



JACKSON LEWIS LLP
SPECIAL REPORT

**COMPLIANCE & ETHICS
REQUIREMENTS FOR
FEDERAL CONTRACTORS**

Presented By:

Jackson Lewis Corporate Governance Practice Group

TABLE OF CONTENTS

SECTION	TOPIC	PAGE #
I.	FIRM OVERVIEW	4
II.	THE CORPORATE GOVERNANCE PRACTICE GROUP	5
III.	INTRODUCTION TO THIS SPECIAL REPORT	7
IV.	REQUIREMENTS FOR A COMPLIANCE & ETHICS PROGRAM FOR FEDERAL CONTRACTORS	9
V.	OUR APPROACH TO DEVELOPMENT OF A COMPLIANCE & ETHICS PROGRAM	13
VI.	THE EVOLUTION OF ORGANIZATIONAL COMPLIANCE & ETHICS PRACTICES	16
	THE CORPORATE CORRUPTION AND SCANDALS OF THE 1970s AND 1980s	
	FOREIGN CORRUPT PRACTICES ACT	
	DEFENSE INDUSTRY INITIATIVE ON BUSINESS ETHICS AND CONDUCT	
	THE US SENTENCING GUIDELINES FOR ORGANIZATIONS	
	THE SARBANES-OXLEY ACT OF 2002	
	DEPARTMENT OF JUSTICE GUIDANCE	
	IMPLICATIONS FOR THE NOT-FOR-PROFIT INDUSTRY	
VII.	LOOKING FORWARD: INCREASED CORPORATE GOVERNANCE REQUIREMENTS ON THE HORIZON	25
	REQUIREMENTS IMPOSED VIA TROUBLED ASSET RELIEF PROGRAM	
	AMERICAN RECOVERY AND REINVESTMENT ACT OF 2009 AND ITS WHISTLEBLOWER PROTECTIONS	
	ADDITIONAL LEGISLATION AND REGULATIONS PENDING	
VIII.	CONCLUDING REMARKS	30

APPENDICES

1. FEDERAL ACQUISITION REGULATION CASE 2006-007 (FINAL RULE) (THE 2007 AMENDMENT)
2. FEDERAL ACQUISITION REGULATION CASE 2007-006 (FINAL RULE) (THE 2008 AMENDMENT)
3. JACKSON LEWIS CORPORATE GOVERNANCE UPDATE: *NEW RULES FOR GOVERNMENT CONTRACTORS – NEWLY PUBLISHED RULES REQUIRE WRITTEN CODES OF BUSINESS ETHICS, DECEMBER 26, 2007*
4. U.S. SENTENCING GUIDELINES FOR ORGANIZATIONS, SECTION 8B2.1
5. MAY 3, 2004 U.S. SENTENCING COMMISSION NEWS RELEASE
6. FEDERAL SELF-REPORTING FORM ISSUED BY THE DEPARTMENT OF DEFENSE
7. SELECTED EXCERPTS OF THE TROUBLED ASSET RELIEF PROGRAM (“TARP”)
8. IRS FORM 990 FOR TAX-EXEMPT ORGANIZATIONS AND ARTICLE

NOTE: The Appendix material is not attached to this paper copy of the Special Report. We encourage you to download this information and material from the Jackson Lewis LLP website at the following address: <http://www.jacksonlewis.com>.

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FIRM OVERVIEW

Jackson Lewis is one of the largest law firms in the country dedicated exclusively to representing management on workplace issues. The firm has successfully handled cases in every state and is admitted to practice in all Circuit Courts of Appeal and in the United States Supreme Court. With 40 offices and over 530 attorneys, the firm has a national perspective and sensitivity to the nuances of regional business environments.

Since 1958 we have represented a wide range of public and private businesses and non-profit institutions in a vast array of industries. When issues arise, we devise optimal solutions that minimize costs and maximize results. Whether we are counseling on legal compliance or litigating a complex case, we assist our clients in achieving their business goals.

In addition, we help employers create policies and procedures promoting positive employee relations. We have built our practice and earned our national reputation over the years by helping companies reduce workplace-related litigation by educating management on legal trends, judicial developments, and statutory and regulatory compliance in the rapidly evolving area of workplace law. Our state-of-the-art preventive law programs utilize the firm's expertise and unmatched experience to evaluate employment trends and related litigation, minimizing the risk of exposure in future lawsuits.

THE CORPORATE GOVERNANCE PRACTICE GROUP

Effective corporate governance today requires an inquisitive, proactive and comprehensive approach across a continuum of issues including: establishing an appropriate board of directors and management composition; implementing a code of ethics and business conduct that promotes a culture of compliance; developing policies and practices, coupled with state of the art training, that reinforce these values; and developing enforcement mechanisms that allow for auditing, investigation and reporting procedures. Litigation is also a by-product of today's corporate environment as employees, characterized by both legitimate as well as opportunistic litigants, claim whistleblower status and assert claims of retaliation.

The Jackson Lewis LLP Corporate Governance Practice Group has a team of experienced attorneys with a proven track record of leadership. Our Corporate Governance Practice Group includes former senior in-house corporate counsel, distinguished trial attorneys and former government attorneys who collectively provide a multi-disciplinary approach to solving corporate governance issues. The skills Jackson Lewis clients have relied on for nearly half a century in areas such as investigation, policy and program development, training and preventative strategies are now benefiting clients in this new era of corporate governance.

Jackson Lewis attorneys proactively assist employers in managing the myriad of corporate compliance challenges by developing responsible business practices that minimize risk, by training employees to promote a culture of compliance, and by responding effectively and efficiently to audits, investigations and lawsuits. Our attorneys assist clients in:

- Developing compliance and ethics programs in accordance with the U.S. Sentencing Guidelines for Organizations, the Sarbanes-Oxley Act of 2002, the Federal Acquisition Regulations, as well as regulatory agencies such as the New York Stock Exchange and NASDAQ.
- Conducting training and employee awareness as mandated by the U.S. Sentencing Guidelines for an effective compliance and ethics program.
- Managing, assisting or supporting internal employee investigations involving alleged improper conduct, stock option backdating, conflicts of interest, and related breaches of the company's code of ethics and business conduct.
- Counseling on FINRA/NASD Form U-4 and U-5 disclosures for registered representatives in the financial services industry and mitigation of associated defamation claims.
- Developing, reviewing and auditing company communications, policies, executive compensation plans and practices.
- Representing employers in whistleblower and retaliation litigation under the Sarbanes-Oxley Act before OSHA, the Office of Administrative Law Judges, the Administrative Review Board and in the federal courts.

- Drafting and providing counsel on employment agreements for senior executives as well as counsel on the termination and separation agreements for these high level employees.

Jackson Lewis attorneys can assist and provide counsel to senior management as well as boards of directors, audit committees and special committees in identifying legal needs, conducting internal investigations, building a solid defense, meeting compliance requirements, and developing best practices. For more information, please contact our Co-Chairs of the Corporate Governance Practice Group: Richard J. Cino or David R. Jimenez.

