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LEARNING THE HARD WAY: ETHICS AND COMPLIANCE PROGRAM LESSONS GLEANED FROM RECENT U.S. RESOLUTION AGREEMENTS

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Little more than a decade ago, few public companies outside of the financial and healthcare sectors had a dedicated, internal compliance function. Today, a dedicated compliance function has become the norm, and Compliance and Ethics ("C&E") programs have correspondingly gained in significance, resourcing, and visibility. Historically, compliance officers were rarely a part of senior management or the C-suite. Today, by contrast, compliance officers have become increasingly elevated and independent within management, and increasingly pivotal in their contributions to the day-to-day operation of major companies.

The federal government has been a key driver in this evolution, first through the Federal Sentencing Guidelines for Organizations, and more recently through consent orders, deferred prosecution agreements, and other resolution agreements connected to the investigation of suspected corporate wrongdoing. Increasingly, federal authorities have included detailed requirements for a corporate defendant's compliance program as part of the injunctive relief included in a resolution agreement. Thus, resolution agreements, and the obligations contained within them, have become more and more important as a source of guidance and prescriptive authority. Resolutions can provide insight into the government's view of the elements of an effective compliance program and how such programs should be implemented. In turn, that insight can be more broadly instructive to corporations in designing, staffing, and implementing their own compliance programs. In point of fact, that insight has already begun to "spill over," with some organizations outside the resolution arena voluntarily adopting related compliance reforms as a leading indicator of good practice.

In this paper, we identify some key lessons contained in recent U.S. Department of Justice ("DOJ") and U.S. Securities and Exchange Commission ("SEC") corporate non-prosecution and deferred prosecution agreements, as well as U.S. Department of Health and Human Services ("HHS") corporate integrity agreements. We bring to this discussion our respective experiences as an in-house compliance counsel at a major public company and as an external advisor to many such companies.

Lessons from Recent Resolutions

Deferred prosecution agreements and other resolution agreements reflect a trend toward increasing government interest in compliance programs as a basic remedial measure to resolve criminal and civil investigations. As early as 2007, DOJ included specific requirements for compliance programs in some of its resolutions, but the number of elements typically included was only nine. More recent resolution agreements have included as many as 18 explicit compliance program elements.[1] Many of the elements commonly included in DOJ resolutions are based on the Federal Sentencing Guidelines and the Guidelines' blueprint for what constitutes an effective compliance program. Even so, DOJ resolution agreements provide additional color on those elements and on how DOJ views and interprets the elements of effective compliance. More recent DOJ resolutions have gone even further, with mandates for a range of deeper implementation practices in compliance, touching on the strength of corporate culture; the oversight role of the Board or committees of the Board; the authority, positioning and independence of the Chief Compliance Officer ("CCO"); and the role of management in supporting compliance.

Requirements for effective compliance programs gleaned from recent DOJ resolution agreements include the following:

- *High-Level Commitment*: Strong, explicit, and visible support from senior management and directors.
- *Policies and Procedures*: A written compliance code including appropriate policies and procedures addressing, *inter alia*, gifts, hospitality, entertainment, customer travel, political contributions, charitable donations and sponsorships, facilitation payments, solicitation, and extortion, as well as a reasonably designed financial controls system.
- *Periodic Risk-Based Review*: Risk-based development of the aforementioned policies and procedures, as well as at least annual review and update of these policies and procedures to take into account evolving international and industry standards.
- *Proper Oversight and Independence*: One or more senior executives charged with implementation and oversight of compliance responsibilities, who report or have the authority to report to independent bodies, including internal audit, the board, and/or a board committee.
- *Training and Guidance*: Effective communication of the compliance code, policies, and procedures throughout the company and its business partners, periodic training on these policies, and annual certifications of compliance with training requirements. In addition, a mechanism to provide guidance and advice on complying with the code, policies, or procedures.
- *Internal Reporting and Investigation*: A system for internal, confidential reporting of policy violations, as well as an effective system for investigating these reports.
- *Enforcement and Discipline*: Mechanisms to enforce the compliance program and appropriate disciplinary procedures.

