

**Application of Robert E. Cooper, Jr.
to Serve as Independent Compliance Auditor for
Herbalife**

Prepared For:

The Federal Trade Commission



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David R. Esquivel

Susan V. Sidwell

Samuel E. Stumpf, Jr.

Executive Summary

Robert E. Cooper, Jr. submits this application to serve as the Independent Compliance Auditor (“ICA”) pursuant to the Stipulated Order for Permanent Injunction and Monetary Judgment entered in the case of *Federal Trade Commission v. Herbalife International of America, Inc. et al.* (“Order”), with assistance from selected attorneys at Bass, Berry & Sims PLC, the law firm where he is a partner. General Cooper would also engage the assistance of a professional services firm with resources in accounting and information technology.

General Cooper has broad experience in consumer protection and compliance monitoring. He served eight years as Tennessee Attorney General and four years as legal counsel to Tennessee Governor Phil Bredesen, and he currently is the Compliance Monitor in a consumer protection consent decree involving the Commonwealth of Kentucky and Daymar Colleges Group, a for-profit college system. The other lawyers from his firm selected for this engagement have extensive experience in regulatory audits pursuant to consent decrees, the compliance obligations of public companies, and accounting.

If retained as ICA, General Cooper would quickly complete a selection process, already underway, for a professional services firm with expertise in accounting and information technology. General Cooper would promptly consult with Federal Trade Commission (“FTC”) staff and Herbalife regarding the scope and expectations of the ICA’s work. The full ICA compliance team would initiate an orientation at Herbalife to fully understand its products, distribution model, and accounting, audit, and compliance processes and to identify relevant points of contact at the company. The compliance team would then develop rigorous and transparent audit procedures and would divide the audit procedures into work streams structured around the relevant substantive requirements under Section I of the Order.

Upon approval of the work plan and budget, the compliance team would execute the audit procedures in on-site and remote reviews of relevant data and procedures and would communicate interim findings and any concerns with Herbalife as each procedure is completed. The first stage of the engagement would culminate in November 2017 with delivery of a comprehensive report to Herbalife and the FTC that sets forth the ICA’s evaluation of the company’s substantial compliance with pertinent provisions of the Order, as well as significant observations and recommendations arising from execution of the audit procedures. The compliance team would apply the experience and lessons learned from this first audit cycle to the planning and execution of subsequent audits and reporting through the end of the ICA’s seven-year term.

Personnel

General Cooper is a partner at Bass, Berry & Sims PLC. He served as Tennessee's Attorney General from 2006 to 2014 upon appointment by the Tennessee Supreme Court. Prior to his appointment, he was Legal Counsel to Tennessee Governor Phil Bredesen from 2003 to 2006. In these positions, he gained a broad perspective on all aspects of a compliance monitor's role. As the state's chief law enforcement officer, General Cooper helped negotiate and craft settlement agreements requiring on-going compliance enforcement and worked with monitors on enforcement issues. As Counsel to Tennessee Governor Phil Bredesen, General Cooper advised the Governor as the chief executive of a state that was subject to numerous consent decrees and monitorships. Since returning to private practice, General Cooper has served as the Compliance Monitor appointed by the Kentucky Attorney General to supervise enforcement of a consumer protection settlement between the Commonwealth and Daymar Colleges Group.

If appointed ICA, General Cooper would be assisted by a legal team of three attorneys in his firm with extensive experience and qualifications in the areas of compliance auditing, accounting, and public company representation—David R. Esquivel, Susan V. Sidwell, and Samuel E. Stumpf, Jr. Messrs. Esquivel and Stumpf worked for eight years as regulatory auditors for the New York Stock Exchange (“NYSE”), employing and working alongside a global professional services firm to conduct a comprehensive audit of the NYSE's regulatory and compliance programs. Ms. Sidwell was educated and trained in accounting, worked as part of an in-house corporate accounting department, and focuses her legal practice on advising publicly held companies with respect to Securities and Exchange Commission (“SEC”) regulatory compliance.

