD, Business Roundtable, National Chamber, etc..), and expressed interest in identifying additional follow-up initiatives resulting from upcoming CLO ThinkTank session on "Corporate Liability: Prosecutorial Trends and Tactics."

EXECUTIVE COMPENSATION

- Executive Comp/ Use of Consultants: Participants discussed issues regarding the use of compensation consultants and how to define their roles (e.g., should there be one set for management and another set for the compensation committee?). Experiences in approaching this area include:

  Use two consultants (one for management, one for compensation committee), and define clear roles so there isn't overlap. The compensation committee consultant sets compensation for CEO, and management's consultant sets compensation for management below the CEO and Board-level.

  Use one consultant and clearly define when that consultant is advising on management or Board compensation (experience shared regarding Board's discomfort of not having separate consultant to represent it).

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Internally propose compensation for management and the Board with use of outside consultant to validate.

- Executive Comp/ Compensation Features: Participants discussed the SEC's position regarding disclosing material changes to compensation arrangements for named officers and Directors, and approaches for Director compensation structures and disclosure methods, including:

  Tiered Director compensation based on roles of Directors, including differential equity grants based upon how involved Directors are in the Board process. This practice includes developing and disseminating to the Board a chart showing committee roles and how Directors would be compensated for each role (the chart is filed as part of the company's proxy). Using this model, the Board ultimately approves its compensation structure. In describing these practices, one participant also noted a recent initiative to scour expenses at the senior executive level to enhance detailed disclosure, and the disclosure of components that might conceivably be construed as a perquisite.

  Disclosure of Director compensation program description in the company's 8K (at least annually). One participant described a practice involving auditing the company's top 25 senior executives (executive officers and one level below) for T&E expenses. The CEO's T&Es are approved by Board.

  Simplified plan to one option plan, a Director 401k, and a bonus plan (no pension). One participant described a practice involving recommending balance-restricted stock options.

  Plan includes 401(k), option plan, pension plan, executive compensation component consisting of simple cash bonus based on performance metrics (bonus is evaluated twice a year; either get it or don't), and long-term incentive plan (in lieu of options).

  Point-to-point bonus plan methodologies and concerns associated with these methods were also described. Ideas on possible alternative to the point-to-point methodology include using averages over time or using two objective performance measures (this latter approach appears to be among more recent outside consultant recommendations).
- Executive Comp/ Best Practice Ideas: Auditing executive officers and the next-level down to identify T&E expenses, disclosure of compensation charts, enhanced transparency and disclosure on expenses such as security, etc.. were identified as best practice ideas.
- Executive Comp/ Potential for Conflicts: Participants discussed the concept of a potential conflict of interest for CLO regarding advising on compensation discussions when the CLO is also a recipient under the company's executive compensation programs. One possible solution: protect with outside counsel and expert advice and refrain from making substantive comments on certain components of methodologies for compensation calculations.

DIRECTOR EDUCATION

- Director Education/ Outside Seminars: Participants described a general lack of interest among the Director community in attending outside seminars – not because of laziness but because experienced directors find very little that is beneficial. Ideas on informing Directors about opportunities for outside seminars include sending a quarterly roster of external programs with communications regarding encouragement to attend and opportunity for expense reimbursement. One Director education experience involved conducting a 2-day, customized off-site training session for entire Board; the provider was flexible and the experience was described as positive.
- Director Education/ Ideas on Customized or In-House Programs: Participants described the CLOs role in suggesting topics to the Board's Nominating & Governance Committee and in working with external provider to develop a customized program with panelists of interest to the Board. Flexibility in timing was described (e.g., can do 3 or 4 two-hour sessions over a Board dinner rather than one day-long session). In addition, participants described a general view that outside sessions aren't very useful and a general preference to bring training inside and incorporate the education into a meeting setting.

