

# Challenges in Compliance and Corporate Governance

**Sixth Annual Webcast**



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# **2010: The Year of Risk** **Management**

Compliance in the Current Environment

# Compliance in the Current Environment

- The recent financial crisis has elevated the importance of risk management and exposed new areas of risk.
- The government continues to enact new regulations and pursue aggressive enforcement agendas.
- Boards of Directors actively must oversee compliance and risk.
- General counsels, compliance professionals, and outside lawyers may face personal liability for regulatory violations.
- The costs of a comprehensive compliance program are outweighed by the costs of noncompliance.
- Compliance programs should be integrated and flexible, such that they can respond to diverse silos of exposure and emerging areas of risk.

# Looking Back: Last Year to Today

As we predicted last year, the new Administration has responded to the financial crisis with **“heightened enforcement activity”**:

- **False Claims Act (“FCA”)**: *\$2.4 billion* in settlements and judgments in cases involving fraud against government
  - **Healthcare Fraud**: *\$1.6 billion* in recoveries, including *record \$540 million* settlement with New York City and New York State for alleged Medicaid billing fraud
  - **Government Contracts**: *\$608.4 million* in settlements and judgments involving procurement fraud, including *record \$128.7 million settlement* with Network Appliance, Inc. for alleged best-price violations
- **Antitrust Violations**: More than *\$1 billion* in fines for the year
- **Trade Violations**: Record fine of *\$536 million* for violation of U.S. sanctions—largest penalty in history of U.S. Treasury’s Office of Foreign Assets Control (“OFAC”)
- **Foreign Corrupt Practices Act (“FCPA”)**: “[T]his past year was probably the most dynamic single year in the more than 30 years since the FCPA was enacted. We saw a *record number of trials*, a *record number of individuals charged with FCPA violations*, and *record corporate fines*, including \$1.6 billion in global penalties in the Siemens matter and \$579 million in penalties in Halliburton/KBR.” (Lanny Breuer, Assistant Attorney General, Nov. 17, 2009)

# Looking Back: Last Year to Today

## For example: Increase in SEC Enforcement Actions

- Increased enforcement actions, with a “trend toward filing more enforcement actions as injunctive actions in federal court, rather than as administrative proceedings” (GD&C 2009 Annual Review of SEC Enforcement, Jan. 12, 2010)

	CALENDAR 2008	CALENDAR 2009	PERCENT CHANGE
INJUNCTIVE ACTIONS	<b>232</b>	<b>320</b>	<b>38%</b>
NUMBER OF DEFENDANTS	<b>620</b>	<b>981</b>	<b>58%</b>

# Enforcement Trend Will Continue: What the Agencies Are Saying

## ➤ General

- SEC amended its rules “to delegate authority to the Director of the Division of Enforcement to issue formal orders of investigation,” in order to “*expedite the investigative process* by removing the need for enforcement staff to seek Commission approval prior to performing routine functions.” (SEC Release No. 34-60448, Aug. 5, 2009)

## ➤ Healthcare Fraud

- New inter-agency effort between the Department of Justice and the Department of Health and Human Services “raise[d] the stakes on health care fraud by launching a *new effort with increased tools, resources and a sustained focus by senior-level leadership.*” (Eric Holder, Attorney General, May 20, 2009)
- “*Fighting healthcare fraud is a priority* of the Department of Justice.” (Tony West, Assistant Attorney General, Oct. 28, 2009)

## ➤ Government Contracts

- “Addressing *procurement fraud* [remains] among [the] highest priorities at the [DOJ] and for the Civil Division.” (Tony West, Assistant Attorney General, Nov. 18, 2009)

## ➤ FCPA

- Five new specialized units, including an FCPA unit, will have “better capability to detect emerging fraud and misconduct” and “*greater capacity to file cases with strike-force speed.*” (Robert Khuzami, Director, SEC Div. of Enforcement, Jan. 13, 2010)
- We must *vigorously enforce our own laws that prohibit bribery* of foreign officials ....” (Eric Holder, Attorney General, Nov. 7, 2009)
- “I fully expect that the *number of FCPA prosecutions—of corporations and individuals alike—will continue to rise ....*” (Lanny Breuer, Assistant Attorney General, DOJ, Oct. 1, 2009)

# Enforcement Trend Will Continue: What the Agencies' 2010 Budgets Suggest

**FY 2010 budget requests for DOJ, SEC, and HHS suggest that enforcement activities are on the rise and shed light on enforcement priorities:**