As the ICA, General Cooper would lead the compliance audit efforts, overseeing the planning and budgeting process, development of audit procedures, execution of the audit, and interim and final reporting to Herbalife and the FTC. Ms. Sidwell and Messrs. Esquivel and Stumpf would be responsible for the day-to-day work of the audit—developing budgets, plans, and audit procedures, overseeing each of the teams formed to execute the audit procedures, keeping General Cooper informed on the progress of the audit, and drafting interim and final reports for Herbalife and the FTC.

In addition to this legal team, General Cooper would engage a professional services firm to assist in his work. The professional services firm would provide accounting and information technology resources. Staff from the professional services firm would work with the legal team

to develop and execute audit procedures. In order to obtain the appropriate firm with due consideration to cost, General Cooper would select from a number of national and regional professional services firms using an interview process similar to that being used by the FTC and Herbalife in selecting the ICA. To respond as fully and quickly as possible to the FTC's Request for Applications, General Cooper has already conferred on a preliminary basis with several professional services firms. Where relevant, this Application incorporates observations and estimates gleaned from those discussions.

General Cooper does not have other time commitments that would limit his ability to function as the ICA. Ms. Sidwell and Messrs. Esquivel and Stumpf are available to devote the time required to ensure the audit procedures are executed efficiently and effectively. The legal team expects the time commitment required by this engagement to be substantial during the period between the selection of the ICA and the first reporting deadline in November 2017, then significantly less during the balance of the seven-year audit period, assuming there are no material changes to Herbalife's operations or systems related to the subject matter of the audit. The legal team will be able to draw as necessary on resources at the law firm, including associate attorneys and technology personnel.

Additional information regarding each member of the proposed legal team is attached to this application as an appendix.

Qualifications

Robert E. Cooper, Jr.

As Tennessee Attorney General from 2006 to 2014, General Cooper oversaw the enforcement of settlement agreements between the state and numerous entities. These agreements covered matters in a variety of industries and a broad spectrum of laws enforced by the Tennessee Attorney General, including state and federal consumer protection laws.

The Tennessee Attorney General's Office was an active participant in multi-state consumer protection investigations during General Cooper's term, and his Office served on a number of executive committees that helped lead these efforts. General Cooper personally participated in negotiating sessions that led in 2012 to the \$25 billion mortgage loan servicing and foreclosure settlement with five major banks, which included robust compliance monitoring provisions.

Consumer protection settlements involving weight management or nutritional supplements that were negotiated and enforced by the Tennessee Attorney General's Office under General Cooper's leadership include:

- ✦ *Airborne*. Tennessee alleged that Airborne made unsubstantiated and unlawful marketing claims that its dietary supplement served as a cold prevention remedy and took the lead among 33 states and the District of Columbia in negotiating a \$7 million settlement in 2008. The company reached separate settlements with the FTC and a private class action.
- ✦ *Dannon*. Tennessee alleged deceptive-advertising complaints against Dannon Company Inc. for claiming its Activia yogurt helped regulate the digestive system and its DanActive dairy drink product provided "immunity" and cold and flu prevention benefits. Tennessee was co-leader among 39 states in negotiating a \$21 million settlement in 2010. The settlement followed a closely coordinated investigation with the FTC, which entered into a separate settlement with Dannon.
- ✦ *HRC Medical Centers*. Tennessee obtained injunctive relief and a receivership against HRC Medical Centers in 2013 after challenging HRC's allegedly deceptive advertising that claimed its so-called "bio-identical" hormone replacement therapy—large doses of hormones over extended periods of time—was "completely safe."

