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COMPLIANCE PROGRAMS

The Apple Monitor's First Report: Serious Lessons on Compliance Programs

BY JOSEPH E. MURPHY

Shortly after the start of Apple's government-imposed monitor arrangement—the result of the company's loss in the government's antitrust case relating to its e-books price-fixing activity—the big headlines seemed to be about the messy conflict between the Monitor and Apple's lawyers. What exploded in media headlines was the rare case of a company openly attacking its monitor in public. Juicy details spilling out of the story included the Monitor's $1000-plus hourly fees and the company's refusal to allow interviews with its executives. Thus, on April 14, 2014, when the Monitor issued his first report as required under the court order,[1] for the press the singular focus was still the public conflict between Apple and the Monitor.

However, for compliance and ethics professionals and others interested in the field of compliance and ethics, there was much more of interest in the report, revealing clues about the real source of that infamous Apple vs. Monitor conflict.

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What's Going on Here?

Reading the report from a compliance and ethics professional's perspective, a likely core source of friction between Apple and the Monitor was that when the lawyers and executives at Apple looked at the court order, they saw a compliance program as a simple little exercise. Write some policy statements, swear a mighty oath and bore the life out of the junior employees with lectures. Then just tell the Monitor you did this and you are done.[2] It was, however, a pleasant surprise in reading the Monitor's report to see how much insight he had into compliance programs. And thus we see one likely reason for conflict between Apple and the Monitor: if a compliance program is to have an effect and mean anything, it must be deeply involved in the company. Mere superficial touches, which may have been acceptable before the Sentencing Guidelines came into effect more than two decades ago, no longer pass muster. So I sus-

[1] Report of the External Compliance Monitor, United States v. Apple, Inc., No. 1:12-CV-2826, and the State of Texas, et al. v. Penguin Group (USA) Inc., No. 1:12-CV-3394, http://online.wsj.com/public/resources/documents/2014_0414_bromwich.pdf [hereinafter "Report"].

[2] Sadly, the Apple executives and their lawyers are not the only ones so removed from reality; we still see this elsewhere among people who purport to be compliance and/or ethics experts, but who do not take the time to learn the field.

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pect the Apple bosses and their lawyers may have been truly shocked that the program was actually going to have to mean something, and not be a mere pro forma paper and lecture exercise.

The Senior Executives.

There is a saying in the compliance and ethics field: the big guys get in trouble and the little guys get ethics training.

Often people will fret about how difficult it is to reach and train all those folks out in the field. But if one reads the Wall Street Journal, the big cases are not about working folks; they are about the senior people. In antitrust, for example, case after case comes from direct involvement by the executives. In the court's opinion in the Apple case, I do not recall a single reference to misconduct by Apple store employees or junior level staff managers. Here is another point where it appears that Apple was in denial, and it was reflected in Apple's initial resistance to the Monitor's work. The Monitor noted in his report, observing the comments of Apple's Senior Director of Competition Law and Policy: ''Mr. Andeer said that any plan that included interviews of senior Apple personnel was problematic because those individuals did not expect to have to deal with the Monitor directly.'' Andeer said that such interviews of board members and senior executives were not relevant to the Monitor's mandate.[3]

The Monitor, however, saw through this completely. He correctly pointed out that in this case particularly, the senior-most people, including the lawyers, were the drivers of the problematic conduct. As he noted in his executive summary:

> The Court also singled out Apple's senior leadership, stating that the conduct underlying the e-books Litigation ''demonstrated a blatant and aggressive disregard at Apple for the requirements of the law,'' including among ''Apple lawyers and its highest level executives.''[4]

The reality was likely a surprise to Apple's outside lawyers, but here is the point: if you do not know what is going on with the executives and senior leaders, you do not know what is happening with the compliance program. Like it or not, risk number one is the top people. How can someone assess a compliance program yet ignore the highest risk group?

