



1025 Connecticut Avenue, NW, Suite 200
Washington, DC 20036-5425

Tel 202.293.4103
Fax 202.293.4701

www.ACCA.COM

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.

*Copyright © 2005, Association of Corporate Counsel
For more information, visit www.acca.com*



1025 Connecticut Avenue, NW, Suite 200
Washington, DC 20036-5425

Tel 202.293.4103
Fax 202.293.4701

www.ACCA.COM

- 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.



1025 Connecticut Avenue, NW, Suite 200
Washington, DC 20036-5425

Tel 202.293.4103
Fax 202.293.4701

www.ACCA.COM

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



1025 Connecticut Avenue, NW, Suite 200
Washington, DC 20036-5425

Tel 202.293.4103

Fax 202.293.4701

www.ACCA.COM

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



1025 Connecticut Avenue, NW, Suite 200
Washington, DC 20036-5425

Tel 202.293.4103
Fax 202.293.4701

www.ACCA.COM

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).



1025 Connecticut Avenue, NW, Suite 200
Washington, DC 20036-5425

Tel 202.293.4103
Fax 202.293.4701

www.ACCA.COM

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.



1025 Connecticut Avenue, NW, Suite 200
Washington, DC 20036-5425

Tel 202.293.4103

Fax 202.293.4701

www.ACCA.COM

- 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.