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Is Your Compliance Program Ready For DOJ and Delaware Courts' Scrutiny?

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Program Roadmap

- Speaker introductions
- Two trends elevating compliance programs to a strategic imperative
  - Recent DOJ Enforcement Actions
  - Recent Delaware Cases on Director Duties
- Risk Assessment Objectives and Fundamentals
  - Effective Reporting Templates
- Avoiding Common Risk Assessment Pitfalls
  - Bottom Up v. Top Down
  - “Keep the Main Thing the Main Thing,” “Don’t Boil the Ocean,” etc.
  - Integrating subjective judgments and objective evidence

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Today's Speakers

Matt Jacobs (mjacobs@velaw.com)

- Managing Partner of San Francisco Office and Co-Chair of Government Investigations & White Collar Criminal Defense group
- Former federal prosecutor, Northern District of California
- Practice emphasis on company defense and government and internal investigations representing companies and boards

Jessica Heim (jheim@velaw.com)

- Partner in San Francisco Office and member of Government Investigations & White Collar Criminal Defense group
- Extensive experience in internal investigations and defending companies facing US DOJ, SEC, OCC, State Attorneys General, and other enforcement agencies

Michael Ward (michaelward@velaw.com)

- Partner in San Francisco Office and member of Government Investigations & White Collar Criminal Defense group
- Former federal prosecutor, District of Minnesota
- Former Chief Risk and Compliance Officer, Juniper Networks, and established award winning compliance programs at Adobe, Cisco, McKesson and Target

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Two Trends Elevating Compliance to a Strategic Imperative

- ***First***, US Department of Justice corporate enforcement policy and actions.

- ***Second***, recent decisions of the Delaware Supreme Court revising the *Caremark* standard.

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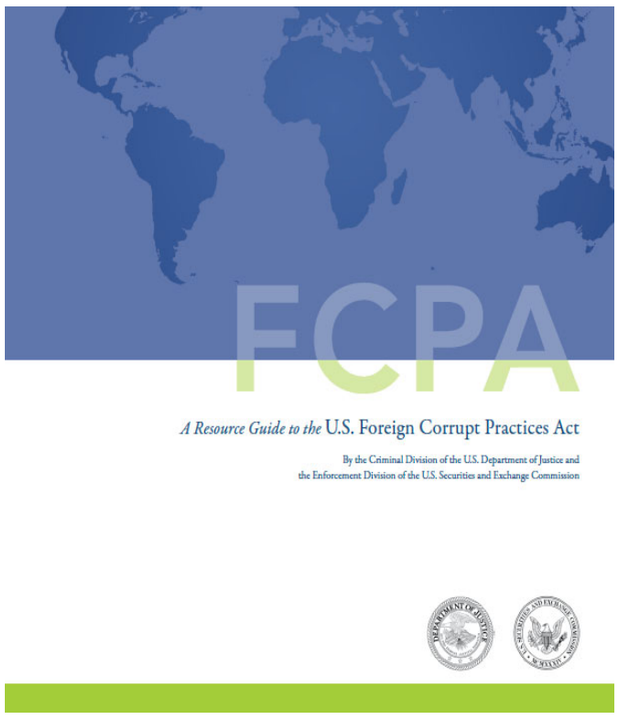
US DOJ Policy Evolution – Through 2012



DOJ & SEC FCPA
Resource Guide, 2012

"In appropriate circumstances, DOJ and SEC *may* decline to pursue charges against a company based on the company's effective compliance program . . ."

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April 2016 Forward – The "Pilot Program" and Presumptive Declinations

Rod Rosenstein

"When a company has voluntarily self-disclosed misconduct in an FCPA matter, fully cooperated, and timely and appropriately remediated, all in accordance with the standards set forth below, *there will be a presumption that the company will receive a declination* absent aggravating circumstances . . ."

DOJ FCPA Corporate Enforcement Policy, USAM 9-47.120

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The Rubber Meets the Road – Select DOJ Enforcement Outcomes

- **Juniper Networks** (2019) received a declination from DOJ in FCPA investigation, *despite lack of voluntary disclosure*, based on its cooperation and extraordinary compliance program remediation.
- **Cognizant Technologies** (2019) received a declination from DOJ in FCPA investigation, *despite the CEO and GC authorizing the misconduct,* based on its disclosure, cooperation and compliance program.
- **Goldman Sachs** (2020) not charged by either DOJ or SEC, *despite employee engaging in bribery conspiracy in course of his duties*; the compliance program credited with detecting and shutting down the corrupt transactions.