Apparently Apple also believed that if some senior people put their names on a few compliance policies, this was proof of their support of the program and tone at the top. The Monitor hit the nail on the head in addressing this point: ''by themselves [written and e-mail messages to employees] do not support any conclusion about the commitment to antitrust compliance by Apple's senior executives.''[5]

As Donna Boehme has described it, tone at the top is not ''tone from my mouth.''[6] Words, usually written by the lawyers, do not set the tone or tell us what the top people think. Nor do these statements typically convince employees. If employees think management does not believe the words, then the words have no impact. The Monitor is correct in expecting real signs that management understands and actively supports the commitment to ethics and compliance.[7]

Reporting to the Board.

The Monitor seized the high ground on an issue that has been fraught with ambiguity: what does it mean to have the compliance officer ''report'' to the board? Apple said the antitrust compliance officer (ACO) was ''authorized'' to contact the audit committee. The Monitor saw right through that and stated firmly and correctly: ''authorization alone is hardly a guarantee of a direct and meaningful relationship.''

The Monitor gave Apple some straightforward guidance. For example, he wants the ACO to talk with the board's Audit and Finance Committee chairman at least once a month, and he expects the board to follow the Sentencing Guidelines' language about knowing what is going on in the compliance program. He wants ''frequent and substantive meetings,'' and says the ACO's reports should include ''detail and substance.'' He notes that Apple's conduct in the e-books case occurred at the most senior levels, and that it is essential there be a ''strong and direct'' reporting relationship between the ACO and the Audit and Finance Committee made up of only outside directors.

The Monitor gets it. He went on to say:

> Given Ms. Said's [the ACO] recent arrival at the company, we would expect Dr. Sugar [the committee chair] and other members of the Audit and Finance Committee to work actively with her to fulfill her responsibilities to the Board and under the Final Judgment, including through frequent and substantive meetings. We recommend that Ms. Said and Dr. Sugar participate in a regular monthly call or meeting regarding Ms. Said's work, as well as the status of the activities under the Final Judgment and the Antitrust Compliance Program generally.

As for reporting to the board committee:

> The reporting relationship between the Antitrust Compliance Officer and the Audit and Finance Committee must be genuine. Ms. Said's quarterly reports to the Audit and Finance Committee should be more than perfunctory. Ms. Said should include detail and substance in her reports, and the outside directors should have an opportunity to question her on anything and everything relating to her role as the Antitrust Compliance Officer.[8]

''Reporting,'' which is nothing more than a few sheets of paper scrubbed useless by the lawyers, or a short, happy statement that there were 125 helpline calls and all is well, may be worse than useless because it may lull the board into inappropriate complacency. The more open and regular the communications, the better for all involved.

Claiming Privilege.

Lawyers sometimes will proclaim that everything in a compliance program has to be the exclusive domain of lawyers to assert privilege. Putting aside that this inac-

[3] Report at 13.
[4] *Id.*
[5] Report at 52.
[6] Donna Boehme, *Kumbaya Compliance Is Not Good Enough*, Compliance and Ethics Professional (May/June 2013), *available at* http://compliancestrategists.com/csblog/2013/05/30/kumbaya-compliance-good-enough/.
[7] *See, e.g.*, Joe Murphy, *How the CEO Can Make the Difference in Compliance and Ethics*, 20 Ethikos 9 (May/June 2007).
[8] Report at 54–56 (footnotes omitted).

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curate claim often is based on a misunderstanding of privilege, one can see in the Monitor's report how this leads to trouble. Apple objected to the Monitor actually witnessing the antitrust compliance training for fear that privileged communication would be compromised. Of course, if a party wants to cooperate there are ways to deal with this. But it also goes to a central point. By the time you are dealing with the government, the burden is on you to prove that the program is effective. You can stand on privilege all you want, but if you withhold evidence about the program because of privilege, how can you make your case? For the Monitor, how can he determine whether the training is effective or a waste, interactive or boring, attention-getting or sleep-inducing?

Today, if training is not top notch, it is certain that the audience will be on their iPhones and iPads doing something else. Of course the Monitor needs to be there. Here is a point for Apple: you cannot rely on trust in anti-trust compliance. The company has to prove that it works; the Monitor cannot be asked to take someone's word for it.

Risk Assessment.