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INTRODUCTION TO THIS SPECIAL REPORT

This Jackson Lewis Special Report provides an overview of newly issued government requirements mandating the development of compliance and ethics programs. These requirements apply to federal contractors that meet certain thresholds. **Section IV** details these new requirements as set forth in the Federal Acquisition Regulations (“FAR”), describes the thresholds that identify which federal contractors are subject to the requirements, and explains how these requirements turn to specific elements of a program that every federal contractor should consider for their respective organization. **Section V** identifies how Jackson Lewis works with clients to develop a customized compliance and ethics program that includes, among other things, the requisite written code of ethics and business conduct, an employee reporting procedure, and an employee awareness program.

The requirements set forth in the FAR are, in large measure, the result of specific developments in the field of compliance and ethics for organizations. To better understand the specific requirements and their intended purpose, it helps to understand how these elements have developed in response to industry-specific crises that occurred in the past 30 to 40 years. Beginning with a Securities and Exchange Commission study on many U.S. companies that made questionable payments to foreign officials in the 1970s, to defense contractor fraud and insider-trading of the 1980s, and finally to the spectacular Enron scandal, these events have been a significant force in shaping the evolving practices related to organizational compliance and ethics programs. Similarly, the United States Sentencing Commission’s Guidelines for Organizations issued in 1991 and amended in 2004 were also a major milestone in the development of compliance and ethics practices.

Given the importance of the history related to compliance and ethics programs for purposes of establishing an effective program today, **Section VI**, entitled “The Evolution of Organizational Compliance and Ethics Practices” provides a detailed account as to how these programs have evolved by virtue of the events alluded to above and why all organizations – public, private and not-for-profit – need to establish an effective code of ethics and business conduct.

Undoubtedly critical events of our times affect how we view the effectiveness of organizational compliance and ethics. The current economic turmoil and the immense federal bail-out efforts have again placed a spotlight on the government’s ability to condition its financial investment in organizations with specific mandates aimed at curbing abuse deemed wasteful of taxpayer money. We believe that the Troubled Asset Relief Program (“TARP”) and the American Recovery and Reinvestment Act (“ARRA”) will enable the federal government to impose additional corporate governance requirements on recipient organizations. Executive compensation limits, divestiture and avoidance of corporate aircraft, and heightened scrutiny of business planning are all “fair game” at this point as taxpayers demand greater accountability and transparency. As important perhaps are new whistleblower protections provided to the employees of organizations that receive covered funds. **Section VII** thus outlines these developments in corporate governance as they emerge before us.

Finally, the Appendix section contains additional resource material that provides further detail and direction related to the development of an effective compliance and ethics program.

We hope you find this Jackson Lewis Special Report to be a helpful resource as you develop a compliance and ethics program that is appropriate for your organization. We hope to partner with you as you endeavor to develop a tailor-made compliance and ethics program and we encourage you to visit the Jackson Lewis Corporate Governance web-site for additional information and resources.

REQUIREMENTS FOR A COMPLIANCE & ETHICS PROGRAM FOR FEDERAL CONTRACTORS

With the much debated and heavily anticipated passage of the American Recovery and Reinvestment Act (“ARRA”), we anticipate that the federal government’s business dealings with private contractors will grow substantially. Indeed, private companies doing business with the federal government will undoubtedly shoulder a significant portion of the work outlined within the stimulus legislation. The ARRA unquestionably provides federal government contractors with a welcomed business opportunity in today’s challenging environment. However, most government awards and contracts created as a result of this new stimulus legislation will include requirements that federal contractors implement organizational compliance and ethics programs. A primary goal of these requirements is to ensure that federal contractors have the requisite organizational structures to prevent fraud and corruption in the performance of federal contracts. Much like the Sarbanes-Oxley Act, which imposed compliance and ethics programs on public companies for the benefit of the investing public, these newly mandated requirements are designed to protect taxpayer money. While contractor compliance is not new, these emerging rules do impose additional substantive requirements, the implementation of which will require a multi-function and multi-resource effort. Moreover, unlike other forms of contract compliance, these compliance structures require specific customization and alignment to the culture, dynamics, risks and internal resources of each organization. “Off-the-shelf” programs are, in fact, expressly discouraged by the requirements.

By way of background, the Federal Acquisition Regulations (“FAR”) contain the uniform policies and procedures for government acquisition.¹ Following a public comment period, the Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council (the “Councils”) amended the FAR, effective December 12, 2008, to provide for stricter ethics and compliance requirements for government contractors. These newly issued 2008 requirements added to a prior 2007 FAR amendment which already had mandated federal contractors to develop specific elements of a compliance and ethics program. Essentially, the 2007 FAR amendment required government contractors and subcontractors with contracts over \$5 million and a performance period of 120 days or more to:

- Have a written code of ethics and business conduct;
- Establish an employee awareness and training program to support the code of ethics and business conduct;²
- Implement an internal controls system; and

¹The Federal Acquisition Regulations - codified at Title 48 of the Code of Federal Regulations - contain the uniform policies and procedures for federal government acquisitions. Although many agencies supplement the FAR with their own requirements, the FAR represents a Congressional effort to create a uniform framework for contracting with private entities.

² The 2007 FAR Amendment did not specify the requirements of an awareness program but merely provided that the contractor shall establish, within 90 days after contract award (unless the contracting officer establishes a longer time period), an "ongoing business ethics and business conduct awareness program."

- Display a federal agency fraud hotline poster or establish an internal employee reporting process.³

The more recent 2008 FAR amendment fastens additional requirements to the compliance and ethics elements made mandatory by the 2007 FAR Amendment. The 2008 requirements outline specific components of an internal controls system; broaden the scope of the ethics and compliance requirements of the federal regulations; and impose upon federal contractors significant self-regulating measures, most notably a mandatory disclosure provision that requires contractors to self-report violations of certain criminal laws and overpayments in connection with the award or performance of a contract or subcontract.⁴ In so doing, the 2007 and 2008 FAR Amendment requirements collectively have come a long way towards mandating specific management measures to prevent organizational fraud and corruption. Indeed, the mandates require avoidance, monitoring and detection, correction, and now self-reporting to the government. These requirements are described in further detail below.

I. Specific Guidance on Internal Controls System

Although the 2007 FAR Amendment required federal contractors to implement an internal control system, it provided limited guidance on the details of such a system. In contrast, the 2008 FAR Amendments mandate specific characteristics for an internal controls system as follows:

1. Establish standards and procedures to facilitate timely discovery of improper conduct in connection with government contracts;
2. Ensure that corrective measures are promptly instituted and executed;
3. Assign responsibility to a high-ranking individual at the company with sufficient resources to ensure the effectiveness of the business ethics and compliance program;
4. Prevent individuals who previously violated the company's code of ethics and business conduct from serving in senior leadership positions;
5. Include a periodic audit and review of the company's business practices, procedures, and policies for compliance with the code of ethics and business conduct and other government contracting requirements;

³ See Appendix 1 Federal Acquisition Regulation Case 2006-007 (Final Rule) (referred to in this Special Report as "the 2007 FAR Amendment"). For a more complete discussion and review of the 2007 FAR Amendment, see also, *New Rules for Government Contractors – Newly Published Rules Require Written Codes of Business Ethics*, Jackson Lewis LLP Corporate Governance Update, David Jimenez, December 26, 2007, at Appendix 3.