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- Director Education/ Practice of Including FASB rules in Binders: Practice that enables the CLO to keep the importance of the FASB rules at the forefront. This practice is paired with a general tutorial on these issues delivered as part of the Board meeting preliminaries, and then highlighted as part of the regular financial presentations.
- Director Education/ Conflict with Governance Rating agencies and Training Certification: Concerns about 'standards' being set by rating agencies that also have interest in certifying and selling training were noted. Pushback was identified as an idea for strategic action.
- Director Education/ Client Education Challenges-General: Ideas on training for financial business clients on sensitive issues such as earnings management and discretionary events were described. Practices include: at least annual sessions on discretionary events, do's and don'ts of share purchase plans, providing examples of investigations and cases involving finance personnel, and evaluating main decisions on reserves.

RELATIONSHIPS WITH EXTERNAL AUDITORS

- External Auditors/ Requests for Privileged Information: Participants discussed auditor demands for internal investigations reports and other information that may be privileged and auditor refusals to sign-off on audit letters without access to the information. One participant described an experience with the PCAOB involving an audit of an audit, requests for a privileged document, and refusal to clear the audit absent satisfactory information on the disclosure.
- External Auditors/ Exception to Privilege: Initiatives underway and discussions with audit firms to vet concept of creating privilege exception for information shared with auditors were discussed. The group also discussed issues involving the potential for legislative fix.

CONCLUSION

The session ended with CLOs confirming interest in ACC CLO ThinkTank session format as useful forum for discussions on issues of interest and importance to CLOs, with the limited size of the group cited a positive factor. Key action items identified for follow-up include:

- Trying to affect pushback with governmental rating agencies;
- Advocating for an exception to privilege with regard to auditor requests for information;
- Exploring opportunities to exert more control over the changing role of CLO (to ensure its focus remains on client service); and
- Evaluating ideas regarding CLO liability flowing from upcoming ACC CLO ThinkTank session on Corporate Liability: Prosecutorial Trends and Tactics.

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ACC's CLO THINKTANK EXECUTIVE REPORT

LAW DEPARTMENT'S ROLE IN FINANCIAL COMPLIANCE & RELATIONSHIPS WITH AUDITORS

This Executive Report provides an overview of discussion results from ACC's CLO ThinkTank session titled "Law Department's Role in Financial Compliance & The Relationships with Auditors" held in Philadelphia, PA on March 24, 2006. ACC's CLO ThinkTank sessions are designed to provide a forum for CLOs who wish to exert greater leadership at the bar, in the courts, and in the halls of government on emerging issues of greatest concern. Following is summary information on key topics and takeaways, discussion point highlights, and follow-up initiatives identified by these private company CLO thought leaders.

ThinkTank participants included the following legal leaders:

- Brad Brubaker, Senior Vice President, General Counsel & Corporate Secretary, SAP America, Inc.
- Greg Butler, Senior Vice President & General Counsel, Northeast Utilities
- Steve Feder, Senior Vice President & General Counsel, Safeguard Scientifics, Inc.
- William Gallagher, Senior Vice President, General Counsel & Secretary, Crown Holdings, Inc.
- Don Liu, Senior Vice President, General Counsel & Chief Compliance Officer, Toll Brothers, Inc.
- Robert Lonergan, Vice President, General Counsel & Corporate Secretary, Rohm and Haas Company
- Mark McGuire, Vice President & General Counsel, Eaton Corporation
- Ken Pina, Former Senior Vice President, Chief Legal Officer & Secretary, Henkel Corporation
- Helen Pudlin, Senior Vice President & General Counsel, The PNC Financial Services Group
- Andrea Utecht, Vice President, Secretary & General Counsel, FMC Corporation

KEY TOPICS

Below is a list of key topics discussed during this CLO ThinkTank session:

- **Compliance Structure & Certifications**
- **Reporting Compliance Matters**
- **Ethics Officers/Ethics Committees**
- **Litigation Reserves & Reports**
- **Relationships with External Auditors**

- **Growth by Acquisitions/ Integrating Financial Compliance & Culture**
- **Compliance Training**
- **Internal Investigations**

KEY TAKEAWAYS

Thought leaders participating in this session described a number of ideas and practices. Listed below are some top themes and takeaways. Ideas on additional issues are described in the Discussion Highlights section below, and thoughts on action items are summarized in the final section on Conclusions & Proposed Action Items.