When the Sentencing Guidelines compliance program standards were revised in 2004, one of the central revisions was to make risk assessment part of any effective program.[9] So logically the Monitor wanted to see Apple's risk assessment. How could he possibly know if the program was geared to address the risks if no one in the company had analyzed what those risks were? Yet there was no indication that Apple had done this or even thought seriously about it. The Monitor set out one of the best explanations I have ever seen for risk assessment in a specific risk area like antitrust:

> An antitrust risk assessment is a fundamental component of any antitrust compliance program, and a systematic assessment of the risks that arise from Apple's businesses, the activities of its employees, and its third-party interactions will help ensure that its Antitrust Compliance Program makes sense for Apple. We believe that such an assessment is a key component in making Apple's Antitrust Compliance Program comprehensive and effective. Simply applying general compliance concepts in response to Final Judgment requirements, or adopting an off-the-shelf compliance program, without incorporating known or expected risks that specifically relate to Apple, is unlikely to lead to an effective and comprehensive Antitrust Compliance Program for the company.
>
> A risk assessment, which should be conducted periodically and as a regular part of Apple's compliance efforts, would also make the Antitrust Compliance Program dynamic; it would allow the company to respond to new risks as they develop. The assessment, if done well, would detect new risks that Apple could then take into account in its Antitrust Compliance Program in an effort to prevent violations. The assessment should consider antitrust concerns that have historically been important for the company, including non-public instances in which antitrust issues have been detected and addressed internally.[10]

[9] U.S.S.G. § 8B2.1(c), http://www.ussc.gov/Guidelines/2010_guidelines/Manual_PDF/Chapter_8.pdf; Report of the Ad Hoc Advisory Group on the Organizational Sentencing Guidelines, at 88–92 (Oct. 7, 2003).

[10] Report at 45.

Assessing the "Compliance Program?" Or Just Pieces of a Court Order?

There is a hole in the court's order that could lead to pointless and unnecessary squabbles. The Monitor, logically enough, assumes he should be assessing the compliance program, not just some loose parts. He refers extensively to the Sentencing Guidelines. The ACO referred in her communications with him to the program's ''seven elements,'' which, of course, means the Sentencing Guidelines standards.[11] What is the problem? Between the judge and the Antitrust Division someone dropped the ball; there is no reference in the court's order to the Sentencing Guidelines standards for an effective compliance and ethics program.

The Sentencing Guidelines standards have been around for over 20 years. Yet no one thought to incorporate them by reference into the order. Instead, the order refers to some specific elements like training, an annual audit and having a compliance officer, and includes a catch-all reference to the monitor assessing the company's ''policies and procedures,'' along with its training. Policies are likely construed as the program's paper; nice to have, but mostly useless with nothing more. Training is an important element, but only one single compliance tool;[12] on its own it cannot make a program successful. Can the word ''procedures'' in the order be interpreted to include all the rest of the Sentencing Guidelines elements? At least under the Guidelines commentary the word is defined to include ''internal controls.''[13] But if ''procedures'' also included all of the other seven elements, then why are those seven elements listed separately in the Guidelines? Yes, the Monitor can and should make the argument, but he should not have to do this, at least if the court and Antitrust Division are serious about getting results.

This could become critical when addressing an important point the Monitor picks up:

> Apple has not provided information related to procedures developed to provide appropriate incentives to Apple employees to abide by the company's policies and to discipline employees who do not. We believe that such procedures will be important to ensuring that Apple employees are aware of the new policies and procedures and choose to abide by them. We will be seeking additional information regarding Apple's plans, if any, regarding incentives and discipline related to the Antitrust Compliance Program.[14]

Of course, the Monitor is spot on with this point, and it is why the Sentencing Guidelines specifically include

[11] The Sentencing Guidelines standards on compliance programs are universally referred to as ''the seven steps.''

[12] Training does not even constitute one element of the Sentencing Guidelines seven steps; step 4, which includes training, also calls for ''otherwise disseminating information,'' a broader concept than just training. U.S.S.G. § 8B2.1(b)(4)(A), http://www.ussc.gov/Guidelines/2010_guidelines/Manual_PDF/Chapter_8.pdf.