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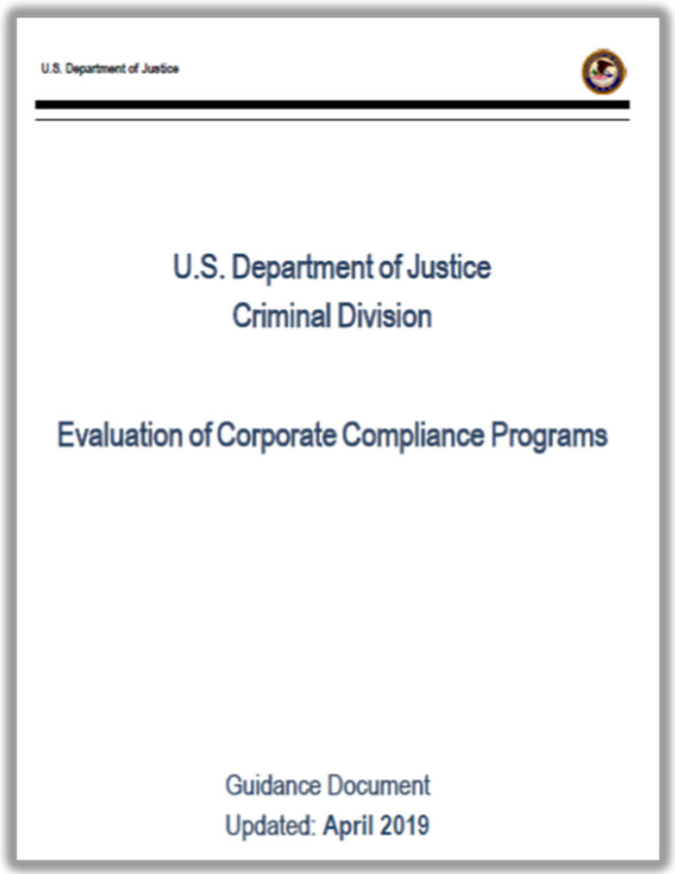
DOJ: A Program Is Not 'Well Designed' If It Is Not Risk Based


U.S. Department of Justice

U.S. Department of Justice
Criminal Division

Evaluation of Corporate Compliance Programs

Guidance Document
Updated: April 2019

"**The starting point for a prosecutor's evaluation** of whether a company has a well designed compliance program is to understand the company's business from a commercial perspective, **how the company has identified, assessed, and defined its risk profile**, and the degree to which the program devotes appropriate scrutiny and resources to the spectrum of risks."

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How Rigorous an Assessment Does DOJ Expect?

- "[P]rosecutors should consider whether the company has analyzed and addressed the varying risks presented by, among other factors:
  - the location of its operations,
  - the industry sector,
  - the competitiveness of the market,
  - the regulatory landscape,
  - potential clients and business partners,
  - transactions with foreign governments,
  - payments to foreign officials,
  - use of third parties,
  - gifts, travel, and entertainment expenses, and
  - charitable and political donations."
- Prosecutors should also consider "[t]he effectiveness of the company's risk assessment and the manner in which the company's compliance program has been tailored based on that risk assessment" and whether its criteria are "periodically updated."

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POLL QUESTIONS

1. Our company has annual revenue of:

a) $500 million or less
b) $501 million to $1 billion
c) $1 billion to $5 billion
d) $5 billion to $10 billion
e) More than $10 billion

2. Our company is primarily or substantially engaged in:

a) A “regulated” industry (healthcare, financial, other)
b) “Non-regulated” industry

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The Narrowing of the Caremark Defense?

- *In re Caremark International Inc. Derivative Litigation* (Del. Ch. 1996) established that corporate directors could theoretically be liable for failure to exercise adequate compliance oversight.

- *Caremark* has been interpreted to protect directors from any liability unless they:
  1) *completely or "utterly"* fail to implement any reporting or information system or controls, or

  2) consciously ignore red flags or issues brought to their attention.

