

Contents

Preface	xxv
Introduction	1
A. What are Governance, Risk Management, and Compliance?	1
B. The Role of Attorneys	5
C. Subject Areas	7
Part I Governance	9
OECD Principles of Corporate Governance	10
Douglas M. Branson, Proposals for Corporate Governance Reform: Six Decades of Ineptitude and Counting	11
Basel Committee on Banking Supervision Consultative Document—Core Principles for Effective Banking Supervision	12
Chapter 1	
Shareholders	15
A. Pros and Cons of Shareholder Power	15
Lucian Bebchuk, The Case for Increasing Shareholder Power	19
Stephen M. Bainbridge, The Case for Limited Shareholder Voting Rights	20
B. Shareholder Proposals	21
SEC Rule 14a-8	21
C. Say on Pay	25
D. Investor Activists	28
E. Proxy Advisers	29
Chapter 2	
The Board of Directors	31
A. The Full Board	31
1. Powers	31
2. Size	33
3. Tenure in Office	35
Sally Beauty Holdings, Inc. 2013 Proxy Statement	36
4. Qualifications	41
a. Independence	42
NYSE Listed Company Manual §303A.02	46
b. Skills	48
c. Diversity	51

5. Fiduciary Duties	52
a. The Duty of Care	54
<i>In re Citigroup Inc. Shareholder Derivative Litigation</i>	54
b. The Duty of Loyalty	57
<i>In re Southern Peru Copper Corp. Shareholder Derivative Litigation</i>	58
c. Caremark and the Duty of Oversight	59
<i>In re Caremark International Inc. Derivative Litigation</i>	60
<i>Stone v. Ritter</i>	66
<i>Rich ex rel. Fuqi Int'l, Inc. v. Yu Kwai Chong</i>	68
<i>In re Pfizer Inc. Shareholder Derivative Litigation</i>	71
B. Chairmen	77
Hess Corporation 2013 Proxy Statement	77
C. Lead Directors	81
Carlson Corporation Charter of the Lead Independent Director	81
D. Audit Committees	83
E. Risk Committees	85
Greenbrier Corporation Risk Committee Charter	88
F. Compliance Committees	94
Applied Bosonics Compliance Committee Charter	94
G. Governance and Nominating Committees	98
NYSE Listed Company Manual, ¶ 303A.04:	
Nominating/Corporate Governance Committee	98
<i>Klaassen v. Allegro Development Corporation</i>	102
H. Compensation Committees	106
1. General Considerations	107
2. Structure and Function	108
<i>In re The Walt Disney Company Derivative Litigation</i>	108
3. Consultants	114
4. The Role of Shareholders in Compensation	117
5. Compensation of Independent Directors	118

Chapter 3

Executives	121
A. Introduction	121
B. The Management Team	122
General Electric Company Annual Report to Shareholders, for the Fiscal Year Ended December 31, 2012	124
C. Chief Executive Officer	126
General Electric Company Annual Report to Shareholders, for the Fiscal Year Ended December 31, 2012	128
D. Chief Financial Officer	130
E. Chief Audit Executive	130
1. What Is Internal Audit?	130
2. How Does Internal Audit Work?	132
3. Best Practices	133
Board of Governors of the Federal Reserve System	
Federal Deposit Insurance Corporation	
Office of the Comptroller of the Currency	

Office of Thrift Supervision, Interagency Policy Statement on the Internal Audit Function and Its Outsourcing	134
Board of Governors of the Federal Reserve System, Supplemental Policy Statement on the Internal Audit Function and Its Outsourcing	137
4. Vendors	141
Board of Governors of the Federal Reserve System, Interagency Policy Statement on the Internal Audit Function and Its Outsourcing	142
Board of Governors of the Federal Reserve System, Supplemental Policy Statement on the Internal Audit Function and Its Outsourcing	145
F. Chief Compliance Officer	147
Chief Compliance Officer	147
G. General Counsel	148
H. The Chief Risk Officer	151
I. Director of Human Resources	153