[1] *Compare* Paradigm B.V. NPA, App'x B (Sept. 21, 2007) *with* Parker Drilling Co. DPA, Attach. C (Apr. 15, 2013). Note that while the corporate compliance program elements are most often designated Attachment C, sometimes these elements may be Attachments B or D, depending on the number and type of various certifications attached to the end of deferred prosecution agreements. *See*, *e.g.*, Archer Daniels Midland Co. DPA, Attach. B (Dec. 20, 2013); Hewlett-Packard Polska, SP. Z O.O. DPA, Attach. D (Apr. 9, 2014). Note that Professors Brandon Garrett and Jon Ashley of the University of Virginia maintain a database of all publically available DPAs here: http://lib.law.virginia.edu/Garrett/prosecution_agreements/DP (last visited May 13, 2014).

- *Third-Party Relationships*: Risk-based due diligence program pertaining to agents, business partners, or other third-parties and appropriate contractual guarantees that third-parties will comply with anti-corruption laws.
- *Mergers and Acquisitions*: Risk-based due diligence program for mergers and acquisition activity, including the prompt integration of the newly acquired entity into the company's compliance program.
- *Monitoring and Testing*: Periodic testing and review of the compliance code, policies, and procedures and taking into account relevant developments and evolving international and industry standards.

Looking across these thematic elements from recent resolution agreements, we would like to offer several broad observations and suggestions about the implications for compliance. It is important to keep in mind that these obligations are part of resolutions of enforcement actions and are imposed on companies alleged to have gone astray. All of these elements may not be required for every company, in every industry, of all sizes and levels of sophistication. But for companies seeking to respond proactively to DOJ, the SEC, and their sister agencies, the trends in recent resolution agreements offers important insight into how expectations for compliance programs may evolve in the future.

1. Recent Resolution Agreements Increasingly Emphasize Risk-Based Approaches to Compliance, But Raise Continuing Questions for Companies and Their Compliance Officers

As the recent joint DOJ-SEC Resource Guide to the Foreign Corrupt Practices Act ("FCPA")[2] emphasizes, many of the requirements contained in resolution agreements emphasize the importance of a risk-based approach to compliance. A thoughtful, analytical approach to identifying, measuring, and addressing key compliance risks is critical to an effective C&E program, as is the application of risk-based compliance logic to policies and procedures, periodic reviews, training, third-party relationships, and mergers and acquisitions. Many questions remain, however, regarding what a "risk based approach" to all of these aspects of compliance fully entails. Is there one standard that defines appropriate risk tolerance across all companies and all situations, or is it up to every individual company to define the level of risk it reasonably deems appropriate for its situation? Is it appropriate for company management to weigh compliance risks against available compliance resources? Will the government use evidence of a compliance violation alone to argue that a company did not appropriately identify and address its underlying compliance risks?

Absent answers to these sorts of questions, what we can conclude is that the federal government is recognizing the importance of a well-thought out risk-based approach to compliance in the context of government resolution and enforcement activity. Companies will need to wrestle with deep questions about how to design and implement an approach to

[2]DOJ & SEC (2012), *FCPA: A Resource Guide to the U.S. Foreign Corrupt Practices Act*. Available for download at http://www.justice.gov/criminal/fraud/fcpa/guide.pdf (last visited May 15, 2014).

compliance risks, in order to fulfill a standard that is continuing to emerge through government resolution agreements.

2. *More Compliance Obligations Are Being Imposed on Boards and Managers Through Government Resolution Agreements*

Some recent resolution agreements specify board-level oversight of the compliance program, with additional related requirements for boards such as annual compliance certifications or board-level compliance training. DOJ resolutions commonly require that the chief compliance officer (CCO) be given unfiltered access to communicate with the Board or with a committee of the Board, and some resolutions further require that directors provide strong, explicit, and visible support for the compliance program.[3] Similarly, HHS corporate integrity agreements now contain standard provisions imposing board compliance oversight responsibilities.

For example, the behemoth 101-page Johnson & Johnson corporate integrity agreement (signed in October 2013) includes a long list of compliance program requirements, not least being three-year executive compensation clawbacks, board-level compliance training, and compliance certifications both for the board and for designated persons in management.[4] Similar mandates for compliance certification have, in particular, been included in several other recent HHS corporate integrity agreements. Notably, these mandates tend to be particularly detailed, requiring certifications from business unit heads, as well as vice presidents in charge of human resources, strategy, medical affairs, communication, finance, and chief scientific officers.[5] As a policy matter, this requirement is reminiscent of the CEO and CFO internal controls certifications required under the Sarbanes-Oxley Act, although the requirements for compliance certification permeate much further down the corporate chain of command.[6] To our knowledge, the HHS practice of mandating compliance certifications has not so far spread to DOJ or SEC corporate resolutions, but it could do so in the future.