- *Caremark* claims are "possibly *the most difficult theory in corporation law* upon which a plaintiff might hope to win a judgment."

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It Begins . . . Marchand v. Barnhill (Blue Bell Creameries)

- Blue Bell Creameries was one of the country's largest ice cream manufacturers. In 2015, the company suffered a listeria outbreak from its ice cream. Three people died as a result of the outbreak.
- Management had received multiple reports from regulators about food safety violations at plants, including about listeria.
- But the board never received any information about listeria or more generally about food safety issues.
- A derivative action was filed and the Court of Chancery dismissed the complaint.
- In June 2019, on appeal, the Delaware Supreme Court *reversed*.

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In Marchand, A Failure To Get Informed and Actively Monitor

- On appeal, the Delaware Supreme Court found that the complaint did sufficiently allege a claim in that the Blue Bell *directors were passive* and had not adequately monitored its key risk, food safety.
- Key Allegations in Support of Allowing the Complaint:
  - No board committee formally assigned to food safety.
  - No standards or protocols for management to keep the board informed of food safety or developments.
  - There was no recurring schedule for the board to review key food safety risks.
  - The board minutes showed no evidence that red flags were disclosed to the board.
  - Board minutes were devoid of any suggestion that there was any regular discussion of food safety issues.

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"There's something happening here,. . ." Clovis Oncology, Inc.

- Pharmaceutical company Clovis Oncology, Inc. had one drug that underwent unsuccessful clinical trials.
- Following a settlement with the SEC related to the trials, a derivative action alleged that the directors had breached their duties by failing to monitor the company's execution of the clinical trials.
- In October 2019, the Delaware Chancery Court found that the complaint properly stated an oversight claim because, even though there were reporting and compliance systems in place, *the board ignored red flags that the results were being misreported*.
- The court cited *Marchand*, stating, "'to satisfy their duty of loyalty, directors must make a good faith effort to implement an oversight system and then *monitor* it.'"

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Higher Standard for Compliance Risks v. Business Risks?

Q: *Are Delaware courts now more willing to second guess board oversight of compliance risks than other risks?*

A: *There is little doubt*.

- In *Clovis*, Vice Chancellor Slights explicitly observed that Delaware courts are *more likely to find liability under* Caremark *for oversight failures involving compliance obligations* under regulatory mandates than for those involving oversight of ordinary business risks.
- "In this regard, as it relates to *Caremark* liability, it is appropriate to distinguish the board's oversight of the company's management of business risk that is inherent in its business plan from the board's oversight of the company's compliance with positive law - including regulatory mandates."

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ACTION ITEMS *from Newly Emerging Caremark Standards*

1. Directors *can no longer passively wait for management* to bring compliance risks and issues to their attention.
   - Directors need not directly *manage* the risks but must take a proactive role in compliance risk *oversight*.
2. Directors must assure themselves that the company has a reliable process to examine its compliance risks and *identify the "mission critical" compliance risks.*
3. Directors must *proactively understand and monitor* the company's compliance risk management system and controls.

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ACTION ITEMS *from Newly Emerging Caremark Standards*

4. Directors should ask themselves: 'Does the board itself have *the necessary structure and expertise'* to effectively oversee the compliance and other 'mission critical' risks?

5. Directors should *ensure that the relevant committee charter, board minutes and materials accurately document the board's time and attention* to overseeing the company's compliance and other risks.

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POLL QUESTION

3. Our company:

a) Does not conduct any recurring compliance risk assessment

b) Conducts a periodic risk assessment for compliance program purposes only

c) Conducts a recurring compliance risk assessment and presents the results to CEO and other senior leaders

d) Conducts a recurring compliance risk assessment and presents the results to the Board (or committee)

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So, . . . Let's Review

- The DOJ is rewarding companies with an effective compliance program and it says a risk assessment is the starting point.
- And the Delaware courts are saying that a director's *Caremark* duties include proactively identifying and prioritizing attention to the company's most significant compliance risks.

Now what exactly is a risk assessment?