During General Cooper's tenure, the Tennessee Attorney General's Office joined with the FTC in a number of other investigations, lawsuits, settlements, and public outreach efforts not related to weight management or nutritional supplements. Some public examples include:

- ✦ *Operation Tele-Phoney*. In 2008, Tennessee provided substantial assistance to an FTC investigation of an alleged illicit charitable solicitation operation based in Arizona, resulting in an FTC enforcement lawsuit, as part of a year-long national enforcement effort against deceptive and unfair telemarketing practices involving charitable solicitations, magazine subscriptions, automotive warranties, advance-fee credit cards, prescription drugs, and "free" gifts and prizes.
- ✦ *Lifelock*. In 2010, the FTC, Tennessee, and 34 other states entered into a settlement with Lifelock, an identity theft protection provider, over allegedly misleading advertising and sales tactics, which included up to \$11 million in consumer refunds.
- ✦ *U.S. Benefits LLC and United Benefits of American LLC*. In 2010, Tennessee and the FTC jointly prosecuted a lawsuit against these related companies, which allegedly sold fraudulent and deceptive health insurance products. The State and the FTC

successfully obtained injunctive relief, an asset freeze, appointment of a receiver, a ban on future business, and restitution.

- ✦ *Skechers*. The FTC and a group of states co-led by Tennessee investigated alleged deceptive advertising practices related to the manufacturer's claims of purported health benefits of its shoes. Settlement agreements negotiated in 2012 by the FTC and the group of 44 states and the District of Columbia totaled \$45 million.
- ✦ In 2013, Tennessee participated in a multi-state, multi-national enforcement initiative coordinated by the FTC against deceptive practices conducted by travel promoters and timeshare resellers.
- ✦ In November 2011, General Cooper co-sponsored a workshop at Vanderbilt Law School on consumer protection issues – the “Common Ground Conference” – with David Vladeck, Director of the FTC's Bureau of Consumer Protection, and Cindy Liebes, Director for the FTC's Southeast Region.

David R. Esquivel, Susan V. Sidwell, and Samuel E. Stumpf, Jr.

Ms. Sidwell and Messrs. Esquivel and Stumpf are practicing lawyers with a combined 84 years of legal experience. In representing a substantial number of sophisticated businesses and organizations over that time, they are accustomed to completing complex projects within anticipated deadlines and budgets. A large majority of Mr. Esquivel's practice consists of federal court litigation, requiring preparation for and participation in court proceedings ranging from preliminary filings to jury trials and appeals. Ms. Sidwell regularly counsels public companies on issues of corporate governance, fiduciary duties, and SEC compliance. She received her undergraduate degree in accounting and is a Certified Management Accountant (inactive). In addition to his mergers and acquisitions, private equity, and securities industry regulation practice, Mr. Stumpf has extensive experience working with various product distribution structures, including licensing, dealership, and franchise system formation and operation, and related FTC regulatory matters.

Messrs. Esquivel and Stumpf have significant experience auditing the performance of organizations pursuant to settlements and consent decrees. From 2005 to 2013, they helped lead the Bass, Berry & Sims team that served as the Regulatory Auditor for the NYSE. Selected by the NYSE and approved by the SEC, Bass, Berry & Sims personnel, assisted by professional service firms, spent eight years interviewing regulatory personnel on-site at the NYSE, reviewing the written requirements and specifications for automated surveillance technology, assessing the policies and procedures governing the NYSE's enforcement of internal Exchange

rules and federal securities laws, and reviewing many other components of the NYSE's regulatory and compliance program.

Concurrently, the firm served as the third-party auditor for the American Stock Exchange ("Amex"), also selected by the Exchange and confirmed by the SEC, to ensure compliance with a separate Consent Order between the SEC and the Amex. Messrs. Esquivel and Stumpf also helped lead the firm's work on the Amex third-party audit.

The NYSE regulatory audit and Amex third-party audit required frequent interim reports to the NYSE and Amex regarding observations and recommendations that resulted from the team's execution of various audit protocols. Over the course of eight years, Messrs. Esquivel and Stumpf each drafted dozens of these interim reports and discussed their findings during in-person meetings with relevant NYSE and Amex regulatory personnel. In addition, the NYSE engagement required four bi-annual reports that rendered conclusions on the effectiveness of the NYSE's policies and procedures and summarized the findings of two years of audit procedures. The Amex engagement required two such comprehensive reports. Mr. Stumpf was the principal drafter for each of the six reports.

