

Key Issues Facing Boards of Directors: New SEC Enforcement Initiatives and Corporate Governance Risks

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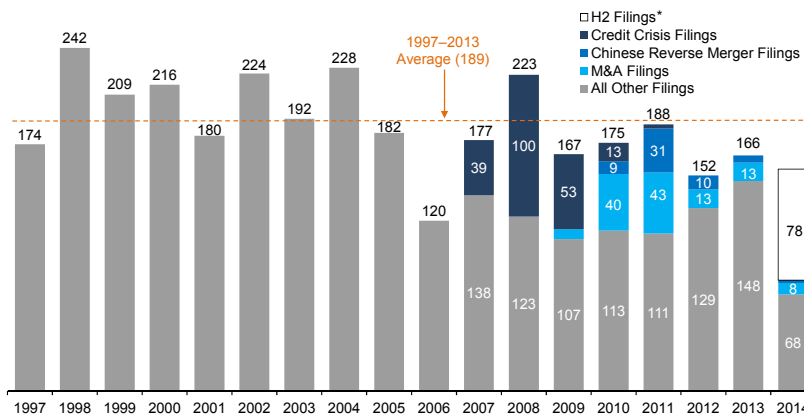
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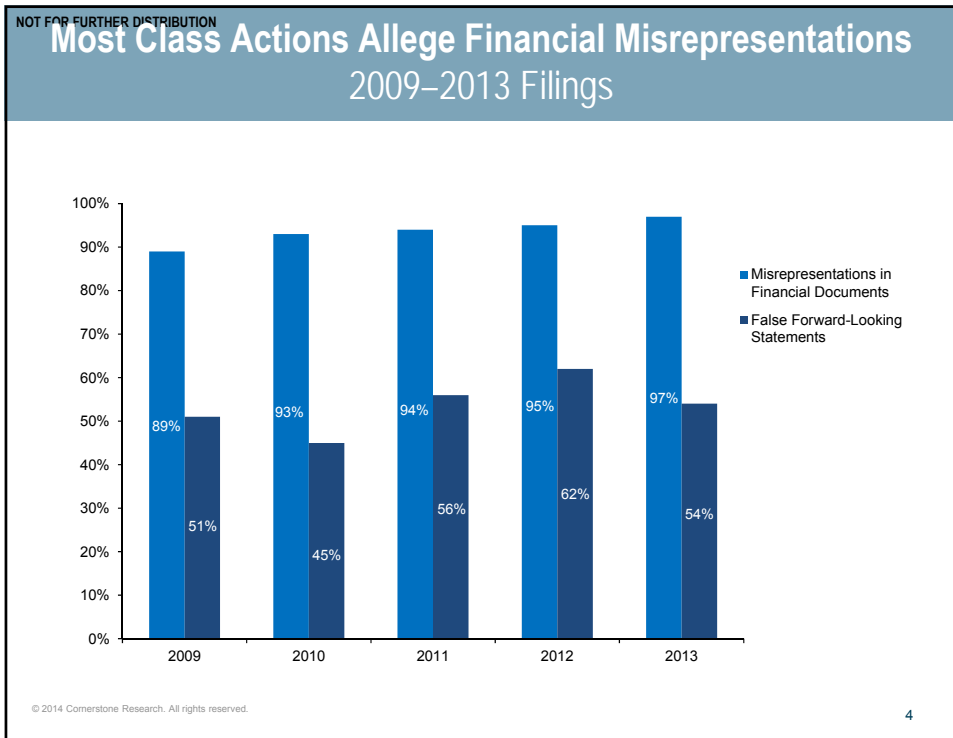
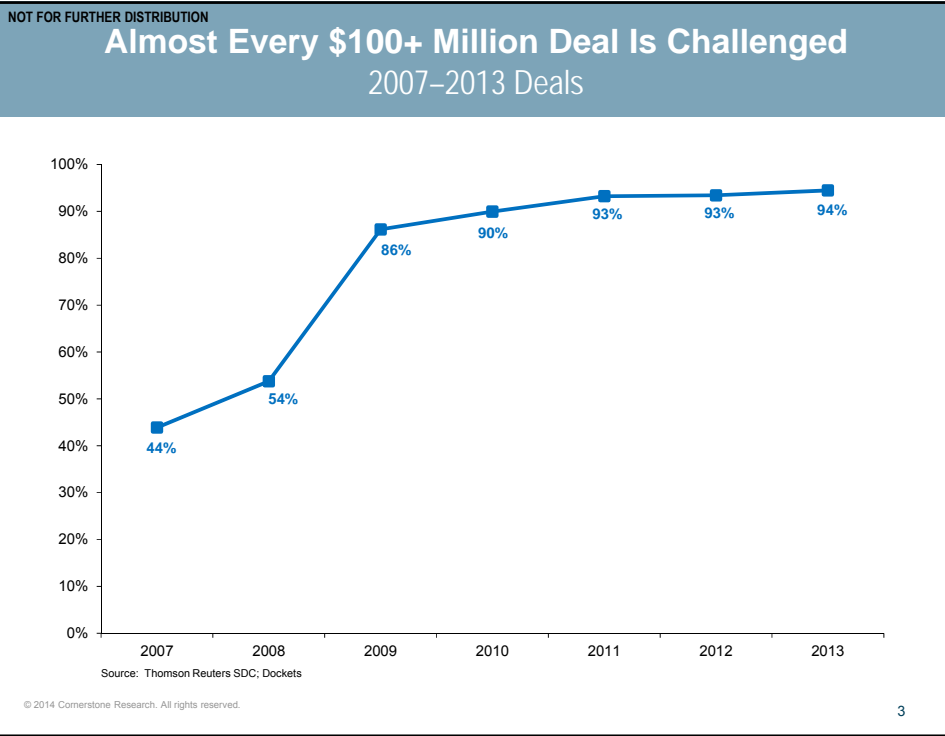
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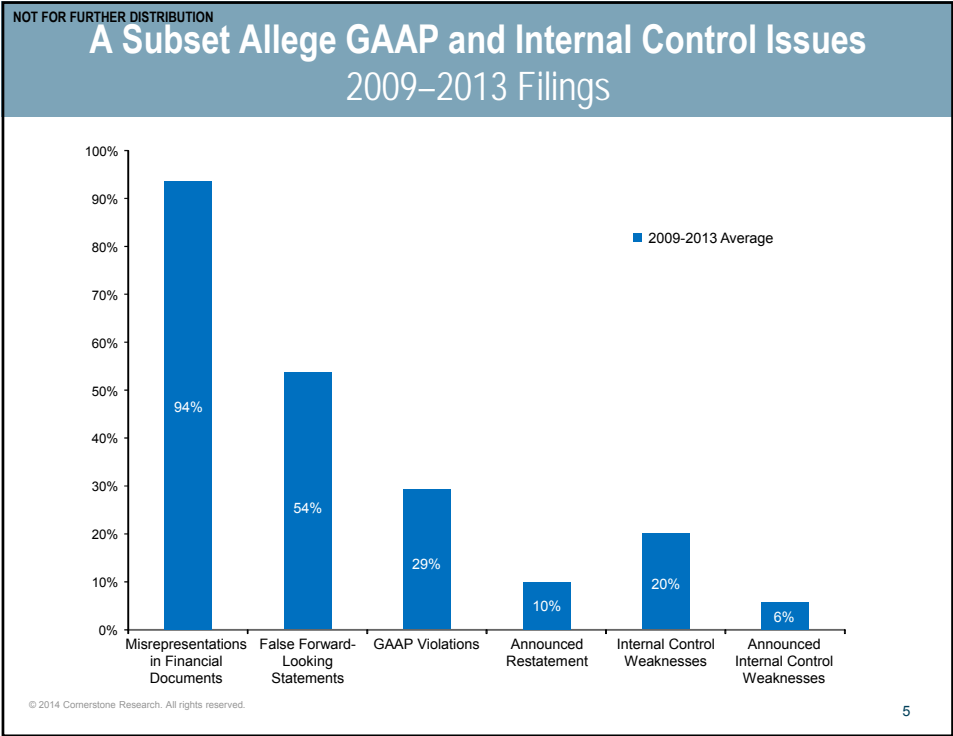


Class Action Filings Have Been Lower in Recent Years 1997-1H 2014 Filings

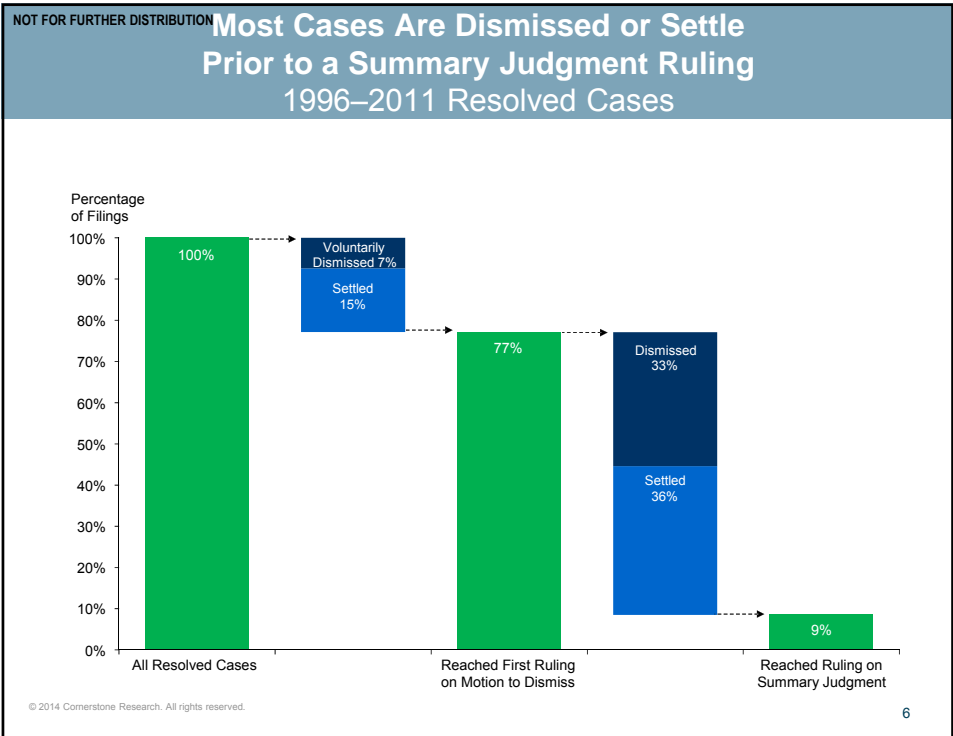


* If the number of filings in the second half of 2014 equals the first half.





