



710:Conflicts of Interest in the Corporate Environment

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Faculty Biographies

Melissa M. Allain
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Jeffrey M. Kaplan

Jeffrey M. Kaplan is a partner in Stier Anderson, LLC, a law firm in New York City, Skillman, New Jersey, and Washington, DC. He specializes in all aspects of assisting companies in developing, implementing, and reviewing corporate compliance programs, including conducting risk analyses, writing/editing codes of conduct and other policy documents, counseling companies in matters regarding training, developing compliance audit protocols and reporting systems, establishing compliance/ethics offices, and assisting boards of directors in meeting their fiduciary duties under the *Caremark* case. Mr. Kaplan is also compliance and ethics training advisor to Midi Inc., a developer of Web-based and CD-ROM compliance training programs in Princeton, New Jersey, and adjunct professor-markets, ethics and law, at the Stern School of Business at New York University.

He is a former partner of Chadbourne & Parke, where he served in the special litigation group, and also a former partner of Akin Kaplan & Cohen LLP.

He co-author with Rebecca Walker of the forthcoming treatise-*Conflicts of Interest in Business and the Professions: Law and Compliance* and with Joseph Murphy and Win Swenson co-editor of *Compliance Programs and the Corporate Sentencing Guidelines*. He is also co-publisher of the bi-monthly journal *ethikos*. He serves pro bono as counsel to the Ethics Officer Association, a professional association of more than 1,200 ethics and compliance officers.

He received his BA, magna cum laude, Phi Beta Kappa, from Carleton College and his JD, cum laude, from Harvard University.

Rebecca S. Walker

Rebecca Walker is a member of Walker Compliance, P.C., a law firm specializing in corporate compliance, ethics, and governance, located in Santa Monica, California. Ms. Walker advises clients on the development and implementation of ethics and compliance programs to prevent and detect violations of law. Ms. Walker also advises clients on corporate governance matters, including assisting clients in drafting corporate governance guidelines and board committee charters, and advising clients on board oversight of their compliance programs.

Before forming Walker Compliance, Ms. Walker was associated with the law firm of Skadden, Arps, Slate, Meagher & Flom, LLP, where she practiced in the compliance program practice group.

Ms. Walker is the coauthor, along with Jeffrey Kaplan, of a forthcoming book regarding compliance and conflicts of interest. She has published numerous articles regarding corporate compliance and is a contributing editor of *Ethikos*, a leading compliance and ethics journal. Ms. Walker chairs the

Practicing Law Institute's annual Corporate Compliance Institutes in San Francisco and New York. She is a frequent speaker on ethics and compliance issues, including for the Practicing Law Institute, the American Law Institute, ABA, and other legal and business groups.

Ms. Walker received her BA, magna cum laude, Phi Beta Kappa, from Georgetown University and her JD, cum laude, from Harvard Law School.

Angela F. Williams

Angela F. Williams is the vice president and deputy general counsel for financial services and home services and the chief compliance officer of Sears, Roebuck and Co, located in Hoffman Estates, Illinois. As the deputy general counsel, she has ultimate responsibility for the management of all legal services provided to a significant portion of the company's business. As the chief compliance officer, she is responsible for ensuring that ethical practices and policies are developed, embedded, and enforced throughout the company. As a strategic business partner, she assists in the identification of applicable laws, regulations, and other requirements to ensure that current business practices comply.

Ms. Williams' legal background includes practicing law with Bryan Cave LLP, as a federal prosecutor in the U.S. Attorney's office in the middle district of Florida, as special counsel on criminal law to Senator Edward M. Kennedy on his senate judiciary committee staff, and in the U.S. Air Force Judge Advocate General Corps.

The *New York Times* and *L Magazine* featured Ms. Williams in articles about people who pursue two full-time professions. Ms. Williams is the founder of two ministries, angelaw Ministries, a ministry preaching and teaching the relevancy of God's Word for today, and WoW 4 the Word Ministries, Inc. which facilitates ministry leadership conferences around the world. Ms. Williams is currently cochairing groundbreaking research through the ABA's commission on women in the profession on women of color in the legal profession. She serves on various charitable boards.

