Corporate Liability, Compliance And Governance

- HIPPA ‘96 and Corporate Scandals
- The New Era of Corporate Responsibility
- Sarbanes-Oxley Act of 2002
- Department of Justice Principles of Federal Prosecution of Business Organizations of 2003
- United States Sentencing Guideline Amendments of 2004 and 2010
Corporate Liability, Governance And Compliance

• Eliminate conflicts of interest and promote independent decision-making in the best interests of the business organization

• Self governance, self reporting and acceptance of responsibility are building blocks of the organizational culture expected from reordered enforcement priorities

Sarbanes-Oxley and The Sentinel Effect On Business Organizations

• Public companies – governance and integrity of financial information

• Private companies – fiduciary obligations of Board of Directors and shareholder derivative liability

• Not-for-profit organizations – fiduciary obligations and Attorney General oversight

• Caremark Decision – all organizations
  • Duty of compliance oversight enters the Boardroom – fiduciary obligation of individual Board members
Caremark Decision

• Oversight and responsibility for compliance by the Board of Directors and high level personnel of the organization
• Board knowledge about the content and operation of the organization’s compliance program to prevent and detect violations of the law
• Board exercises reasonable oversight with respect to implementation and effectiveness of the compliance program.

Sarbanes-Oxley Act

• Corporate scandals resulted in quick legislative action in 2002
• Attempt to foster change in the way business organizations act and assign greater responsibility to executives for failures in the accuracy of financial statements
Sarbanes-Oxley Act (cont’d.)

- Increased accountability of corporate executives and board members and improved self governance
- Accuracy and full disclosure of corporate financial information
- Elimination of internal and external conflicts of interest
- Foster compliant corporate culture by protecting reports of misconduct.

Department of Justice Principles of Federal Prosecution of Business Organizations “Thompson/McNulty/Filip Memo”

- Voluntary disclosure and self-reporting as quasi mandatory function of cooperation
- Cooperation in investigating business organizations own wrongdoing
- Affects charging decision against business organization
- Affects sentence under sentencing guidelines
- Business organization’s cannot run the risk of failing to have an effective compliance program
- Failure to detect and prevent wrongful conduct will result in consequences for any business organization in current enforcement environment.
  - Deferred Prosecution Agreements and Corporate Integrity Agreements
What Changed?

• More consistent, nationwide law enforcement response to corporate fraud

• Proactive approach and faster prosecutions encouraged

• Greater uniformity in case disposition with potentially grave consequences for business organizations.

What Changed?

• New emphasis on completeness of cooperation

• Did business organization, while purporting to “cooperate”, engage in conduct that actually impeded investigation, e.g.:
  - Overly broad assertions of legal representation (organization and employees)
  - Directions not to meet/cooperate with government agents
What Changed? (cont’d.)

- Incomplete or delayed document production
- Failure to promptly disclose illegal conduct known to corporation and waiver of privilege: Modified by McNulty/Filip Memos
- Continued financial or other support of culpable employees: Modified by Impact of McNulty/Filip Memo
- Joint defense agreements with culpable employees: Modified by McNulty/Filip Memos.

What Does The Government Expect From Business Organizations

- Partnership with Federal and State governments in detecting and preventing misconduct and promoting an ethical corporate culture
- Organizations which fail to ferret out wrongful conduct and non-compliant activity will likely suffer the consequences of not doing so
- Cooperation in investigating an organization’s own wrongdoing.
Sentencing Guideline Amendments of 2004

- Sentencing guidelines for organizations introduced concept of compliance program to reduce criminal culpability for business organizations in 1991
- Sarbanes-Oxley Act required United States Sentencing Commission to review and amend guidelines to enhance compliance program effectiveness
- Amendments encourage business organizations to partner with Federal government and promote self policing, reporting and cooperation in investigations of its own wrongdoing.

