

COMPLIANCE COMMUNICATORSM

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To: Managers

From: Ethics/Compliance Officer

Subject: Lessons Learned from Société Générale

In late January, a fraud unprecedented in size was uncovered at Société Générale, the second largest bank in France. Jerome Kerviel made a series of unauthorized trades and covered them up. When the bank discovered what Kerviel had done, it cost them \$7.2 billion to unwind the trades he made. No, that is not a typo. \$7.2 billion - the largest single act of fraud in corporate history.

Obviously, we are not a financial services firm and fraud on that scale is unthinkable here. We also believe that we have a sound system of internal controls to prevent fraud of any magnitude. But the key to any system of internal controls is us – managers and leadership. This memo is intended to help us learn valuable lessons from this nightmare to minimize the chances that anything like it will ever happen here.

1. Be vigilant.

There are some indications that several of Mr. Kerviel's trades raised questions in the past, but they were not fully explored. He may have been given too much "slack" because of his previous experience in the back office where he gained experience on the control side. Unfortunately, nobody should receive a pass when flags are raised. Just because someone has experience or special expertise does not place them above reproach. After all, several of the largest insider trading scandals on Wall Street were perpetrated by traders who had previously worked in compliance.

2. Protecting passwords and user IDs is not a joke.

Kerviel used his relationships with people in the back office to obtain their passwords and user IDs, which he used to cover up his trades. Remind your employees of the importance of protecting their passwords, IDs and confidential information.

3. Encourage communications of sensitive issues.

It is very difficult to believe that any one individual, even a "computer genius," as Kerviel was described, could pull off a fraud of such magnitude without others being aware. Most fraud is known or suspected by at least one coworker and often by many more. It is critical for every leader to demonstrate that they are available and interested in hearing about suspicious behavior. Each of us needs to take steps to be sure that others know they can come to us and that we can be trusted whether its little things or serious problems.

Please consider talking to your people about this case sometime in the next week, while it is fresh in their minds and yours. If you find it helpful, feel free to start with the outline below. I am interested to learn how your conversations turn out.

1. Bring up the Société Générale fraud.

“Did you hear about the huge fraud at that French bank, Société Générale?” (For the non-French speaker, it is OK to pronounce this “Society General.”) The perpetrator took \$7.2 billion. He was a young trader who wasn’t very highly paid (under 100K) and had no incentive to make millions for himself. While nothing of that scale could happen here, there are some lessons we can learn to make sure we’re doing all we can to prevent fraud.

2. Breached multiple levels of internal controls.

The perpetrator used to work in the control section, so he knew what the controls were and how to get around them. He obtained passwords and user IDs from colleagues in the controls area of the bank, and used them to breach controls. He falsified trades, records and other documents. He was finally discovered when he didn’t adequately cover up one trade, and his explanations for the trade were not supportable.



3. What are the main controls we use in our area?

Many people outside of finance don’t think intuitively about controls, so stepping back and reminding people about them can be helpful. Your controls may include time sheets, expense reports, signature authorities, approvals on expenditures, inventories, etc.

4. One control is with IT access. Please make sure you protect your passwords, user ID and other confidential information.

Nobody should ask you for these items. Sharing your passwords means losing control of their security.

Please come to me if you believe we have any weakness in our controls.

I’d like to know about them, or anything we can do to keep our organization on the right track and doing the right thing.

NOTEWORTHY QUOTES

“There is no innocent explanation.”

- Bernard Madoff to the FBI

BERNARD L. MADOFF,
BERNARD L. MADOFF INVESTMENT
SECURITIES LLC,

Defendants.

“Going through the crisis there are two advisers I’ve paid no attention to. The first are the lawyers, and the second are the accountants. It’s not about the money or the legal liability. This is about our being accountable for providing consumers with safe food.”