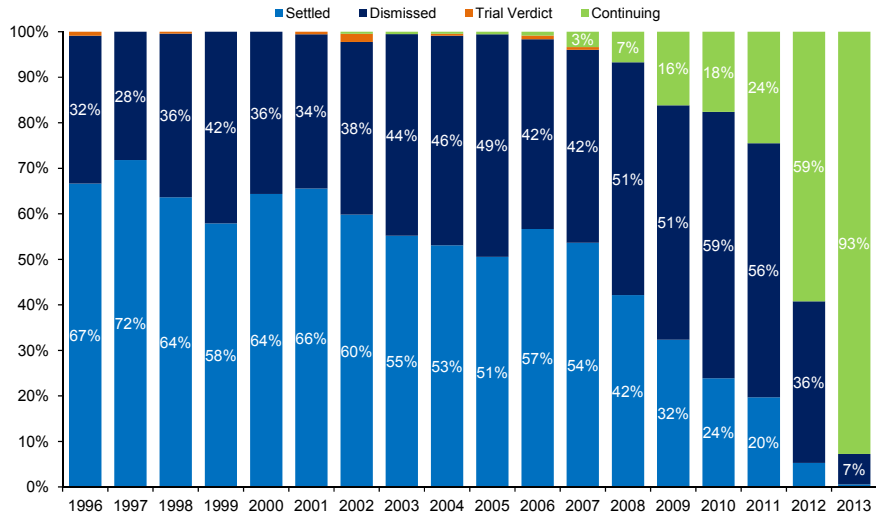
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An Increasing Proportion of Cases Are Dismissed Status of 1996–2013 Filings

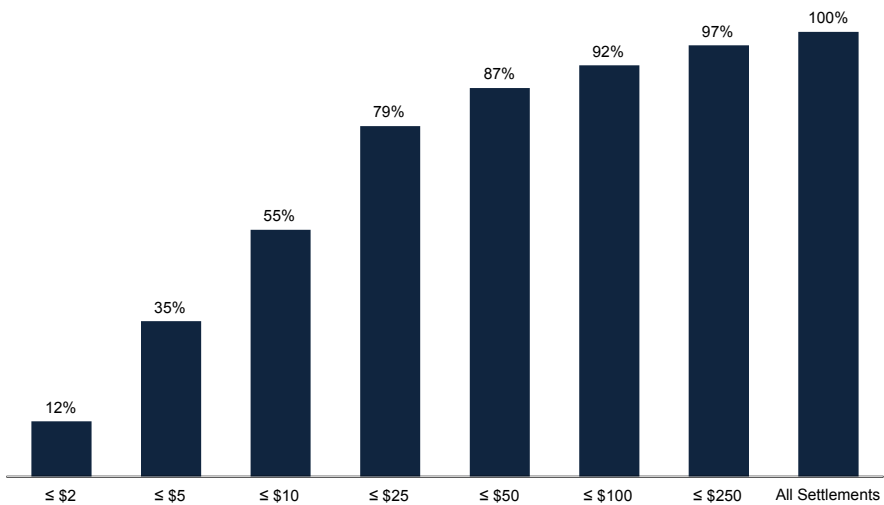


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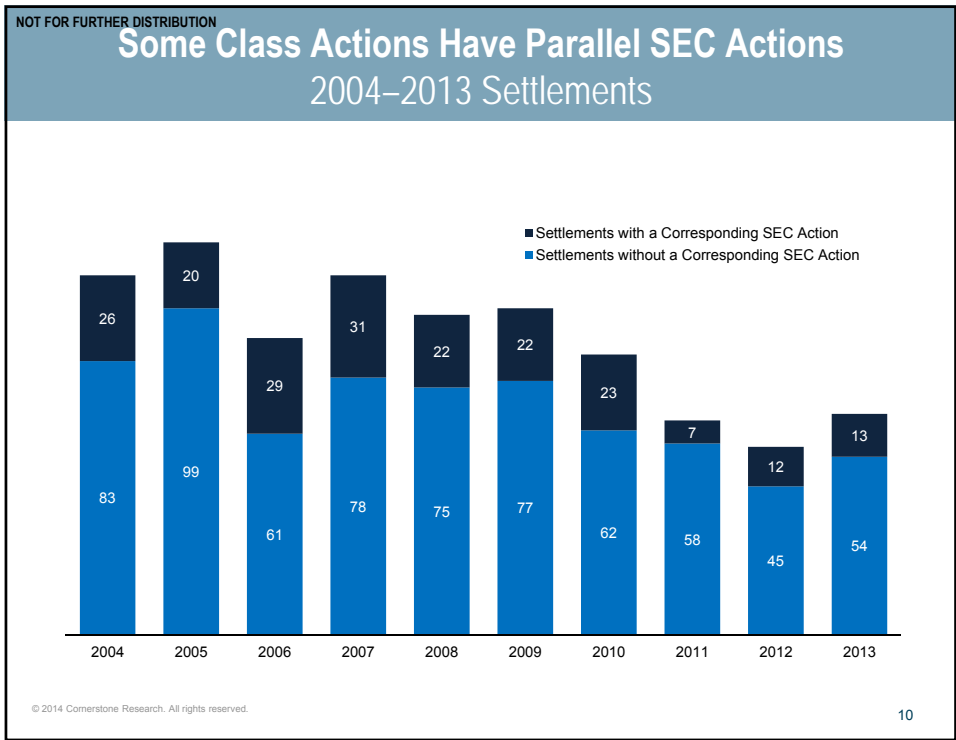
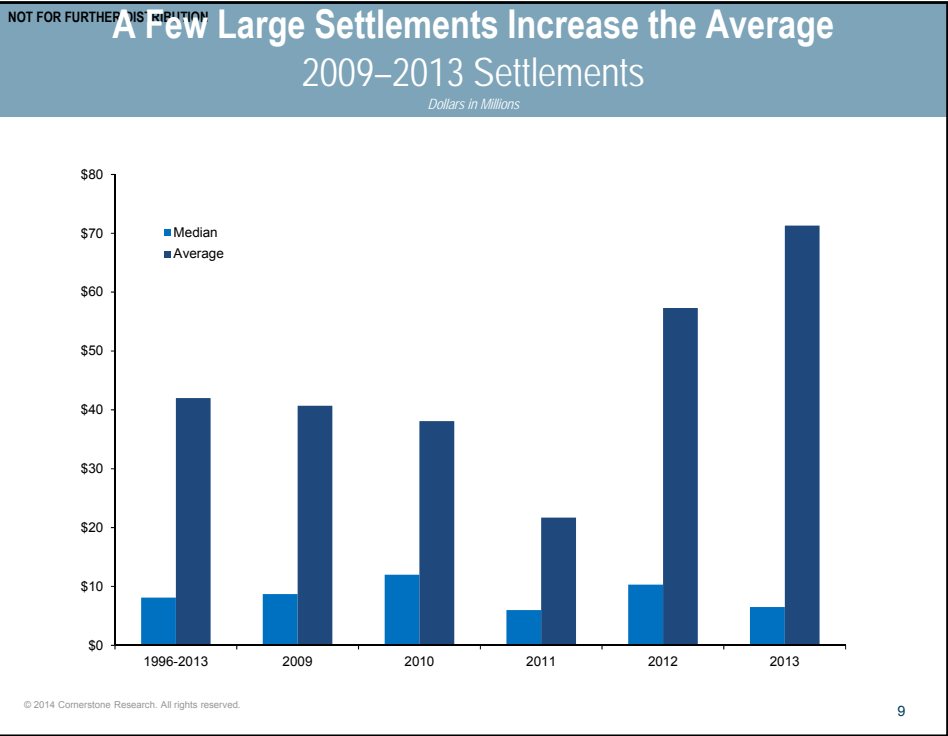
The Vast Majority of Cases Settle for ≤ \$50 Million 1996–2013 Settlements

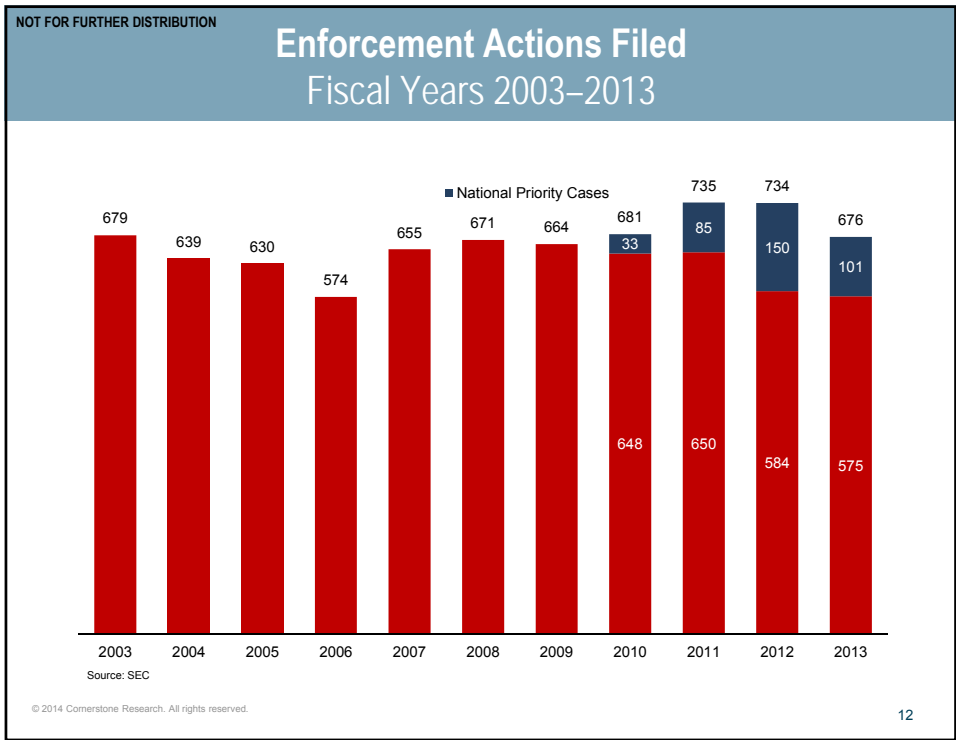
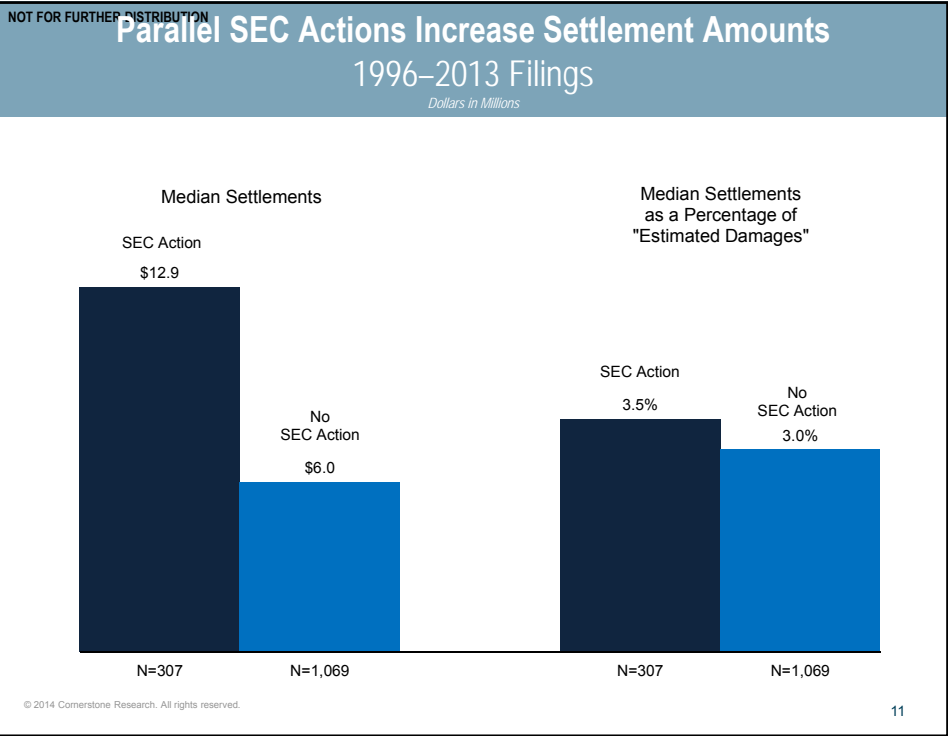