Ms Williams received a BA from the University of Virginia where she was an Echols Scholar, a JD from the University of Texas School of Law, and a Master of Divinity, cum laude, from the Samuel DeWitt Proctor School of Theology, Virginia Union University.



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Introduction

- One of the most enduring and complex of compliance/ethics program issues
- Comments are based on a forthcoming book Jeff and Rebecca are writing
- One of the most difficult areas to deal with because:
 - Lack of unified law
 - Highly personal contexts in which issues often arise

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Background

- A major focus of the scandals of 2001-present
 - Financial services industry alone has had several major scandals:
 - Research analysts
 - Mutual fund trading
 - Mutual fund sales
 - Insurance brokerage

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Recent Conflicts Cases

- Other areas:
 - Corporate
 - Financial reporting: conflicts between executives and shareholders
 - Executive compensation
 - Friends and family stock
 - Corporate directors' lack of independence
 - Accounting – independence issues

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Conflicts Overview

- Medical
 - Conflicts involving medical treatment
 - Pharma sales practices
 - PBM's
 - Group Purchasing Organizations for hospitals
- Law
 - Lawyers' duty to report violations/Sarbanes 307
 - Independent investigations/Sarbanes 301

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Conflicts Overview

- Numerous other conflicts areas – journalists, scientific research - in the news recently
- All of these cases demonstrate *the need for a proactive approach to conflicts*
- Many companies are seeking guidance on dealing with conflicts, including how to:
 - Recognize
 - Audit for
 - Control for
 - Prohibit or Waive

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Sarbanes-Oxley

- Based on regulations promulgated under Sarbanes-Oxley 406, companies need to adopt codes requiring that conflicts be handled in an ethical manner
- “Ethical Handling” is not further defined by the regulations
- Waivers of codes for certain officers must be disclosed

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Sarbanes-Oxley

- SEC defines waiver as “the approval . . . of a material departure from a provision of the code”
- “Implicit waivers” of § 406 code must also be disclosed
 - “failure to take action within a reasonable period of time regarding a material departure from a provision of the code that has been made known to an executive officer”
- Does pre-approval of a conflict amount to a waiver?
- Companies should be thinking of these issues now and preparing to deal with them

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Handling Conflicts

- Think of conflicts broadly
 - Consider underlying principles
 - Don't be bound by industry experience
 - SEC has cautioned against this
 - Remember what happened in financial services
 - Consider the potential harm to the company

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Handling Conflicts Ethically

- But also recognize that conflicts are increasingly part of modern business and professional life
 - Many business organizations are assuming more diverse roles
 - So are some individuals

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Handling Conflicts Ethically

- Need to understand some of the “positive” reasons for conflicts
 - Efficiency/shared costs
 - Specialization/expertise

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Handling Conflicts Ethically

- Identifying a conflict is not necessarily the end of the analysis
 - Zero tolerance isn't always desirable
 - Zero tolerance is not required by Sarbanes
 - Conflicts “experience” (e.g., in engineering) often progresses from prohibition regime to disclosure one
 - But, need to ensure that conflicts are dealt with adequately

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The Role of Compliance

- Need to consider various compliance program elements in addressing conflicts
- The revised Sentencing Guidelines' emphasis on considering risks on an element-by-element basis underscores this

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Conflicts Risk Analyses

- Lessons from the recent scandals – that conflicts risks are very frequently missed or not fully appreciated
 - Example – Research analysts
- SEC Enforcement Chief calls for “top to bottom” conflicts risk analyses in financial services companies (Sept. 2003 speech)

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Conflicts Risk Analyses

Need to understand all the relevant duties that could give rise to conflicts, both:

- Personal and
- Organizational

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Risk Analyses

- General fiduciary duty of loyalty, e.g., to
 - Company
 - Clients
- Fiduciary duties arise from relationships of trust
- Gatekeeper duties
 - Do you have S-Ox 307 program?
- Professional standards, which can create duties to the public
- These can overlap

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Risk Analyses

- Risk issues – Organizational
 - To whom are duties owed?
 - What interests are in possible conflict?