- Michael McCain, CEO of Maple Leaf Foods in a public announcement to those affected by listeria contamination at one of his plants that was linked to 20 deaths

Super Tuesday – A Good Day to Review Your Company’s Ethics and Compliance Readiness for the Election Year

It’s a presidential election year and for ethics and compliance officers that means a long list of potential risks and challenges. Consider the following steps and questions to mull over to head off embarrassing incidents or worse.

- Review your Code and policies to make sure they are clear and up-to-date regarding contributions and campaign financing. These issues are complex and can vary from state to state.
- E-mail reminders to employees, especially senior managers, reminding them of the rules and encouraging them to ask questions if they’re in doubt. This is especially important if you’re a government contractor or if your company or industry has a PAC.
- Often employees are unclear about the limits on using company resources for political activities. They may need a reminder that it’s not OK for an employee to make copies of campaign flyers and that using the company’s e-mail to urge clients or customers to support a candidate would be clearly wrong.



- Most companies prohibit employees, without clearance, from speaking on behalf of the company and publicly endorsing a candidate, but have you given thought to what you would do if a sales associate insists it’s her right to wear a candidate’s button when visiting customers?
 - If you have the opportunity to suggest topics for senior managers to discuss, consider raising the issue of using company facilities for rallies. Will you make exceptions if the rally focuses on particular issues – like healthcare, energy or defense – that are directly related to your business?
- Another topic that ought to be addressed is pressure. What if a senior executive hosts a fund raiser and encourages peers and subordinates to attend? What constitutes inappropriate pressure? What happens to those who decline? How would you respond to a complaint from an employee who feels he is being retaliated against by his boss after discussing their political preferences?

Laptop Theft Leads to Violation of UK's Data Protection Act

Marks & Spencer (M&S), a London-based retailer, with 760 stores in more than 30 countries, has been found to have violated the Data Protection Act after the theft of a laptop containing the personal details of 26,000 employees. The laptop was stolen in April, 2007 from the home of an M&S contractor. The employee data, which included pension information, was not encrypted.

The ruling came from the Information Commissioner's Office, which is "the UK's independent authority set up to promote access to official information and to protect personal information" (see www.ico.gov.uk). Failure to comply with the enforcement order, which requires encryption of all M&S hard drives by April, 2008, is a criminal offence, the ICO said.

GE Attorney's Class Action Lawsuit to Go Forward

A U.S. District judge has ruled that a class-action lawsuit can proceed against General Electric (GE) accusing GE officials of giving unfair preference to men in promotions to top-paying legal jobs. The lawsuit potentially seeks damages of \$500 million and seeks an injunction to halt GE's pay and promotion policies.

The lawsuit was brought by Lorene Schaefer, the former general counsel of the Erie, Pa.-based GE Transportation. She has accused GE of having a "very male-dominated culture". In a statement, Schaefer said the ruling would benefit hundreds of GE employees. "Those women have long struggled to shatter the GE glass ceiling and its culture of gender discrimination that have prevented females from advancement

and equal pay," she said.

GE argued that the case should not be allowed to proceed since, as a high-ranking GE attorney, Ms. Schaefer had access to confidential information while employed with GE. In the ruling, the judge did note that "If at any point during discovery, the defendants learn and can demonstrate that plaintiff is inappropriately using confidential client confidences in asserting her claims or representing the class, the court may reconsider the propriety of plaintiff's class allegations at that time."

Racial Harassment Lawsuit Settled

Henredon Furniture Industries Inc., of High Point, NC, settled a racial harassment lawsuit brought against the company for \$465,000. The U.S. Equal Employment Opportunity Commission (EEOC) announced the settlement and said African-American employees had been subjected to a persistent racially hostile work environment.

According to the settlement, African-American employees were subjected to racial slurs as well as threats by hangman's nooses that were displayed at the plant. The suit alleged that the harassment occurred almost daily.

