



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

Tel 202.293.4103
Fax 202.293.4701

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ACC'S CLO THINKTANK EXECUTIVE REPORT PRIVATE COMPANY ISSUES: CORPORATE LIABILITY & OTHER HOT TOPICS

This Executive Report provides an overview of discussion results from ACC's CLO ThinkTank session titled "Private Company Issues: Corporate Liability & Other Hot Topics" held in Minneapolis, MN on December 2, 2005. 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 private company legal leaders:

- CG Appleby, Senior Vice President and General Counsel, Booz Allen Hamilton, Inc.
- John Boswell, Vice President and General Counsel, SAS Institute
- Steve Euller, General Counsel, Cargill, Inc.
- Nick Giampietro, General Counsel, Reyes Holdings, LLC
- Ellen Kollar, General Counsel North America, Mars, Inc.
- Bill Lipsman, Executive Vice President, General Counsel and Secretary, OSI Industries
- John Oviatt, General Counsel, Mayo
- John Page, General Counsel, Golden State Foods
- Andy Schiesl, General Counsel, Quad Graphics
- Bill Van Brunt, Senior Vice President and General Counsel, Carlson Companies

KEY TOPICS

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

- Compliance Programs: 'selling' them to clients, structures, global challenges and the government's perspective on sufficiency
- Internal Investigations: employee issues and who should conduct them
- Cooperation: value and sufficiency of for charging and sentencing credit
- Comparison between public and private companies: views on compliance and governance; relevance and impact of Sarbanes-Oxley
- Liability for in-house lawyers: insurance and indemnification issues
- Records Management, especially focusing on e-discovery frustrations



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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 Conclusion & Proposed Action Items.

- Private companies face challenges in implementing compliance and governance programs: ownership and management may not readily see the need to change in the absence of legal requirements to do so, yet external stakeholders, board members, auditors may be looking to evaluate companies using Sarbanes-Oxley standards as “reasonable” behavior.
- Standards for cooperation with government investigations are unclear, and government regulators and prosecutors define corporate cooperation as it suits their purposes in making charging decisions, and controlling company responses.
- The increasing criminalization of business conduct errors presents challenges in dealing with employees who may be accused by the government of wrongdoing but may not have clearly participated in wrongful conduct; severance, indemnification/attorney fees support and advancement, remedial actions and forcing employee cooperation are issues associated with this predicament.
- Globalization requires clear messages from leadership on corporate expectations for compliance and conduct and may necessitate adjustments in approaches for effecting compliance (such as including provisions in joint venture agreements, developing a global code of conduct, having a global law department, etc..)
- Records management, and in particular responses to electronic discovery requests impose burdens and challenges; there is a need for practical standards acceptable to the government, courts, plaintiffs, and other stakeholders (including internal tech and records managers).

DISCUSSION HIGHLIGHTS

COMPLIANCE PROGRAMS: GOVERNMENT’S PERSPECTIVE ON SUFFICIENCY & DEMONSTRATING VALUE TO CLIENTS

Compliance Programs/Demonstrating Value: There is difficulty in explaining why companies should change what they’re doing and adopt new programs for compliance or governance absent problems; public companies have Sarbanes-Oxley as a requirement to point to and private companies do not and may not have the same imperative to support and fully staff these programs. Ways to demonstrate value of compliance programs include providing information on fines paid by companies to resolve compliance matters, demonstrating the costs (both financial and human resource) involved in complying with government investigations, and showing management what a consent order (or corporate integrity agreement) for a compliance program might look like for companies who run afoul of requirements and are forced to adopt programs as a condition of deferred prosecution or settlement. Compliance programs are valuable even if they don’t ultimately prevent all enforcement actions; participants described compliance programs as being more likely to prevent charges from being filed in the first place than in helping to reduce sentences. Using annual certifications as a tool has positive impacts and can result in information on matters (and opportunities to resolve them) that may not have otherwise been communicated.

Compliance Programs/Structure and Process: Most of the participants’ companies have a compliance and ethics committee. Around half of the companies have independent Directors on their Boards. Some companies are moving from paper-based compliance certification statements to required web-based training with completion certifications. The



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level of program detail is an issue: is it more useful to develop high-level programs that express principles but avoid granular detail that may discourage employees from thinking for themselves or to develop more detailed approaches? Decisions on what compliance training modules to require and who should complete them present challenges. In developing and implementing programs there is a need to focus on the risk rather than on papering the process: there may be some individuals who, despite the best programs, may be likely to ignore the rules, and the challenge is how to identify and weed out those individuals.