[13] U.S.S.G. § 8B2.1 Commentary app. note 1, http://www.ussc.gov/Guidelines/2010_guidelines/Manual_PDF/Chapter_8.pdf.

The specific reference to internal controls is widely overlooked by compliance and ethics practitioners in the U.S., who treat the Sentencing Guidelines reference as if it said ''standards and standards''; but procedures is not a synonym for standards or policies.

[14] Report at 63.

''incentives'' in item 6.[15] He also refers to discipline. But on these important points he has to interpret the reference to ''procedures'' in the court's order. I think he is right, but the court left this unnecessarily ambiguous in not incorporating by reference the Sentencing Guidelines standards; if it had, this would be completely clear and Apple would have been directed to implement a compliance and ethics program that had a chance of being successful.

The court, perhaps considering recommendations from the Antitrust Division, missed an opportunity it should not have missed. There is simply no reason not to have used the accepted standards for compliance programs in the U.S., the Sentencing Guidelines standards. The court's order could readily have had all the specific provisions it had, plus a requirement to meet the Guidelines standards.

Comparison to Anticorruption Training That Was "Sleek and Elegant."

The Monitor was impressed by the anticorruption training, which he describes as ''sleek and elegant.''[16] Why is that not surprising? Why would the anticorruption work be so far ahead of antitrust? Consider that the Department of Justice's Criminal Division and the Securities and Exchange Commission have provided specific guidance on compliance programs, are serious about them and take them into account in enforcement decisions; simply put, the Antitrust Division does not. The Monitor might have been surprised by this difference in approach, but I am not. When the government wants strong compliance and ethics programs to prevent violations, it provides meaningful incentives; when it does not care, it provides no incentives. The Antitrust Division provides no incentives.

Training.

There are definitely some ''wow'' moments in reading about training in the Report. One is the note that the company was unable to document or tell who attended the training, even though it was mandatory![17] Really? Mandatory and they could not tell who was trained? Was there anyone involved in this process with experience in compliance programs?

The Monitor also noted, merely in a footnote, that: ''We understand the September 2013 training on the Final Judgment requirements also included phone attendees.''[18] It is at least interesting that there is no comment on this point. Based on decades of experience in doing compliance training, I can see no surer sign that this process did not really matter at Apple than that they would let people participate by phone. For those who believe that straight lectures are the worst means of reaching people, they must not be thinking of training by phone. That is far worse than lectures. At least with lectures the people are actually there (if they are sleeping or reading the newspaper, the trainer can see it). With phone, they are probably doing ''important'' work at their desks while they barely notice what is being presented in the background over the phone.

Lawyers Running the Program?

There are two interesting compliance program points within the Report related to lawyers' roles in the Apple compliance program. The first is the Monitor's surprise that Apple would consider anyone other than a lawyer to be the antitrust compliance officer. Of course, this case is unusual in having a standalone antitrust compliance officer. In any other situation this would be a terrible idea. There are other important compliance issues in companies; environmental and safety, where lives are at issue, certainly merit at least as much attention as antitrust. Securities fraud, consumer protection, anticorruption, product safety—antitrust does not tower over any of these. There is simply no future in the idea of having standalone compliance officers for each important risk area and thinking they will have meaningful face time with senior officers and the board. In a reasonable program, the person responsible for the antitrust compliance program would have a reporting relationship with an empowered, independent chief compliance officer who would report to the board.

But did Apple need another lawyer in the mix? Did it need a lawyer running compliance? Apple did say to the Monitor that, ''traditionally, this type of position has often been filled by non-lawyers.'' It is fair to note that in antitrust especially there is a need for legal expertise, so it can be understood why someone would think ''lawyer'' first. But a bit of reflection points to the conclusion that the need here is not for a lawyer per se; there were likely more than enough lawyers at Apple already.