In addition to the \$465,000 settlement, the three year consent decree resolving the case includes requirements that Henredon Furniture not engage in racial harassment or retaliation; requires anti-discrimination training; requires the posting of a notice about the settlement; and requires the company to report complaints of racial harassment to the EEOC for monitoring.

SEC Civil Case Against AOL and PurchasePro.com Executives Heads to Trial

Civil trials against executives from America Online (AOL) and software developer PurchasePro.com will begin in March in what may be the final act in a case that began over six years ago. The four defendants – two former AOL and two PurchasePro.com executives -- are accused of taking part in a scheme to deceive investors and accountants by inflating the revenue of PurchasePro.

The four had requested that the civil fraud claims against them be dismissed. Three of them have already been acquitted by a jury of criminal charges and the Justice Department dismissed criminal charges against the fourth. But last week, Senior Judge Gladys Kessler of the U.S. District Court for the District of Columbia ruled that the SEC's civil case could proceed. It is not unusual for the government to pursue a civil case after losing a criminal case and the burden of proof is much lower in civil matters. The SEC needs only to show "through a preponderance of evidence" that the defendants knowingly engaged in aiding and abetting the fraud.

The case grew out of a broader investigation into accounting practices and alleged sham advertising deals at AOL beginning in 2002. In December 2004, AOL reached a settlement with the government by agreeing to pay \$510 million in fines and penalties.

Utility Accused of Kickbacks Scheme

An attorney is seeking to include hundreds of thousands of utility customers in a lawsuit accusing Duke Energy Corp. of paying kickbacks to some large Cincinnati-area customers to win support for a rate hike. Duke denied the allegations made in the lawsuit. The lawsuit charges that Duke gave illegal and unfair electricity price advantages to some large corporate customers in southern Ohio to quiet their opposition to rate hikes that cost homeowners

and small businesses millions of dollars. Duke said then that it believed the agreements were legal and appropriate and

that the terms of the contracts and the names of the companies were confidential.



EPA Official Sentenced in Fraud Case

An EPA official has been sentenced to a year in prison for his part in a scheme to defraud Fruit of the Loom. A federal jury in September convicted Kenneth S. Harris, of Euless, Texas, of conspiracy to commit mail fraud. Harris was also ordered Wednesday to pay more than \$341,000 in restitution. Harris was accused of conspiring with a former Fruit of the Loom executive and two contractors to defraud the company. Prosecutors said Harris started an environmental consulting firm in 1998 at the

behest of an executive who promised Harris business if she were made a silent partner in the consulting firm.

Tougher Corporate Governance Rules for Non-UK Firms

The Financial Services Authority (FSA) of London is considering bringing in tougher corporate governance rules for overseas firms seeking to list in London. In particular, it is considering whether it should require all companies to comply with the Combined Code for Corporate Governance or explain why they did not. Currently, overseas companies are only required to disclose whether they comply with their local corporate governance regimes and how those differ from the UK code. The FSA is seeking comments on its discussion paper by April 14, with a feedback statement to be published in the third quarter of the year, after which the watchdog will detail its planned changes in a consultation document.

Drug Firms Raided

Some of the world's largest drug firms were raided as part of a European Union inquiry into the use of patents. GlaxoSmithKline,

Pfizer, AstraZeneca and Sanofi-Aventis confirmed they were involved in the sector-wide investigation and are fully cooperating. The firms are suspected of conspiring to delay the introduction of cheap generic drugs. EU antitrust chief Neelie Kroes said she was looking at the entire pharmaceutical industry and wanted to know why generic drugs were so slow to be launched in Europe. It has been reported that U.S. regulators are also examining the issues.

China Warns of Crackdown on Insider Trading and Corruption

China's Central Commission for Discipline Inspection, the country's anti-corruption watchdog, called for improvements to the regulatory framework in place to tackle corruption and malpractice. According to the Xinhua news agency, efforts will be focused on cases involving prominent officials colluding with business people to benefit from construction bids, land sales, and property rights.