Part II Compliance 155

Chapter 4 Introduction to Compliance 157

A. What Is Compliance?	157
B. Landmarks in the History of Compliance	158
C. The Rise of the Administrative State	160
1. Increases in the Scope and Complexity of Regulation	161
2. From Judging to Administration	161
a. The Power to Establish Norms of Conduct	161
SEC v. Chenery Corp.	161
National Cable & Telecommunications Association v. Brand X Internet Services	164
City of Arlington v. F.C.C.	166
b. The Power to Determine Legal Rights	171
Crowell v. Benson	171
Atlas Roofing Co., Inc. v. Occupational Safety and Health Review Commission	175
Gray Financial Group, Inc. v. SEC	176
Camp v. Pitts	179
Ex parte Young	182
Sackett v. Environmental Protection Agency	184
3. Enforcement Powers	188
a. Power to Obtain Information	188
Donovan v. Dewey	189
b. The Power to Impose Penalties	191
D. The Compliance Response	195
E. The Compliance Industry	196

Chapter 5	
Internal Enforcement	197
A. Introduction	197
B. Compliance Policies	197
C. Compliance Programs	201
Zambac Co. Compliance Program	201
D. Hiring	205
1. Background Investigations	205
2. Use of Information	206
a. Arrests and Convictions	206
Equal Employment Opportunity Commission, EEOC Files	
Suit Against Two Employers for Use of Criminal	
Background Checks	207
b. Credit History	209
E. Training	210
F. Monitoring	211
1. Drug and Alcohol Testing	211
Texas Workforce Commission, Model Drug-Free Workplace	
Policy	212
2. Surveillance	214
G. Investigations	215
1. Types of Investigations	215
Miriam Hechler Baer, Corporate Policing and Corporate	
Governance: What Can We Learn from Hewlett-Packard's	
Pretexting Scandal?	218
2. Comparison of Internal Investigations and Government	
Investigations	220
3. The Role of Counsel	223
4. Disclosure	224
5. Enforcement Credit	225
Assistant Attorney General Leslie R. Caldwell	
Remarks at the Compliance Week Conference	225
 Chapter 6	
Regulators	229
A. Individual or Corporate Liability?	229
Individual Accountability for Corporate Wrongdoing, Deputy	
Attorney General Sally Quillian Yates	230
B. Regulation of the Compliance Program	235
1. General Considerations	235
2. "Best Practice" Recommendations	237
Remarks by Assistant Attorney General for the Criminal	
Division Leslie R. Caldwell	237
3. Legislative and Regulatory Mandates	239
Bank Secrecy Act	240

Securities and Exchange Commission Final Rule: Compliance Programs of Investment Companies and Investment Advisers	241
4. Compliance Terms in Settlements	247
<i>Consent Order, In the Matter of: RBS Citizens, N.A.</i>	247
<i>Consent Order, In the Matter of: HSBC Bank USA, N.A.</i>	248
<i>United States v. International Brotherhood of Teamsters, Chauffeurs, Warehousemen and Helpers of America, AFL-CIO</i>	252
C. Regulation of Compliance Officers	258
1. Requirements to Establish and Empower Compliance Officers	258
Securities and Exchange Commission Final Rule: Compliance Programs of Investment Companies and Investment Advisers	258
2. Obligations to Compliance Officers	261
Securities and Exchange Commission, <i>In the Matter of Carl D. Johns</i>	261
3. Liability of Compliance Officers	263
<i>In the Matter of Judy K. Wolf</i>	264
Statement of Commissioner Daniel M. Gallagher on Recent SEC Settlements Charging Chief Compliance Officers with Violations of Investment Advisers Act Rule 206(4)-7	271
<i>In the Matter of Theodore W. Urban</i>	273
D. Oversight Liability	277
SEC, <i>In the Matter of Steven A. Cohen</i>	277
<i>United States v. S.A.C. Capital Advisors, LLP</i>	279
E. Mitigation of Penalties	280
EPA, Incentives for Self-Policing: Discovery, Disclosure, Correction, and Prevention of Violations	280
SEC, Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions	285
F. Advice	289
G. Admissions	291
SEC's Memorandum of Law in Response to Questions Posed by the Court Regarding Proposed Settlement	291
<i>SEC v. Citigroup Global Markets, Inc.</i>	295
<i>SEC v. Citicorp Global Markets, Inc.</i>	298