⁴ See Appendix 2 Federal Acquisition Regulation Case 2007-006 (Final Rule)(referred to in this Special Report as "the 2008 FAR Amendment")

6. Feature an internal reporting mechanism, such as a hotline, which allows employees to report improper conduct anonymously;
7. Implement disciplinary action for improper conduct or for failing to take reasonable steps to prevent improper conduct; and
8. Provide full cooperation with any government agencies responsible for audits, investigations, or corrective action.

Accordingly, the 2008 FAR amendments provide greater guidance to federal contractors as to the key characteristics of an internal controls system. In so doing, the FAR rules draw upon the well-known guidelines for an effective compliance and ethics program as espoused by the United States Sentencing Commission in its *U.S. Sentencing Guidelines for Organizations* (these Guidelines are reviewed in further detail in Section VI of this Special Report.). The guidelines, applicable to organizations both public and private, identify many of the key hallmarks for such systems as now referenced by the FAR.

II. New Mandatory Disclosure Provisions

The 2008 FAR Amendment also revised the FAR to require federal contractors to make timely disclosures to the procuring agency's Office of the Inspector General, among others, whenever the federal contractor has "credible evidence" of a violation of certain criminal laws, the civil False Claims Act, or significant government overpayments in connection with the award or performance of a contract or subcontract. The mandatory disclosure requirement extends for three (3) years after final payment on the government contract.⁵ Further, federal contractors face stiff penalties for failing to disclose misconduct including suspension and potential debarment. This new requirement marks a significant shift from the 2007 FAR Amendment, as self-reporting of improper or criminal conduct to the government is now expressly mandatory.

III. Broader Coverage of Federal Contracts

Finally, the 2008 FAR Amendment expands the coverage of compliance and ethics requirements in relation to international contracts while maintaining some of the exemptions for commercial items contracts and for contractors that are deemed small business. The 2007 FAR Amendment did not apply to international contracts, but the 2008 FAR Amendments makes clear that such contracts are subject to the ethics and compliance requirements set forth above.

In addition, the 2008 FAR Amendments do impose the requirement of a written code of ethics and business conduct on all federal contractors with contracts that exceed \$5 million and a performance period of 120 days or more, including those with commercial items contracts and contractors deemed to be small businesses. However, for small business contractors as well as those

⁵ A copy of the Department of Defense self-reporting form is at Appendix 6 of this Special Report.

with commercial items contracts, the 2008 FAR Amendment maintains the exemption with regard to development of an internal controls system and the requirements pertaining to establishing an employee awareness program.

These exemptions for small businesses and commercial items contracts, while appealing on their surface from a cost perspective, ignore the reality that a code of ethics and business conduct is at risk of being rendered ineffective if not coupled with an appropriate internal control program to provide enforcement as well as an employee awareness program that effectively communicates the code requirements to the organization's employees. The net purported savings from these exemptions is questionable, if not dubious, given that the majority of the contractor's cost is likely in the development of a code. Thus taking advantage of these exemptions likely will yield insignificant savings and yet they will put at risk the invested time, resources and capital that was invested in the development of a written code of ethics and business conduct.

IV. Final Remarks

Perhaps more than ever before, building and maintaining an ethical corporate culture is a prerequisite to doing business with the federal government. These newly mandated federal ethics and compliance requirements are consistent with the current political, social, and economic climate that demands increased accountability and transparency with how the federal government spends taxpayer money. Separate and apart from the government's mandates, ethics and compliance programs are critical for organizations to maintain their ethical health and such programs serve as a viable avenue for management to preserve and promote key organizational values such as trust and integrity. Federal contractors are wise to consider the FAR amendments as a baseline and to invest their talent and resources in the development of best-in-class ethics and compliance practices that will surely provide a return on investment.

OUR APPROACH TO DEVELOPMENT OF A COMPLIANCE & ETHICS PROGRAM

The Jackson Lewis Corporate Governance Group is available to assist your organization with developing a tailored and comprehensive compliance and ethics program that represents your industry's best practices and is fully compliant with the FAR mandates. Recognizing that the specific components of an ethics and compliance program are not expressly stated by the FAR, Jackson Lewis attorneys will work with your organization to develop a program that is consistent with your culture, industry dynamics, and your resources - while at the same time meeting all applicable government mandates. Neither the FAR nor its predecessors – the U.S. Sentencing Guidelines for Organizations and the Sarbanes-Oxley Act compliance requirements – identify with specificity what should be included within the body of a written code of ethics and business conduct, nor what comprises an awareness program, nor do they describe with any specificity how to design an internal employee reporting procedure. Thus the rules are written so as to provide companies with wide latitude in crafting compliance and ethics programs to fit the particular needs of their company and industry. While it is clear that elements must exist, the intricate details of such elements are left for organizations to determine. In fact, the requirements expressly state that organizations need to consider their internal resources as well as the challenges and best practices of their corresponding industry.

The Jackson Lewis Corporate Governance Group will assign a Code Development Team (“CDT”) to work with the client's designated internal Code project team. Quite often, the client will staff its internal Code project team with representatives from legal, human resources, finance, compliance, the company's audit committee, and other vital functions. Collectively, the client's Code team and the firm's CDT will establish a project plan including time frames, budget, and deliverables. The end result is a project that develops and implements the various requirements for an effective compliance and ethics program including:

- I. Written Code of Ethics and Business Conduct
- II. Monitoring, Enforcement Controls and Systems
- III. Internal and/or External Employee Reporting procedures
- IV. Employee Awareness Program
- V. Case Management Protocols & Investigations Training
- VI. Reporting & Disclosure Procedures

The specific work and approach taken to these elements are described further below. While the specifics of any engagement will depend on a number of factors including client needs and resources, Jackson Lewis endeavors to develop and implement an effective compliance and ethics program that meets all applicable government mandates, represents best practices of the client's industry, and does not unnecessarily burden the client's limited resources.

Written Code of Ethics and Business Conduct: We will develop and draft a Code of Ethics and Business Conduct (“Code”). Your company has likely adopted an employee handbook which provides employees with valuable information on what they can *expect from the company* in terms of benefits, vacation and the work environment. The Code, on the other hand, provides your employees with information regarding *what is expected of them* as representatives of your company. Thus the Code speaks in terms of their interactions with management, other employees, business partners, government officials and other external parties. The Code provides a statement of the company’s principles and core values. The Code will incorporate existing critical workplace policies, procedures and relevant contact information for your employees. The CDT will review and update these policies and incorporate new policies into the Code to meet your company’s specific needs, particularly with respect to applicable government regulatory requirements and the key requirements of government contracts.

The CDT will also draw upon this firm’s knowledge and experience including its established **Key Sections of a Code of Ethics and Business Conduct** and will supplement these critical sections depending on your organization’s industry and related dynamics. For example, organizations with an international presence will have a Code with greater dedication to the Foreign Corrupt Practices Act. Organizations that do business with the federal government will have substantive Code sections dedicated to doing business with government agents and to adhering to federal procurement laws. Similarly, high technology organizations tend to have greater emphasis on confidentiality agreements and adherence to trade secret laws and thus the Code will have appropriate regard for those topics. From an internal perspective, the Code will take into account the company’s culture by using, as appropriate, common conventions for referring to employees (e.g., associates, colleagues, etc.). Most importantly, for purposes of increased clarity, the Code will incorporate hypothetical situations and examples that draw upon actual business scenarios that occur at the client organization. These industry and client-specific “finger-prints” are a necessary ingredient for developing a best-practice Code. To be sure, such hallmarks are emblematic of an effective Code to which your employees will relate, understand and likely enforce.