Sentencing Guidelines Amendments of 2004 (cont’d.) - The United States Sentencing Commission’s Original Essential Elements For A Compliance Program

- Standards of Conduct and Policies and Procedures
  - Developed and distributed to all employees to promote a commitment to compliance
- Compliance Officer
  - Focal point for compliance activities
- Education and Training
  - Continued education and training essential for an effective compliance program
- Monitoring and Auditing
  - Process for continuing evaluation for a successful compliance program
Sentencing Guideline Amendments of 2004 (cont’d.) - The United States Sentencing Commission’s Original Essential Elements for a Compliance Program

• Reporting and Investigation
  ➢ Communication to detect and prevent misconduct with ability to investigate and implement corrective action

• Enforcement and Discipline
  ➢ Discipline for failure to adhere to compliance standards and procedures

• Response and Prevention
  ➢ Ability to respond to and correct non-compliant activity and conduct.

Sentencing Guideline Amendments of 2004 (cont’d.)

• Amendments continue to emphasize prevention and detection of criminal conduct, but further emphasize promotion of organizational culture which encourages compliant and ethical conduct

• Amendments stress organizational responsibility, risk assessment and ethical behavior

• Strict legal compliance must be accompanied by a strong commitment to proactive governance and management of risk and ethical behavior

• Compliance with law, but also implement “best practices”
Sentencing Guideline Amendments of 2004 (cont’d.)

- Amendments continue to adopt “carrot and stick” approach regarding criminal penalties for business organizations
- Sustained effective compliance program can mean difference between survival and demise of business organizations
- Effective compliance programs can impact charging and sentencing decisions.

Content Of Sentencing Guideline Amendments of 2004

- Establishment of compliance standards and procedures and creation of code of conduct reasonably capable of reducing misconduct and promoting ethical behavior
  - Focus on areas of high risk and adopt procedures to reduce non-compliant activity
- Assigning oversight and responsibility to high level personnel and governing authority for organizational compliance program
Content Of Sentencing Guideline Amendments of 2004 (cont’d.)

- Knowledgeable about content and operation of compliance program
- Ensure implementation and effectiveness of program
- Compliance professionals provided with adequate resources and authority and reporting responsibility to governing authority.

Content Of Sentencing Guideline Amendments of 2004 (cont’d.)

- Compliance Responsibilities Should Not Be Delegated to Individuals Who Have Engaged in Misconduct
  - Organizational Screening Process Required for Hiring and Promotion
- Training of Upper Level Management and Employees and Agents Addressing Specific Risk Areas
- Auditing and Monitoring to Detect Violations of the Law
  - Procedures for Allowing Anonymous Reporting
Content Of Sentencing Guideline Amendments of 2004 (cont’d.)

- Expanded Focus of Reporting to Include Potential Misconduct and Seeking Guidance on Compliance Matters
- Expand Enforcement of Compliance Program by Disciplinary and Incentive Measures with Employees
- Responsiveness to Misconduct Through Investigation, Corrective Action and Possible Voluntary Disclosure.

Ongoing Risk Assessment for Business Organizations and 2010 Amendments to Sentencing Guidelines

- Amendments expect more than creation of compliance program – compliance program must actually be effective in detecting and preventing misconduct
  - Offense by high level personnel creates rebuttable presumption of ineffectiveness of compliance program
  - Exception to this rebuttable presumption if organization can meet four conditions
Ongoing Risk Assessment for Business Organizations and 2010 Amendments to Sentencing Guidelines (cont’d.)

- Compliance professionals have direct reporting authority to governing authority
- Internal discovery of misconduct before external discovery and investigation
- Prompt reporting to governmental authorities
- No compliance professional participated in misconduct
  - Organization takes reasonable steps to respond to suspected criminal conduct, including use of “outside counsel” to assess and recommend the implementation of modifications to organization’s compliance program.