Chapter 7

Prosecutors 305

A. The Problem of Corporate Criminal Liability	305
Samuel W. Buell, The Blaming Function of Entity Criminal Liability	306
B. The Decision to Prosecute	309
United States Attorneys Manual, Principles of Federal Prosecution of Business Organizations	310
C. Plea Bargains, Deferred Prosecution Agreements, and Non-Prosecution Agreements	319

1. Plea Bargains	320
United States Attorneys Manual, Principles of Federal Prosecution of Business Organizations	320
2. Deferred Prosecution and Non-Prosecution Agreements	322
a. Nature and Rationale	322
United States Attorneys Manual, Principles of Federal Prosecution of Business Organizations	322
b. Contents	323
<i>Deferred Prosecution Agreement, United States of America v.</i> <i>Aibel Group Limited</i>	323
c. Judicial Review	328
<i>United States v. Fokker Services B.V.</i>	328
D. Sentencing	335
Federal Sentencing Guidelines, §8B2.1 Effective Compliance and Ethics Program	335

Chapter 8

Whistleblowers

A. Whistleblowers	339
1. Who Is a Whistleblower?	339
Testimony of Sherron Watkins Before the Oversight and Investigations Subcommittee of the House Energy and Commerce Committee	340
2. Encouraging Whistleblowing	343
a. Tone at the Top	344
b. Protections for Whistleblowers	345
<i>Lawson v. FMR LLC</i>	345
c. Rewards and Bounties	352
d. Mandatory Reporting	355
3. Whistleblower Policies	356
OVb Inc. Whistleblower Policy	356
4. Responding to the Whistleblower	359
Report of Investigation by the Special Investigative Committee of the Board of Directors of Enron Corp.	359
B. <i>Qui Tam</i> Actions	363
<i>Darity v. C.R. Bard Inc.</i>	365
Department of Justice, Office of Public Affairs, C.R. Bard Inc. to Pay U.S. \$48.26 Million to Resolve False Claims Act Claims	367

Chapter 9

Gatekeepers

A. Introduction	371
<i>Lincoln Savings & Loan Ass'n v. Wall</i>	373
B. Attorneys	374
1. Zealous Advocates or Public Servants?	375

a. Lord Brougham, Dean Pound, and the Rules of Professional Conduct	375
b. The Kaye Scholer Affair	378
Harris Weinstein, Attorney Liability in the Savings and Loan Crisis	379
c. Lauren Stevens	385
<i>United States v. Stevens</i>	385
d. Cahill Gordon	389
<i>Williams v. BASF Catalysts LLC</i>	389
2. Organization Clients	394
a. Who Is the Client?	394
ABA, Model Rule of Professional Conduct 1.13, Organization as Client	395
b. Relations with Employees	396
United States Attorneys Manual, Principles of Federal Prosecution of Business Organizations	398
3. Confidentiality	399
a. Scope of the Lawyer's Duty of Confidentiality	399
ABA, Model Rule of Professional Conduct 1.6(b), Confidentiality of Information	400
b. Special Confidentiality Rules for Organization Clients	402
ABA, Model Rule of Professional Conduct 1.13, Organization as Client	402
4. Attorney-Client Privilege	404
a. Scope	404
<i>Upjohn Co. v. United States</i>	404
<i>In re Kellogg Brown & Root, Inc.</i>	409
b. The Crime-Fraud Exception	413
c. The Fiduciary Exception	413
<i>Garner v. Wolfenbarger</i>	414
5. Work-Product Protection	416
<i>Hickman v. Taylor</i>	416
6. Waiver of Privilege	422
United States Attorneys Manual, Principles of Federal Prosecution of Business Organizations	422
United States Attorneys Manual, Principles of Federal Prosecution of Business Organizations	424
7. Reliance on Counsel	425
C. Accountants	426
D. Auditors	427
1. Introduction	427
PCAOB, Proposed Auditing Standards—The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion	428
<i>Indictment, United States of America Against Arthur Andersen, LLP</i>	430
2. Independence Requirements	434
3. Attestation of Internal Controls	435