The take-away here is that resolution agreements increasingly spotlight boards and senior managers as having specific compliance obligations, moving somewhat beyond the contours of the Federal Sentencing Guidelines. Not only have resolution agreements compelled boards and managers to undertake more compliance training and more compliance oversight, but directors and management have also been required to take on more direct and explicit responsibility through certification mandates (at least on the HHS side). At least in companies involved in

[3] *See* Archer Daniels Midland Co. Non-Prosecution Agreement ("NPA"), Attach. B, ¶¶ 1, 7 (Dec. 20, 2013).

[4] Corporate Integrity Agreement between the Office of Inspector Gen. of the Dep't of Health & Human Servs. and Johnson & Johnson, at 8–10, 24, 32 (Oct. 13, 2013) ("J&J CIA"); *see also* Corporate Integrity Agreement between the Office of Inspector Gen. of the Dep't of Health & Human Servs. and GlaxoSmithKline LLC (June 28, 2012).

[5] *Id.*; *see also* HHS CIAs with Bayer Healthcare LLC (Nov. 25, 2008); Eli Lilly and Co. (Jan. 14, 2009); AstraZeneca LP (Apr. 27, 2010); Allergan (Aug. 30, 2012); Abbott Pharmaceuticals (May 7, 2012).

[6] Sarbanes Oxley Act, Pub. L. No. 107-204, §§ 302, 906, 116 Stat. 745, 777–78, 806 (July 20, 2002).

regulatory resolutions, if this trend continues there is likely to be increasing pressure on boards and management to become knowledgeable about their companies compliance activities and to play an active role in compliance endeavors in the future.

3. Government Resolutions Are Placing More Compliance Emphasis on Due Diligence and Management of Third Parties

Several recent resolutions involve allegations of corporate misconduct through third-party intermediaries, underscoring the importance of effective compliance due diligence programs to vet business partners. This area plays a particularly central role in compliance with the FCPA, in light of the statute's aggressive attenuated liability standards. The December 20, 2013 Archer Daniels Midland ("ADM") FCPA resolution is a good illustration.[7] There, according to the criminal information, ADM's German and Ukrainian subsidiaries engaged third-party intermediaries in a scheme to kick-back 18 to 20% of the value of VAT refunds to Ukrainian tax officials in return for the officials releasing the refunds due to ADM. In total, between 2002 and 2008, the ADM subsidiaries are alleged to have paid $22 million to secure the release of more than $100 million in VAT refunds. In brief, the ADM resolution agreement compelled the company to tighten its compliance controls and due diligence in connection with the actions of its subsidiaries and intermediaries going forward.

Due diligence on third-party intermediaries is also becoming a focal point in resolution agreements outside of the anti-corruption space. For example, the Johnson & Johnson corporate integrity agreement required J&J to undertake numerous obligations related to third-party personnel by imposing downstream compliance obligations and controls in the context of its various third-party relationships.[8]

In a companion white paper in this volume, Scott Killingsworth[9] writes in detail about emerging trends in "private" compliance, as companies impose increasing compliance burdens on each other through a web of bilateral contracts. Federal government enforcement activity and resolutions are amplifying the same trend by creating explicit requirements for more third-party due diligence. In resolution agreements, the government is increasingly focusing on third-party due diligence processes and procedures, and on the actions companies involved in resolutions are taking to monitor the actions of commercial partners and counterparties. Once again, the expectation is that CCOs will take a risk-based approach to identifying and mitigating this risk.

4. Recent Enforcement Activity Spotlights the Importance of Compliance Training and Management Engagement as Mitigating Factors

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[7] Press Release, Dep't of Justice, ADM Subsidiary Pleads Guilty to Conspiracy to Violate the Foreign Corrupt Practices Act (Dec. 20, 2013), *available at* http://www.justice.gov/opa/pr/2013/December/13-crm-1356.html (last visited May 13, 2014).