Mr. Esquivel is currently working with General Cooper in his role as Compliance Monitor for Daymar Colleges Group. Mr. Esquivel oversees day-to-day responsibilities and ensures effective monitoring and reporting of relevant findings to Daymar and the Kentucky Attorney General's Office.

Prior Experience and References

In addition to the settlements monitored by the Office of the Tennessee Attorney General when he led that office, since returning to private practice in 2015, General Cooper has been appointed Compliance Monitor in the following matter:

Daymar Colleges. The Kentucky Attorney General asked General Cooper to serve for two years as the court-appointed Compliance Monitor in a \$12.4 million consumer protection settlement with Daymar Colleges Group, a for-profit college based in Owensboro, Kentucky, with on-line courses and brick-and-mortar campuses throughout the state. General Cooper and the firm began their work in September 2015.

Under the settlement and consent decree, the Compliance Monitor focuses on Daymar's personnel training program, marketing and disclosures to prospective students, quality of faculty, and provision of financial aid. In the course of their work, General Cooper and the compliance monitor team have observed personnel training sessions, reviewed marketing

materials, conducted on-site visits to interview students, faculty, and administrators, monitored telephone calls between Daymar and prospective students, and worked with an outside vendor to implement a comprehensive “mystery shopping” program used to assess Daymar’s interactions with prospective students.

General Cooper and the Daymar compliance monitoring team provide informal, bi-monthly updates to the Kentucky General’s Office, conduct quarterly, in-person meetings with the Daymar General Counsel and Director of Compliance to discuss progress of the monitorship and any Daymar concerns, and provide Daymar written reports with pertinent observations and recommendations following each on-site campus visit.

Contacts:

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During the time General Cooper was in public service, Bass, Berry & Sims served as compliance monitor or regulatory auditor in the following matters:

New York Stock Exchange. The firm was approved by the SEC to serve as the Regulatory Auditor for the NYSE from 2005 to 2013, following the SEC’s findings in a Consent Order that the NYSE had failed to police specialists who were “interpositioning” and “trading ahead” of customer orders. The firm’s engagement covered ongoing audits of regulatory policies and procedures, including interviews with regulatory personnel, review of business requirements and functional specifications for automated surveillance technology, IT testing of

regulatory controls, and observation of trading activity on the NYSE floor. The firm provided comprehensive, bi-annual reports to the SEC and NYSE, as well as frequent, interim reports to the NYSE as it completed individual audit procedures. Two of the lead partners in the NYSE engagement, Messrs. Esquivel and Stumpf, would be part of the legal team for this engagement.

American Stock Exchange. In September 2009, the firm was retained by the Amex, and confirmed by the SEC, to serve as the third-party auditor to conduct comprehensive reviews of the Amex's surveillance, examination, investigation, and disciplinary program relating to trading applicable to floor members. The audit was similar in scope and process to the concurrent audit the firm performed for the NYSE. As with the NYSE audit, the firm rendered interim reports to the Amex as it completed individual audit procedures and two comprehensive reports (in June 2010 and May 2012) to the SEC and Amex. Messrs. Esquivel and Stumpf also were lead partners in the Amex regulatory audit.

Contacts for NYSE and Amex:

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Global Professional Services Firm (name confidential). In 2007, Bass, Berry & Sims was appointed by the SEC as the nationwide compliance monitor to review the fraud detection programs of a global professional services firm and submit a confidential report of its findings to the SEC's New York Regional Office.

The written work product for the engagements described in this section is confidential and therefore cannot be shared in response to this Request for Applications. The references

provided for each of these engagements, however, can speak generally to the quality of the work product provided to the government agencies and regulated entities.

Proposed Activities

The ICA's work as required by the Order falls into three phases. The number of hours for each phase and the percentage of work conducted on-site and off-site are discussed in the Estimated Costs section of this application. The following is a description of proposed activities to be conducted in the first fifteen months of the engagement, leading up to the first semi-annual report required under the Order in November 2017.