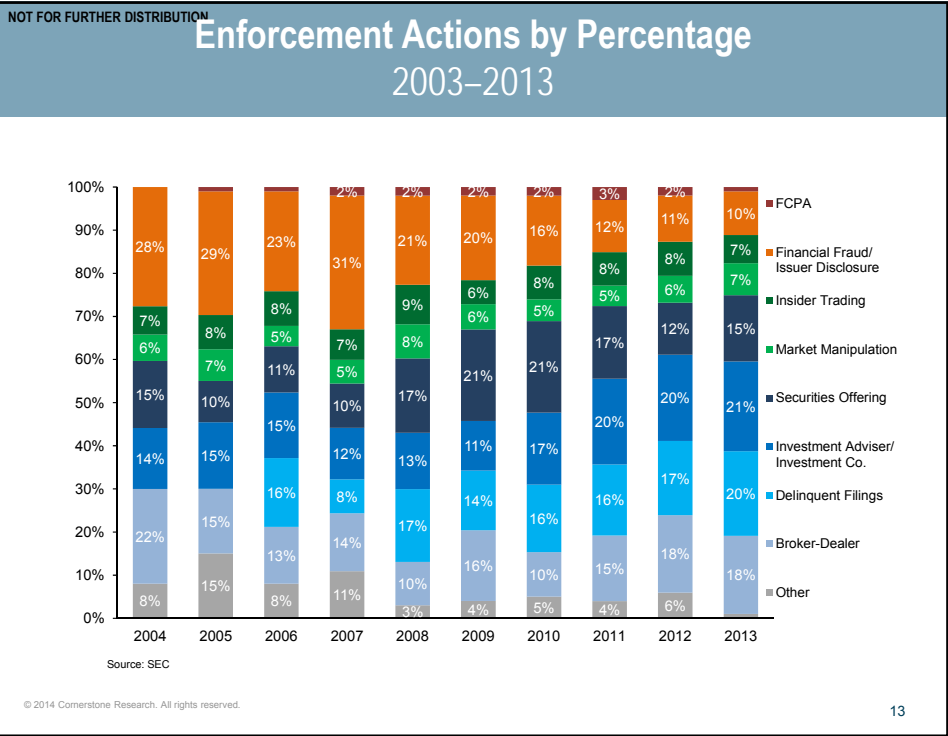
Note: Settlement dollars adjusted for inflation; 2013 dollar equivalent figures used.

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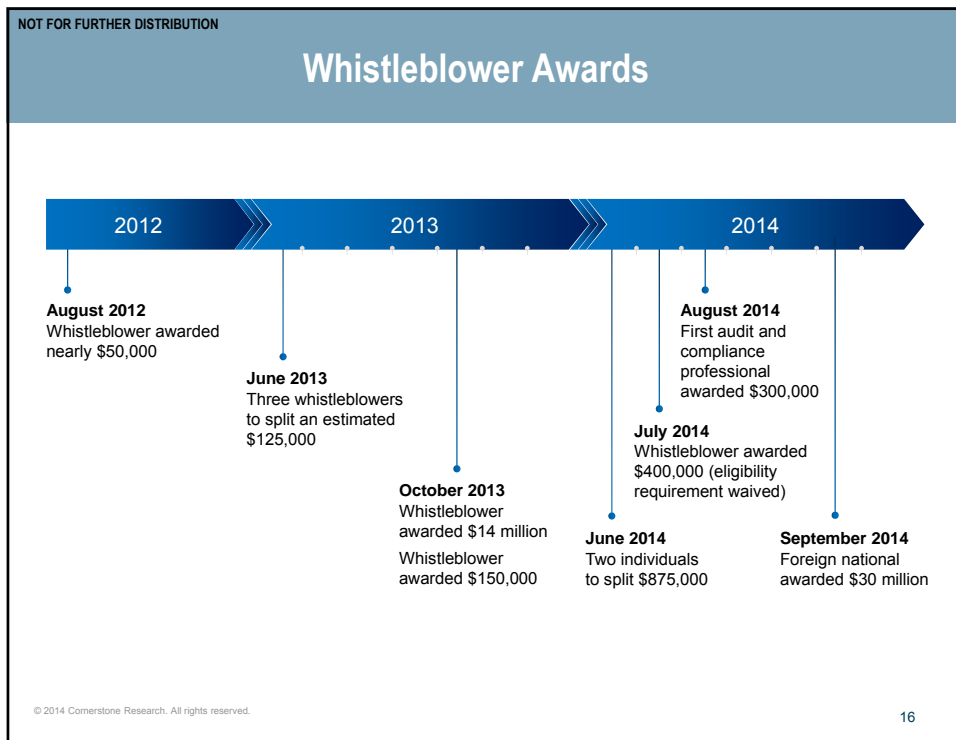
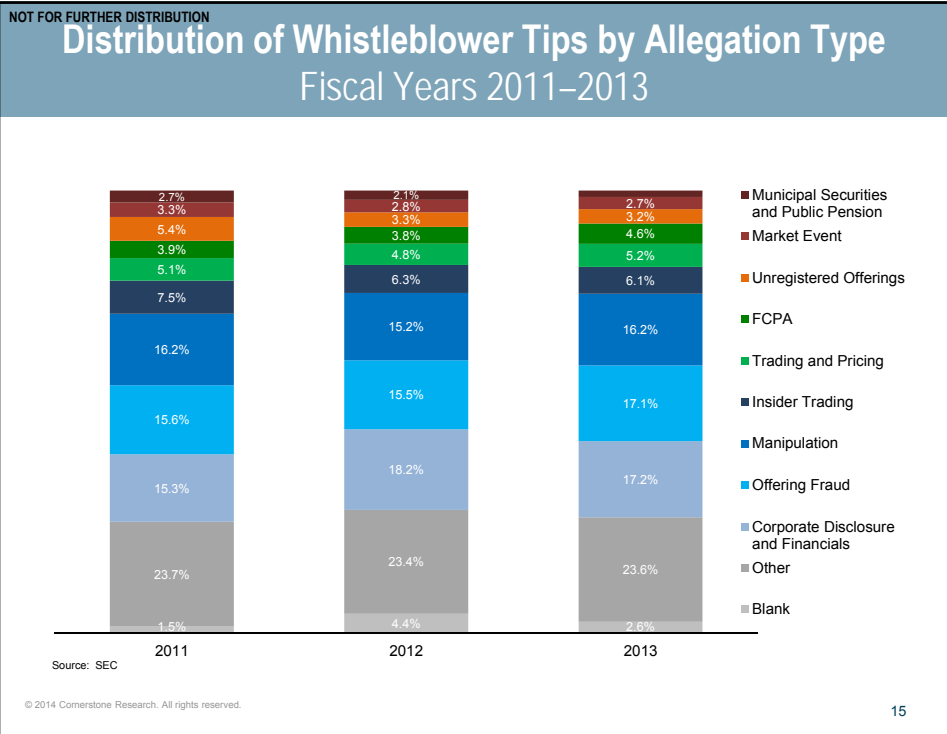
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Financial Fraud Cases

- › Large decline
 - 20% in 2009
 - 10% in 2013
- › Renewed SEC focus on financial fraud?
 - Financial Reporting and Audit Task Force
 - Fraud detection software

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WHISTLEBLOWER ISSUES UNDER THE DODD-FRANK ACT

Dodd Frank – Whistleblower Provisions

- Dodd-Frank Act of 2010 Whistleblower Provisions
 - › Whistleblowers may recover between 10% and 30% of monetary sanctions collected by the Commission in an action in which over \$1 million in sanctions is ordered.
- To be eligible for award, whistleblower must:
 - › Voluntarily
 - › Provide original information to SEC
 - › Leading to the successful enforcement by the SEC of federal court or administrative action, or a related action

Financial Incentives for Whistleblowers

- › Recent awards exceeding \$1 million:
 - SEC September 22, 2014 Press Release awarding \$30 million to whistleblower who uncovered “difficult to detect fraud.”
 - SEC October 1, 2013 Press Release announcing award of more than \$14 million to whistleblower: “The whistleblower . . . provided original information and assistance that allowed the SEC to investigate an enforcement matter more quickly than otherwise would have been possible.”

Use of Internal Compliance Systems

- Internal Compliance and Reporting
 - › If employee first submits information internally and company subsequently discloses potential violation to the SEC, the employee will receive credit for additional information uncovered by the company's investigation.
 - › If whistleblower reports to the SEC within 120 days of making an internal report, the SEC will consider the submission to be effective as of the date that the information was first reported internally. (Rule 21F-4(b)(7)).