[8] J&J CIA, at 11, 36.

[9] See Scot Killingsworth, The Privatization of Compliance (2014), this volume.

Recent resolutions suggest that robust employee training and communication on compliance issues are key elements to an effective compliance program that may, in some circumstances, even help a company avoid corporate penalties for the actions of a rogue employee. For example, in April 2012, a former Morgan Stanley executive, Garth Peterson, pleaded guilty to charges for conspiring to evade Morgan Stanley's internal accounting controls. Mr. Peterson had, among other indiscretions, surreptitiously transferred an ownership interest in one of Shanghai's buildings from a Morgan Stanley fund to himself and his friend, who was a Chinese government official. DOJ declined to prosecute Morgan Stanley, citing its internal controls, regularly updated compliance policies, and extensive compliance training program.[10] Above and beyond Morgan Stanley's ongoing compliance program monitoring, random audits, due diligence on all new business partners, and controls on payments, the extensive training program cited included well-documented anti-corruption training directed to Morgan Stanley's Asia employees on 54 occasions during the relevant period, FCPA training for Mr. Peterson on at least seven occasions, and FCPA compliance reminders to Mr. Peterson at least 35 occasions.[11]

The Morgan Stanley case demonstrates the importance of compliance training in DOJ's analysis of the culpability of an organization for the actions of a rogue employee, especially when the rogue employee evades the requirements of a robust compliance program, flouting clear compliance directives from management. In consequence, companies and their CCOs would be well advised to consider robust and documented compliance training activities as an important component to mitigating the risk of material violations perpetrated by rogue actors who intentionally violate the law.

5. Compliance Risk through Marketing Activities Is Another Focal Point in Recent Resolution Agreements

Recent resolutions and enforcement activity suggest that CCOs should continue to concentrate on the corporate marketing and sales function, and focus compliance training efforts in this area. Related risk has been increasingly important in the healthcare compliance area, with the dramatic increase in pharmaceutical off-label marketing cases over the past decade.[12] But the concern over the marketing and sales function cuts across industries, and examples of related

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[10] Press Release, U.S. Securities and Exchange Commission, SEC Charges Former Morgan Stanley Executive with FCPA Violations and Investment Adviser Fraud (April 25, 2012), *available at* https://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171488702#.U3Yn2Ch8qko (last visited May 13, 2014).

[11] See discussion in Davis Polk, Morgan Stanley's FCPA Declination and the Benefits of Effective Compliance (October 9, 2012), *available at* http://www.davispolk.com/files/uploads/Webcasts//Morgan.Stanley.FCPA.Webinar.FINAL.2012.10.02.pdf (last visited May 13, 2014).

[12] *See* David W. Bradford, John L. Turner, & Jonathan W. Williams, *Off-Label Use of Pharmaceuticals: Trends and Drivers*, at 1 (April 22, 2013), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2230976 (last visited May 13, 2014).

compliance failures are not limited to those involving a vast international FCPA conspiracy or a multibillion dollar pharmaceutical case. For example, on August 30, 2013, Bashas' Inc., a family-owned grocery store chain, entered into a non-prosecution agreement with DOJ, after an investigation revealed "Prime" tenderloins being sold at certain Bashas'-owned AJ's stores in Arizona that were actually lesser-quality "Choice" tenderloins, as well as the sale of mislabeled "Kobe" beef cuts.[13] DOJ agreed that senior management had no knowledge of this practice, but nevertheless faulted the company for an administrative consolidation at in the corporate meat department that "fail[ed] to provide adequate corporate oversight over the operations of individual AJ's locations."[14]

The lesson from the resolution in *Bashas'* is that in some cases DOJ expects corporate compliance efforts to penetrate all the way to the individual store meat-counter level. The failure to do so cost Bashas' nearly $1.5 million in restitution, in addition to other fees, costs, and reputational harm. By extension, where a company is involved in local-level retail sales and marketing, its compliance function may need to drill down to the local level in its monitoring and training efforts.

6. Recent Resolution Agreements Focus on the Roles and Responsibilities of the CCO and the CCO's Ability to Communicate Directly with the Board or a Board Committee

Recent criminal and civil resolution resolutions have provided new insight into regulators' views on the authority and independence of the CCO, both as formalized in the management structure of an organization and as implemented through channels of communication to independent authorities, such as the board of directors and internal audit.