“Cooperation” Or “Unconditional Surrender”

- Cooperation taken into consideration in charging decisions by Department of Justice
  - Organization’s ability to make witnesses available
  - Disclosure of organization’s internal investigation, including waiver of attorney/client privilege when necessary, to identify individuals responsible and scope of conduct: Substantially Modified by McNulty/Filip Memos
  - Disclosure in a timely and complete manner before facts become stale and to better enable recovery of losses
“Cooperation” Or “Unconditional Surrender” (cont’d.)

- Cooperation evaluated on case-by-case basis
- Deferred prosecution agreement – survival of business organization – corporate integrity agreement with Department of Health and Human Services

- Circumstances literally coerce business organizations into cooperation, but the United States Sentencing Commission, the Courts and Congress responded to constitutional abuses.

- Powerful incentives involved in business organization’s decision to cooperate in investigation of own wrongdoing

“Cooperation” Or “Unconditional Surrender” (cont’d.)

- Department of Justice views self-reporting as a quasi mandatory function of cooperation
- Drives wedge between organization and its employees
  - Undermines fundamental employer/employee relationship.
Deferred Prosecution Agreements ("DPA")

- Deferred Prosecution Agreement – creature of Department of Justice – consequence of enforcement of corporate culpability
  - Organization commits to “best practices” for effective governance and promotion of ethical culture of compliance
  - Chief Compliance Officer reporting directly to Board
  - Extensive training and education programs
  - Hotline reporting of non-compliant conduct
  - Appointment of monitor to oversee obligations under deferred prosecution agreement.

Corporate Integrity Agreements ("CIA")

- Creature of Office of the Inspector General ("OIG") of the United States Department of Health and Human Services
  - Obligations in return for continued participation in Federal health programs
- A part of global criminal and/or civil settlement
- May represent OIG’s opinion on the organization’s compliance programs
Corporate Integrity Agreements ("CIA")

- Adopts and adheres to seven essential elements of an effective compliance program, including:
  - Education and training
  - Focused audit and monitoring
  - Independence of compliance officer
- Reporting requirements to OIG.

Independence Of The Compliance Officer

- Dual responsibility of compliance officers are suspect to the OIG at large organizations
- Concern with sufficient commitment of resources
- Reporting to Board of Directors/Trustee
- Independent CCO.
OIG Expectations
Compliance Training

• Broad based compliance program training
• Extensive and specific training for risk areas
• Document training
• Efforts made to train physicians
• Technology training
• Essential for effective compliance programs

Board Of Directors
Duty Of Care

• Duty of care involves determining whether the directors acted:
  ➢ In good faith
  ➢ With the level of care that an ordinarily prudent person would in like circumstances
  ➢ In a manner that they reasonably believe is in the best interest of the corporation
Director’s Obligations

• Decision-making function
  ➢ Applying duty of care principles to a specific decision or board action

• Oversight function
  ➢ Applying duty of care principles with respect to the general activity in overseeing the day-to-day business activities of the corporation

• Responsible Corporate Officer Doctrine

Why Corporate Compliance Programs?

• Risks associated with non-compliance have grown dramatically

• Board compliance program oversight responsibility is an ongoing element of the duty of care

• Compliance programs are designed to mitigate risks to health care organizations in a heavily regulated industry.
RESPONDING TO A GOVERNMENT INVESTIGATION

When the Government Knocks Who Should Respond?

• In-house counsel
• Regular outside corporate counsel
• Independent special outside counsel
How Should You Respond?

- A “rapid fire” response is essential
- It is critical to establish trust from the outset
- Having an effective compliance program already in place is key
- There should exist a “culture of compliance”
- There should be a written policy mandating full cooperation and the organization should cooperate fully with the investigators

What is Full Cooperation?

- Self-reporting the violation
- Acting quickly and establishing trust
- Cooperation should be thorough
- At a minimum, cooperation should include:
  - Making witnesses available
  - Producing all relevant documents
  - Discussing results from the internal investigation
The DOJ Corporate Prosecution Principles

• Implemented on August 28, 2008
• Previously, DOJ could request a waiver of the attorney client privilege and consider a refusal to waive as one factor in evaluating cooperation
• Can no longer request or consider whether company waives the attorney client or work product privileges
• Exceptions: Advice of counsel defense & Crime Fraud Exception

The DOJ Corporate Prosecution Principles (cont’d.)