Internal and/or External Employee Reporting Procedures: In conjunction with the Code, we assist client organizations with establishing an internal reporting procedure (often referred to as a “Hotline”) for the receipt of internal and external complaints. The reporting procedures are intended to provide employees with the means to raise issues of concern to a designated forum. Whether the concerns are routed to senior management, an Ethics Committee, the audit committee of the Board of Directors or a combination of these, the mechanics of such routing, the triage of every call and the corresponding case management must be thoughtfully and deliberately established. The organization will need to assess whether concerns can be raised in a confidential or anonymous manner and what will be the service commitment to such calls. Reporting protocols, file management, and legal considerations are also reviewed in the context of establishing an internal reporting mechanism.

Employee Awareness Program: Critical to the success of a compliance and ethics program is that it be well-known to its employees and easily related to in the context of the work and ethical dilemmas that arise in the particular organization. To that end, the program has to be repeatedly communicated to the employees in a manner that is consistent with the communication vehicles already available within the organization. Moreover, the program must be based on actual work scenarios that can and do occur within the organization. Accordingly, the CDT will work with the internal project team to develop a communication and training program tailored for the organization's various internal audiences: new hires, current employees, and management. The initial training, as well as periodic refresher training will incorporate real-life scenarios and hypothetical situations that illustrate true circumstances and are realistic to the company's employees. The CDT will also identify and develop channels for training reinforcement to provide repeated and redundant messages to employees via alternative internal forums and media such as town-halls, emails, posters, and newsletters. As importantly, the CDT will offer to assist clients with developing mechanisms for encouraging feedback from employees about the Code and employees' perception of ethics via ethics surveys or ethics questions embedded within general surveys. These awareness program elements will be designed via a communication strategy that best applies to the company's culture.

Monitoring, Investigations, and Self-Reporting: With the new 2008 FAR amendments, it is vital that the client organization establishes an internal controls system that delivers effective monitoring, investigations and self-reporting systems and protocols. As with the prior elements of the program, the CDT will offer to work with the client's internal Code project team to establish these required elements including standards and procedures to: facilitate timely discovery of improper conduct, implement corrective measures, delegate duties to appropriate personnel, conduct periodic audits, implement disciplinary action protocols, and cooperate with government agencies as well as law enforcement. Many of these efforts entail writing appropriate guidelines and protocols that provide added governance as significant portions of the work are delegated throughout the organization. In addition, upon request the CDT will provide specifically designed investigations training for compliance officers. This training will be aligned with the specific provisions of the newly developed code of ethics and business conduct and will assist the client with preparing for the most likely types of matters to be investigated.

The Jackson Lewis commitment to your organization does not end once the compliance and ethics program is in place. Our attorneys will work with you to refine, enhance and improve various aspects of the program to ensure it continues to meet the changing needs of your organization and industry, and that it comports with the latest legal and regulatory developments.

THE EVOLUTION OF ORGANIZATIONAL COMPLIANCE & ETHICS PRACTICES

To better understand the importance of effective compliance and ethics programs as well as why such programs are important for organizations of every character, it is helpful to review why such programs originated and how they have evolved over the last forty years. These programs have, in large measure, originated from a series of events from the 1970s through today that played a major role in shaping the current dialogue about the characteristics of an effective compliance and ethics program.⁶ The programs are in part a legislative, law enforcement and, in some cases, an industry response to a crisis of confidence in an organization's ability to manage corrupt behaviors. Additionally, the U.S Sentencing Commission, as it set about to establish criminal penalty guidelines for organizations, undertook a bold approach to provide an incentive for organizations to adopt effective compliance and ethics practices irrespective of whether they are expressly mandated to do so. From a criminal law perspective, all organizations are susceptible to criminal liability for the actions of their employees and the U.S. Sentencing Guidelines for Organizations leveraged this fact to encourage organizations to adopt an effective compliance program. Thus the development of ethics and compliance programs in response to critical events in recent history and in connection with innovative efforts by the U.S. Sentencing Commission are reviewed below.

In addition to the value of historical perspective, a review of the development of such programs also provides added insight as to the details for structuring them. At their core, compliance and ethics programs constitute an organization attempt through people, process, and systems to manage away organizational crime, fraud, and other misconduct that may cause harm to an organization as well as to other stakeholders. In some aspects, the specific elements and general framework for such programs are mandated by a legal statute or by a regulation. At a more granular level, however, the detailed components of such programs are not specifically identified by laws or regulations, but rather are the result of "best-practices" that have proven to be effective at mitigating organizational misconduct. Accordingly, organizations that today seek to establish an effective compliance and ethics program are often frustrated in their efforts by the lack of clearly mandated components to an effective program. For example, federal contractors meeting certain thresholds now understand that they are required to have a written code of ethics and business conduct and an employee awareness programs – the specific elements of these two key components, however, are not set forth anywhere. To the contrary, these elements must be tailored to the specific culture, dynamics, and resources of the organization. Indeed, it is well-established that a "template" approach runs counter to the requirements of an effective compliance program given that it will be less effective and not truly responsive to the internal workings and vulnerabilities of a particular organization. Moreover a non-tailored approach may create unnecessary burden and potentially added liability for the organization. Merely downloading the code of ethics and business conduct of a well-known, best-practice organization may unwittingly impose requirements that are not

⁶ See Rebecca Walker, *The Evolution of the Law of Corporate Compliance in the United States: A Brief Overview*, Corporate Compliance and Ethics Institute, Practising Law Institute (March 2007).

manageable for a smaller organization of a different industry. Thus a review of the development of these programs sheds further light on how such programs should be drafted and maintained.

I. The Corporate Corruption and Scandals of the 1970s and 1980s

The 1970s were marked in part by the Watergate scandal and the Nixon Administration which provoked a major public focus on corruption. Lesser known at the time was a report issued by the Securities and Exchange Commission (“SEC”) disclosing that over 400 U.S. companies, including 117 of the then Fortune 500, made “questionable payments” to foreign officials.⁷ This prompted the Ford Administration and the Congress to enact the Foreign Corrupt Practices Act (“FCPA”) in 1977 which provided, among several anti-bribery provisions, mandates for organizations to have internal financial controls, anti-bribery compliance programs and codes of ethics and business conduct on issues extending beyond bribery.⁸ These mandated code provisions also require companies to make and keep books, records, and accounts which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the company’s assets.⁹ The legislative response embodied by FCPA has been cited by some as among the most stringent of responses by the government in its efforts to restore public confidence in the integrity of the American business community.¹⁰ Thus FCPA triggered a wave of compliance and ethics programs, particularly for organizations that did business abroad.