In 1998, the HHS Office of Inspector General cautioned against having CCOs report to the General Counsel or CFO.[15] Subsequent HHS corporate integrity agreements went further, requiring that the CCO be a member of "senior management," and precluding the CCO from reporting to or serving as the General Counsel or CFO.[16] In 2008, HHS extended this trend and began explicitly requiring a direct reporting relationship to the CEO—a requirement that continues to this day.[17] For example, on February 21, 2014, Endo Health Solutions Inc. and its subsidiary Endo Pharmaceuticals paid $192.7 million to resolve DOJ and HHS criminal and civil

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[13] Bashas' Inc. NPA, at 1.

[14] *Id.* at ¶ 4.

[15] Office of Inspector General, Dep't of Health & Human Servs., Compliance Program Guidance for Hospitals, 63 Fed. Reg. 8987, 8993 n.35 (Feb. 23, 1998).

[16] *See, e.g.*, Corporate Integrity Agreement between the Office of Inspector Gen. of the Dep't of Health & Human Servs. and Serono Holding, Inc., at 5–6 (Oct. 14, 2005); Corporate Integrity Agreement between the Office of Inspector Gen. of the Dep't of Health & Human Servs. and Boston Scientific Corp., at 5 (Dec. 23, 2009).

[17] *See, e.g.*, Corporate Integrity Agreement between the Office of Inspector Gen. of the Dep't of Health & Human Servs. and The Jackson-Madison Cnty. Gen. Hosp. Dist., at 2 (Nov. 26, 2008); Corporate Integrity Agreement between the Office of Inspector Gen. of the Dep't of Health & Human Servs. and Pacific Health Corp., *et al.*, at 4 (Jun. 8, 2012).

regulatory actions arising from of the marketing of off-label uses for the prescription anesthetic Lidoderm.[18] Both Endo's deferred prosecution agreement with DOJ and its corporate integrity agreement with HHS require that Endo's CCO report to its CEO. Both agreements also require that Endo's CCO make regular compliance reports to Endo's board of directors. This reporting structure is most frequently imposed by HHS resolution agreements in the context of healthcare cases. DOJ and the SEC tend recognize a wider variety of reporting structures and are less likely to preclude the unity of the legal and compliance functions.

While many companies' CCOs report to their general counsels – and do so for well-thought purposes in an effort to have the most effective compliance programs within their organizational structure and operating environment – other companies, particularly in the healthcare and financial services sectors, appear to be following the government's lead by having the CCO report to the Board, a committee of the Board, or the CEO. For example, a number of large banks have split their compliance departments from their legal departments, including giants such as Barclays and JPMorgan.[19] The HSBC deferred prosecution agreement even took the unusual step of requiring that the CCO be elevated to the ranks of the top 50 managers of the firm.[20] Of course, in some contexts, depending on many factors, including the nature of the business, the size and sophistication of the company, and the compliance risks it faces, among others, a company may reasonably determine that it would be more effective in its situation to unite the compliance and legal departments.

Without addressing the long-running argument over the structural pros and cons of having the CCO report directly to the CEO, we instead spotlight a more basic point regarding government enforcement efforts: namely, that resolution agreements have increasingly focused on the positioning of the CCO within the organization, and on ensuring the CCO has unfettered communication access to both senior executives and the Board. Even when they do not segregate the CCO to an independent function, several recent DOJ non-prosecution and deferred prosecution agreements have focused on ensuring an open line of communication between the CCO and senior oversight authorities within the company, notably including boards. For example, the previously mentioned ADM non-prosecution agreement contained language requiring that the CCO "have the *authority to report directly* to independent monitoring bodies," such as internal audit and the board.[21] In addition, the ADM resolution agreement, like some others, contains requirements that the CCO have an "adequate level of autonomy from

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[18] Press Release, Dep't of Justice, Endo Pharmaceuticals and Endo Health Solutions to Pay $192.7 Million to Resolve Criminal and Civil Liability Relating to Marketing of Prescription Drug Lidoderm for Unapproved Uses (Feb. 21, 2014), *available at* http://www.justice.gov/opa/pr/2014/February/14-civ-187.html (last visited May 13, 2014).

