

**HOW GOOD COMPANIES CAN GET IN TROUBLE:
EXPORT COMPLIANCE & CORPORATE INTEGRITY**
Remarks by Hank Shea at the MTS Conference

June 24, 2008

“TOP 10 WAYS GOOD COMPANIES CAN GET IN TROUBLE”

Background:

MTS Systems Corporation, a Minnesota company that manufactures and sells test systems throughout the world, recently pled guilty and was sentenced in federal court for submitting false export license applications to the U.S. Department of Commerce, involving proposed shipments to India’s nuclear energy programs.

The United States imposed economic sanctions on India in 1998 after India conducted a series of nuclear tests. These sanctions require American companies to obtain an export license when exporting certain goods and services to identified Indian entities. On two license applications, MTS knowingly omitted disclosing knowledge that its testing equipment was being sold for a nuclear end-use, that is, use by unregulated nuclear facilities in India. More information is available from the [Department of Justice](#).

As part of its plea agreement and sentence, MTS sponsored a public export compliance conference on June 24, 2008, enabling other entities to learn from the company’s mistakes. More than 200 persons from 100 companies attended. Hank Shea, one of the Assistant United States Attorneys who prosecuted the case, spoke on the “Top Ten Ways Good Companies Can Get in Trouble.”

Good afternoon. Today I am wearing two hats: one in my old role as a federal prosecutor, as I am still serving as a Special Assistant United States Attorney for the District of Minnesota, and in that capacity, I am expressing my own views and not the position of the U.S. Department of justice. I am also here in my new role as a Senior Distinguished Fellow at the University of St. Thomas School of Law and Holloran Center for Ethical Leadership in the Professions. Today, however, I am wearing my professor hat more than my prosecutor hat. My goal is to help each of you learn about the practices that can get your company or organization into trouble, and how to avoid them.

I want to thank MTS Systems, the Center for Ethical Business Cultures and the Minnesota High Tech Association for sponsoring today’s event. This part of the program says “MTS Case Presentation,” but I have expanded my remarks to focus on how *any* good company can get in trouble. In doing so, I have drawn upon 20 years of prosecuting all types and sizes of companies and other organizations to provide you with a snapshot of “lessons learned.” So, while some of what I present will touch upon MTS, it can happen and does happen everywhere—including possibly your company or organization—or for the attorneys here, your client.

So, here is my Top 10 list of how good companies can get in trouble:

REASON No. 10 – THE WRONG PERSON IN THE WRONG POSITION (AT THE WRONG TIME).

This is a common problem for many companies. It is one thing if the wrong person is involved in menial tasks, but when you put the wrong person in charge of export controls or auditing or as your in-house counsel, you are playing with fire. These positions are the organization's "gatekeepers." Individuals serving in these roles should be specially qualified to oversee and protect your company. Consequently, it is imperative that your company or business makes sure these employees are up to the task *and* that it takes immediate corrective action if they are not meeting their responsibilities. MTS fell short regarding the person who had been in charge of export compliance and it paid a heavy price. It eventually addressed and beefed up export controls when it brought in Jeff Zinsli and his team. But this happened way too late—*after* the violations had already taken place.

REASON No. 9 – INADEQUATE TRAINING AND SUPERVISION.

Even if the wrong person is in a particular position, it is possible to avoid most breakdowns *if* those higher in the chain-of-command provide extra training, support, and supervision. This often takes time and expense that busy executives may not want to spend. Nevertheless, when a key employee makes a serious blunder, a supervisor needs to step in and take charge. Or if a key employee asks for help, *get the person help*. When supervisors ignore these requests, they do so at their peril and risk incidents similar to what occurred at MTS.

REASON No. 8 – INADEQUATE MONITORING/AUDITING & EVALUATION.

Even if the wrong person is in the wrong position *and* there is inadequate direct supervision, companies can still detect and avoid problems if they are proactively checking and weighing employee performance. A company needs both internal and external audits focusing on its most vulnerable areas, which can include past problem areas for the company or the industry as well as new employees or those recently given new responsibilities.