- Outside Auditors are implementing a range of practices in connection with engagement letters and lawyer response to audit letters, including range of practices implemented by same auditor but with different companies.
- Certification and sub-certification practices vary from company-to-company, and include range of programs that involve no certifications to those that involve certifications by all.
- Auditors and underwriters are requesting more detailed information, including information on litigation.

DISCUSSION HIGHLIGHTS

COMPLIANCE STRUCTURE & CERTIFICATIONS

Compliance Structure & Certifications/ Models: Participants describe various structural models for their compliance, legal and internal audit functions and requirements for compliance training and certifications. Some include having CLO provide knowledge sub-certifications (formal or informal) for areas of responsibility or for which CLO has knowledge. Level of industry regulation and size of law department may impact model. Some approaches are summarized below:

- Global compliance program with compliance as separate department led by a Chief Governance & Compliance Officer; mandatory biannual compliance training (for all employees and the Board). In addition, the company's program requires all employees around the world to sign annually a compliance certification regarding compliance with the company's Code and noting any exceptions, which are transmitted to the CLO and shared with the Board by the CLO as appropriate.
- Global compliance program that includes receiving certifications of compliance from U.S. employees and from business unit presidents for non-U.S. operations.
- Compliance program that does not include matrix of sub-certifications to support CEO and CFO certifications.
- Compliance program with Disclosure Committee that consists of leaders from various functional divisions, including the CLO. The Disclosure Committee is led by the company's CFO.
- Compliance program with Disclosure Committee that is chaired by the company's Chief Accounting Officer/Controller. The financial compliance process includes a senior disclosure review (undertaken by the company's operating unit presidents, the CLO and CFO). The organizational compliance structure also includes an internal controls committee.

Compliance Structure & Certifications/ Internal Audit: Among the reporting structures for Internal Audit are:

- Internal Audit reports to CEO and CLO (concept of reporting to CFO is viewed as a challenge)
- Internal Audit reports directly to Audit Committee of the Board, with a dotted-line to the Head of Risk Management, who in turn reports to the CEO
- Internal Audit reports directly to the Audit Committee of the Board, with a dotted line to the CFO

Compliance Structure & Certifications/ CCO: Participants describe various reporting structures for the CCO and whether the individual on point for compliance needs to have a CCO title. They also describe challenges associated with having the CLO as CCO, including separating budgets and maintaining testing and monitoring services separate from advisory services. Another issue is possible impacts to attorney-client privilege if CLO is CCO. Reporting structures range from:

- No CCO
- CLO as CCO (some by title; some de facto; some by virtue of Code)
- CCO is not part of legal dep't but reports to CLO
- CCO reports to CEO & Compliance Committee of Board
- CCO leads separate compliance dep't and reports to Vice Chair of the Board

Compliance Structure & Certifications/ Disclosure Review Committee: Some companies have a Disclosure Review Committee that helps determine matters for disclosure. The process involves asking employees to report matters that are material to their business and having the Disclosure Review Committee determine whether the matters are material to the company and require disclosure.

Compliance Structure & Certifications/ Approaches and Challenges: Participants identify challenges associated with implementing global compliance programs and requiring certifications from non-U.S. employees. One participant describes receiving some objections from U.S. employees on religious and/or political grounds. A participant notes working with European Works Councils to help develop the company's global Code. Another shares that compliance with the Code is considered a condition of employment and certifications must be provided or employees may be subject to termination; still another shares that compliance with the Code is required yet it has eliminated requirements for employee certifications. One participant's company implements practices that require employees to sign certifications as part of their performance reviews. An idea to help track awareness of the Code and the need to comply with it without an embedded certification requirement is to build capabilities into global compliance training modules that enable the company to determine who has completed the training even if certifications aren't included at the end.