[19] Bora Yagiz, *Better Career Paths, New Reporting Lines as Compliance Gains Status at Banks*, Reuters Financial Regulatory Reform (Mar. 20, 2014), *available at* http://blogs.reuters.com/financial-regulatory-forum/2014/03/20/better-career-paths-new-reporting-lines-as-compliance-gains-status-at-banks-global-report/ (last visited May 13, 2014).

[20] *See* HSBC Bank USA, N.A. and HSBC Holdings PLC DPA, ¶ 5 (Dec. 11, 2012).

[21] Archer Daniels Midland Co. NPA, Attach. B, ¶ 7 (emphasis added); *see also* Weatherford Int'l DPA, Attach. C, ¶ 7 (Nov. 26, 2013); Bilfinger SE DPA, Attach. C, ¶ 7 (Dec. 9, 2013).

management," and that the CCO be provided "sufficient resources . . . to maintain [his or her] autonomy."[22]

At least four other deferred and non-prosecution agreements reached in 2013 by DOJ and the SEC have explicitly required the company's CCO have "direct reporting obligations to independent monitoring bodies, including internal audit, the Company's board of directors," or an appropriate board committee.[23] The general movement of recent resolution agreements in this direction notably follows the logic of the joint DOJ-SEC Resource Guide on the FCPA,[24] as well as the logic of the Federal Sentencing Guidelines,[25] both of which underline the need for a reporting channel between CCO and the "governing authority" of a corporation (i.e., the Board), in order to safeguard the autonomy of the CCO and the effectiveness of the compliance program that he or she operates.

For companies, the most practical take-away from all of this is that resolution agreements have placed increasing emphasis on the role of the CCO, the CCO's reporting relationships appropriate to its industry and operations, and the authority and communication channels of the CCO. In addition, ensuring the CCO has the appropriate empowerment also allows governing boards to be able to carry out their own compliance oversight responsibility. Recent resolutions have included a range of specific provisions and requirements along these lines. Broadly, these agreements are increasingly focusing on the CCOs empowerment, as well as effective and open lines of communication to directors, senior managers, and others to ensure that unfiltered CCO communications can reach the senior governing authorities of the corporation.

Conclusion

In recent years, DOJ, HHS, and other regulators have become increasingly focused on corporate ethics and compliance programs, their structure, their implementation, and their power to address risks and prevent violations of law and regulation. The government's focus has notably manifested itself through resolution agreements, which discharge civil and criminal investigations and prosecutions against corporate wrongdoers. Such resolution agreements can exert influence on the business community, not only through their direct impact on the defendants who specifically enter into them but also, more broadly, as sources of guidance on compliance best practice. They illustrate what enforcement agencies are looking for when they

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[22] Archer Daniels Midland Co. NPA, Attach. B., ¶ 7.

[23] Ralph Lauren Corp. NPA, Attach. C, ¶ 7 (Apr. 22, 2013); Total, S.A. DPA, Attach C, ¶ 6 (May 23, 2013); Diebold, Inc. DPA, Attach. C, ¶ 7 (Oct. 15, 2013); ArthroCare DPA, Attach. C. ¶ 7 (Dec. 30, 2013). *See also* Las Vegas Sands Corp. NPA, Attach. B, ¶ 1 (Aug. 26, 2013) (requiring an overall compliance structure with "oversight by an independent Committee of the Board of Directors with direct oversight of the Company's Chief Compliance Officer [] and the Compliance Program.").

[24] *See* U.S. Dep't of Justice and U.S. Securities & Exch. Comm'n, A Resource Guide to the U.S. Foreign Corrupt Practices Act 58 (Nov. 12, 2012).

[25] U.S. Sentencing Guidelines § 8B2.1(2)(C) (2013).

review the vitality and effectiveness of a compliance program. Trends toward more explicit risk-based approaches to compliance, a greater emphasis on third-party due diligence, open and direct lines of communication, and effective training programs that permeate an organization, all serve to underscore a more basic point. Namely, federal corporate resolution agreements are increasingly focusing on the effectiveness of compliance programs as remedial measures, often setting forth detailed requirements for an effective compliance program in the context of each case. This shows an increasing interest among regulators about the role an effective compliance program can play in preventing future violations. Companies can learn from these agreements and evaluate whether the provisions set forth in them are right for them.