Use of Internal Compliance Systems (cont'd)

- › When determining the amount of an award, the SEC will consider whether the whistleblower utilized internal reporting procedures first. (Rule 21F-6(a)(4)).
- › According to the *New York Times*, "more than 80 percent of whistleblowers have reported internally first."
- › Compliance officer awarded \$300,000 in August 2014.

Anti-Retaliation Provisions

- “No employer may discharge, demote, suspend, threaten, harass, directly or indirectly, or in any other manner discriminate against a whistleblower in the terms and conditions of employment because of any lawful act done by the whistleblower – (i) in providing information to the [SEC]” (1934 Act, Section 21F(h)(1)(A)).
- “No person may take any action to impede an individual from communicating directly with the Commission staff about a possible securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement” (Rule 21F-17).

Anti-Retaliation Provisions

- Private right of action in federal court if suffer adverse employment action as a result of a protected activity.
 - › Reinstatement with same seniority status.
 - › Double back pay owed (and interest/litigation fees/costs).
 - › Fifth Circuit has held that protections extend only to individuals who report to SEC; other courts have construed more broadly to include those who report internally.
- Chief of Office of Whistleblower: SEC is “actively looking for ways to be proactive in pursuing” enforcement actions against companies that retaliate against whistleblowers.

Anti-Retaliation Provisions – Limitations and Extensions

- Does not apply extraterritorially to foreign nationals employed by foreign companies, even if company's stock trades in U.S. markets. *Liu v. Siemens AG*, (2d Cir. 2014).
- Arguably applies to private contractors and subcontractors. *Lawson v. FMR, LLC*, 134 S. Ct. 1158 (2014) (applying anti-retaliatory provision to SOX whistleblowers).

“Real World” Issues

- “Poor Performers”
 - › Claim raised for first time in connection with termination.
 - › Termination and severance package?
 - › Is record sufficient to establish that termination was not retaliatory?
- Termination Agreements
 - › Cannot prohibit external reporting of alleged violation.
 - › Should not include language purporting to require individuals to forego an award or disclose to company external reporting.
 - › Legitimate use of provisions prohibiting the disclosure of proprietary or confidential information.

Responding to Dodd-Frank Whistleblower Provisions

- Best Practices
 - › Educate employees on compliance programs and encourage use of internal reporting systems, i.e., establish a “culture of integrity.”
 - › Develop policies relating to management’s response to whistleblower reporting.
 - › Promptly investigate and appropriately respond to whistleblower complaints.
 - › Ensure that strong anti-retaliation policies are in place and enforced.
 - › Invest in training and infrastructure to ensure compliance.

Responding to Whistleblower Complaints

- Initial Considerations
 - › Whether to conduct an investigation?
 - › Who will conduct?
 - › How to obtain/develop factual information?
 - › Whether/how to report any investigation?
- Promptly advise Audit Committee of allegations involving financial impropriety or serious misconduct by senior management.
- Consider temporary steps such as temporary reassignment or leave with pay.

CURRENT INSIDER TRADING ISSUES

Insider Trading: A Top Government Priority

- DOJ and SEC have ramped up insider trading investigations and prosecutions
 - › 2009-2013: SEC filed 212 civil insider trading actions; 87 individuals were charged criminally in S.D.N.Y. during same period.
 - › SEC filed 44 insider trading actions in 2013 alone; DOJ brought criminal charges involving insider trading against 20 individuals; and FINRA referred a record 660 insider trading cases to various enforcement agencies.
- “Illegal insider trading is rampant” ... “we have devoted significant resources to this and are adding more” ... “a top criminal priority.” (Preet Bharara, U.S. Attorney, S.D.N.Y.)

Insider Trading: A Top Government Priority (cont'd)

- “Insider trading continues to be a high priority area for the SEC’s enforcement program.”
(<http://www.sec.gov/spotlight/insidertrading.shtml>)
- High Profile Cases
 - › *United States v. Mathew Martoma* (9 years)
 - › *United States v. S.A.C. Capital Advisors*
 - Agreed to pay the DOJ and SEC a combined \$1.8 billion penalty – the largest insider trading penalty ever.
 - › *United States v. Raj Rajaratnam* (11 years)

Insider Trading: A Top Government Priority (cont'd)

- › *United States v. Rengan Rajaratnam*
 - Broke U.S. Attorney for the SDNY’s record of 85 consecutive wins. Court dismissed securities fraud charge, apparently based on no knowledge of benefit to tipper issue raised in Newman, Chiasson and Steinberg cases. Jury acquitted on sole remaining conspiracy charge.
- › *United States v. Gupta* (two years in prison and fined \$5 million.)
- › *United States v. Whitman*
 - Menlo Park based founder of Whitman Capital convicted by a jury based in trading in Google, Polycom and Marvel. Sentenced in 2013 to two years in prison, one year of supervised release, and a \$250,000 fine.

Insider Trading: A Top Government Priority (cont'd)

- › *SEC v. Manouchehr Moshayedi* (June 2014 acquittal)
- › *SEC v. Cuban* (acquittal)
 - October 2014 acquittal by a Texas jury which deliberated for less than five hours.
- › *SEC v. Wyley*
 - Jury convicts Samuel and Charles Wyley (Michaels Stores) of hiding stock holdings and evading trading limits. Liability of \$300-400 million in disgorgements, penalties, and interest. Took a decade to get to trial.

Insider Trading: Legal Overview

- Insider trading is viewed as a manipulative device in violation of the anti-fraud provisions of Section 10(b) of the Exchange Act
- Congress has not specifically defined what constitutes “insider trading”
- SEC Rule 10b5-1 (adopted October 2000) provides that an individual who is “aware” of material nonpublic information at the time of the trade may be held liable for violations of Section 10(b):
 - › A trader is aware of all material information in his/her possession
 - › Mere possession is enough; proof of “use” not required

Insider Trading: Legal Overview (cont'd)

- No “bright line” test to guide business people and traders in their day-to-day activities
- Materiality: Likelihood that a reasonable investor would consider the information important (examples: financial information/projections, significant transaction, management change, results of an internal investigation)

Liability of Non-Insiders

- Despite its name, “insider trading” liability extends beyond corporate insiders and “temporary insiders” in various circumstances.
- A tippee assumes a fiduciary duty to a corporation’s shareholders not to trade on MNPI when the disclosing insider has breached a fiduciary duty to the corporation’s shareholders and the tippee knows or should know of the breach.
 - › Fiduciary duty is breached when the insider receives a direct/indirect personal benefit from the disclosure. *Open question whether the tippee has to have knowledge of personal benefit flowing to the tipper.* This question is at issue in the Newman, Chiasson and Steinberg appeals in Second Circuit, and played a role in Rengan Rajaratman’s acquittal.

Liability of Non-Insiders (cont'd)

- “Misappropriation Theory”: Section 10(b) of the Exchange Act is violated when confidential information is misappropriated for securities trading purposes, in breach of a duty of trust and confidence owed to the source of the information.
- Rule 10b5-2 identifies three “non-exclusive” circumstances under which a duty of trust or confidence arises:
 - › The recipient “agrees to maintain information in confidence.”
 - › The insider and recipient have a “history, pattern or practice of sharing confidences ...”, or
 - › The recipient “obtains material nonpublic information from his or her spouse, parent, child or sibling”

Ways to Avoid Liability – Rule 10b5-1 Trading Plans

- 10b5-1 Trading Plans: Purpose and Requirements
 - › Provides affirmative defense to the assertion that the purchase or sale of a security was made on the basis of MNPI
 - › Generally allows prearranged plan for future stock trades
 - › Plan must be entered into in good faith when person/entity does not possess MNPI
 - › Plan must:
 - Specify the amount, price (may include limit price) and specific dates of purchases or sales;
 - Include a formula or similar method for determining amount, price and date; or
 - Give broker exclusive right to make purchases and sales

Scrutiny of Rule 10b5-1 Trading Plans

- April 24, 2013 WSJ Article
 - › Nonexecutive directors' use of 10b5-1 trading plans increased by 55% since 2008 (compared to 36% increase among other insiders)
 - › 2006-2011: Nearly 25% of nonexecutive directors with trading plans sold more stock in one month than in prior two years, including the selling of all or the bulk of an investment fund's holding in a company
 - › Government focus on timing and plan provisions
 - › Cited examples:
 - Tesla Motors/Valor Equity Partners
 - Double-Take Software/ABS Capital Partners
 - Cardiovascular Systems/Easton Capital Group

Corporate Officials and Rule 10b5-1 Trading Plans (cont'd)

- April 30, 2013 WSJ Article reported that federal prosecutors are investigating corporate directors' misuse of trading plans
- Council of Institutional Investors Call for Reform
 - › "Evidence continues to mount that many companies and company insiders have adopted practices that are inconsistent with the spirit, if not the letter, of Rule 10b5-1"
 - › Allow adoption only during issuer's open trading window
 - › Prohibit the adoption of multiple, overlapping trading plans
 - › Require a three-month or longer delay between plan adoption and the execution of the first plan trade
 - › Limit the frequency of modifications/cancellations
 - › Mandatory disclosure of plan adoptions, amendments, terminations, and transactions.

Rule 10b5-1 Trading Plans: Best Practices

- Adoption only during open trading window
- Avoid frequent modifications/cancellations – should take place, if at all, only during an open window, absent special circumstances and general counsel approval
- Ensure that any overlapping trading plans cover separate securities
- Waiting/“seasoning” period between plan adoption and first trade
- Plan duration should be carefully considered at outset
- Consider requiring company pre-clearance or review
- Consider general, public disclosure of a plan’s adoption

FOREIGN CORRUPT PRACTICES ACT “FCPA”

Is There Still A Problem?

- E&Y 2014 Global Fraud Survey (2700 Executives):
 - › 20% do not have an anti-bribery / anti-corruption policy.
 - › 6% willing to justify misstating company financial performance.
- Dow Jones 2014 Survey (383 Compliance Professionals):
 - › 54% reported their companies delayed or called off business endeavors due to difficulties getting information to assess corruption risk from countries like Russia, China, Iran, and India.

Is There Still A Problem?

- Kroll + Compliance Week - 2014 Anti-Bribery and Corruption Report (200 Compliance Executives):
 - › 81% anticipate that bribery and corruption risks for their companies will increase (51%) or remain the same (30%) over the next two to three years. Only 5% think the risk will decrease.
 - › 58% reported their companies never train third parties on anti-bribery and corruption.
- Grant Thornton Corporate General Counsel 2014 Survey (256 General Counsel Respondents)
 - › 47% reported not implementing compliance guidelines because they were not sufficiently familiar with the SEC and DOJ guidelines.