Compliance Structure & Certifications/Ethics Officer and Committees: Some companies have a Chief Ethics Officer in addition to a Chief Compliance Officer. In noting the difference in the scope of responsibilities for these positions, compliance is identified as more rule-oriented. Two participants describe an Ethics Officer that reports to the Head of HR. Companies also implement practices that include having some sort of Ethics Committee comprised of top business and/or functional leaders, including the CLO. The Ethics Committee is described as an approach for dealing with major ethical or policy issues that allows key organizational leaders with different views to add perspectives and help make tough decisions. One participant described an annual practice that includes having the Head of HR/Ethics and the CLO review questionable issues identified on Conflict of Interest forms submitted each year.

REPORTING COMPLIANCE CONCERNS

Reporting Concerns/ Information to Board: Notion that amount of information to Board may impact definition of Board's role—whether it is oversight or management. Participants discuss relative merits and demerits of how Boards consider the quality and quantity of information received—both from a liability perspective and with regard to engaging in appropriate leadership functions.

One participant notes that all issues that are reported through the company's ethics line are communicated to the Board. Some have practices that include having the law department work the Audit Committee to develop protocols that describe the types of reported concerns that should be reported to the Board (examples include accounting issues, allegations against senior executives, etc..). Another practice includes reporting issues that could conceivably have some impact on the company's financial statement (without thresholds).

Reporting Concerns/Ombuds: Concept of having individuals in ombuds roles may help address questions or concerns. One participant notes that using ombuds practices has helped reduce EEOC claims.

Reporting Concerns/ Help Lines: Participants all have help lines that are administered by an external service provider. Practices to consider implementing to help monitor effectiveness of call intake is to test the help line system by making a call to see how the matter is processed and/or test the help line system as part of an internal audit.

LITIGATION RESERVES & REPORTS

Litigation Reports/ Board; Outside Auditors: Question as to whether outside auditors are excused from Audit Committee meetings when litigation reports are provided to Committee. For some, outside auditors may be present. Other approaches include: segmenting Audit Committee meeting agenda and having the CLO provide the litigation report to the Audit Committee in executive session; providing the litigation report to the company's Public Policy Committee (rather than Audit Committee); and providing information on significant litigation to the full Board. Having separate quarterly meetings on litigation with outside auditors is another practice.

Litigation Reports/ Underwriters: Question of whether underwriters are requiring disclosures that are more detailed than public disclosures, and whether joint defense-type arrangements among counsel may allow for additional detail when required.

Litigation Reports/ Outside Auditors & Reserves: The general sentiment is that auditors are looking for more justification for numbers. Companies are implementing a range of practices for setting litigation reserves, including quarterly meetings with auditors. Some outside auditors have taken the position that settlement offers should be viewed as a minimum for reserve purposes, but this raises difficulties because of a need for reasonable belief that the offer would be accepted. Example of how a settlement demand could be as unrealistic as a number included in a complaint. Some cases may be viewed as a corporate distraction where a company may be willing to settle the matter to avoid distraction but the number may not qualify as probable for reserve purposes and this situation can present additional challenges.

Litigation Reports/ Audit Response Letters from Lawyers: Outside auditors appear to be implementing a range of practices in connection with requiring audit response letters from in-house and/or outside counsel. Practices range from audit response letters from in-house lawyers only to audit response letters from both in-house and outside counsel. Some also require periodic 'bring-down' letters from in-house and/or outside counsel.

OUTSIDE AUDITOR ENGAGEMENT LETTERS

Outside Auditor/ Terms of Engagement: Provisions in audit engagement letters have changed post-Sarbanes Oxley. Among the provisions most heavily negotiated are: privilege, dispute resolution, and indemnification. These provisions can be negotiated and companies have had success in excluding ADR and limits on liability from the engagement letter. Several participants note practice of working with audit firm partners rather than more junior auditors. In addition, companies note an issue regarding disclosure of terms of engagement.

GROWTH BY ACQUISITIONS; INTEGRATING FINANCE FUNCTIONS

Growth by Acquisitions/ Timing to Integrate & Culture: Due diligence provides an opportunity to obtain baseline information on financial practices; however, there can be challenges associated with integrating corporate culture and tension between the finance and legal departments. An issue to consider includes how quickly to integrate the finance departments, and answering this question may depend in large part on operational issues. Another financial compliance issue area for consideration relates to corporate tax departments and related practices and interpretations.