4. PCAOB Enforcement Actions	438
<i>In the Matter of Ernst & Young LLP</i>	438
<i>In the Matter of PricewaterhouseCoopers LLP's Quality Control Remediation Submissions</i>	443
5. Compliance Audits	447
E. Monitors	448
<i>United States v. HSBC Bank USA, N.A. and HSBC Holdings PLC</i>	449
F. Consultants	455
<i>In re American Continental/Lincoln Savings & Loan Securities Litigation</i>	455
NYDFS, <i>In the Matter of Deloitte Financial Advisory Services LLP</i>	457
NYDFS Announces PricewaterhouseCoopers Regulatory Advisory Services Will Face 24-Month Consulting Suspension; Pay \$25 Million; Implement Reforms After Misconduct During Work at Bank of Tokyo Mitsubishi	462
G. Providers of Financial Services	465
<i>In re Rural Metro Corporation Stockholders Litigation</i>	465

Chapter 10

Plaintiffs' Attorneys

A. Shareholders Derivative Litigation	471
1. Procedural Hurdles	472
a. The Demand Requirement	472
<i>Grimes v. Donald</i>	472
b. Special Litigation Committees	475
<i>Zapata Corp. v. Maldonado</i>	475
<i>In re Oracle Corp. Derivative Litigation</i>	479
2. Compliance Remedies	482
<i>In re Johnson & Johnson Derivative Litigation</i>	482
B. Class Actions	485
<i>In re JPMorgan Chase & Co. Securities Litigation</i>	486
<i>Chevron Corporation v. Donziger</i>	490
<i>Chevron Corp. v. Donziger</i>	491

Chapter 11

Information Security

A. Introduction	495
Viator Email to Customers	501
B. Gramm-Leach-Bliley Act	503
Gramm-Leach-Bliley Act §501	503
Federal Financial Institution Examination Council, Interagency Guidelines Establishing Information Security Standards	505
Federal Financial Institution Examination Council, Interagency Guidance on Response Programs for Unauthorized Access to Customer Information and Customer Notice	511

C. HIPAA	514
Health and Human Services, 45 C.F.R. §164.306 Security Standards: General Rules	515
Resolution Agreement, U.S. Department of Health and Human Services and Wellpoint, Inc.	518
<i>Acosta v. Byrum</i>	520
D. FTC Act	522
<i>Federal Trade Commission v. Wyndham Worldwide Corporation</i>	522
<i>FTC, In the Matter of Dave & Buster's, Inc.</i>	524
E. Securities Law	527
1. Disclosure Requirements	527
SEC, Cybersecurity	527
2. Regulated Entities	532
<i>In the Matter of R.T. Jones Capital Equities Management, Inc.</i>	
<i>Securities and Exchange Commission Investment Advisers Act Release No. 4204</i>	532
F. Fiduciary Duties	535
G. Rules of Professional Responsibility	537
State Bar of Arizona Ethics Opinion 05-04	541
Note on Cloud Computing	544
Pennsylvania Bar Association Committee on Legal Ethics and Professional Responsibility	
Ethical Obligations for Attorneys Using Cloud Computing/Software as a Service While Fulfilling the Duties of Confidentiality and Preservation of Client Property	545