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Your Goals, the DOJ's Focus and the Board's Obligations Are Aligned

- What is our most significant compliance risk?
  - Why? Which is most likely? Most impactful? Weakest controls?
- How and where should we spend our limited time and financial resources to reduce the most compliance risk?
  - What are the remedial actions? In what order should we invest in them?
  - Who is accountable for each risk and the specific remediations? What is the timetable for completion?
- Has this particular compliance risk increased or decreased compared to last year?
  - Why? Did the controls improve/degrade? Did the inherent risk change?
- Is the methodology reliable? Consistent? Objective?

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Alignment of Acme Compliance Program to Enforcement Guidance

Compliance Program Element	Best Practices	Current Acme Co. State	Potential Gaps
1. Program Oversight and Commitment Board shall be knowledgeable and exercise reasonable oversight of compliance program. [FSG, § 8B2.1(b)(2)(A)] A specific senior officer shall be assigned "overall responsibility for the compliance and ethics program." [FSG, § 8B2.1(b)(2)(B)] Senior management and board should demonstrate and instill a commitment to a "culture of compliance." [DOJ/SEC FCPA Resource Guide p. 57] Senior leaders and board should: • Enforce and not compromise compliance standards in the face of commercial pressures. • Ensure that clear standards are communicated in unambiguous terms throughout the organization and scrupulously followed. [DOJ/SEC FCPA Resource Guide p. 57] • "DOJ and SEC . . . evaluate whether senior management has [1] clearly articulated company standards, [2] communicated them in unambiguous terms, [3] adhered to them scrupulously, and [4] disseminated them throughout the organization."	• Board/Audit Committee has direct and regular oversight of the program as evidenced by regular agenda items. • Gov't consent decrees often separate the CCO and General Counsel roles. • CEO and senior leaders regularly emphasize their expectation that compliance standards be strictly followed. • Regular internal and external communication of the company's commitment to zero tolerance for bribery/misconduct. • Leadership reinforces instances of pro-compliant behavior by employees. • Consequences of non-compliant conduct are consistent at all levels of the organization.	• CCO attends all Audit Committee meetings and meets in executive sessions. • Audit Committee provides regular compliance updates to full Board. • Corporate Compliance Committee comprised of: CFO, EVP GTM, GC, SVP HR, SVP IT, Controller, CCO & CAO. • Regular reporting by CCO to CEO and CFO on compliance program. • Dedicated commitment through past integrity-related terminations of senior executives, senior sales leaders and critical channel partners. • Commitment to compliance and ethical business practices communicated at regional sales conferences, partner meetings and global managers' meetings.	• There is a risk that the compliance program is conflated with the most serious individual compliance risk instead of the broader set of compliance risks. This might result in diminished support for the compliance program to prepare for and protect Acme from future compliance risks.

Exemplar Data

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Compliance Risks – Heat Map View

Compliance Risk Areas

1. Anti-Corruption
2. Anti-Trust/Competition
3. Conflicts of Interest
4. Employment
5. Environmental, Health & Safety (EHS)
6. Financial Reporting
7. Government Relationships
8. Information Security (InfoSec)
9. Privacy
10. Records & Information Management (RIM)
11. Securities
12. Supply Chain
13. Tax
14. Third Party Relationships
15. Trade Controls/Export
16. US Government Contracting

Assessed Design Effectiveness of Controls

= High (4)

= Medium-High (3)

= Medium-Low (2)

= Low (1)