Compliance Programs/Global Challenges: Issues with regard to differences in culture and international resistance to complying with US-based global compliance programs were discussed. Successfully implementing a global program requires top leadership support. Approaches for applying US-based company principles and requirements to non-US operations may include incorporating these requirements into joint venture agreements. An example includes writing the terms of the FCPA into a joint venture agreement and how having the terms within the agreement appears to be more palatable than stating that non-US operations are subject to US law. Additional practices include developing and implementing 'suitcase training' programs that can be disseminated around the globe. Law department structures, with a global law department that reports into the company's General Counsel, a global code of conduct and up-the-ladder reporting policy, and a law department intranet are additional methods to help implement a global program. Challenges regarding civil law lawyers and encouraging proactive practice of law were also discussed.

Compliance Programs/ Impact on Entrepreneurial Process: Participants raised the issue of whether complex compliance programs with multiple layers and bureaucratic processes (a la Sarbanes-Oxley) adversely impact entrepreneurial and creative processes.

Compliance Programs/ Government's View on Sufficiency: Questions were raised about the government's view on the sufficiency of compliance programs and the ability to use them affirmatively and defensively in the charging and sentencing phases. As noted above, participants described compliance programs as being more likely to prevent charges from being filed in the first place than in helping to reduce sentences. A concern about being caught among various levels of governments was raised: namely, one level may view a compliance program or practice to be sufficient and appropriate; however another may not. The notion of the difficulty of complying with the differing governmental agency agendas was raised. Also described were challenges in dealing with the disparity in viewpoints and actions among Federal and State Attorneys General; the latter were described as more likely to bring actions even in situations where there is evidence of an ethical and compliant corporate culture. Political and other motivations among State Attorneys General were described as challenges.

Compliance Programs/ External Demands: Companies are facing demands from external constituencies regarding need for effective compliance programs in areas that could impact the customer (e.g., employment and environmental practices).

INTERNAL INVESTIGATIONS: EMPLOYEE ISSUES & IMPACT OF TIMING ON COOPERATION DECISIONS

Internal Investigations/Employee Issues: The government's increase in activities to criminalize business conduct creates complicated issues for how to deal with employees who may be identified by the government as wrongdoers. If it is clear that the employee's actions were wrong, then the course of action for the company is straightforward. However, in those situations where wrongdoing on the part of the employee is not clear (but rather is a business error or assertion of the government), there is tension with regard to the proper course of remedial action. Participants discussed possible approaches and difficulties presented by the Thompson memo. One approach may be to go slowly with the employee and help secure friendly counsel while the investigation is taking its course. Questions about when to separate an employee



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accused of wrongdoing (but not clearly or obviously responsible for wrongdoing) were raised. Difficulties relating to waiver of privilege and joint defense agreements were also discussed.

Internal Investigations/ Timing Considerations & Cooperation: Companies need some time to conduct an internal investigation to determine whether allegations of wrongdoing are warranted. As part of the preliminary activities, an approach taken by some companies includes developing a white paper to provide the government with background on the company's industry and operations; however, this takes time. While the background to help educate the government can be very useful, the tension is that the government may negatively view the time taken and deem these activities as evidence of non-cooperation.

Internal Investigations/ Positive Impacts on Compliance: While there are a broad range of challenges with regard to conducting internal investigations, a positive view of them may be the ability to help change a company's compliance environment.

COOPERATION: DOES IT REALLY INFLUENCE CHARGING AND SENTENCING DECISIONS?

Cooperation/ Charging Phase: Some feel that the real decisions on charging are made by individuals who have made up their mind in advance. Some noted that the federal attorneys general are more likely to consider not charging a company when there is no evidence of a bad culture than the state attorneys general (who may have career or political aspirations impacting charging decisions). Participants described apparent arbitrariness or capriciousness when it comes to charging decisions with challenges for companies in their ability to predict when and for which government agency or prosecutor a given compliance program or approach on cooperation will be deemed sufficient.

Cooperation/Standards are Unclear: What the government says are the standards and what appears to be happening in practice are not consistent. It is difficult to tell whether companies are truly receiving credit for cooperation. When trying to provide background information to assist the government investigators in understanding the company's industry and taking the time to do this is viewed as uncooperative, this is frustrating. If the government is going to be arbitrary in its decisions and apply standards that effectively prevent people from doing their jobs, why should companies care about cooperating? While there appear to be uneven practices with regard to the government's view on cooperation, the notion that cooperation may help prevent bringing charges against the company (which can be a huge issue- especially for companies facing potential debarment) is persuasive.