• Can’t consider joint defense agreements (JDAs”) adversely against a company
• Can request non-disclosure of information DOJ provides to company, and consider it against the company if it breaches by disclosing per a JDA
• Encourages companies to avoid being disabled by JDAs and to consider crafting JDAs to allow for flexibility in disclosing relevant facts to DOJ
The DOJ Corporate Prosecution Principles (cont’d.)

• DOJ may consider whether company has disciplined employees *determined by company* to be culpable, and then only as part of evaluating the company’s remedial measures or its compliance program

• Leaves unchanged the “McNulty Memo” policy concerning indemnification of fees

The DOJ Corporate Prosecution Principles (cont’d.)

• DOJ can still consider the following factors:
  • Whether corporation has disclosed all relevant facts
    ➢ Including facts discovered through witness interviews during an internal investigation
    ➢ Encourages method of fact-gathering that will not invoke privilege issues (i.e. using non-lawyers to interview witnesses)
The DOJ Corporate Prosecution Principles (cont’d.)

- Whether corporation has produced all non-privileged documents
  - Including accounting and business records
  - Including e-mails between non-attorney employees or agents
  - Whether corporation has assisted in interpreting complex business records
- Whether corporation has made key witness available

Obstruction

- DOJ will consider whether an organization, while purporting to cooperate, had attempted to impede the investigation
  - Overbroad or frivolous assertions of the attorney client privilege or work product doctrine
  - Directions to employees not to cooperate
  - Making presentations or submissions that contain misleading assertions or omissions
  - Failing to promptly disclose illegal conduct known to the organization
BOARDS IN TIMES OF CRISIS AND UNCERTAINTY

Boards in Times of Crisis and Uncertainty

- The financial markets and the financial well-being of companies around the world have changed dramatically.
- The financial crisis has spread beyond companies directly involved in sub-prime mortgages and directors may have heightened concerns about their duties, role and obligations in this rapidly changing world.

► In-house counsel plays an important role in helping boards understand their fiduciary obligations to the company and its shareholders.
Boards in Times of Crisis and Uncertainty (cont’d.)

- Even in the most uncertain of times, fundamentals of directorship continue to apply
- Directors must responsibly oversee company affairs and the business judgment rule remains the standard for judicial review
  - It is the responsibility of the directors to oversee the affairs of the company and it is management’s job to run the day-to-day business of the company
  - The degree of vigilance may change depending on the circumstances

The Business Judgment Rule

- The business judgment rule is a well-established standard of judicial review to encourage innovation and risk-taking by the board
- Under the business judgment rule, courts defer to the decisions of disinterested directors, absent evidence, that the directors did not act in good faith or were not reasonably informed, or that there is no rational business purpose for the decision that promotes the interests of the company or its shareholders
- The business judgment rule is not a duty, but is a defense to a claim of breach of duty
- In times of economic stress, directors must often make difficult choices—these choices must be guided, at all times, by their duties to the company and its shareholders
Loyalty

• Duty to give higher priority to corporate interests than to his/her personal interests

• Conflict of interest. Directors should identify all potential conflicts that impair, or create the appearance of impairing, the ability of a director to discharge his duty of loyalty to shareholders
  ➢ A compensatory, financial, professional or business relationship, or
  ➢ A significant social, personal or family tie

Loyalty (cont’d.)

• Corporate opportunity. Directors may not use their strategic position for their own advantage to the exclusion or detriment of the company they represent

• Confidentiality. The duty to keep company information confidential. Under the NYSE listing standards, listed companies must address the duty of confidentiality in their code of ethics
Care

- Directors must act diligently and with the level of due care appropriate to the particular situation
- According to the American Bar Association’s Corporate Director’s Handbook, directors should take the following actions to meet their duty of care:
  - Committing time and regularly attending meetings
  - Being adequately informed
  - Relying on others in appropriate circumstances

Candor

- DE courts have articulated a duty of candor that derives from the duty of loyalty and the duty of care
- Calls on directors to disclose to their fellow directors and the company’s shareholders all information that is relevant to them that is relevant to the decision under consideration
What Constitutes an Effective Compliance Program?