Understanding the FCPA

- Foreign Corrupt Practices Act of 1977 (“FCPA”) adopted in response to government investigations in mid-1970s which revealed that a number of U.S. corporations maintained off-shore “slush funds” and engaged in systematic bribery of foreign officials to obtain business details.
- Two Prongs
 - 1) Anti-bribery provision covering issuers, “domestic concerns,” and other persons or entities acting while in U.S. territory.
 - 2) Accounting Provisions
 - a) Books and records, reasonable detail accurately reflect transactions and disposition of assets.
 - b) Internal controls, aimed at detecting and preventing FCPA violations.
- Accounting provisions often used when government cannot establish elements of anti-bribery. No requirement the false record or inadequate control be linked to improper payment.

Enforcement of the FCPA

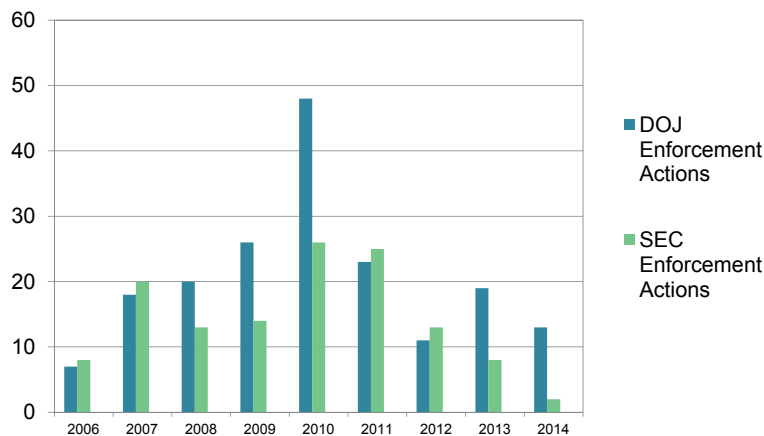
- DOJ and SEC share jurisdiction for investigations and enforcement actions.
- DOJ has jurisdiction over all criminal investigations and prosecutions.
 - › Criminal penalties for each violation of the anti-bribery provisions:
 - up to \$2 million fine for companies, up to \$250,000 fine for individuals, or twice the amount of gross pecuniary gain resulting from improper payment; up to 5 years imprisonment; or both.
 - › Criminal penalties for each willful violation of the books and records provisions:
 - up to \$25 million fine for companies and up to \$5 million fine for individuals; up to 20 years imprisonment for individuals.
- Potential debarment (suspension of right to do business with the U.S. government).

Notable FCPA Developments & Trends

- Release of joint DOJ/SEC publication in November 2012, “**A Resource Guide to the U.S. Foreign Corrupt Practices Act**”
- Two blockbuster oil company settlements in 2013: Total, S.A. (\$398.2 million) and Weatherford (\$152.7 million).
- Renewed focus on holding individuals accountable: 12 of the 19 DOJ enforcement actions in 2013 were against individual defendants and 11 of the 13 DOJ enforcement actions in the first half of 2014 have been against individuals. Both SEC enforcement actions in the first half of 2014 have been against individuals.
 - › Most of the individuals targeted are C-level executives.
- DOJ and SEC continue to stress that companies that self-report and cooperate are rewarded with more lenient penalties.
 - › *Alcoa, HP, Smith & Wesson* – Govt. cited cooperation as factor in levying fines.
 - › *Marubeni* – stiffer penalties for not cooperating.

Trends in DOJ/SEC Enforcement

Enforcement Actions Brought by DOJ and SEC



FCPA Anti-Bribery Provision

- “Anti-bribery” provision makes it illegal to corruptly offer or provide anything of value to officials of foreign governments with the intent to obtain or retain business.
 - › Unlawful to “**corruptly** in furtherance of an offer, payment, promise to pay or authorization ... of the giving of **anything of value** to any **foreign official** for purposes of – influencing any act or decision of such foreign official in his official capacity ... [or] do or omit to do any act ... [or] securing any improper advantage [or] induce such foreign official to use his influence with a foreign government or **instrumentality** ... in order to assist in obtaining or retaining business.” 15 U.S.C. § 78dd-2.

Persons and Entities Subject to the FCPA

- Any individual, company, officer, director, employee, or agent of a company, and any shareholder acting on behalf of a company.
 - › Jurisdictional limits were tested: *Staub vs. Steffen*
 - › *SEC v. Staub* (S.D.N.Y. 2013) – Retained jurisdiction over executives of a Hungarian issuer (Magyar) that traded as an ADR on U.S. exchanges. Although the executives’ emails discussing corrupt payments did not originate or terminate in the U.S., the court noted that the emails passed through U.S. servers.
 - › *SEC v. Steffen* (S.D.N.Y. 2013) – Declined jurisdiction over an executive of German corp. (Siemens) that traded ADRs on a U.S. exchange. The Court held that the executive was involved in the bribery scheme only to the extent that he urged others to follow through with the transactions on a single phone call originating in the U.S. “Minimum contacts” was not satisfied.
- Expansive view of jurisdiction on foreign conduct:
 - › Foreign issuers/individuals subject themselves to jurisdiction by placing a telephone call or sending an email, text, fax, from, to or through the U.S., using the U.S. banking system, or traveling to/from U.S.
 - › *United States v. AU Optronics Corp.* (9th Cir. 2014) – Joined 2nd, 3rd, and 7th Circuits in holding that the FTAIA, which governs when federal antitrust laws apply to foreign anti-competitive conduct, sets out substantive elements of an antitrust claim, and survives a subject matter jurisdiction challenge.

FCPA Definition: “Foreign Officials”

- **FCPA Prohibits Payments to “Foreign Officials”**
 - › The FCPA broadly defines “foreign officials” as those officials who:
 - Act as employees or officers of any government department, such as a customs official or a building inspector.
 - Act as employees or officers of any state-owned, state-controlled, or governmental enterprise, such as an employee of a university, public health institution, or a national gas or petroleum company.
 - Act in an official capacity for, or on behalf of, a foreign government — even if not employed by the government (e.g., a government consultant).
 - Are elected officials.
 - › Supreme Court asked to clarify definition of “Foreign Official”
 - *Esquenazi v. United States* (11th Cir. 2014) - held that state-owned enterprises (“SOE”) can be “instrumentalities” of a foreign government. This means SOE employees can be “foreign officials” under the FCPA.
 - Petition for Certiorari filed August 14, 2014. Will the Supreme Court uphold this broadening of the FCPA statute?

FCPA Accounting Provision: Books & Records

- Requires all public companies to “make and keep books and records, and accounts which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer.” 15 U.S.C. § 78m.
 - › No “scienter” or bad intent requirement.
 - Even individuals who do not intend to violate the FCPA may be liable by failing to maintain proper books and records.
 - › No materiality threshold.
 - Even a relatively small accounting misstatement is improper and can give rise to liability.

FCPA Accounting Provision: Internal Controls

- **FCPA Internal Control Provision - 15 U.S.C. § 78m(b).**
 - › Requires public companies to “devise and maintain” an “adequate system of internal accounting controls.”
 - Must be able to provide reasonable assurance that it is correctly maintaining its accounting records.
 - Must maintain a reasonably detailed system to ensure transactions are made with proper authorization.
 - Must ensure that transactions are recorded properly and described accurately.
 - Must ensure that accounts are carefully monitored and any payments, especially by an employee or agent in a foreign country, are recorded in accordance with GAAP.

Major Corporate Settlements in Last 12 Months

- **Diebold** – settled for \$48.1 million w/ DOJ (DPA) and SEC on October 23, 2013.
 - › Government alleged that Diebold’s subsidiaries spent \$1.8 million on entertainment, travel, and improper gifts for government-owned bank officials in China and Indonesia.
 - › DOJ noted Diebold’s initiative in voluntary disclosure and starting internal investigation.
- **Weatherford International** – settled for \$152.7 million w/ DOJ (DPA) and SEC on November 26, 2013.
 - › Government alleged that Weatherford authorized bribes and improper travel and entertainment for foreign officials in the Middle East and Africa to win business.
 - › Weatherford cooperated and undertook substantial remediation: Established high-level compliance officer position, Significantly increased size of compliance department.
- **Bilfinger SE** – settled for \$32 million w/ DOJ (DPA) on December 11, 2013.
 - › DOJ alleged that Bilfinger bribed Nigerian officials to obtain and retain contracts related to the Eastern Gas Gathering System, which was valued at approximately \$387 million.
- **Archer-Daniels-Midland Company (“ADM”)** – settled for \$42.8 million w/ DOJ (NPA) and SEC on December 20, 2013.
 - › ADM’s subsidiaries were charged with bribing Ukrainian government officials to release outstanding amounts of Value Added Tax refunds owed to ADM’s Ukraine affiliate.

Major Corporate Settlements in Last 12 Months

■ Alcoa Inc.

- › \$398 million settlement on January 9, 2014.
 - DOJ (plea) = \$223 million; SEC = \$175 million
- › Government alleged that Alcoa's Australian subsidiary retained a consultant to assist in negotiating a long-term aluminum supply agreements with foreign officials in Alba and Bahraini. This consultant paid bribes to the foreign officials.
- › SEC noted that Alcoa took extensive remedial measures – Comprehensive compliance review of anti-corruption policies and procedures, including its relationship with intermediaries; enhancing internal controls and FCPA compliance procedures; conducting comprehensive anti-corruption training throughout organization.

■ Marubeni Corporation

- Settled for \$88 million with DOJ (plea) on March 19, 2014.
- DOJ alleged that Marubeni used intermediaries to pay bribes to Indonesian officials to secure a \$118 million power contract.
- Plea noted that DOJ increased fine due to several factors, including failure to voluntarily disclose conduct, cooperate, and remediate; as well as repeat violations.

Major Corporate Settlements in Last 12 Months

■ Avon

- › \$135 million settlement on May 1, 2014.
 - DOJ (DPA) = \$68 million; SEC = \$67 million
- › Avon charged with bribing Chinese officials via 2005 internal audit report.
- › Avon's \$12 million settlement offer was rejected by DOJ/SEC last August.
- › Chinese Avon subsidiary will plead guilty to violating books/records provision of FCPA.

■ Smith & Wesson

- \$107.9 million settlement with SEC on July 28, 2014.
- SEC alleged that Smith & Wesson made improper payments and provided gifts to foreign officials Pakistan, Indonesia, Turkey, Nepal, and Bangladesh in an attempt to win contracts to sell firearm products to foreign military and law enforcement departments.
- SEC noted Smith & Wesson's cooperation and prompt remediation efforts in negotiating the settlement.