- **DOJ Criminal Division's Budget Requests for Program Increases:**
  - Additional 14 positions and *\$2.5 million* “to identify, investigate, and prosecute *fraud against the government*, including *procurement fraud* and public corruption”
  - Additional 7 positions and *\$1.808 million* “to fund a strategic *response to the current financial crisis* affecting the mortgage markets, credit markets, and banking system”
  
- **DOJ U.S. Attorneys' Budget Requests for Program Increases:**
  - Additional 43 positions and *\$7.5 million* for its initiative “focusing on *prosecution efforts* in the areas of mortgage fraud, bankruptcy and *white collar crime*/public corruption”
  
- **SEC's Budget Request for \$1.026 billion is a 7 percent increase from 2009 funding level**
  - *Almost two-thirds* (\$646,729,000) would be to “*enforce compliance with federal securities laws*”
  
- **HHS Budget Request for \$311 million** for Healthcare Fraud and Abuse Control: “to *minimize inappropriate payments*, pinpoint weaknesses in program integrity oversight, *target emerging fraud schemes* by provider and type of service, and establish safeguards to correct programmatic vulnerabilities”

# This Calls for an *Integrated Approach* to Compliance

➤ **Companies should implement integrated compliance programs responsive to:**

- Health, Safety, and Welfare laws
- Discrimination laws
- Harassment laws
- Anti-Money Laundering laws
- False Claims Act
- Trade Regulations
- Foreign Corrupt Practices Act and other anti-bribery and anti-corruption laws
- Best practices in the company's industry

# The Current Environment: Now *We* Are the Targets

Compliance Officers,  
General Counsels,  
and Outside Lawyers:  
No longer only counselors to the targets, but  
rather targets themselves

## *The Gatekeepers Must Be Responsible*

- Despite the *inherent tension*, lawyers are expected to act as both *advocates* for clients and *gatekeepers and whistleblowers* for government. In other words, lawyers are expected to balance *servicing their clients' interests and the public interest*.
- “The market relies on *lawyers to act as gatekeepers* who exercise their function in good faith.” (Katherine Addleman, Director, SEC Atlanta Regional Office, May 2009)

### *On targeting lawyers as gatekeepers:*

“[W]here you could have . . . the *biggest impact* is focusing on those *licensed professionals*. They have the *most to lose*, but they’re most likely to flip, and they *make the best examples*.”

(Testimony of Neil Barofsky, TARP Special Inspector General, before Senate Judiciary Comm., Feb. 11, 2009)



# The Current Environment: Now *We* Are the Targets

## Examples:

- **“Responsible Corporate Officer” Misdemeanor:** Former general counsel of Purdue Pharma paid \$8 million fine and was debarred from pharmaceutical industry for 12 years based on a *strict-liability* misdemeanor (Aug. 28, 2009).
  - U.S. Attorney reached settlement with three top executives of Purdue Pharma over alleged misbranding of OxyContin. The company pleaded guilty to felony misbranding, preventing it from getting any new government contracts.
  - Former general counsel pleaded guilty to a criminal misdemeanor on strict-liability theory of “responsible corporate officers”: *Without proof of misconduct, he was held strictly liable* for failing to act on his authority as general counsel to prevent, detect, or correct the federal drug violations.
  - U.S. Attorney: *“It was important to have individuals charged as well as the company.”*
  - HHS’s Office of Inspector General debarred the general counsel—by administrative order—*excluding him from participating in Medicare, Medicaid, and other federal healthcare programs* for 15 years. On appeal, HHS reduced the exclusion to 12 years.
- **Stock-Option Backdating:** Former general counsel of video-game maker Take-Two Interactive Software settled SEC’s civil claim alleging that he enriched himself and others by knowingly or recklessly allowing the company’s Chairman/CEO to backdate stock-option grants (Aug. 3, 2009, SEC Lit. Release No. 21163).
  - He will pay a civil penalty of \$125,000 and disgorgement of \$363,185, plus pre-judgment interest of \$111,115.
  - He will consent to entry of administrative order suspending him from appearing or practicing before the SEC.
  - SEC previously had settled related charges with Take-Two and its CEO/Chairman.