Phase I – Preliminary Tasks (September 2016 to May 2017)

The first phase lays the groundwork for the substance of the audit. These preliminary tasks would consist of the following items, identified by general category:

- ✦ Engage a professional services firm to provide accounting and IT resources. General Cooper and his legal team have already begun this process by talking with several professional services firms and would engage a firm promptly so it can participate in the remaining preliminary tasks.
- ✦ Consult with the FTC and Herbalife about scope and expectations for conducting the audit.
- ✦ Conduct orientation with Herbalife business, accounting, compliance, IT, and audit and identify key points of contact at Herbalife in each of these areas.
- ✦ Review and assess accounting, compliance, IT, and audit functions upon which the compliance team may rely with appropriate testing and verification.
- ✦ Devise a detailed work plan, scope, and budget. This will include creating specific audit protocols that identify relevant information and documents to be gathered, the need for interviews or meetings with relevant Herbalife personnel, and how the relevant information and materials will be analyzed in order to determine compliance with the substantive provisions of the Order.
- ✦ Review the proposed work plan, scope, and budget with FTC and Herbalife.

Phase II – Execution of Audit Procedures (May 2017 to October 2017)

While details of this phase will be further developed and refined based on the information gathered in Phase I, General Cooper currently anticipates the compliance team will divide the substantive provisions of the Order subject to audit by the ICA into five separate work streams. Each work stream would consist of individual audit protocols that would reflect the

specific requirements embodied by the relevant subsections of Section I of the Order. The work on each stream would be staffed with resources from Bass, Berry & Sims and the professional services firm, as appropriate for the skillset required for each work stream. Each protocol or work stream would produce pertinent observations and recommendations for interim informal reports to Herbalife and the FTC, as appropriate. The goals of interim reporting would be: (1) ensuring that the company is properly tracking appropriate information to comply with the Order; (2) assisting the company in addressing and resolving any issues before they can grow into areas of substantial noncompliance; and (3) attempting to resolve any such issues before the first semi-annual reporting deadline.

The anticipated five main work streams are as follows:

1. Compensation to Participants (Order Sections I.A. and I.E.)
 - A. Verify Rewardable Transactions
 - B. Verify neutrality of Non-Rewardable Transactions in compensation
 - C. Verify value of points in point system
 - D. Verify Net Rewardable Sales in proportion to Total Net Sales
 - E. Verify no compensation is paid solely for enrolling a Participant or Preferred Customer
 - F. Verify limitations on Rewardable Personal Consumption
 - G. Verify that limitations on Rewardable Personal Consumption are accurately re-set annually
2. Classification of Preferred Customers and Business Opportunity Participants (Section I.B.)
 - A. Verify proper classification
 - B. Verify appropriate documentation of changes in classification
 - C. Verify limitations on pre-change benefits and status of Preferred Customers who become Business Opportunity Participants
3. Collection of Retail Sales Information and Verification of Retail Sales and Preferred Customer Sales (Sections I.C. and I.D.)
 - A. Ensure collection and maintenance in a standardized format

- B. Review of reasonable steps, including company random and targeted audits, to verify retail sales and Preferred Customer Sales
- C. Ensure Multi-Level Compensation does not exceed cap
- 4. Limitations, Conditions & Training Regarding Participants (Sections I.F. and I.H.)
 - A. Ensure no minimum purchase requirements
 - B. Verify targets are met exclusively through Profitable Retail Sales & Sales to Preferred Customers
 - C. Ensure no auto-shipment program for Participants
 - D. Verify Participants have undergone required training
- 5. Leased or Purchased Business Locations (Nutrition Clubs) (Section I.I.)
 - A. Verify compliance with 12-month Participant requirement
 - B. Verify compliance with training course requirement
 - C. Verify compliance with written business plan requirement

Phase III – First Semi-Annual Report (November 2017)

Based on the executed audit protocols, interim findings discussed with Herbalife, and the company's response to interim observations and recommendations, General Cooper and the compliance team will prepare a comprehensive report (the first being due in November 2017) that presents the ICA's conclusions, observations, and any pertinent recommendations from the most recently concluded audit period.