- Corporate culture encourages ethical conduct
- Chief Compliance Officer (CCO) reports to Board
- CCO has sufficient authority and resources
- Executives and directors ensure effectiveness
- Due diligence to prevent and detect violations
- Effective training
- Anonymous reporting and no retaliation
- Periodic evaluation and modifications

Role of Executives in Compliance

- Be a good role model
- Foster a culture of compliance
- Insist on compliance
- Actively support the program
- Implement the program fully
- Adequately fund the program
- Keep Board apprised
Role of Directors in Compliance

- Directors owe “duty of good faith” to corporation in oversight of program (In re Caremark)
- Board should define the scope of the program
- Board should approve key policies and procedures
- Board should require periodic reporting on compliance matters

Board Focus in Times of Crisis and Uncertainty

- During market uncertainty, there are five main areas on which directors should focus their attention:
  1) The state of the company’s business
  2) The quality and depth of management
  3) The company’s liquidity
  4) The company’s risk profile
  5) Ethics and integrity
#1 – The State of the Company’s Business

- In crisis and uncertainty, it is important to assess and question the sustainability and adaptability of the company’s business model.
- Focus should be on making sure the board fully and completely understands:
  - How revenue is generated
  - Operating costs – labor, costs of goods sold, and selling, general and administrative expenses
  - Business levers
  - The company’s products, industry and suppliers
  - Competition

#1 – The State of the Company’s Business

- The board with management should run various business scenarios
  - Negative, flat and positive growth
  - Loss of key customers or suppliers
  - M&A
  - Sustained economic crisis
  - Loss of financing/credit
#2 – The Quality and Depth of Management

- The board has an obligation to make sure senior management has experience, expertise, commitment, leadership ability, and depth
- Especially in times of crisis, the strength of the management is critical
- The board should feel confident that management is managing through the crisis (not sticking its head in the sand)
  - Rapid response
  - Good judgment
  - Communication with the board

#2 – The Quality and Depth of Management

- Adequate succession planning is a key function of the board
- Directors should be aware of information or decisions by management that may be “red flags” or those that seem “odd”, inconsistent or are not supported by the facts and circumstances
  - Remember Worldcom. The special committee found that the board and its committees “did not function in a way that made it likely that they would notice red flags” and “were distant and detached from the workings of the company.”
# 3 - Liquidity

- Liquidity is important in a crisis
- The board should assess the company’s current and projected cash flow
  - Seasonality
  - Forecast assumptions
- Management should actively monitor and manage the company’s cash and should report its cash management and investment policies to the board (or the audit committee of the board)
  - In light of recent events, it is critical for management to stay in close contact with all financial institutions where cash is invested and report such communications with the board

# 3 - Liquidity

- The company’s investments should be closely monitored and should be re-evaluated in light of the current economic environment
- The board should understand the company’s credit arrangements and any existing financial covenants
  - Is the company at risk of failing to meet financial obligations
#4 – The Company’s Risk Profile

- The board should – whether director or through the audit committee – review whether management has adopted and implemented proper risk assessment and risk management policies and procedures.
- This risk assessment should be reviewed in light of the rapidly changing financial markets:
  - New risks
    - Are customers, suppliers, products at risk?
    - What are the risks in a sustained economic down-turn?

#4 – The Company’s Risk Profile (cont’d.)