Major Corporate Settlements in Last 12 Months

■ Hewlett Packard

- \$105.8 million settlement on April 9, 2014.
 - DOJ: HP Russia (plea) = \$58.8 million
 - DOJ: HP Poland (DPA) = \$15.5 million
 - DOJ: HP Mexico (NPA) = \$2.5 million
 - SEC = \$29 million
- Government alleged HP's subsidiaries in Russia, Poland, and Mexico made improper payments to foreign officials. HP's parent company was not charged.
 - HP tested the limits of what is "improper" – Providing HP products in the context of an IT contract does not necessarily violate the FCPA, but HP Poland gave computers, printers, iPods, TVs, cameras, etc., which was excessive conduct.
 - Despite having anti-corruption policies in place, HP failed to detect its problems and its internal controls were easily evaded.
- Government did note that HP cooperated with the investigation and took significant remedial measures.

Prosecuting Individuals in 2014 and Beyond

- PetroTiger Prosecutions:
 - › January 6, 2014 – DOJ charged PetroTiger's co-CEOs and General Counsel, with making improper payments to an official of a Colombian state-owned petroleum company to secure a \$40 million oil services contract for PetroTiger.
 - › Hammarskjold and Weisman pled guilty. Sigelman's trial set for January 2015.
- Group DF Prosecutions - April 2, 2014, DOJ unsealed grand jury indictment:
 - › Five defendants were charged with paying \$18.5 million in bribes to Indian officials to obtain titanium mining rights in Andhra Pradesh State.
 - › This prosecution showcases U.S. jurisdictional reach over foreign conduct by almost all foreign nationals. Only U.S. connection is bribes paid via U.S. bank accounts.
- Direct Access Partners ("DAP") Prosecutions:
 - › DAP's former CEO and MP charged with bribing official of Venezuelan state-owned bank in exchange for bringing the bank's business to DAP.
 - › China and DeMeneses scheduled for trial in February 2015.
- Alstom SA Prosecutions (Connected to Marubeni's Plea):
 - › Four Alstom executives charged with paying bribes to Indonesian officials to win \$118 million power project. Two defendants pled guilty. Pomponi's trial is set for November 2014. Hoskin's trial is set for June 2015.

Outlook for Remainder of 2014 and Beyond

- The DOJ and SEC are currently investigating dozens of companies (and individual actors) for FCPA violations.
 - › FedEx – In June 2014, FedEx confirmed that it self-reported to DOJ/SEC about allegations that its Kenya operation paid bribes to government officials. Status of investigation still pending.
 - › GlaxoSmithKline – U.S. authorities have been investigating potential FCPA violations in GSK's healthcare operations in China and Syria. Operations in Poland, Iraq, Jordan, and Lebanon are being investigated as well.
- Focus on Prosecuting *Individuals* in 2014 and beyond:
 - › “Certainly . . . There has been an increased emphasis on, let's get some individuals.”
- Leslie Caldwell, Chief of DOJ Criminal Division, September 12, 2014.
 - › “I want to dispel any notion that the SEC does not charge individuals often enough or that we settle with entities in lieu of charging individuals. The simple fact is that the SEC charges individuals in most of our cases, which is as it should be.”
- Mary Jo White, SEC Chairwoman, May 19, 2014.

Recent Developments in California (Non-FCPA)

- ***United States v. Federal Express*** (N.D. Cal. 2014)
 - › On August 14, 2014, USAO filed superseding indictment charging FedEx with:
 - Conspiracy to Distribute Controlled Substances
 - Distribution of Controlled Substances
 - Conspiracy to Distribute Misbranded Drugs
 - Conspiracy to Launder Money
 - › USAO alleged that, beginning in 2004, FedEx trafficked controlled substances and misbranded prescription drugs for illegal “Internet pharmacies” in violation of the CSA, FDCA, and numerous state laws.
 - › USAO alleged that FedEx employees actively conspired with the Chhabra-Smoley Organization and Superior Drugs (illegal online pharmacies) to sell and deliver drugs to dealers and addicts, knowing that these pharmacies were closed down by federal and state law enforcement agencies.
 - › USAO alleged that deliveries were made in parking lots, schools, and vacant homes. After FedEx's SVP of Security learned of these illegal deliveries, rather than shutting down the operation, approved a procedure where packages from problematic shippers were held for pick up at specific stations.
 - › Pre-trial motions hearing currently scheduled for February 2015.

Key Components of an Effective FCPA Compliance Program

- “Tone at the Top” most important factor cited by DOJ/SEC.
- Company’s Code of Ethics memorializes the Company’s zero tolerance policy regarding violations of the FCPA.
- Imposes obligations to report actual or suspected FCPA obligations.
- Mandates participation in FCPA training.
- Provides a mechanism for due diligence as to third party agents.
- Establishes a process for internal review of FCPA compliance.

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**Environmental Scan
Evolving Trends
Integrated Risk Management**

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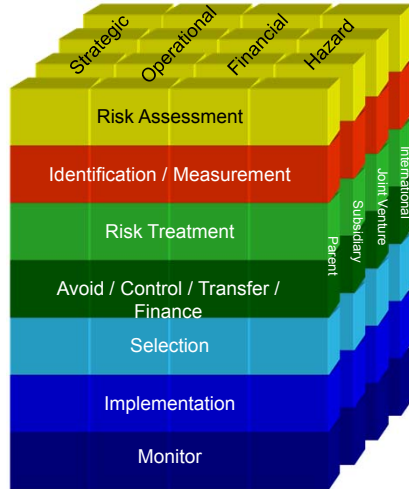
Domestic & International Environmental Scan...
Continuing Challenges / Evolving Risks: D&O Market Reactions:
Loss Ratios: **High**. Result: **Increased Scrutiny; Premiums; and Retentions**

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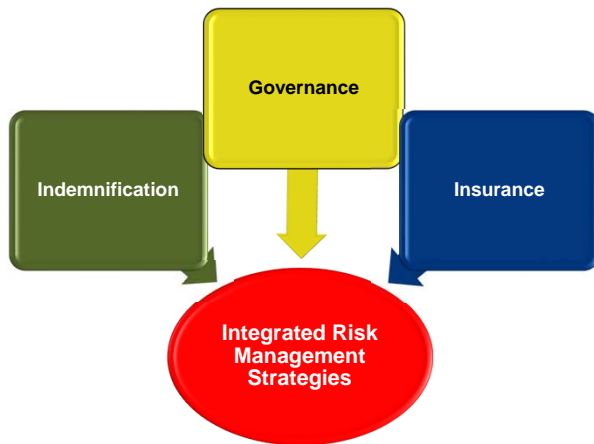
Enterprise Risk Management

Foundational Platform For Today's Complex Environment



- **Strategic**
 - Competition, Social, Capital Availability, Merger, Acquisition
- **Operational**
 - Cyber, Product Failure, Regulatory, Compliance, Internal Controls, Integrity, Reputational
- **Financial**
 - Pricing Risk, Asset Risk, Currency Risk, Liquidity Risk, Credit Risk, Investment Management Risk
- **Hazard**
 - Property Damage, Income, Liability, Personnel

Integrating Risk Management Strategies



CORE BENEFITS

- **Reduced Risk Profile**
- **Reduced Cost of Risk**
- **Enhanced Personal and Organizational Asset Protection**

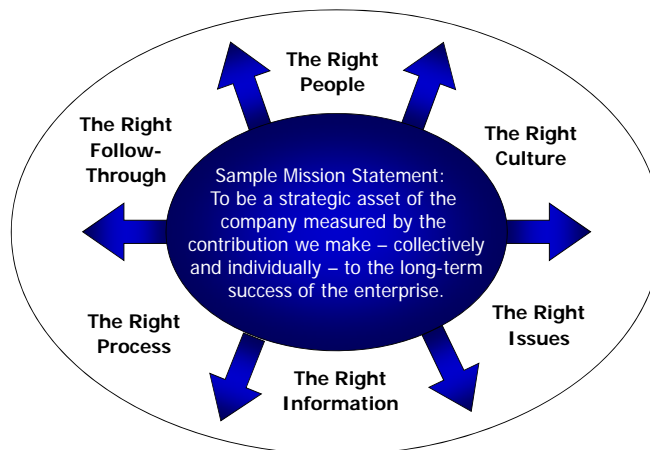
Governance Risk Management

Management & Professional Liability

Board Dynamics...

Structure Versus Execution...Substantial Source of D&O Claims
More Than Guidelines, Charters & Checklists ...

These High-Performance Characteristics...



...Foster Superior Shareholder Value & Risk Mitigation

How Effective Are We?

- **Sample Core Areas of Board Governance**
 - Structure & Composition
 - Director & CEO Compensation
 - Strategic Planning
 - Processes & Procedures
 - Interaction
 - Information
 - Committees
 - Roles & Responsibilities
 - Accountability Methods
 - Risk Oversight; Organizational Compliance Efficacy
 - Code of Conduct & Ethics

How Engaged Should We Be?

LEAST INVOLVED  MOST INVOLVED

The Passive Board

- Functions at the discretion of the CEO.
- Limits its activities and participation
- Limits its accountability
- Ratifies management's preferences

The Certifying Board

- Certifies to shareholders that the CEO is doing what the board expects and that management will take corrective action when needed.
- Emphasizes the need for independent directors and meets without the CEO.
- Stays informed about current performance and designates external board members to evaluate the CEO.
- Establishes an orderly succession process.
- Is willing to change management to be credible to shareholders.

The Engaged Board

- Provides insight, advice, and support to the CEO and management team.
- Recognizes its ultimate responsibility to oversee CEO and company performance; guides *and* judges the CEO.
- Conducts useful, two-way discussions about key decisions facing the company.
- Seeks out sufficient industry and financial expertise to add value to decisions.
- Takes time to define the roles and behaviors required by the board and the boundaries of CEO and board responsibilities.

The Intervening Board

- Becomes intensely involved in decision making around key issues.
- Convenes frequent, intense meetings, often on short notice.