The problem was not an absence of lawyers. After all, the whole ugly tempest with the Monitor appears to have been covered top to bottom with lawyers. No, when dealing with senior managers who have gone the wrong way and a large dynamic organization like Apple's, the need is not for yet another lawyer. The need is for a powerful, senior-level manager who knows how to reach people and get things done. More specifically, a serious program calls for an experienced compliance and ethics professional who is positioned within the organization with the independence and empowerment to succeed. (The person needs access to a good lawyer, but does not need to *be* a lawyer.) If that powerful manager also happens to have a law degree, so much the better. But it is a mistake to think of compliance as a legal function. If it is going to have any impact, it needs to be a high-powered management function with direct connection to the board. This is one point where, at least on the staffing question, Apple had it right. History will judge if this specific ACO had the gravitas and dynamism necessary to perform the task, but it will not turn on the person's ability to practice law.

So while Apple did get one thing right, it certainly showed it had not invested much if any time learning about compliance. The Monitor noted that

> We asked Mr. Sewell whether Apple had considered restructuring its compliance function so that the compliance officer would not report through the General Counsel. He responded that he was unaware of other companies that structure their compliance functions in that way and that he

[15] *See* Murphy, ''Using Incentives in Your Compliance and Ethics Program'' (Soc'y Corp. Compliance and Ethics 2012), http://www.corporatecompliance.org/Resources/View/smid/940/ArticleID/724.aspx.

[16] Report at 39.

[17] Report at 40 n.94.

[18] Report at 65 n.164.

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believed it was a corporate best practice to have the compliance officer report to the General Counsel.[19]

I would wager that if one took a first-year law student and gave the person 15 minutes to do a Google search, he or she would come up with plenty of debate and discussion on this issue. There is no chance at all that the student could say he or she ''was unaware of other companies that structure their compliance functions'' other than reporting to the lawyers. Indeed, so much has been written on the topic, with the notion of independent compliance functions gaining increasing recognition, that even some lawyers have called for a truce in the battle on the issue. In reality, not only are there many examples of lawyers not sitting on top of compliance officers, but according to recent surveys, the predominant model is not to have such reporting.[20] On this point the Monitor could well be excused for believing he detected an air of contempt from the company's side for not even bothering to do rudimentary research. Remember, they did not argue that reporting to the lawyer was better on some rationale, but that this was the *only* way it was done. Clearly, this is a wrong statement reflecting an absence of any interest in the topic.

[19] Report at 26 n.72.

[20] *See* PwC's *3rd Annual State of Compliance 2013 Survey* at 9, http://www.pwc.com/us/en/risk-management/2013-state-compliance-survey.jhtml (''When asked whom the CCO reports to on a formal basis, survey respondents' responses were split among three groups: CEOs (27%), general counsels (25%) and boards/audit committees (23%). It is worth noting that relative to last year's results, more companies are establishing formal reporting to CEOs and fewer to general counsels and boards. This would suggest that CEOs are starting to play a more 'hands-on' role in compliance oversight.'')

Lessons.

What can compliance professionals learn from this report? The Monitor provides an excellent explanation on why risk assessment should include assessments within each risk category. There is also important guidance on what ''reporting'' to the board should mean. We should make sure the compliance officer's relationship with the audit committee is strong and substantive. The report also reminds us that senior management support is not shown by signing formalistic statements; it has to be much deeper and more active to be meaningful.

On the policy side, unfortunately it may be difficult for the Antitrust Division to manage the antitrust compliance monitoring process at Apple. Unlike the rest of the Department of Justice, the Division has steadfastly eschewed any role in evaluating compliance programs. Its approach seems to be, ''if the fines are big enough we need nothing else.'' Now they are purporting to help manage a process to change corporate culture. It does appear the monitoring team has some expertise. It appears that Apple does not.

Due to its own practice of absenting itself from the discussion, the Division also may be ill prepared to participate meaningfully in the process. Perhaps the managers and lawyers at Apple and the lawyers at the Division at least could do a little research into the area. Even a couple hours of background research could have made a big difference in this case. The Monitor has shown some good insights into compliance programs. Let's hope the lawyers for both Apple and the government read this report carefully with an open mind; they could learn some valuable lessons.