# The Prism of Principles Remains Stable

- **Organizational Sections of Federal Sentencing Guidelines**
  - “The organization shall periodically assess the risk of criminal conduct and shall take appropriate steps to . . . reduce the risk of criminal conduct identified through this process.” (Fed. Sentencing Guidelines § 8.B.2.1.(c))
- **COSO Enterprise Risk Management**
  - “Process designed to identify potential events that may affect the entity, and manage risk to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives.” (COSO, Enterprise Risk Management – Integrated Framework Executive Summary)
- **Auditing Standard No. 5**
  - “[The PCAOB] replaced the existing auditing standard under 404 with a much shorter, risk-based and principles-based approach that will make compliance more rational and efficient, while at the same time better focusing the internal control assessment and auditing effort on what is truly material to the integrity of the financial statements.” (Christopher Cox, SEC Chairman, Oct. 9, 2007)
- **Caremark Duty**
  - Boards of Directors must “attempt in good faith to assure that a corporate information and reporting system, which the board concludes is adequate, exists . . . . [F]ailure to do so . . . may . . . render a director liable for losses caused by non-compliance with applicable legal standards.” (*In re Caremark Int’l Inc.*, 698 A.2d 959 (Del. Ch. 1996))

**Big Picture: What are your primary risks?**

# Managing and Overseeing Risk

- **Enterprise Risk Management:**  
Companies should assess risk by gauging and prioritizing risks across their organizations.
- **Role of the Board:**  
Boards of Directors must see that their companies have installed information and reporting systems and oversee compliance programs.
- **Codes of Conduct:**  
Companies should set forth “living, breathing” codes of conduct responsive to evolving risks.
- **Implementing Ethical Principles:**  
Companies should take steps to see that employees internalize ethical principles.

# Role of the Board in Risk Oversight: Legal Duties

- ***In re Caremark (1996):***  
Boards are required to “attempt in *good faith to assure that a corporate information and reporting system, which the board concludes is adequate, exists . . . . [F]ailure to do so . . . may . . . render a director liable for losses caused by non-compliance with applicable legal standards.”*
- ***Stone v. Ritter (2006):***  
Directors may be held personally liable if they either completely fail to implement or consciously fail to oversee a reporting system, information system, or controls.
- ***In re Citigroup (2009):***  
Boards must ensure the existence of information and reporting systems; “only a sustained or systemic failure of the board to exercise oversight . . . will establish the lack of good faith that is a necessary condition to liability.” *Citigroup* reaffirmed the business judgment rule, underscoring that courts generally will not second guess decisions made by informed and disinterested directors acting in good faith.
- ***In re Dow Chemical (2010):***  
In dismissing a shareholder derivative action against directors, the court held that “[p]laintiffs cannot simultaneously argue that the . . . board ‘utterly failed’ to meet its oversight duties yet had ‘corporate governance procedures’ in place without alleging that the board deliberately failed to monitor its ethics policy or its internal procedures.”



# Enterprise Risk Management: Know & Plan for Your Risks

“Enterprise risk management is a process, effected by the entity’s board of directors . . . applied in strategy setting across the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within the risk appetite, to provide reasonable assurance regarding the achievement of objectives.”

(COSO Integrated Framework (2004))

- **Enterprise Risk Management:** Identify your company’s particular risks and opportunities
  - Risk from lines of business?
  - Product Liability Risk?
  - Financial and Financial Instrument Risk?
  - Environmental Risk?
  - Antitrust Risk?
  - Reputational Risk?
- **Assess each risk’s likelihood and magnitude of impact:** Prioritize risks, because penalties are often assessed based on revenue relating to the violation
  - Create more comprehensive plans for higher-risk areas
  - Create models for risk
  - Assure that even less severe risks are monitored
  - Determine a response strategy
  - Monitor progress and reassess risk profile
- **Analyze Industry Issues:** When a competitor struggles with a compliance issue, assess your company’s performance relating to that issue

# Role of the Board in Risk Oversight



- **NYSE**: Corporate governance rules require audit committees of listed corporations to discuss risk assessment and risk-management policies.
- **SEC**: In December 2009, the SEC adopted final rules expanding proxy disclosures about the impact of compensation policies on risk-taking and requiring disclosure of the role of the Board in risk oversight.
- **U.S. Sentencing Guidelines**: In defining an effective compliance program, the Guidelines recommend Board involvement in overseeing programs designed to identify areas of potential risk.

# Role of the Board in Risk Oversight

“A board’s focus on effective risk oversight is critical to setting the tone and culture towards effective risk management through strategy setting, formulating high level objectives, and approving broad-based resource allocations.”