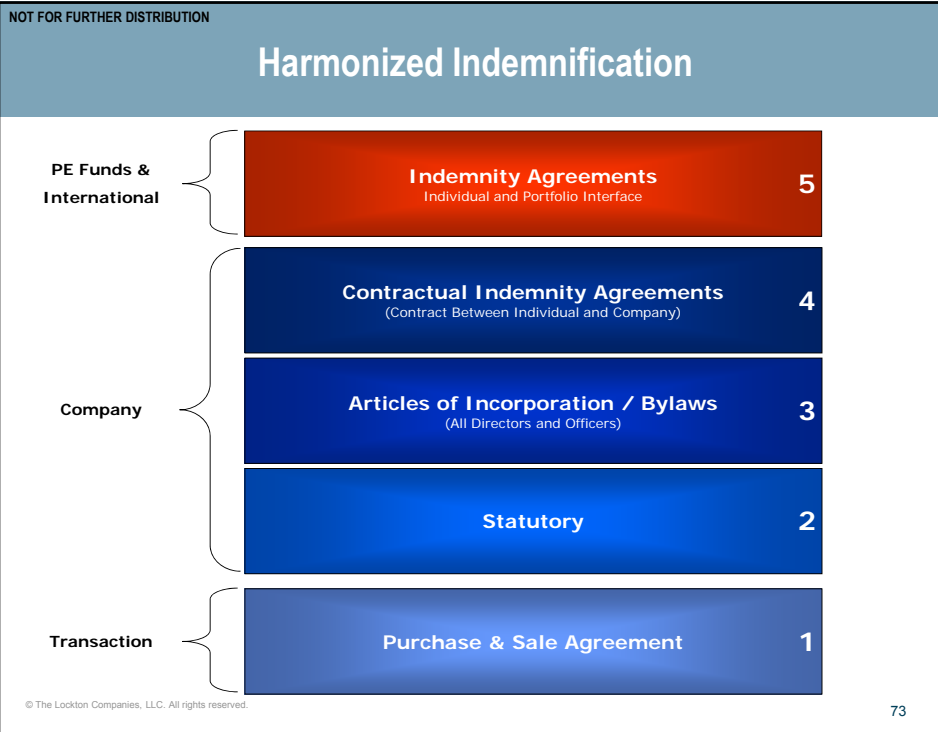
The Operating Board

- Makes key decisions that management then implements.
- Fills gaps in management experience.

Individual Contractual Indemnity A Critical Tool

Indemnification...Generally

- 3 **Contractual Indemnity Agreements**
(Contract Between Individual and Company)
- 2 **Articles of Incorporation/Association/Bylaws**
(All Directors and Officers)
- 1 **Statutory**



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International Indemnity Topics

A Partial Sampling

- ❖ Individual contractual agreements (U.S. and international) expand and clarify the nature and scope of indemnification.
- ❖ Enhanced indemnification will create more financial risk for funding organization.
- ❖ Enhanced indemnification is consistent with original intent of indemnification to encourage good faith risk-taking on the part of directors and officers.

- ❖ Mandate indemnification
- ❖ Not prohibit indemnification for gross negligence, recklessness, etc. (standards of conduct)
- ❖ Mandate advancement of defense expenses "on demand"
- ❖ Terms to discourage wrongful refusals to indemnify; enhance enforcement rights
- ❖ Create individual contractual rights that cannot be unilaterally amended, or misinterpreted by successor organizations
- ❖ Expand expense definition to include federal, state, local, or foreign taxes based upon actual or deemed receipt of indemnity payments or advancements
- ❖ Specify outside directorships
- ❖ Provide right and prosecution costs to enforce rights
- ❖ Accelerate determination process
- ❖ Clarify lack of action to be deemed favorable determination
- ❖ Provide appropriate severability provisions
- ❖ Burden of proof on corporation to overcome indemnity presumptions; order or plea not determinative of good faith conduct
- ❖ Provide litigation appeal rights
- ❖ Strengthen binding effect provisions in change of control situations

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D&O Liability Insurance Overview

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D&O Liability Insurance Coverage Part Overview Including Enhanced Personal Asset Protection (DIC)

Important Note: Terms, conditions, limitations, exclusions, and exceptions apply.

Enhanced Personal Asset Protection

- Dedicated limits personal asset protection which cannot be impaired by corporate liabilities.
- Non-rescindable under any circumstance.
- Drop Down Provision (When Underlying Insurance or Indemnification Fails.)
- Broader Coverage (Insuring Agreements / Definitions)
- One Conduct Exclusion for Officers (Adjudicated Personal Conduct with Defense Cost Carve Back)

Enhanced Personal Asset Protection (DIC)

Coverage A
Excess & Difference-In-Conditions (DIC) Policy
\$50MM Aggregate Limit

Coverage A
Personal Asset Protection For Non-Indemnifiable Claims

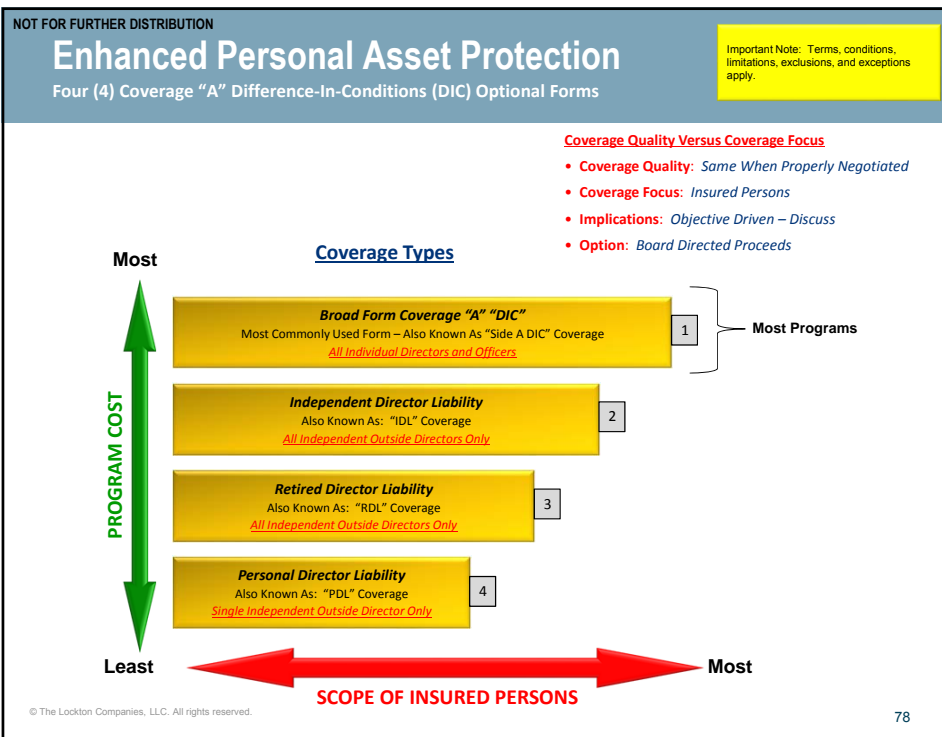
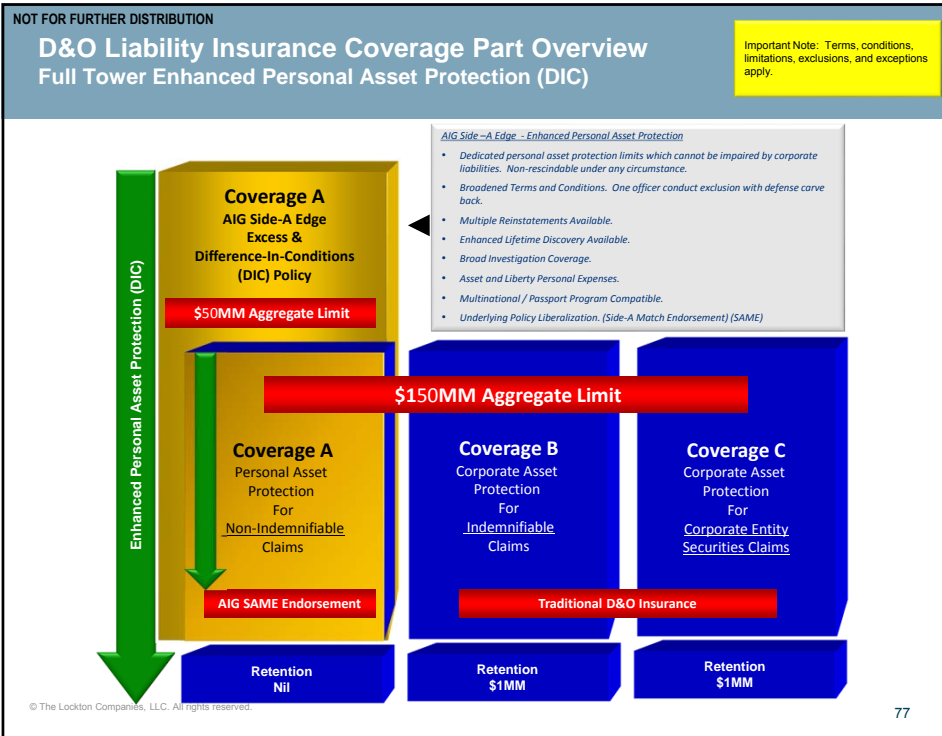
Coverage B
Corporate Asset Protection For Indemnifiable Claims

Coverage C
Corporate Asset Protection For Corporate Entity Securities Claims

Traditional D&O Insurance

Retention Nil Retention \$1MM Retention \$1MM

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Basic Insuring Agreement Preambles

A Partial Sampling

Important Note: Terms, conditions, limitations, exclusions, and exceptions apply.

■ Coverage A / Non-Indemnifiable Loss

- › Policy shall pay the **Loss** of any **Insured Person** that no Organization has indemnified or paid arising from a **Claim** against an Insured Person for any **Wrongful Acts** of such Insured Person.
- › Applies to Pre-Claim Inquiry without Wrongful Act requirement.

■ Coverage B / Indemnifiable Loss

- › Policy shall pay the **Loss** of an **Organization** arising from a **Claim** made against an Insured Person for any **Wrongful Act** of such Insured Person, but, only to extent Organization has indemnified such Loss.
- › Applies to Pre-Claim Inquiry without Wrongful Act requirement.

■ Coverage C / Organization

- › Policy shall pay the **Loss** of any **Organization** arising from a **Securities Claim** made against such an Organization for **Wrongful Acts** of such Organization. (Derivative demand investigation [sublimit] and derivative dismissals included)

Basic Definitions

A Partial Sampling

Important Note: Terms, conditions, limitations, exclusions, and exceptions apply.

■ Loss

- › Damages; settlements; judgments; Defense Expenses; Crisis Loss; Derivative Investigation Cost (sublimit); Liberty Protection Costs; Pre-Claim Inquiry Costs; and others.

■ Insured Persons & Entities (Organizations)

- › Entities (Organizations): named entity and each subsidiary (>50% control).
- › Persons: executives –past, present, future duly elected or appointed director, officer, trustee, governor, management committee member of JV, management board of LLC; foreign equivalents including supervisory boards; shadow directors; general counsel; risk managers; employees (co-defendant basis); and others.