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Risk Analyses

- From individual perspective
 - Who is in a position to profit/cause harm from acting in a conflicted way?
 - Is the individual truly exercising discretion?
 - As general matter, risks higher for high-level persons
 - May be uncomfortable territory for ethics officer
 - Consider safety in numbers approach
 - Stress the example set by high-level personnel

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Risk Analyses

- Appearance as an independent risk consideration
 - Particularly important in the post-Enron environment

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Risk Analyses

- What are conflicting interests?
- Review of law/different contexts suggests this should be viewed broadly
- Consider, e.g.,
 - Future interests
 - Intangible ones (such as reputation)
 - Social relationships?

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Risk Analyses

- Conflicts in a larger setting
 - Need to consider general system of controls/business processes to assess conflicts-related risks
 - E.g., how good are procurement controls?

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The Role of Agents

- Are agents covered by your conflicts policies?
 - Often are considered high risk
 - *But*, don't always have the same duties that employees do
 - What is the harm that a conflicted agent could cause your organization?

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Conflicts Policies

- Need for specificity vs. flexibility
 - Definitions of family
 - Gift limits
 - Should these be specified in the code of conduct or a separate policy?
 - Need a certain amount of detail
 - But
 - Need to state general principles
 - Need to be aware of waiver/disclosure issues
 - Remember appearance issues

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Conflicts Auditing

- Questionnaires
 - Need to review/compare
 - Large companies may need system to manage this data
- Review T&E receipts for sensitive procurement areas
- Auditing is more important under revised Sentencing Guidelines

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Conflicts Investigations

- The hardest part is often getting third party cooperation
- Consider requiring such cooperation as part of documentation with vendors

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Conflicts and Discipline

- Need to ensure fairness and rigor
- Particularly challenging with conflicts, as often no governing legal standards
- As much as any area, having high-level review is important here

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Conflicts and Incentives

- Incentives are a new (and somewhat vague) element of Corporate Sentencing Guidelines
 - Does it just include incentives for good conduct?
 - Or also incentives for bad conduct?
- Consider how compensation structures might provide incentives for conflicts
 - “Moral hazard” as a conflicts risk

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Conflicts and Waivers

- Different models:
 - From a central (e.g., ethics, law) office
 - From supervisors
- If the latter, consider requiring supervisor to get approval
- Consider guidelines/controls

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Conflicts and Waivers

- Safety in numbers – have these decisions made by a committee
- Keep records
 - Could be key to meeting S-Ox 406 requirements
- Interplay of conflicts/406/stock exchange disclosure requirements – a complicated story yet to unfold

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Conflicts Management

- Need to consider:
 - Frequency and detail of any reporting
 - Ensuring that person managing the process isn't herself conflicted
 - Records important here, too
 - Remember Enron!

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Session No. 710
**Conflicts of Interest in the
Corporate Environment**

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AutoNation

- **Largest U.S. retailer of new automotive vehicles**
- **Nearly 400 dealership franchises and repair centers in 18 states**
- **Approximately 28,000 employees in five regional districts**
- **Founded in 1996, NYSE-traded, Fortune 100**

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AutoNation's Business Ethics Program

- **A program mandated by the Board of Directors since 1998**
- **Purpose is to instill a corporate culture of conducting business according to the highest ethical standards, and to prevent, detect, and discourage violations of law or company policy**
- **Scope includes all operations:**
 - **Sales and service**
 - **Interactions with associates, customers, vendors, and governmental agencies**
- **Program applies to all directors, officers and associates**

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AutoNation's Business Ethics Program