## **4 priorities of Board oversight of risk management:**

1. Understand the entity’s risk philosophy and concur with the entity’s risk appetite.
2. Know the extent to which management has established effective risk assessment and management programs.
3. Review the entity’s portfolio of risk and consider it against the entity’s risk appetite.
4. Be apprised of the most significant risks and whether management is responding appropriately.

(COSO: Effective Enterprise Risk Oversight: The Role of the Board of Directors (2009))

# Role of the Board in Risk Oversight: Allocation of Responsibility

- **Board Structure:** Boards should be structured to assign risk-management responsibilities such that general and company-specific risks are addressed by capable individuals and committees.
  - Full Board: In some companies, the full Board may be principally responsible for risk oversight.
  - Audit Committee: NYSE rules reinforce the conventional view that audit committees lead the Board in risk management.
  - Risk Committees: Dedicated risk committees marshal expertise to assess and respond to company-wide risks.
  - Mixed Approach: Companies should consider taking advantage of different committees' competencies: finance committees, compliance committees, and compensation committees.
- **Restoring American Financial Stability Act (Sen. Dodd Discussion Draft circulated on Nov. 10, 2009):** Publicly traded financial companies and publicly traded bank holding companies with total assets of \$10 billion or more **must establish risk committees responsible for the oversight of the enterprise-wide risk management practices of the company.**

# Chief Compliance Officers: Reporting Relationships

- Companies should appoint Chief Compliance Officers (“CCOs”) to implement compliance principles, identify and respond to risks, oversee day-to-day compliance activities, and relay compliance issues to the CEO and the Board.
- Compliance executives report to various corporate functions
  - 19.7% to the Audit Committee
  - 19.1% to the General Counsel
  - 12.1% to the GC with a dotted line to the Audit Committee
  - 8.3% to the Chief Executive Officer
  - 17.8% to another executive
  - 8.9% to another executive with a dotted line to the Audit Committee
  - 5.7% have other reporting relationships

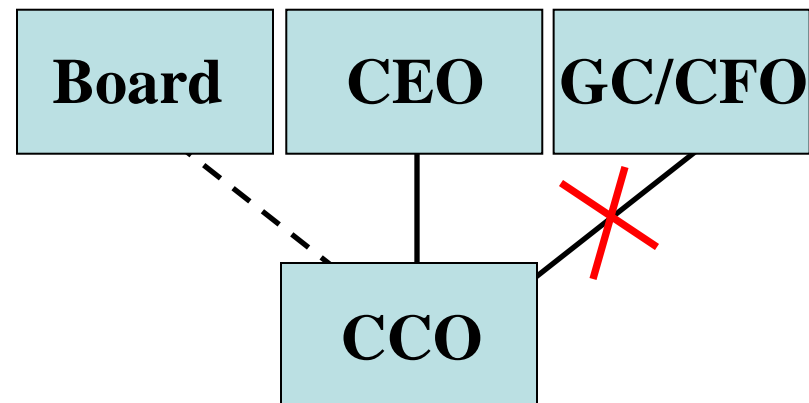
(2009 Compliance Week Global Integrity Survey)
- Approximately 40% of CCOs work full time at their positions. (OCEG Survey, Dec. 3, 2009.)
- Companies should consider having their CCO report directly to the CEO.
- CCOs should report along a dotted line to the Board and update the Board on compliance at least quarterly.



# Chief Compliance Officers: Settlement-Mandated Reporting Relationships

Recent Deferred Prosecution Agreements and Corporate Integrity Agreements have mandated that Chief Compliance Officers (“CCOs”) sit as members of senior management and report directly to the CEO and on a dotted line to the Board. The agreements set forth that CCOs shall not “be, or be subordinate to, the general counsel or chief financial officer.”

- Spectranetics Corp. (Dec. 2009)
- Pfizer, Inc. (Aug. 2009)
- Quest Diagnostics (Apr. 2009)
- NeuroMetrix, Inc. (Feb. 2009)
- Eli Lilly & Co. (Jan. 2009)
- Bayer Healthcare LLC (Nov. 2008)
- Biomet (Sept. 2007)
- DePuy Orthopedics (Sept. 2007)
- Zimmer (Sept. 2007)



# Codes of Conduct: Living, Breathing Documents

## Requirements:

- **NYSE Section 303A.10:** “Listed companies must adopt and disclose a code of business conduct and ethics for directors, officers and employees, and promptly disclose any waivers of the code for directors or executive officers.”
- **U.S. Sentencing Guidelines:** Compliance policies established to prevent and detect criminal conduct are an important element of an effective ethics and compliance program.