After the conclusion of the first audit period, the compliance team will employ the same three-phase approach to each subsequent audit period, culminating in semi-annual and, after the third year, annual reports. Certain preliminary tasks, such as engaging a professional services firm and familiarizing the compliance team with Herbalife products and processes, will not be required in subsequent audit periods, except to the extent material changes in Herbalife's operations and systems have occurred. Likewise, it is anticipated that execution of the audit procedures and preparation of reports will take significantly less time in subsequent audit periods based on the knowledge gained and work performed during the first year's audit.

Potential Conflicts of Interest or Bias

Neither General Cooper nor any other legal team member from Bass, Berry & Sims has an actual, potential, or perceived conflict of interest. General Cooper's firm has not been engaged to represent Herbalife. Neither General Cooper nor any other legal team member has been employed by Herbalife or the FTC, contracts or grants with the FTC or Herbalife, or has any close, familial, or business relationship with Herbalife or the FTC, or their agents or employees. Neither General Cooper nor any other legal team member is a previous Herbalife board member or employee, or a previous FTC Commissioner or Bureau Director.

Estimated Costs







Appendix



Robert E. Cooper, Jr.

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Bob Cooper, former Tennessee Attorney General, rejoined the firm in April 2015 after 12 years of public service. As a member of the firm's Compliance & Government Investigations Practice Group, Bob advises clients on matters related to compliance and enforcement issues and assist clients in responding to internal investigations from federal, state, or local governments. He has significant experience in investigations and enforcement matters conducted by the Federal Trade Commission, Consumer Financial Protection Bureau, states' Attorneys General offices, and other federal and state regulators. In September 2015, he was appointed to serve as the Compliance Monitor for the consent order reached between the Commonwealth of Kentucky and Daymar Colleges Group.

Education

Yale Law School - J.D., 1983
Princeton University - B.A., 1979



David R. Esquivel

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David Esquivel concentrates his practice on counseling, investigations, and litigation in the financial services sector. He regularly advises clients on financial services compliance issues, handles investigations conducted by the Federal Trade Commission (FTC) and Consumer Financial Protection Bureau (CFPB), and defends companies in individual and class action litigation. David's experience in financial services compliance programs, government investigations, and regulatory proceedings is complemented by his engagement by the New York Stock Exchange to serve as a regulatory auditor.

Education

Duke University School of Law - J.D., 1997
Duke University - B.A., 1992



Susan V. Sidwell

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Susan Sidwell has advised private companies on preparing to go public and public companies on ongoing SEC compliance, corporate governance issues, and compliance with various stock exchanges for more than 25 years. She has significant experience helping clients with regulatory and fiduciary obligations in the context of strategic transactions such as mergers, going private transactions, and tender offers. Susan applies her accounting background to assist clients with the technical side of securities work, guiding clients through complex SEC filings. Susan received a bachelor's degree in accounting and is a Certified Management Accountant (inactive). She worked within an in-house accounting department prior to attending law school.

Education

Vanderbilt Law School - J.D., 1989
Auburn University - B.S., 1982



Samuel E. Stumpf, Jr.

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Sam Stumpf has extensive experience in counseling clients on mergers and acquisitions, and private equity and venture capital transactions. He is also experienced in working on license, dealership, and franchise system formation, related agreement negotiation, and regulatory matters; hedge fund and other investment partnership formation; and investment advisor and broker-dealer registration and compliance matters. From 2005 to 2013, Sam helped lead the team that served as the Regulatory Auditor for the New York Stock Exchange, pursuant to a consent order between the NYSE and the Securities and Exchange Commission.

Education

Vanderbilt Law School - J.D., 1978
Yale University - B.A., 1972