Chapter 12	
Off-Label Drugs	551

A. Background	551
U.S. Department of Justice Press Release, Pharmaceutical Company Eli Lilly to Pay Record \$1.415 Billion for Off-Label Drug Marketing: Criminal Penalty Is Largest Individual Corporate Criminal Fine	552
FDA, Guidance for Industry: Responding to Unsolicited Requests for Off-Label Information About Prescription Drugs and Medical Devices	554
FDA, Good Reprint Practices for the Distribution of Medical Journal Articles and Medical or Scientific Reference Publications on Unapproved New Uses of Approved Drugs and Approved or Cleared Medical Devices	555
<i>United States v. Caronia</i>	557
B. The Compliance Response	560
Corporate Integrity Agreement Between the Office of Inspector General of the Department of Health and Human Services and Cephalon, Inc.	561

Chapter 13	
Foreign Corrupt Practices	569
A. Basics	569
1. Elements of the Statute	569
2. What Is an “Instrumentality” of a Foreign Government?	576
<i>United States v. Esquenazi</i>	576
3. Consultants and Business Partners	579
<i>SEC, In the Matter of Alcoa, Inc.</i>	580
4. Successor Liability	585
DOJ Opinion Procedure Release No. 14-02	585
5. Problems	587
B. Elements of Effective FPCA Compliance	590
1. FCPA Compliance Programs	590
U.S. Department of Justice and SEC, A Resource Guide to the U.S. Foreign Corrupt Practices Act	591
2. FCPA Investigations	600
Avon Products, Inc., 2010 Form 10K	601
 Chapter 14	
Anti-Money Laundering, the Bank Secrecy Act, and OFAC	603
A. Anti-Money Laundering/Bank Secrecy	604
FinCEN Guidance on Preparing a Complete and Sufficient Suspicious Activity Report Narrative	605
FinCEN Guidance on Preparing a Complete and Sufficient Suspicious Activity Report Narrative	606
<i>United States v. Wachovia Bank</i>	608
Board of Governors of the Federal Reserve System, Written Agreement by and Among M&T Bank Corporation, Manufacturers & Traders Trust Company and Federal Reserve Bank of New York	612
B. Sanctions	615
<i>United States v. Barclay’s Bank</i>	615
Department of Justice Office of Public Affairs	621
BNP Paribas Agrees to Plead Guilty and to Pay \$8.9 Billion for Illegally Processing Financial Transactions for Countries Subject to U.S. Economic Sanctions	621
C. Attorneys	623
ABA Task Force on Gatekeeper Regulation and the Profession, Voluntary Good Practices Guidance for Lawyers to Detect and Combat Money Laundering and Terrorist Financing	624
ABA Standing Committee on Ethics and Professional Responsibility, Formal Opinion 463: Client Due Diligence, Money Laundering, and Terrorist Financing	627

Chapter 15

Sexual Harassment 631

- A. Introduction 631
 - Faragher v. City of Boca Raton* 632
- B. Sexual Harassment Programs 635
 - U.S. Equal Employment Opportunity Commission, Vicarious Employer Liability for Unlawful Harassment by Supervisors 635
- C. Enforcement 639
 - EEOC v. Carrols Corp.* 639

Chapter 16

Ethics, Social Responsibility, and Culture 645

- A. Charitable Gifts 645
 - A.P. Smith Mfg. Co. v. Barlow* 645
- B. Public Benefit Companies 650
- C. Codes of Ethics 651
 - Mike's Bagels, Code of Ethics and Professional Conduct 652
- D. Social Responsibility 653
- E. Human Rights 656
 - United Nations High Commissioner on Human Rights, Guiding Principles on Business and Human Rights 656
- F. Sustainability 662
 - Judd F. Sneirson, Green Is Good: Sustainability, Profitability, and a New Paradigm for Corporate Governance 663
 - Plexus Inc. Sustainability Policy 666