PUBLIC AND PRIVATE COMPANY DIFFERENCES: SARBANES-OXLEY & BEYOND

Public vs. Private/ Support for Compliance & Governance Programs: Participants discussed challenges in gaining support for compliance and governance programs. Although public companies have Sarbanes-Oxley as a driving requirement, private companies that may not be facing enforcement problems may have a tougher sell with management to adopt new practices. Another view is that many private companies are family-owned and one would expect them to feel more motivated and have more of a personal stake in the company and its successes.

Public vs. Private/ Sarbanes-Oxley & Auditors: Even though private companies may not be required to comply with Sarbanes-Oxley, it is influencing practices. Relationships and requirements with outside auditors who may serve both public and private companies can result in changes in the way private companies implement their practices. In addition, private company Boards that include Board members with Fortune 500 experience are facing public company governance expectations and standards in all of their activities and expect all boards and companies to be so behaved. Financial



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institutions are also imposing Sarbanes-like standards because of the level of regulation present in other laws governing the industry.

Public vs. Private/ Shareholder Interests and Financial Risks: Question was raised whether shareholders of private companies have the same types of concerns as shareholders of public companies. While there may not be stock or stock option considerations, activities such as loaning money against financial statements, contract kickbacks, etc.. present risks and would create financial stakeholder issues.

Public vs. Private/ Governance Ratings Agencies: Ratings agencies are using the same check-the-box approach for private companies as public, and this results in lower scores for private companies that don't implement Sarbanes-Oxley standards even though they're not required to. Distaste was expressed for the methodology/business model of many ratings companies in that they believe that one-size governs all.

Public vs. Private/ Who is the Client?: General Counsel of family-owned companies or with a chairman who is also the CEO face additional difficulties when who is the client questions arise. Ultimately, the General Counsel is responsible to the Board and not to the CEO; however many General Counsel report administratively to the CE. When the CEO is also the board chairman, things get even more confused. Private company General Counsel may face more situations where family owners request lawyer involvement in matters that may seem personal (e.g., prenuptial agreements, divorce settlements, etc.) but which impact structure and governance of the company in ways that are not the norm for public companies. Succession issues are important.

LIABILITY FOR IN-HOUSE LAWYERS: INSURANCE & INDEMNIFICATION CONSIDERATIONS

Liability for Lawyers/ Trace Decision and Impacts: Case was discussed among participants and concerns regarding impacts for General Counsel were raised. Questions about the interpretation of Trace were noted: does the decision imply an obligation for the General Counsel to oversee compliance or the company?

Liability for Lawyers/ Insurance and Indemnification: Practices for providing coverage to in-house lawyers include having a rider for D&O policies to specifically cover lawyers. On providing separate indemnification agreements, participants described demands for these from individuals who serve as directors on Boards in foreign jurisdictions. Most shared that they do not provide separate indemnity agreements within the US and that indemnification is provided via the company's Articles of Incorporation.

RECORDS MANAGEMENT

Records Management/Systems: Records management and destruction present challenges. Participants asked questions regarding whether companies are implementing mandatory and automated document destruction approaches. Electronic documents and discovery requests that seek these documents present increasing challenges.

Records Management/Discovery: Participants indicated a desire for a 'best practices' view on approaches for responding to discovery requests. There is a need for a sensible approach to discovery; abuse in overly broad discovery is expensive and can even be viewed by the government as not being cooperative since they may then have huge volumes of documents and electronic files to weed through. To what extent do companies need to forensically re-create what was on their hard drives?



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CONCLUSION & PROPOSED ACTION ITEMS

Ideas on possible action items to prioritize and select for follow-up include:

- **Board Survey:** Participants described an interest in receiving survey information on private company Boards, including whether the Boards have Audit Committees. NACD may have this information. If not, ACC may develop a survey that will explore Board issues.
- **Discovery Whitepaper- Best Practices:** Participants identified an interest in having a whitepaper that describes best practices adopted by companies in responding to electronic discovery requests. The Sedona Conference, ARMA International, and the Defense Research Institute were identified as possible sources of information.

Following is a list of topics that were not addressed but identified as being of interest for future ThinkTanks:

- Board governance and composition
- Relationship between internal audit and the law department
- Succession of ownership
- Law Department management (includes compensation; use of non-lawyer personnel; and a variety of other management themes.)