COMPLIANCE TRAINING

Compliance Training/ Budget: Participants discuss where the budget sits for compliance training. If governance and compliance is on the CEO's budget rather than the law department's, then it may be easier to obtain the necessary budget for training.

Compliance Training/ Methods & Products: Participants use a broad range of compliance training practices, including web-based products (both off-the-shelf and customized). The law department often plays a role in pre-screening content. One participant's company tracked the preference for web-based vs live training and found a marked preference among employees for web-based training.

INTERNAL INVESTIGATIONS

Internal Investigations/Role of Law Department: Law department's role includes lawyers on internal audit teams, and some have lawyers lead investigations. In-house lawyers also provide training to internal audit members on preparing written communications and the distinction and significance between facts and conclusions.

Internal Investigations/ Who Takes Lead: Views on what entity should take the lead in conducting internal investigations vary and may depend on what expertise is at issue. One participant notes that the in-house finance department would generally take the lead on financial matters unless there are questions about conduct of internal resources and then forensic accountants may be brought in. Another participant notes that if the issue is significant, outside counsel would likely be engaged. Participants also note the merits of using companies that specialize in conducting investigations (as an alternative to outside counsel) and the possibility of conducting such investigations as privileged if the law department retains/directs the investigation. Additional practices include having a specialized outside counsel list of independent firms and using retired employees (for matters that might be considered 'routine') or security personnel (which might include retired FBI personnel).

CONCLUSION & PROPOSED ACTION ITEMS

The session ended with the CLOs sharing ideas on possible tools or action items, including:

- **Develop Resource on Compliance Training Programs:** with a focus on how to create a program that's practical, effective and sustainable.
- **Survey on Audit Engagement Experiences:** survey CLO members on experiences relating to negotiating and enforcing provisions in audit engagement letters.
- **Model Engagement Letter:** consider having ACC (perhaps in concert with other bar organizations) work with audit firms to create model audit engagement letter language.
- **Explore Strategic Resource Options for Smaller Companies:** concept is that larger companies may have more resources than smaller companies for e-learning initiatives; explore whether leverage in numbers or support resources on e-learning for smaller law departments.

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CLO's Role in Financial Compliance: Trusted Legal Advisor, Advocate & Leader
Insights of Michael Fricklas, CLO Viacom Inc.

"The relationship with the financial side of the business is one of the most important relationships a General Counsel has, and developing an open and trusting relationship is fundamental to success," explains Michael Fricklas, Executive Vice President and General Counsel for Viacom. As General Counsel, Fricklas leads by example and spearheads initiatives within the company to develop strong processes for legal support for financial compliance and internal controls. In addition, Fricklas plays a key leadership role within the broader legal community on the critical and related issue of ever-expanding auditor requests for information and the client's (and counsel's) need to preserve the attorney-client privilege and work product protections. Highlighted below are perspectives shared by Fricklas on practices chief legal officers can implement within their companies and how they can strengthen the role of law departments in their company's financial compliance processes and their relationship to corporate governance and brand integrity.

BUILDING TRUST AND EFFECTIVE PROCESSES

"Internal and outside auditors heavily rely on General Counsel and in-house lawyers when certifying the books and financial statements. While our participation in the audit process is increasing, our finance role is not limited to this function. We implement a variety of 'preventive' practices that help build trust and support the integrity in our financial processes, and this reinforces the value and important role lawyers play," shares Fricklas. Among these practices are:

- **Be 'in-the-loop'.** In-house lawyers need to be on top of the latest finance information in the company so that they may proactively help spot issues and ask questions during internal discussions. They should also be involved in the process to help identify legal issues and ensure comfort with external statements by senior management to the investment community. Fricklas notes that his law department and senior management have established practices that help enable the law department to be so familiar with the numbers that they can provide advice on-the-spot, or in advance of company announcements or management's speaking engagements.
- **Establish collaborative relationships with company financial staff and auditors that foster information-sharing with minimal intrusion.** Fricklas believes that, under most circumstances, auditors don't need access to privileged documents, and companies can find an alternative way to support accounting positions without risking the attorney-client and work product privileges. As an example, Fricklas notes that business personnel can focus on fact-based reasons supporting financial positions rather than focusing on advice of counsel since most circumstances will necessarily involve fact-based decision-making as justification for a given course of action.
- **Hire lawyers who are financially literate and provide tools to support continued learning.** In-house lawyers working with inside financial personnel and outside auditors need to stay current on significant accounting rule changes and related financial rules to that they can stay plugged in to the entire set of accounting processes and ask informed questions. But even more fundamental, they need to have a good grasp of how the company's business and finances are connected, which many lawyers don't spend time focusing on. Within the Viacom law department, lawyers attend an internal company 'corporate college,' and appropriate lawyers receive advanced training that supports their relationship with auditors and company financial managers.
- **Communicate with the Board.** In-house lawyers should brief the full Board on significant litigation, and Fricklas attends all meetings of the Board's Audit Committee, including executive sessions of the committee during which outside auditors are not present. There is also an executive session attended only by the Committee and himself as General Counsel.
- **Help structure internal controls processes and certify the process.** At Viacom, in-house lawyers are deeply involved in quarter-end review processes to help ensure the reliability of divisional certifications of financial information submitted to Corporate. Since the role of in-house lawyers focuses on providing assistance and process support, select in-house lawyers working with the business divisions certify their involvement with the process and whether it was followed.
- **Separate facts and legal opinions in internal investigation reports.** Consider preparing separate legal and factual components of any investigation report prepared so that the factual information may be shared with outsiders, including auditors, while preserving legal privileges and protections for the report that contains legal advice and mental impressions.
- **Meet with outside auditors and have open/honest discussions.** Lawyers take the lead in discussing the business impact of legal matters in a manner that does not constitute waiver, including the likely financial impact and the broader operational impacts of legal affairs.
- **Stay involved in the outside auditor inquiry letter process.** The law department should be engaged with their auditor to help identify which outside law firms may have information on material matters and should therefore provide written responses to audit inquiry letters.

LEADING THE WAY TO CHANGE TO HELP PROTECT PRIVILEGE AND BALANCE AUDITOR NEEDS

As noted above, in addition to playing an important leadership role on financial compliance within his company, Fricklas is a leader within the professional and business community more broadly on issues relating to auditor information requests and legal and work product privileges and protections. More specifically, Fricklas leads the General Counsel Working Group, an informal group comprised of general counsel from major public companies within the New York metropolitan area and convened by The New YorkCity Bar (formerly ABCNY). The Working Group has taken a leadership position on how to positively affect productive change in a meaningful collaborative way on the auditor information issue and more broadly on attorney-client privilege issues and corporate governance.

"In the wake of Sarbanes-Oxley, auditors increasingly feel the need to review material that lawyers view as privileged. Auditors are asking to review information relating to opinions on tax

positions, evaluation of litigation reserves, investigative reports, as well as advice on a broad range of other issues in performing their diligence on financial statements. The law on providing this information to auditors is unsettled—with many courts viewing provision of this material to auditors in connection with a financial audit as a waiver, and the additional complex issues of whether the waiver may extend to other materials not specifically provided. As a result, there is quite a lot of discussion among auditors and the companies they audit on how much auditors need to see and whether what they want to see is privileged. This issue bubbled up among our Working Group discussions, and David Brodsky of Latham & Watkins (former General Counsel of Credit Suisse First Boston) offered to work with us to prepare a white paper reviewing these tensions and suggesting solutions," explains Fricklas.

The White Paper concludes that the audit function "must not be allowed to jeopardize a company's ability to utilize one of the primary tools it has at its disposal to comply with its corporate governance obligations—its legal counsel." Specifically, the White Paper proposes that the SEC, PCAOB, the corporate counsel community, and the principal auditors of the vast majority of U.S. public companies should resolve this issue by proposing legislation that would permit companies to provide certain kinds of needed privileged and work product information to auditors without waiving privileges as to others.