In the 1980s, there were several industry-wide scandals such as the savings and loan crisis, a myriad of defense-contractor fraud investigations, and the much-publicized insider-trading scandals on Wall Street. The dynamics within the defense industry are particularly interesting because of the significant industry-oriented response. At the time, the U.S. was investing heavily in its military in order to defend against a perceived Soviet threat to national security. Contemporaneously, due to a host of highly publicized events involving exorbitant overpricing of goods and services sold to the U.S. Department of Defense, there was a public perception of misconduct and abuse within the government procurement process. The White House formed the so-called “Packard Commission” to review Department of Defense spending and acquisitions management.¹¹ In its 1986 interim report, the Packard Commission concluded that “the defense acquisition process, the defense business environment, and confidence in the defense industry could be improved by placing greater emphasis on self-governance.”¹² Specifically, the report stated:

To assure that their houses are in order, defense contractors must promulgate and vigilantly enforce codes of ethics that address the unique problems and procedures incident to defense procurement. They must also develop and

⁷ Securities and Exchange Commission, *Report on Questionable and Illegal Corporate Payments and Practices* (1976).

⁸ Jeffrey P. Bialos & Gregory Husisian, *The Foreign Corrupt Practices Act: Coping with Corruption in Transitional Economics* (1997).

⁹ *Id.* at 63.

¹⁰ *Id.*

¹¹ See The Defense Industry Initiative on Business Ethics and Conduct, *2007 Annual Public Accountability Report* ([http://www.dii.org/annual/2007/DII-2007-Public Accountability Report.pdf](http://www.dii.org/annual/2007/DII-2007-Public%20Accountability%20Report.pdf)). The Packard Commission was named after David Packard the then Deputy Secretary of Defense.

¹² *Id.* at 14.

implement internal controls to monitor these codes of ethics and sensitive aspects of contract compliance.¹³

The findings of the Packard Commission led major companies within the defense industry to come together and develop six principles that became known as the ***Defense Industry Initiative on Business Ethics and Conduct***. Member firms of the DII pledged to support and promote the following six principles:

- Have and adhere to written Codes of Conduct;
- Train employees on those Codes;
- Encourage internal reporting of violations of the Code, within an atmosphere free of fear or retribution;
- Practice self-governance through the implementation of systems to monitor compliance with federal procurement laws and the adoption of procedures for voluntary disclosure of violations to the appropriate authorities;
- Share with other firms best practices in implementing the principles, and participate annually in “Best Practices Forums”; and
- Be accountable to the public.¹⁴

Similarly, in the 1980s the financial services industry, and specifically the so-called Wall Street industry, was engulfed in several scandals arising from insider trading. Ivan Boesky became a well-known name as he amassed a fortune of over \$200 million by making investments on tips that he received from corporate insiders. The Boesky and other trading scandals prompted legislative action including passage of the Insider Trading and Securities Fraud Enforcement Act of 1988 requiring broker-dealers to establish compliance programs with regard to non-public information. This federal legislation increased the potential liabilities associated with insider trading and other fraudulent activities. This act also provides informers with cash awards, allows individuals who claim damages to file suit, and encouraged companies to implement improved internal controls.

II. The U.S. Sentencing Guidelines for Organizations

Contemporaneously with the developments of the defense-contractor and securities industry, the law enforcement community was charged with addressing how organizations generally would be held accountable for criminal law violations. Formed as a result of the Sentencing Reform Act in 1987, the U.S. Sentencing Commission established the *Sentencing Guidelines for Organizations in 1991*.¹⁵ The Sentencing Guidelines for Organizations suggested a significant change from what had been a reactive approach to organizational fraud, to a pro-active and incentive-based approach to

¹³ *Id.* at 14-15.

¹⁴ *Id.* at 15.

¹⁵ Sentencing Reform Act of 1984, Pub. L.No. 98-473, 98 Stat. 1987.

preventing criminal activity within organizations.¹⁶ The Guidelines accomplish this by, in the first instance, identifying the methodology by which organizations will be assessed fines for criminal activity and then establishing a material reduction in such fines to the extent organizations have an effective compliance and ethics program comprised of the specific elements espoused by the Guidelines. In other words, the Guidelines recognize that organizations are limited in what they can do to prohibit, monitor, and detect criminal behavior amongst their employees. The Commission thus identified elements of an effective compliance and ethics program that would be deemed a reasonable, pro-active approach to mitigating the potential for criminal behavior. These guidelines have been said to have led thousands of corporations to develop formal compliance programs as reflected in a 1997 survey by the Ethics Officer Association.¹⁷ Ten years later, in 2001, the U.S. Sentencing Commission formed an advisory group to further review the guidelines. This effort led to issuance of revised guidelines for organizational compliance programs which were adopted by Congress and became effective on November 1, 2004. The Sentencing Commission's press release about the new revisions conveys their importance as reflected by the statements below:

WASHINGTON, D.C. (May 3, 2004) — The United States Sentencing Commission on Friday, April 30, 2004, sent to Congress significant changes to the federal sentencing guidelines for organizations, which should lead to a new era of corporate compliance. The amendment to the guidelines strengthens the criteria an organization must follow in order to create an effective compliance and ethics program. Establishing an effective compliance and ethics program is essential for an organization seeking to mitigate its punishment (including fines and terms of probation) for a criminal offense. ***The organizational sentencing guidelines have a broad reach, for they define "organizations" to include corporations, partnerships, associations, joint-stock companies, unions, trusts, pension funds, unincorporated organizations, governments, and non-profit organizations.*** The amendment will take effect November 1, 2004, unless Congress disapproves it during a 180-day period of review.

An effective compliance program has been a fundamental component of the organizational sentencing guidelines since the Commission first promulgated them in 1991. Under the guidelines, an organization's punishment is adjusted according to several factors, one of which is whether the organization has in place an effective program to prevent and detect violations of law. ***For such a program to be considered effective, the Commission articulated seven minimum requirements. In 1991, these seven requirements represented the federal government's first attempt to articulate such broad-based standards, and they quickly became the benchmark against which most organizations measured their compliance programs.***

Friday, the Commission enhanced the rigor and detail of these requirements. As a fundamental proposition, organizations must promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law. In particular, the amendment requires boards of directors and executives to assume responsibility for the oversight and management of compliance and ethics programs. ***Effective oversight and management presumes active leadership in defining the content and operation of the program. At a minimum, the amendment explicitly requires organizations to identify areas of risk where criminal violations may occur, train high-level officials as well as employees in relevant legal standards and obligations, and give their compliance and ethics officers sufficient authority and resources to carry out their responsibilities.***¹⁸

¹⁶ See Rebecca Walker, *The Evolution of the Law of Corporate Compliance in the United States: A Brief Overview*, Corporate Compliance and Ethics Institute, Practising Law Institute (March 2007).

¹⁷ See 1997 Member Survey 9 (2000), <http://www.eoa.org>.

¹⁸ See U.S. Sentencing Commission, *Commission Tightens Requirements For Corporate Compliance and Ethics Programs* <http://www.ussc.gov/PRESS/rel0504.html> attached to this Special Report at Appendix 5 (emphasis added).