Chapter 17

When Compliance Fails 669

- A. Introduction 669
- B. Enron 669
 - Report of Investigation by the Special Investigative Committee of the Board of Directors of Enron Corp. 669
- C. WorldCom 674
 - Report of Investigation by the Special Investigative Committee of the Board of Directors of WorldCom, Inc. 674
- D. Sexual Abuse by Priests 682
 - Commonwealth of Pennsylvania
 - Office of the Attorney General
 - A Report of the Thirty-Seventh Statewide Investigating Grand Jury 684
 - Protecting Minors: Declaration by the Director of the Holy See Press Office on Response to Sexual Abuse 692

E. General Motors Ignition Switch Scandal	694
Written Testimony of General Motors Chief Executive Officer Mary Barra	
Before the House Committee on Energy and Commerce Subcommittee on Oversight and Investigations	694
GM Announces New Vehicle Safety Chief	
Jeff Boyer Named Vice President, Global Vehicle Safety	696
Statement of the Honorable David Friedman	
Acting Administrator, National Highway Traffic Safety Administration	
Before the Committee on Energy and Commerce Subcommittee on Oversight and Investigations	
U.S. House of Representatives	696
Anton R. Valukas	
Report to the Board of Directors of General Motors Company Regarding Ignition Switch Recalls	699

Part III Risk Management 707

Chapter 18

Introduction to Risk Management 709

A. What Is Risk?	709
B. What Is Risk Management?	710
C. The Public Interest in Risk Management	711
D. Enterprise Risk Management	713
1. Definition of Risk	713
2. Distribution of Responsibility for Managing Risk	713
3. Risk Mitigation Strategies	715
4. Priority of the Topic	715
5. Focus of Risk Assessment	715
6. Transparency of Risk and Risk Management	716
E. Types of Risk	717
F. Governance of Risk	721
1. Corporate Law Approaches	721
Wachtell, Lipton, Rosen & Katz, Risk Management and the Board of Directors	721
Unwritten Rules: The Importance of a Strong Risk Culture	
Thomas J. Curry, Comptroller of the Currency	723
2. Regulatory Approaches	725
G. Disclosure of Risk	729
Target Corporation 2012 Form 10-K Item 1A	731

Chapter 19	
Approaches to Risk Management	739
A. Data	739
B. Risk Appetite	745
C. Implementing the Risk Appetite	745
1. Compiling a Risk Inventory	745
2. Assessing Inherent Risk	746
3. Assessing Controls and Mitigation Options	747
4. Assessing Residual Risk	748
5. Accepting Residual Risk	749
D. Black Swans, Fat Tails, and Stress Tests	749
Kevin Dowd, Math Gone Mad: Regulatory Risk Modeling by the Federal Reserve	754
E. Drilling Down: Specific Risk-Management Strategies	755
1. Corporate Default Estimation Methods	755
2. Black-Scholes Option Pricing Formula	756
3. Value-at-Risk Models	757
F. Model Risk	758
Board of Governors of the Federal Reserve System, Supervisory Guidance on Model Risk Management	758
<i>In the Matter of: JPMorgan Chase Bank, N.A.</i>	762
G. Rating Agencies	765
H. Government Risk Assessment	766
I. Behavioral-Economic Approaches to Risk Management	768
Geoffrey Miller & Gerald Rosenfeld, Intellectual Hazard: How Conceptual Biases in Complex Organizations Contributed to the Crisis of 2008	769
 Chapter 20	
When Risk Management Fails	771
A. UBS and the Financial Crisis	771
Transparency Report to the Shareholders of UBS AG: Financial Market Crisis, Cross-Border Wealth Management Business, Liability Issues and Internal Reviews	771
B. The London Whale	773
Permanent Subcommittee on Investigations, United States Senate, JPMorgan Chase Whale Trades: A Case History of Derivatives Risks and Abuses	774
C. Benghazi	776
Report of the State Department Accountability Review Board	777

D. Royal Bank of Scotland	781
U.K. Financial Conduct Authority	
Final Notice to Royal Bank of Scotland Plc. et al.	781
<i>Table of Cases</i>	785
<i>Table of Authorities, Statutes, and Other Materials</i>	789
<i>Index</i>	801