■ Claim & Securities Claim

- › See following slides

■ Wrongful Act

- › Breach of duty; neglect; error; misstatement; misleading statement; omission; or act; employees on co-defendant basis; **Organization solely with respect to Securities Claims.**

Claim Definition

A Partial Sampling

Important Note: Terms, conditions, limitations, exclusions, and exceptions apply.

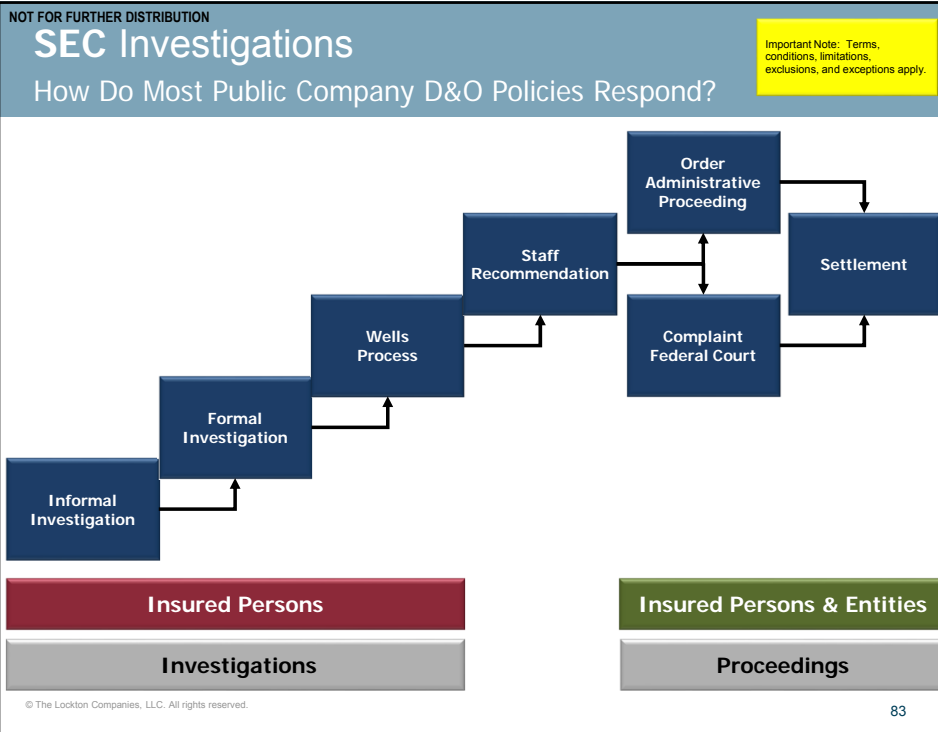
- **Written demand for monetary, non-monetary, or injunctive relief.**
- **Civil, criminal, administrative, regulatory or alternative dispute resolution proceeding against an Insured commenced by:**
 - Service of a complaint or similar pleading;
 - Return of an indictment, information, or similar document (criminal);
 - Receipt or filing of a notice of charges.
- **Civil, criminal, administrative, regulatory investigation of an Insured Person commenced by:**
 - Insured Person identified in writing by an Enforcement Body as a target;
 - Service of a subpoena (or foreign equivalent) against an Insured Person;
 - Target letters can include Wells Notices, whether or not labeled as such.

Securities Claim Definition

A Partial Sampling

Important Note: Terms, conditions, limitations, exclusions, and exceptions apply.

- **Securities Claim, other than an administrative or regulatory “proceeding” against, or “investigation” of an Organization, made against any Insured**
- **Alleging violation of any law, rule, or regulation, whether statutory or common law (including, but, not limited to the purchase or sale or offer or solicitation of an offer to purchase or sell securities).**
- **Which is brought by...**
 - › Any person or entity alleging, arising out of, based upon or attributable to the purchase or sale or offer to purchase or sell any securities of an Organization; or
 - › Any security holder or purchaser or seller of securities of an Organization with respect to such security holder’s, purchaser’s, or seller’s interest in securities of such Organization; or
 - › Derivative Suit.
- **Administrative or Regulatory Proceeding –Organization**
 - › Securities Claim definition does include administrative or regulatory proceeding coverage against the Organization provided that such proceeding is commenced and continuously maintained against Insured Persons.



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Entity Investigation Option Sample

Important Note: Terms, conditions, limitations, exclusions, and exceptions apply.

- **Response Coverage (Separate Program / Not Liability Insurance)**
 - Limits Available: \$1MM to \$50MM
 - Estimated Costs: \$40K to \$60K Per Million of Limits (Expensive)
 - **Part 1:**
 - *Securities Violations By Enforcement Body.*
 - Wrongful Act Not Required to Begin or Sustain Investigation Response Cover.
 - **Part 2:**
 - *Internal Investigations / Derivative Investigations* (With or Without a Securities Claim).
 - Wrongful Act or Enforcement Body Involvement Not Required to Begin or Sustain Investigation Response Cover.
 - **Part 3:**
 - *FCPA, or Foreign Equivalent, Investigations* (With or Without a Securities Claim)
 - Wrongful Act or Enforcement Body Involvement Not Required to Begin or Sustain Investigation Response Cover.

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Entity Investigation Option Sample

Important Note: Terms, conditions, limitations, exclusions, and exceptions apply.

- **Liability Coverage (Part of D&O Liability Insurance Contract)**
 - Limits Available: Same as Underlying Primary and Excess "ABC" Insurance Programs.
 - Estimated Costs: 25% to 40% (of Underlying Insurance Premiums) Additional Premium (AP). (Relatively Expensive)
 - Limited Coverage:
 - **Only Available Concurrently with a Securities Claim Against Insured Persons.**
 - **Not Available for Investigations of Insured Entity that Pre-Date Securities Claims.**
 - **Not Available for Any Form of Informal or Internal Investigation of Insured Entity.**
 - **Only for Formal Investigations. Wrongful Act Requirement.**

Directors & Officers Liability - New

Halliburton – U.S. Supreme Court Decision June 23, 2014

Important Note: Terms, conditions, limitations, exclusions, and exceptions apply.

- **Class Certification Event Study Endorsement**
 - Limits Available: Policy Aggregate
 - Estimated Costs: No Additional Premium
 - Retention: None

Class Certification Event Study Expenses means the reasonable and necessary fees, costs and expenses of an expert witness consented to by the Insurer, which consent shall not be unreasonably withheld, incurred by an Insured to conduct an admissible event study regarding any issues of fact relevant to the court's decision as to whether to grant class certification in a Securities Claim.

If the Panel Counsel firm defending a Securities Claim recommends to the Insured a specific expert witness to conduct an event study in the defense of such Securities Claim, then the Insured may hire such expert witness to perform such event study without further approval by the Insurer.

Other Claim & Coverage Types

A Partial Sampling

Important Note: Terms, conditions, limitations, exclusions, and exceptions apply.

- **Pre-Claim Inquiry** (*Insured Persons*)
 - › Verifiable request to appear at a meeting or interview; or produce documents;
 - › But, only at request of Enforcement Body or Organization; and
 - › As respects Organization, only as part of Enforcement Body investigation; or
 - › An Organization's Derivative Demand Investigation.
 - › **No Wrongful Act requirement.**
 - › Does not include routine or regularly scheduled regulatory actions.
- **Extradition** (*Insured Persons*)
- **Liberty Protection** (*Insured Persons – Foreign*)
- **Personal Reputation** (*Insured Persons*)
- **Employed Lawyers Professional** (*Insured Persons*)
- **Whistleblower Actions** (*Insured Persons and Entities*)
- **SOX 304 and Dodd-Frank 954 Expenses** (*No Actual Clawback*)
- **FCPA & UK Bribery Act** (*No Fines and Penalties – Insured Persons and Entities*)
- **Foreign Liberalization** (*Insured Persons & Entities*)
- **Selling and/or Controlling Shareholders** (*Insured Persons*)

Common Policy Exclusions

A Partial Sampling (*Within Exclusions or Definitions*)

Important Note: Terms, conditions, limitations, exclusions, and exceptions apply.

- **Personal Conduct**
 - › Illegal personal profit, advantage, or remuneration;
 - › Deliberate fraud, or deliberate criminal acts by the Insured;
 - › Subject to a final, non-appealable, adjudication.
- **Prior or Pending Litigation**
- **Personal Injury** (*Securities Claim Carveback*)
- **Bodily Injury or Property Damage**
- **Entity versus Insured** (*With Carvebacks*)
- **ERISA** (*Company Benefit Plans Only*)
- **Compensation and Labor Liability**
- **Taxes, Fines, and Penalties** (*except punitives, multiplied, or exemplary where permitted by law*)
- **Matters Deemed Uninsurable Pursuant to Law**
- **Inadequate Price Paid or Consideration in M&A**

International D&O and E&O Notes...

➤ Top 10 Countries With Mature D&O Liability Systems / Laws

1. Australia
2. Canada
3. England
4. France
5. Germany
6. Hong Kong
7. Italy
8. Japan
9. Korea
10. The Netherlands

➤ Up & Coming Jurisdictions – Economically More Powerful Than Most of the Top 10

- ✓ **Brazil**
- ✓ **China**
- ✓ **India**

☐ Summary Notes

- Public & private company D&O litigation trending upward.
- Mature D&O liability systems (Top 10) all include specific laws focused on right of civil and criminal remedies for class or mass tort actions.
- Heightened awareness of individual culpability within corporate settings, especially amongst regulators.
- Aggrieved overseas investors seek litigation alternatives outside of the U.S.
- Anti-Corruption/Anti-Bribery Laws: FCPA; UK Bribery Act; OECD based; United Nations conventions far reaching.
- Enforcement and follow-on civil actions increasing significantly and now converging with domestic enforcement actions in Asia.

International D&O and E&O Considerations

➤ International litigation increasing.

➤ Many countries have reconsidered (or are reconsidering) D&O insurance and indemnity.

➤ Host Country Considerations:

1. Non-admitted insurances permitted or specifically prohibited?
2. If non-admitted form permitted, does host country form provide specific benefit?
3. Organizational indemnification of individual directors, officers, principals, et al, permitted?

4. Organizational indemnity payments permitted from one country to another?

5. Insurance proceeds repatriated from one country to another?

6. Civil or criminal penalties for such repatriations?

7. Tax implications associated with premium, claim, or indemnity payments?

8. Subsidiary or JV boards?

9. Board member insurance / indemnity expectations?