Many examples exist where companies failed to conduct audits or proper monitoring, which in turn led to criminal prosecutions. Given outside auditor warnings regarding customer credit issues, Katun Corporation should have made that area a priority in its finance department. Similarly, since two-thirds of MTS's revenue comes from exports, it should have made export controls a very high priority.

REASON No. 7 – POORLY COMMUNICATED OR UNENFORCED CODES OF CONDUCT OR COMPLIANCE POLICIES & PROCEDURES.

It does no good for a company to have impressive standards of conduct or compliance programs if its employees are not aware of them or if the company does not enforce them. Mere "paper programs" are often worse than no standards at all. They are worse because they show that the organization was aware of laws or rules that they violated *and* chose not to obey or enforce them.

A key issue for MTS was: what did it do about “red flags”? Employee emails showed real confusion and inconsistency in addressing the company’s knowledge that its exports were headed for India’s unregulated nuclear power industry. When an employee or company agent writes **NUCLEAR** in bold caps in an email to the company export compliance person about a possible sale to India, this is a bright red flag that must be addressed and kept on file.

Inadequate or under-enforced policies or procedures were not an issue just at MTS. Here is an even more telling example. When the general counsel of another company under investigation was interviewed, he was asked who enforced the company’s compliance program. His response: it is “*self enforcing*.” This is an example of a gatekeeper acting like an ostrich, or in other words, engaging in willful blindness. This practice of deliberate ignorance led to felony convictions for the company and its former CEO, COO, general counsel, and others.

REASON No. 6 – FAILURE TO ACCEPT RESPONSIBILITY & REMEDY PROBLEMS WHEN BREAKDOWNS OR WRONGDOING OCCUR.

Not every misstep or breakdown involves wrongdoing. Employees are human; they make mistakes and mess up. Such mistakes are an inevitable part of doing business. The critical point is how an organization and its leadership respond. In dealing with breakdowns or wrongdoing, a company has two general choices: 1) it can ignore it and hope it goes away (and usually get burned again and worse) or 2) it can acknowledge it, fix it, and learn from it.

MTS ultimately took the right course—but one may ask: what took so long? Possibly, it engaged in some of the following reasons:

REASON No. 5 – HIRE THE WRONG ATTORNEY WHEN PROBLEMS ARISE (THAT CAN MAKE MATTERS EVEN WORSE).

Be careful in deciding who a company turns to for help when problems come to light. This is often the most important threshold decision for any company that comes under investigation. Given my experience, I believe that it is essential to retain outside counsel who can fully represent your organization’s interests *and* work with the government to identify and expeditiously resolve issues.

The federal investigation into MTS began in 2001. The investigation had a long, tortuous history involving other Assistant United States Attorneys and other MTS outside counsel. I took over the case in May 2007. MTS hired Bill Mauzy at the same time. The government welcomed this development. MTS also brought in Doug Peterson, Bill Michael, and other outside attorneys. This was even more welcomed by the United States.

Let me tell you why. When Bill Mauzy and Doug Peterson said something on behalf of their clients, we could rely on it. If Bill or Doug made a representation that later changed, we were told as soon as possible. Bill Mauzy worked with us to get us access to people and documents, while still protecting the company’s attorney-client privileges. They never

backed away from negotiations. Doug Peterson, in particular, kept lines of communication open.

The bottom line: if your company gets into trouble, find an attorney who government lawyers respect and trust if you want to avoid expense and delay, or even worse. In my view, if MTS had not hired new outside counsel, this case would not have been resolved by a plea agreement. Instead, MTS would be defending itself against multiple felony charges in a long, expensive trial with a potentially disastrous outcome for the company.

REASON No. 4 – FAILURE TO BE CANDID AND OPEN WITH THE GOVERNMENT FROM THE OUTSET OF ANY INQUIRY/INVESTIGATION.

As with many relationships in life, how you and your company initially respond when the government comes calling will often dictate the future course of events between the parties. If you are respectful and upfront, trying to be as cooperative as you are able to be, you can expect reciprocal treatment by the government. If not, you risk setting the tone for a prolonged, difficult relationship.