- **AutoNation's Business Ethics Program is regulated and monitored by a Business Ethics Committee and the Corporate Governance Committee of the Board of Directors.**
- **Business Ethics means more than complying with the laws and AutoNation's policies.**
- **Business Ethics at AutoNation means operating each dealership according to the highest standards of business conduct.**

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Conflicts & Misappropriation

One of our most significant policies at AutoNation addresses Conflicts of Interest and Misappropriation of Corporate Opportunities. This policy concerns an assortment of situations, and imposes requirements that the employee must follow:

- Full Disclosure
- Written Approval
- Outside Employment & Business
- Business Arrangements
- Competitive Business
- Family Interests
- Personal Financial Gain
- Corporate Opportunities
- Public Service and Charity
- Pre-Existing Interests
- Reporting the Conflicts of Others

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Full Disclosure

An employee must make prompt and full disclosure in writing, to any member of the AutoNation's Business Ethics Committee, of any situation that may involve a Conflict of Interest or pursuit of a Corporate Opportunity.

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Written Approval

An employee may not enter into a transaction or engage in an activity giving rise to a Conflict of Interest or a Corporate Opportunity without the prior written approval of the Business Ethics Committee, the Corporate Governance Committee or the Board of Directors.

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Outside Employment & Businesses

Without full disclosure and written consent, neither an employee nor an immediate family member may own an interest in or otherwise affiliate with an entity that has a business relationship with AutoNation.

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Business Arrangements

**Without full disclosure
and written consent,
an employee may not participate
in a joint venture, partnership
or other business arrangement
with AutoNation.**

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Competitive Businesses

**Without full disclosure
and written consent,
an employee may have no business relationship
with an
AutoNation competitor.**

**Members of the Board of Directors can present
complex situations.**

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Family Interests

An employee must disclose fully the activities of any family member who has a business relationship with an AutoNation competitor, regardless of how harmless it appears.

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Personal Financial Gain

Without full disclosure and written consent, an employee may not engage in even a brief transaction with a customer, prospective customer, supplier, agent or competitor of AutoNation that would result in the employee's personal financial gain.

In addition, an employee may not take personal advantage of opportunities that belong to the Company.

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Other Circumstances

**An employee must fully disclose
any other arrangement
or circumstance,
including family or other personal relationships,
which might dissuade the employee from
acting in the best interest of AutoNation.**

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Golden Rule of Conflicts

**An employee must act in a manner
that is in the best interest of AutoNation
and would not adversely affect
the confidence
of our customers, suppliers or associates in the
integrity of AutoNation
or its procedures.**

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Corporate Opportunities

**Besides avoiding conflicts,
you should advance the Company's interests
when the opportunity is available.
You owe a duty to the Company to advance its
legitimate interests
whenever the opportunity
arises.**

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Public Service & Charity

**AutoNation encourages
all associates
to participate in public service
and charitable activities
so long as they do not
create actual or potential conflicts
with the associate's duties
to the Company.**

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Pre-Existing Interests

An employee must fully disclose and possibly discontinue activities that could create a conflict due to the Company's developing interests, such as the purchase of a new franchise or property with which the employee is already involved.

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Reporting the Conflicts of Others

If an associate knows of or suspects a violation of the conflicts policy, the employee should report it to the Regional President, Senior Vice President, Corporate Department Head, Legal Department or Business Ethics Committee either by writing, emailing or contacting the ACT-AlertLine.

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Tips on Policy Development

The written policy on conflicts should be tailored to fit your company's business culture and include examples of transactions that leave no room for doubt.

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Best Practices

- **Encourage management to practice the following:**
 - **Create a culture where the open door is real; conflicts are not always easy to identify and address**
 - **Set the example and make known to all**
 - **Be on the lookout and take action**
 - **Keep investigations confidential and do not allow retaliation**

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Business Integrity

**A company's policy
on Conflicts of Interest and Misappropriation
of Corporate Opportunities
Should be discussed and nurtured
in order to become part of the corporate culture
and to maintain
the highest degree of integrity
in the conduct of business.**