Compliance Risks – Dashboard/Stack Rank View

Compliance Risk Area (Heat Map Reference #)	Inherent Risk	Control Rating			Residual Risk Score*			Disclosure
	2018	2016	2017	2018	2016	2017	2018	SEC Filings
Antitrust/Competition (2)	High	M-L	M-L	Medium-High	High	High	High	✓
Employment/ US Government Contracting (4-16)	High	M-L	M-L	Medium-High	M-H	M-H	Medium-High	✓
Trade Controls/Export (15)	High	M-L	M-L	Medium-High	M-H	M-H	Medium-High	✓
Third Party Relationships (14)	High	M-L	M-H	Medium-High	M-H	M-H	Medium-High	✓
Privacy (9)	Medium-High	M-L	M-L	Medium-High	M-L	M-L	Medium-High	✓
Anti-Corruption (1)	High	High	High	High	M-H	M-H	Medium-High	✓
Tax (13)	High	High	High	High	M-H	M-H	Medium-High	✓
Records & Information Management (RIM) (10)	Medium-High	Low	M-L	Medium-Low	M-H	M-L	Medium-Low	
Government Relationships (7)	Medium-Low	M-L	M-L	Medium-Low	M-L	M-L	Medium-Low	
US Gov't Contracting / Employment (16-4)	Medium-High	M-H	M-L	Medium-Low	Low	M-L	Medium-Low	✓
Information Security (8)	Medium-High	M-H	M-H	Medium-High	M-H	M-H	Medium-Low	
Conflicts of Interest (3)	Medium-High	M-L	M-H	Medium-High	M-H	M-L	Medium-Low	
Financial Reporting (6)	High	M-H	M-H	Medium-High	M-L	M-L	Medium-Low	✓
Securities (11)	Medium-High	M-H	M-H	Medium-High	Low	Low	Low	✓
Supply Chain (12)	Medium-Low	M-H	M-H	Medium-High	Low	Low	Low	✓
Environmental, Health & Safety (5)	Low	High	High	High	Low	Low	Low	

*Dashboard is sorted by 2018 Residual Risk Score, then by 2018 Control Rating.

Exemplar Data

Anti-Corruption

Likelihood: High

'17 - H

The inherent likelihood (excluding the impact of any controls) is assessed to be High. This risk domain includes both direct and indirect bribery, inaccurate books and records (e.g., parking and expending funds from off books accounts) and improper gifts, travel & entertainment. The high risk rating is due to the high number of sales interactions with foreign government and SOE customers in high risk markets, the reliance on numerous third party resellers (50,000+), a multiple tier channel model, the inherent variability in product discounting and lack of transparency in the third parties' use of discounts, MDF, rebates and other incentives. Finally, a general trend in coordinated, multi-jurisdictional enforcement efforts globally. An increase in direct relationships and reduced dependence on channel partners may reduce risk relatively.

Severity: High

'17 - H

Violations are subject to severe criminal penalties for both the company and individual executives. Substantial fines, disgorgement of related revenue and follow on shareholder derivative lawsuits are also common. Investigative costs are high and operational disruptions are significant. Finally, a conviction could result in the company being barred from federal government contracting.

Controls: High

'17 - H

The control state for this risk area is at best practice not only for a technology company but any industry. The channel partner due diligence process is wholly revamped and uses a cross-company shared due diligence approach which is now consistently applied across all operating theatres. A similar process is applied to higher risk vendor types within high risk markets (including India, Russia, China and Malayasia), and was expanded to other risk-prioritized markets based on industry-accepted corruption indexes. A compliance department prior approval process governs third party gifts and entertainment, marketing development fund (MDF) projects involving SOE recipients, third party travel and EBC visits and significant transaction discounting (NSP) involving SOE's. Automated transaction monitoring has been added to identify unusual T&E and Procure to Pay transactions.

Residual Risk: Medium-High

'17 – M-H

The current residual compliance risk for Anti-Corruption compliance is assessed to be Medium-High. Even with the significant and ongoing enhancement of controls, the high inherent risk (large number of opportunities for non-compliance, high consequence and increased scrutiny of Acme Co.), means the residual risk will continue to be significant to Acme Co.

Key Processes:

- Retention of Channel partners and professional service providers or agents who interact with government officials
- Deal approval process and allocation of discount to partners for permissible purposes
- Provision of gifts, hospitality or travel to government or SOE employees
- Allocation of Marketing Development Funds

Subject Matter Expert(s):

- Dudley Dooright, Chief Compliance Officer

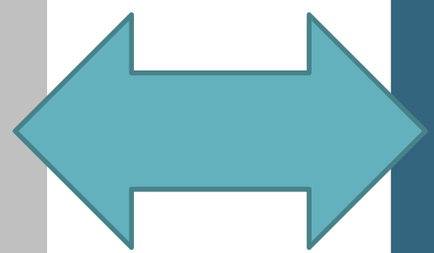
Action Item(s)	Owner	Status
Update of Anti-Corruption Policy to include audit controls/testing.	Compliance	Q4 2018
Implementation of new channel partner governance model to objectively define partner levels and entitlements.	GTM	Completed
Refine process for Non-Standard Discount transactional due diligence and review.	Compliance	Q2 2018

Exemplar Data

"Everything should be made as simple as possible, but not simpler."