I have investigated many companies and have charged relatively few. Nothing is more effective or powerful than being up front with the government. Nothing is more disarming than an apology. That is what voluntary disclosure is all about. It is the opposite of hunkering down and circling the wagons and adopting a scorched earth policy.

REASON No. 3 – ATTACKING THE GOVERNMENT INSTEAD OF TACKLING THE PROBLEM.

A search warrant was executed early in the MTS investigation. Search warrants are always tough calls for the government. It is always a sensitive matter for an organization getting searched. It is frustrating for the company and its executives because they often cannot find out the reasons why the judge authorized the search—but experienced attorneys will explain to their clients how and why the government takes these steps *and* the role of the court in approving the search.

The key point for any company under investigation: find out the nature and extent of the problem. Do this internally. Meet with the government as soon as possible and often. Let me also tell you what not to do. Do not tell newspaper reporters that the government’s investigation is “bizarre” or describe allegations as “absurd” or make up facts about the search that get printed in the paper. That is what MTS did early on. No one likes being ridiculed, even public servants. Government agencies have long, institutional memories.

I want to be fair to MTS and give credit to its senior executives. When MTS entered its plea, the chairman of the MTS board of directors (and its former CEO) personally appeared in court to admit to his company’s wrongdoing. The new CEO went further. She wrote a letter to MTS shareholders, stating in part:

MTS takes full responsibility for these violations of law. While no equipment was shipped, these actions by our employees are still unacceptable. Our Code of Conduct

states that we are expected to conduct ourselves with the highest level of integrity and explicitly that we will comply with both the letter and spirit of the laws wherever we do business. In these instances we did not live up to our own expectations.

Such candor and acceptance of responsibility are to be commended.

REASON No. 2 – COMMITTING THE SAME MISTAKE OR MISCONDUCT MORE THAN ONCE.

Committing the same wrongful act more than once shows that you have learned nothing. For me, MTS presented a challenging dilemma. On one hand, this successful company employed more than 1,000 Minnesotans. On the other hand, the company committed not one, not two, but *three* separate violations—demonstrating a pattern of breakdowns that often is prosecuted as felony conduct. It was apparent to all that charging and convicting MTS of a felony could put them out of business. Yet the government was beyond the point of handling the violations as simply an administrative matter, which is what could have been done if there was only one violation. The multiple misdemeanor charges as well as administrative penalties were a fair and just resolution for all parties.

The situation was made worse for MTS because, even after it brought in outside counsel early in the investigation, communications made by and on behalf of MTS to the Department of Commerce did not disclose all of the important facts that MTS employees (and outside counsel) knew about possible nuclear end-use of its equipment in India. This is cardinal error material. Any time there is possible attorney knowledge or involvement in a matter under investigation, investigators and prosecutors engage in a much higher level of scrutiny because of several factors, including a possible defense of reliance on advice of counsel.

Finally, the number one reason good companies can get in trouble, as we have already heard today,

REASON No. 1 – WHEN SENIOR MANAGEMENT FAILS TO CREATE & MAINTAIN AN ETHICAL CULTURE.

Others today have talked about “walking the talk,” but I am convinced that the daily conduct of senior management in leading by example is the most important factor in determining if a company gets in trouble or stays out of trouble. It is a simple fact—employees and officers observe how their leaders behave in any organization to set their own values and priorities and guide their own performance and work habits. They do so because senior management behavior indicates who gets promoted or not, what gets rewarded or not, and who gets held accountable or not. The model and tone from the top have a far greater impact on employee performance than any mission statement or code of conduct.

At MTS, that commitment to ethical conduct existed among senior management, *but*, it grew fuzzy in how it was communicated and prioritized to the rest of the company. Some employees just did not get it prior to 2004. In my opinion, since 2004, real progress has been made at MTS by Jeff Zinsli and the others who are training employees and implementing new procedures to ensure the corporate culture and behavior is in sync in terms of ethics and

compliance. As always, time will tell how much more needs to be done. Under the company's plea agreement and the court's sentence, the government will closely monitor MTS for several years. We hope it can be pointed to as a model for export compliance for years to come.

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