The result of these revised guidelines was added clarity as to the elements necessary for a compliance program to be deemed effective. Specifically, these elements articulated seven components as paraphrased below:

(b) *Due diligence and the promotion of an organizational culture that encourages ethical conduct and a commitment to compliance with the law within the meaning of subsection (a) minimally require the following:*

- (1)** the organization shall establish standards and procedures to prevent and detect criminal conduct;
- (2)** (A) the organization's governing authority shall be knowledgeable about the content and operation of the compliance and ethics program and shall exercise reasonable oversight;
(B) high level personnel shall have responsibility for the program; and
(C) thoughtful delegation of responsibilities to individuals within the organization with adequate resources, appropriate authority and direct access to the appropriate authority;
- (3)** reasonable efforts not to include within the substantial authority personnel of the organization any individual whom the organization knew, or should have known through the exercise of due diligence, has engaged in illegal activities or other conduct inconsistent with an effective compliance and ethics program;
- (4)** reasonable steps to communicate periodically and in a practical manner its standards and procedures to high level personnel, employees and agents;
- (5)** the organization will take reasonable steps to-
 - (A) ensure compliance with the program including monitoring and auditing to detect criminal conduct;
 - (B) periodically evaluate the effectiveness of the organization's compliance and ethics program; and
 - (C) have and publicize an anonymous and confidential employee hotline wherein callers are protected from retaliation;
- (6)** consistent promotion and enforcement of the program via (A) appropriate incentives; and (B) appropriate discipline; and
- (7)** Appropriate response to the detection of criminal conduct including prevention of future similar conduct and necessary modifications to the compliance and ethics program.¹⁹

Hence, the Guidelines for Organizations provide an elaborate framework for the development and implementation of a compliance and ethics program. Compliance with the framework itself being a critical ingredient for organizations to receive the benefit of a significant reduction of criminal culpability.

Notwithstanding the clarity added by the revised Sentencing Guidelines, the Commission intentionally drafted them without setting forth the specific details of how each element is to be achieved. The "sentencing guidelines do not prescribe particular standards and procedures because

¹⁹ See United States Sentencing Commission, *United States Guidelines for Organizations* (2004), http://www.ussc.gov/2007_guid/8b21.html, a copy of which is attached at Appendix 4 of this Special Report.

these are necessarily unique to each organization. The sentencing guidelines reject a ‘cookie cutter’ approach, or ‘one-size fits all’ programmatic response.”²⁰

III. The Sarbanes-Oxley Act

While the Sentencing Commission guidelines did much in the way of identifying the framework for an effective compliance and ethics program for all organizations, there was new legislation in development with a focus on publicly-traded companies. The late 1990s and early 2000 period brought on additional corporate scandals. In the wake of corporate melt downs such as Enron and Worldcom and their dramatic impact to the U.S. investor community, on July 30, 2002, Congress signed into the law the American Competitiveness and Corporate Accountability Act of 2002, commonly known as the *Sarbanes-Oxley Act* (“SOX”). Its purpose was to rebuild public trust and investor confidence in publicly-traded companies by requiring companies listed on the U.S. stock exchanges to adhere to significant new governance standards and requirements. SOX was developed while the Sentencing Guidelines for Organizations were undergoing review and a specific provision within SOX required that the guidelines be revised as necessary to deter and punish organizational criminal misconduct.²¹

Among the notable SOX requirements are comprehensive requirements for financial controls and certification, board of director independence requirements, disclosure requirements, and whistleblower as well as anti-retaliation provisions. Arguably, these requirements broadened and better defined the roles and responsibilities of company directors and executive officers to the extent that those responsibilities were not previously self-evident.

At its inception, SOX was greeted by mixed commentary from the business and investor community. Politicians and regulators regarded SOX as a much-needed antidote to corrupt corporate practices characterized by executive compensation abuses, financial fraud and the collapse of significant corporations. These events left the investment community at large and regulators with the perception that something had to be done to curb these abuses and SOX was the response. On the other hand, as public companies implemented SOX requirements we began to hear complaints from the business community about the burdens of compliance, the resource drain that it was creating, and the impracticability of the regulations – particularly for small business.

While many of the provisions within SOX are specific to the public company structure, it is critically important to note that the requirements of an effective compliance and ethics program as espoused by the Sentencing Commission apply to all organizations. Moreover, the SOX requirements in some instances articulated in greater detail what organizations need to do in order to satisfy the seven elements of an effective compliance program. SOX requires public companies to disclose whether they have adopted a code of ethics for senior financial officers (later broadened by the

²⁰ Paul J. Desio, *Preventative Measures Against Criminal Conduct Have Wide Ranging Benefits*, (November 2004), <http://www.ci-wackenhut.com/FedSentGuidelinesNov04.pdf>.

²¹ Sarbanes-Oxley Act, § 805(a)(2)(5).

Securities and Exchange Commission to include the Chief Executive Officer) and it defined a code of ethics to mean written standards reasonably designed to deter wrongdoing and to promote (i) honest and ethical conduct, including the ethical handling of conflicts of interest; (ii) full, fair, accurate, timely and understandable disclosure in reports and documents filed with or submitted to the SEC; (iii) compliance with applicable laws, rules and regulations; (iv) prompt internal reporting of code violations to an appropriate person; and (v) accountability for adherence to the Code. Among its other requirements, SOX requires that public companies have procedures in place for the receipt, retention and treatment of complaints received by the company regarding accounting, internal accounting controls or auditing matters and the confidential, anonymous submission by employees of accounting matters. The SOX requirements were further developed by the SEC and the U.S. stock exchange organizations (New York Stock Exchange and NASDAQ) both of which further enumerated compliance and ethics requirements.

IV. The U.S. Department of Justice

Over the last decade, the U.S. Department of Justice (DOJ) also issued guidance on how it determines whether to exercise its discretion to hold organizations accountable for employee misconduct. As might be expected, a critical ingredient is the organization's compliance program. Between 1999 and 2006, DOJ issued three memoranda originally entitled "Federal Prosecution of Corporations" but later referred to by the name of the corresponding U.S. Deputy Attorney General (i.e., the "Holder Memo" after the then U.S. Deputy Attorney General – Eric Holder, the "Thompson Memo," after Larry Thompson, and the "McNulty Memo" after Paul J. McNulty). The 2006 iteration, known as the McNulty Memo, specifically states that federal prosecutors will review the existence and adequacy of a corporation's pre-existing compliance program as well as the corporation's remedial actions, including efforts to implement an effective compliance program or to improve an existing one.

V. Not-For-Profits Increasingly In the Spotlight

In the last five years, not-for-profit organizations have also had a continuing share of scandals associated with their activities and growing pressure to develop compliance and ethics programs. Executive compensation abuses, internal investigations, misuse of organization assets and the like have been common events at many well-regarded not-for-profit organizations. Against the backdrop of the Sarbanes-Oxley Act movement in the for-profit/public company world, the organizational shortcomings spotlighted by the indiscretions of the not-for-profits have raised the question whether they too should be subject to SOX-like requirements. Increasingly, in fact, boards of directors are confronted with questions about corporate governance and why they do not have similar compliance standards and procedures. In the wake of mounting evidence about the improved corporate governance that flows from implementing the Sarbanes-Oxley Act requirements, officers and directors as well as their critics do not find it persuasive to simply respond that their organization is not technically covered by SOX. In fact, the five-year anniversary of SOX was marked in part by a host of public companies that, because of SOX, have made significant public disclosures about re-stated financial earnings, re-constituted boards of directors, re-established audit committee charters, new

codes of conduct with ethics hotlines, and an entirely new focus on organizational compliance structures. On the not-for-profit side, to the contrary, the buzz has not been characterized by these new changes and structures.