- Mitigation strategies
  - Are there ways to mitigate or prevent a crisis?
- When reviewing the company’s risk matrix, it is important for boards to question how the company calculates and identifies risk
  - Is management ignoring risks or under pricing risks?
#5 – Ethics and Integrity

• As a result of Sarbanes-Oxley’s mandate to the U.S. Sentencing Commission, directors and senior executives assume greater responsibilities to ensure the existence of effective compliance and ethics programs. Directors and officers must:
  ➢ Exercise due diligence to prevent and detect criminal conduct
  ➢ Promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law

• SEC rules require a code of ethics in public companies to be a written standard that is “reasonably designed” to deter wrongdoing and to promote:
  ➢ Honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships
  ➢ Full, fair, accurate, timely and understandable disclosure in reports and documents that a registrant files with, or submits to, the Commission and in other public communications made by the registrant
  ➢ Compliance with applicable governmental laws, rules and regulations
  ➢ Accountability for adherence to the code
• The board must insist on good governance practices, transparency and an appropriate “tone at the top” where management acts in accordance with the highest levels of ethics and integrity
  ➢ The tone at the top shapes corporate culture and permeates the company’s relationship with investors, employees, customers, suppliers and the community at-large
  ➢ The CEO and senior management must be personally committed to high ethical standards, principles of fair dealing, full compliance with legal requirements and resistance to Wall Street pressures for short-term results
• Companies should assess their internal ethics compliance program, communicate with the board on their program and should report violations of the Code of Ethics when appropriate

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**Director’s Obligations**

• Decision-making function
  ➢ Applying duty of care principles to a specific decision or board action

• Oversight function
  ➢ Applying duty of care principles with respect to the general activity in overseeing the day-to-day business activities of the corporation
Why Corporate Compliance Programs?

- Risks associated with non-compliance have grown dramatically
- Board compliance program oversight responsibility is an ongoing element of the duty of care
- Compliance programs are designed to mitigate risks to health care organizations in a heavily regulated industry
- Whistleblower threat is acute.

Audit and Compliance Committee

Committee’s Compliance Functions
(as defined by Board Policy)

- Ensure that appropriate policies and procedures are in place to preserve and safeguard the organization’s assets
- Ensure proper ethical and legal standards are present and maintained in meeting all applicable laws, rules and regulations
- Monitor compliance with applicable laws, rules and regulations
Committee’s/Board’s Focus on Compliance

Two Categories

• Structural – the Board’s understanding of the scope of compliance program
• Operational – the Board’s understanding of the operations of compliance program

Structural Questions

• How is Board structured to oversee compliance issues?
• How is the compliance program structured and who are the key employees responsible for its implementation and operation?
• How does the compliance reporting system work and how are reports made to the Board?
• How frequently does the Board receive reports about compliance issues?
Structural Questions (cont’d.)

- What are the goals of the compliance program?
- Does the compliance program address the significant risks that may apply to our organization?
- How were those risks determined and how are new compliance risks identified and incorporated into the program?
- How has management determined the adequacy of the resources dedicated to implementing and sustaining the compliance program?

What are the Goals of the Compliance Program? (cont’d.)

- Develop annual auditing and monitoring work plans
- Effectively communicate regulatory changes to include accountability for implementation
- To create a culture that promotes:
  - Integrity
  - Open Communication
  - Responsiveness to concerns.
Fulfilling the Commitment

- Employee responsibility and accountability
- Policy development
- Code of Conduct
- Education, training, and communication
- Reporting
- Integrity Line
- Monitoring
- Auditing
- Ongoing evaluation and reporting

Accountability

- Directors and Managers are accountable for:
  - Failure to detect and report non-compliance issues
  - Any retaliation or retribution against individuals who report compliance concerns
  - Compliance as an element of performance evaluations
Management Skills v. Compliance

- Compliance
  - Education
  - Communication
  - Policies and Procedures
  - Monitoring and Auditing
  - Prevention and early detection
  - Reporting

- Management Skills
  - Oral and written communication
  - Managing employees and interacting with management and operational administrators
  - Sound decision-making
  - Organizing, coordinating & planning activities
  - Critical thinking
  - Conflict Management & Resolution Implementation Skills
  - Financial Management

THE END