High Level/Subjective Approach

- Narrowing the universe of assessed risks focuses effort but may exclude certain risks from consideration
- Gathers less input from persons with most knowledge of actual controls but also reduces overall burden and resistance from business
- More subjective scoring introduces potential inconsistency but avoids undue complexity and "false precision"
- Wholly subjective judgments in assessments of controls are quick and easy but yield no specific actionable remediation opportunities.
- Top down assessment by Compliance, Legal and/or Audit drives completion, maintains consistency, and inhibits "ownership" of compliance risks by business



Bottom Up/Objective Approach

- Assessment against a broad and detailed risk inventory can better encompass and capture all potential risks but adds burden
- Identification and documentation of every control at each process level is more reliable but is very labor intensive
- Assigning and reporting quantitative scoring of inherently subjective judgments may imply false precision and/or undermine credibility
- Objective assessment criteria tailored to each unique risk area is far more reliable and prescriptive for remediation but requires broad substantive expertise/very labor intensive
- Involvement of business process owners in the assessment of controls leads to their "ownership" of risks but adds burden and/or policing

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"Not everything that counts can be counted and not everything that can be counted counts."

Risk	Likelihood	Impact	Score	Rank
Customer Privacy & Data Protection	6.44	5.44	87.72	1
Information Security	6	5.67	85	2
Revenue Recognition	4.89	5.33	65.19	3
3rd Party Software & Copyright Infringement	5.11	4.67	59.63	4
Government Contracting	5	4.5	56.25	5
EEO/Employment Discrimination	5.56	3.89	54.01	6
Financial Statements & Earnings Manipulation	3.78	5.67	53.52	7
Conflicts of Interest, Gifts & Entertainment	5.11	3.89	49.69	8
Contract Compliance	4.89	3.89	47.53	9
Workplace Harassment	4.67	3.89	45.37	10
Insider Trading & Securities Law	3.78	4.56	43.02	11
Tax Accounting	4.22	3.89	41.05	12
FLSA / Wage & Hour Rules	4.67	3.33	38.89	13
Foreign Corrupt Practices (FCPA)	3.78	3.89	36.73	14
Asset or Liability Recognition	3.78	3.78	35.68	15
Export Controls	4	2.88	28.75	16
Media & External Communications	3.56	2.78	24.69	17
Fair Sales Practices	3.33	2.89	24.07	18
Workplace Safety, Security and Health	2.89	2.89	20.86	19
Antitrust	3.11	2.56	19.88	20

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Risk Assessment Success Factors and Considerations

- "Keep the Main Thing the Main Thing" – avoid mission creep by maintaining focus on your objectives.
- Keep it Simple – "Any intelligent fool can make things bigger, more complex, . . . It takes a touch of genius – and a lot of courage – to move in the opposite direction."
- "Don't boil the ocean" – don't get bogged down. You need to ensure there is time left to actually remediate identified problems.
- "Everything that counts can't be counted . . ."
- "General, I wish that your intelligence estimates would be less precise and more useful." Be direct, candid, self-critical and avoid vague, double-speak language.
- Balance high level and bottom up inputs to ensure reliable data and generate specific action items.
- Ensure process objectivity by incorporating external sources and standards.
- Process need not be centralized but must employ common approach and terminology to enable aggregation, comparison and understanding.

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Conclusion

- Clarify and maintain focus on overall objectives:
  - To inform and engage senior management and board in managing most significant compliance risks.
  - To ensure *proactive* identification of compliance control opportunities and track improvements.
  - To identify the most significant risks **relative to other risks** to prioritize the *allocation of limited time and financial resources* to ensure efforts are focused on the most significant risks.
  - Demonstrate to regulators and courts a proactive risk-based approach to compliance by management and board.
- Consistent process across the enterprise is critical to meaningful comparisons.
- Minimize subjectivity…but only where reasonable.
  - Likelihood and Severity are subjective judgments but use of consistent objective criteria is essential.
  - Be careful with quantifying assessments incorporating subjective judgments.
  - Controls: The presence (or absence) of specific controls over a compliance risk is generally an objective fact and not a matter of opinion.

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Questions?

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