Not surprisingly, the Internal Revenue Service has entered the field of governance and compliance for tax-exempt organizations by virtue of its redesigned Form 990 which became effective for the 2008 tax year and dedicates an entire section to specific questions about the organization's internal governance, its policies, and its disclosure practices.²² Among the more notable Form 990 questions are the following:

- Are officers, directors or trustees, and key employees required to disclose annually interests that could give rise to conflicts?
- Does the organization regularly and consistently monitor and enforce compliance with the conflict of interest policy? If yes, describe how this is done.
- Does the organization have a written whistleblower policy?
- Does the organization have a written document retention and destruction policy?
- Did the process for determining executive compensation include a review and approval by independent persons, comparability data, and contemporaneous substantiation of the deliberation and decision? Describe the process.
- Does the organization make its governing documents, conflict of interest policy, and financial statements available to the public? If so, how.

Thus, as with public companies and federal contractors, we now see specific federal government expectations for compliance and ethics programs in relation to tax-exempt/not-for-profit organizations. While these requirements are in their infancy, as relates to tax-exempt/not-for-profits, the history of such programs is quite clear and compels us to believe that we will only see more requirements versus less for such organizations.

VI. Conclusion

The development of compliance and ethics programs has evolved over the course of the last several decades. Various constituent groups have had input on the development of compliance and ethics best-practices including legislators, regulators, industry leaders and commissions. The history shows with great lucidity where the requirements now imposed on federal contractors originate from and what is expected. As firmly grounded as these elements are, it is also clearly apparent that in today's environment criminal behavior, fraud and misconduct continue to be a significant challenge within all industries. While the framework for such compliance and ethics have the benefit of many points of view across many industries, it is also likely that the development of the details of such programs and the systems by which the programs are implemented and continuously improved within a particular organization have a great bearing on the success of such programs. Hence, the

²² A copy of the new Form 990 along with an IRS article entitled "What's New, Redesigned Form 990 and Instructions for 2008 tax year" is attached to this Special Report at Appendix 8.

challenge for organizations today, in this resource limited environment, is to perhaps leverage this evolving history, to recognize the return on investment of such programs, and to implement a compliance and ethics program that is specific to the nuances of the organization.

LOOKING FORWARD: INCREASED CORPORATE GOVERNANCE REQUIREMENTS ON THE HORIZON

The economic stimulus packages introduced by both the Bush and Obama administrations are reviewed in this section as they contain a myriad of limitations on executive compensation, significant governmental oversight mechanisms for organizations receiving stimulus monies, and even additional whistleblower protections for employees who assert complaints about the manner in which federal dollars are being managed. Subsequent to their passage, Congressional members have proposed additional bills that propose to create more institutions and restrictions further regulating executive pay practices and creating more transparency in corporate affairs. Undoubtedly, as more recipients benefit from receipt of government stimulus monies, these legal restrictions will amplify the need for organizations to revise their internal compliance and ethics policies as well the need to place tighter controls on their corporate governance mechanisms. This enhanced vigilance perhaps is a potential paradigm shift from the government's historical efforts to curb organizational criminal behavior. Rather than a mere focus on criminal deeds by organizations, this new breed of regulations and restrictions seek to deter mismanagement and abuse. This is a lofty and popular goal relative to taxpayer money, however, it does call into question what remains of the business judgment and discretion that both public and private U.S. companies have enjoyed in the past. These emerging developments and potential consequences are of critical importance to organizations as they consider a compliance and ethics program to satisfy existing federal government requirements tied to federal awards and further consider direct or indirect participation in the stimulus programs.

I. REQUIREMENTS IMPOSED VIA TROUBLED ASSET RELIEF PROGRAM ("TARP")

On October 3, 2008, President Bush signed the Emergency Economic Stabilization Act of 2008 ("EESA") containing the Troubled Asset Relief Program ("TARP") which seeks to provide monetary relief to faltering financial institutions. TARP imposed compensation limits for companies receiving TARP funds. On February 17, 2009, less than five months later, however, President Obama signed the American Recovery and Reinvestment Act of 2009 ("ARRA") containing a modified version of TARP. The ARRA places greater limitations on executive compensation as well as additional controls for regulatory oversight on institutions that received TARP assistance. Among the more notable requirements are the following:

- **Executive Compensation Plans:** ARRA dictates that compensation must be structured to avoid incentives for senior executive officers of TARP recipient institutions to take unnecessary and excessive risk that threatens the value of the recipient institution during the period that TARP funding remains outstanding. The ARRA also prohibits compensation plans that would encourage manipulation of reported earnings of a TARP recipient institution so as to enhance the compensation of any employee.
- **Clawback Provisions:** TARP recipient institutions may recover "any bonus or incentive compensation paid to a senior executive officer based on statements of earnings, gains, or other criteria that are later proven to be materially inaccurate." Under the

ARRA, the clawback provisions extend to bonuses and incentive compensation paid beyond the five most highly compensated senior executives to the next 20 highest compensated employees, if such pay is “based on materially inaccurate financial statements or any other materially inaccurate performance metric criteria” regardless of intention or fault.

- **Golden Parachutes:** Golden parachutes, defined by the ARRA as “any payment to a senior executive officer for departure from a company for any reason, except for payments for services performed or benefits accrued,” may not be paid to the senior executive officers and the next 5 most highly compensated employees while the government holds an equity or debt position in the TARP recipient.
- **Restricted Stock as Bonuses:** Bonuses to certain employees of TARP recipient institutions can only be in the form of restricted stock meeting certain requirements set forth by ARRA.
- **Board Compensation Committee:** TARP recipient institutions meeting certain thresholds must establish an independent Board Compensation Committee that will review and evaluate compensation practices.
- **Certifications:** TARP recipient institutions must have their CEO and CFO certify the organization’s compliance with the executive compensation requirements.
- **Corporate Jets and Expenditures:** The TARP recipient’s board of directors must ensure that there are company-wide policies regarding excessive or luxury expenses. Such expenditures include aviation and other travel, office and facilities renovations, entertainment/events and “other activities or events that are not reasonable expenditures for staff development, reasonable performance incentives, or other similar measures conducted in the normal course of the business operations.”

In addition to the restrictions above, TARP recipients must be able to provide adequate documentation and records to substantiate their compliance and must maintain such documentation for at least six years. Any individual or entity making or providing false information or certifications to the Treasury Department is subject to criminal penalties.²³

Thus TARP and ARRA call for significant compliance and corporate governance related efforts on behalf of organizations that receive federal monies. These additional requirements will undoubtedly challenge the independent business judgment of recipient organizations as they are forced to re-evaluate the decision making process for matters that were once within their sole discretion. Management decisions about how compensation programs are designed and approved, how the organization reports on its finances, how it will incent executives to remain with the organization in troubled times in the absence of golden parachute agreements, and how the

²³ Selected excerpts of the TARP provisions are attached at Appendix 7 of this Special Report.

organization will issue bonus compensation and utilize executive perquisites are now all subject to government scrutiny. While labeled corporate governance, it is quite possible that this legislative and governmental response to past abuses coupled with a current popular desire to be watchful on the use of taxpayer dollars, will lead to further review of our current thinking about compliance and ethics practices. Indeed, the U.S. Commission's guidelines for organizations may be headed for further review and commentary if not a substantive revision.