The Association of Corporate Counsel's Board of Directors has endorsed the position in the General Counsel Working Group White Paper, and ACC has also been an active member of the ABA's Task Force on Attorney-Client Privilege, which recently addressed the issue of privilege waiver in the audit context in a Report to the ABA House of Delegates.

RESOURCES

ACC MATERIALS

Compliance:

2005:

ASSOCIATION OF CORPORATE COUNSEL, *Leading Practices in the Law Department's Role in Developing and Implementing Compliance and Ethics Programs: What Companies are Doing*, ACC Practice Profile, July 2005, *available at* http://www.acca.com/protected/article/ethics/lead_compliance.pdf

2004:

Deborah J. Edwards et. al., *What To Do When the Whistle Blows*, ACC Docket, May 2004, *available at* http://www.acca.com/protected/pubs/docket/may04/whistle.pdf

Teresa T. Kennedy et. al., *About That Compliance Thing...Creating and Evaluating Effective Compliance Programs*, ACC Docket, November/December 2004, *available at* www.acca.com/protected/pubs/docket/nd04/compliancething.pdf

Association of Corporate Counsel, *Leading Practices in Board Governance and the Role of In-house Lawyers Post Sarbanes-Oxley*, ACC Practice Profile, 2004, *available at* http://www.acca.com/protected/article/governance/lead_governance.pdf

Association of Corporate Counsel, *Leading Practices in Providing In-House Legal Support For Corporate Governance Initiatives: What Companies Around The World Are Doing*, ACC Practice Profile, 2004, *available at* www.acca.com/protected/article/governance/lead_global.pdf

Michael D. Cahn & Jonathan Spencer, *In-house Counsel Standards Under Sarbanes-Oxley*, ACC InfoPAK, June 2004, *available at* www.acca.com/infopaks/sarbanes.html

Darryl Weiss & Brian P. O'Connor, *Corporate Compliance*, ACC InfoPAK, October 2004, *available at* http://www.acca.com/protected/infopaks/compliance/INFOPAK.PDF

Association of Corporate Counsel, *Management Compliance Training*, ACC 2004 Annual Meeting Materials, *available at* www.acca.com/protected/forms/compliance/training.pdf

Dwight Howes, *Corporate Compliance and Ethics Program Checklist*, ACC Sample Form & Policy, 2004, *available at* http://www.acca.com/protected/reference/compliance/ethicscheck.pdf

Lori J. Shapiro & Philip I. Weis, *Codes of Conduct for Multinational Corporations*, ACC 2004 Annual Meeting Materials, *available at* www.acca.com/am/04/cm/803.pdf

Susan Hallsby, et. al., *Best Practices in Compliance Programs for Privately-Held Companies*, ACC 2004 Annual Meeting Materials, *available at* www.acca.com/am/04/cm/802.pdf

Philip P. Crowley, et. al., *Automated and On-Line Compliance Training: The Future is Now*, ACC 2004 Annual Meeting Materials, *available at* www.acca.com/am/04/cm/105.pdf

Michael J. Lotito, et. al., *Workplace Law Training: A Key Affirmative Defense for Small Law Departments*, ACC 2004 Annual Meeting Materials, *available at* www.acca.com/am/04/cm/702.pdf

Margaret M. Foram, et. al., *Defining the Role of In-House Lawyers in Governance*, ACC 2004 Annual Meeting Materials, *available at* www.acca.com/am/04/cm/711.pdf

Lisa E. Chang, et. al., *Whistle While You Work: Ethical, Fiduciary, and Other Dilemmas Facing Over-SOXed In-House Lawyers*, ACC 2004 Annual Meeting Materials, *available at* www.acca.com/am/04/cm/308.pdf

Kathrine K. Combs, et. al., *Corporate Governance: One Year Later*, ACC 2004 Annual Meeting Materials, *available at* www.acca.com/am/04/cm/708.pdf