II. AMERICAN RECOVERY AND REINVESTMENT ACT OF 2009 AND ITS WHISTLEBLOWER PROTECTIONS

Section 1553 of ARRA also contains provisions, separate from TARP, which provide Sarbanes-Oxley-like whistleblower protection for employees of organizations receiving stimulus funds under ARRA.²⁴ This section establishes procedures and damage remedies that are similar to those provided under Section 806 of the Sarbanes-Oxley Act, but there are meaningful distinctions to SOX and in some ways the whistleblower protections go beyond the SOX protections. Not surprisingly, the purpose of this section is to further ensure that ARRA funds are not mismanaged. The provision applies to state and local governments who receive "covered funds" as well as private employers. It does not apply to federal employers. ***Covered Funds are defined so as to include any contract, grant, or other payment received by the employer if any portion of such money or property has been provided by the federal government and at least some of the funds are appropriated by virtue of ARRA.***

The protection applies to the employees of these covered employers who make complaints *internally* to "any person with supervisory authority over the employee (or such other person working for the employer who has the authority to investigate, discover, or terminate misconduct)." Similarly, the protection applies where such employees make complaints *externally* to one of several entities including the Recovery Accountability and Transparency Board (which is established by ARRA and hereinafter referred to as the "Board"), an inspector general, the Comptroller General, a member of Congress, a State or Federal regulatory or law enforcement authority, a court or grand jury, or the head of a federal agency, or their representatives.

The whistleblower protection is limited to complaints or disclosures where the employee "reasonably believes" there is evidence of: (1) gross mismanagement of an agency contract or grant related to covered funds; (2) a gross waste of covered funds; (3) a substantial and specific danger to public health or safety related to the implementation or use of covered funds; (4) an abuse of authority related to the implementation or use of covered funds; or (5) a violation of law, rule, or regulation related to an agency contract (including the competition for or negotiation of a contract) or grant, awarded or issued related to covered funds.

²⁴ Section 1553 of the American Recovery and Reinvestment Act of 2009 ("ARRA").

Employees who believe they are being retaliated against are to submit a complaint to the inspector general of the government agency having jurisdiction over the covered funds. Similar to SOX, the inspector general has 180 days to investigate the matter and to submit a report. The report will be issued to the employer, the head of the relevant federal agency, and to the Board.

As with SOX, the burden of proof on the employee is relatively low as they need only show that the protected activity was a “contributing factor” to the employer’s adverse action. Moreover, the provisions establish that the burden can be met merely by establishing that the decision-maker knew of the protected activity or that there was “reasonable” temporal proximity between the protected activity and the alleged reprisal. Upon such showing, the burden shifts to the employer to prove by clear and convincing evidence that it would have taken the same action irrespective of the employee’s protected activity. Employees will have the option of also pursuing their complaint in federal court upon receiving an adverse ruling from the inspector general or upon the expiration of 210 days from the filing of the complaint. The available remedies for violation of these provisions include reinstatement, back pay, compensatory damages and attorneys’ fees.

Given the massive funding providing by ARRA and the broad definition of “covered funds,” we believe covered employers will likely see a significant increase in whistleblower claims. For those employers that are not public companies, and thus not previously covered by the SOX whistleblower provisions, this may be a significant trigger of new employment claims.

III. ADDITIONAL LEGISLATION AND REGULATIONS PENDING

It is quite evident that we will continue to see additional legislation and regulations associated with federal government stimulus programs. The ARRA provides that the Secretary of the Treasury will issue regulations concerning executive compensation and corporate governance. The Securities and Exchange Commission has one year from the enactment of the ARRA to issue final rules and regulations related to the Act.

The Senate has recently proposed additional legislation aimed at curbing executive compensation and providing for additional regulatory oversight. On February 12, 2009, the Senate introduced Bill S. 431, which proposes further limits on executive compensation. The Bill would create a watchdog agency called the Office of the Taxpayer Advocate (“OTA”) within the Treasury Department to audit and oversee the recipients of TARP funds. The OTA would have broad access to company books and records belonging to and used by company officers, directors, employees, independent public accounts, financial advisors and other agents and representatives. The OTA’s broad investigative powers include the ability to take depositions and other testimony and to issue subpoenas. The OTA would be authorized by the Treasury Secretary to negotiate compensation arrangements and, if the OTA finds reason to believe that a recipient would become insolvent but for receipt of TARP funds, the OTA will negotiate a reduction in the executive compensation arrangements for the recipient.

Senate Bill 431 also would create a quasi-judicial body called the Temporary Economic Recovery Oversight Panel (“TEROP”) to evaluate settlements reached with the OTA, to approve or deny such settlements and to establish compensation programs. The TEROP would be able to hold evidentiary hearings to review proposed settlements. The OTA or an individual who is subject to the actions of the OTA can appeal an action of the TEROP to the Court of Appeals for the District of Columbia Circuit.

CONCLUDING REMARKS

The myriad of compliance and ethics requirements that are imposed on federal contractors, and indeed, all organizations, can be daunting as well as frustrating to organizations seeking to compete and survive in the challenging business and economic environment of today. At a time perhaps when many organizations are looking for the government to support their entrepreneurial efforts, it may seem to some that the government decision to mandate added costly compliance and ethics policies, structures and perhaps even additional human resources is far from the stimulative support that organizations need to advance our economic recovery. The reality however is that we are at a truly unique time in relation to how Americans view organizations. More and more the demand on government is not only to stimulate the economy and return America to its prominence, but also to do right by all citizens by ensuring that organizations, including their executives, are not exempt from the common notions of equity and fair play. In this environment, it is likely that winning organizations will not be those that do as little as possible to make themselves minimally compliant with government requirements. To the contrary, the winning organizations likely will be those that embrace compliance and ethics requirements, and corporate governance generally, as a call to transparency – transparency of process, of product, of profit and perhaps most importantly of people. Organizations that not only allow but also seek to thrive on the sunlight suggested by these compliance and ethics requirements will undoubtedly have an upper-hand as organizations competing for business from the federal government are matched not only on the basis of price but also their track record of integrity and transparency. We encourage all organizations to strive to develop and implement a best-practice compliance and ethics program. The return on investment for organizations that do so will be immeasurable and well-beyond any short term savings recovered through a minimalist approach to organizational integrity.

ACKNOWLEDGEMENTS

THIS SPECIAL REPORT WAS MADE POSSIBLE THROUGH THE TREMENDOUS SUPPORT OF THE FOLLOWING JACKSON LEWIS LLP ATTORNEYS:

TOKUNBO AKINBAJO, ESQ.

MITCHELL BOYARKSY, ESQ.

JOSEPH TORIS, ESQ.

SALLY WELCH, ESQ.

SPECIAL THANKS ALSO TO MEMBERS OF THE JACKSON LEWIS CLIENT SERVICES ORGANIZATION:

CLARE GROSSMAN

LAURA HEVEY

CARRIE JABINSKY

ANNAIS RHODEN