2003:

Bao Q. Tran & Jonathan Tomes, *Risk Analysis: Your Key to Compliance*, ACC Docket, November/December 2003, *available at* www.acca.com/protected/pubs/docket/nd03/risk.pdf

Le Hammer et. al., *Navigating the Civil and Criminal Whistleblower Provisions of the Sarbanes-Oxley Act*, ACC Docket, March 2003, *available at* www.acca.com/protected/pubs/docket/ma03/whistle1.php

Compliance Systems Legal Group, *Development of "Best Practices" Compliance Program*, ACC Quick Reference Material, 2003, *available at* http://www.acca.com/protected/reference/compliance/bestpractice.pdf

Association of Corporate Counsel, *Leading Practices in Codes of Conduct and Business Ethics: What Companies are Doing*, ACC Practice Profile, 2003, *available at* http://www.acca.com/protected/article/ethics/lead_ethics.pdf

Association of Corporate Counsel, *Emerging and Leading Practices in Sarbox 307 Up-The-Ladder Reporting and Attorney Professional Conduct Programs: What Companies and Firms are Doing*, ACC Practice Profile, 2003, *available at* www.acca.com/protected/article/corpresp/lead_sarbox.pdf

Key Themes

- Legal function provides framework for compliance
  - Lawyers provide technical knowledge, interpretation of requirements, and legal advice
- Compliance function operationalizes guidance from legal
  - Compliance officers establish and monitor the systems and procedures that ensure compliance with legal requirements.

Increased Focus on Compliance

- Corporate scandals inspired statutory and regulatory requirements that require robust compliance programs
  - Sarbanes-Oxley
  - U.S. Sentencing Guidelines
- Judicial rulings also reflect increasing attention to compliance
  - DUTY of CAREmark

Increased Focus on Compliance (cont.)

- Regulatory enforcement agencies have also clarified expectations in ways that emphasize importance of compliance programs
  - Thompson Memo
  - Seaboard Memo
  - Non and deferred prosecution agreements

Compliance With What?

- Laws
- Regulatory requirements
- Self-regulatory standards
- Court orders
- Internal policies

Compliance Programs: Key Elements

- Identify compliance risks
- Implement clear policies and auditable procedures
- Communicate the importance of sound compliance
- Develop effective training programs
- Develop effective monitoring and reporting systems
- Promptly respond to issues and escalate when necessary
- Evaluate lessons learned and incorporate as appropriate

Compliance Programs: Who Is Responsible?

- Not just compliance officers
- Coordinated effort with many other actors:
  - Legal organization
  - Other control functions (Risk, Audit)
  - Business units
  - Senior Management and Board of Directors

Role of Lawyers

- Identify compliance risks (other than operational compliance risks, e.g. systems risks)
- Provide ongoing advice to business and compliance functions
- Monitor and and participate in external legal and regulatory environment
- Manage responses to compliance issues when they arise
  - Conduct internal investigations
  - Manage legal and regulatory relationships
  - Manage communications: Board, employees, press, public

Example: Anti Money Laundering

- Legal advises on legal requirements, SAR reporting obligations, manages actual AML exposures and evaluates/advises on legal and reputation risk
- Compliance establishes and monitors systems and procedures that detect and prevent money laundering.

Example: Ethics Complaints

- Legal manages investigations of ethics complaints and associated reporting obligations
  - Independence
  - Privilege
  - Record retention
- Compliance manages the mechanism for receiving ethics complaints and oversees process for documenting disposition.

Organizational Considerations

- Should Compliance be part of the Legal Department or independent?
  - Either way, close coordination required
- Should Compliance be a centralized function or embedded in business
  - Whoever controls the pay card influences performance
  - Dangers of "going native"
  - Familiarity with business and its management increases effectiveness and credibility

Key Issues for Lawyers

- Provide sound interpretation of legal requirements, advice, guidelines and recommendations
- Monitor issues and apply law properly
- Ensure awareness throughout the enterprise
- Stay current with developments in the law and regulatory environment