## Best Practices:

- Codes of conduct should set the necessary **standards of conduct to address key risks**, describe the methods for obtaining help or advice, and explain the procedures for responding to violations.
- Compliance policies should be written in **positive, comprehensible language**, explaining to employees and third parties how the organization expects them to behave.
- Compliance policies should include a combination of both **rules-based and values-based provisions**; rules-based provisions provide clarity, whereas values-based provisions motivate behavior that reflects the core values of the organization.
- Companies should **frequently reassess and revise** codes of conduct to respond to known risks.



# Implementing Codes of Conduct: Imprimatur of the CEO

## Tone From the Top

- “Only clean business is Siemens business. . . . **Compliance as part of corporate responsibility is our number one priority.**” Peter Löscher, Siemens AG CEO.
- “Statoil is willing to pay the short-term premium that may ensue from doing business the right way. **If there is a conflict, ethics has priority over cost, schedule, and a potential deal.** A persistent, resilient focus on ethical business conduct is critical to our existence and success.” Helge Lund, Statoil CEO.



# Integrated Approach to Compliance

To take an integrated approach to compliance, companies should bear in mind key compliance themes:

1. **“Tone From the Top”**: Business leaders should trumpet compliance principles and be personally accountable for compliance and ethical behavior in their units.
2. **Compliance Organization**: Intelligently structured compliance organizations identify and mitigate risks, scrutinize high-risk activities, and advise business leaders on operational and compliance matters.
3. **Training**: Training ensures that employees are able to identify and respond to risks.
4. **Review & Approval Tools**: Automated and user-friendly review and approval tools facilitate centralized decision making on global compliance matters.
5. **Reporting**: Employees should be able to report corruption concerns easily, anonymously, without fear of retaliation, and with assurance that the issues will be addressed promptly.
6. **Incentives & Discipline**: To provide incentives for employees to comply with laws and company rules, organizations should consider compliance in determining compensation and take appropriate disciplinary actions.

# Integrated Approach to Compliance

7. **Investigating Potential Problems**: Quickly and objectively investigating potential compliance problems projects a strong “tone from the top” and allows organizations to identify areas of risk.
8. **Financial Controls**: Robust financial controls ensure that funds are only released as authorized by company policies—and not for illicit purposes.
9. **Integrity Due Diligence**: Due diligence is the best way to guard against potential counterparties acting corruptly or fraudulently. Companies should conduct significant due diligence on potential M&A targets.
10. **Internal Audit**: Internal auditors play key roles in evaluating the effectiveness of companies’ compliance controls and activities.
11. **Sales & Marketing**: Companies should implement controls to govern interactions with government officials, procurement, contracting, lobbying, marketing expenditures, and financial transactions.
12. **Supplier Contracting Controls**: Because procurement presents risks, vendors should be treated as counterparties and subjected to compliance due diligence, which should include screening for risk factors and “red flags.”

# Compliance Compensation Incentives: Siemens AG



## Siemens AG:

- Siemens ties a portion of senior employees' bonuses to compliance criteria.
- The compliance portion of senior management's variable compensation is based on the results of Siemens' worldwide employee compliance awareness survey, in addition to other criteria.
- Siemens prioritizes compliance targets when determining bonus payouts. Based on this principle, Siemens raised bonus payout amounts by 15%.

(Siemens AG 2009 Annual Report)

# Compensation and Risk Management: Goldman Sachs

## Goldman Sachs's compensation is structured to discourage improper risk-taking and other conduct detrimental to the firm.

- For 2009, all 30 management committee members will receive 100% of their discretionary compensation in equity, which is subject to significant restrictions for five years.
- As employees become more senior, they receive larger percentages of their compensation in deferred equity, none of which may be sold for five years.
- Goldman requires employees to retain a significant portion of their equity compensation until they retire.
- Goldman has imposed a “clawback” mechanism that allows it to recapture shares when employees have (1) engaged in materially improper risk analysis; (2) failed to raise concerns about risks; or (3) engaged in “any conduct that is detrimental to the firm.”
- Goldman ties employees' variable compensation to the performance of (1) the firm; (2) the employee's unit; and (3) the employee.

The Goldman Sachs logo is displayed in white text on a blue rectangular background. The word "Goldman" is positioned above the word "Sachs", and both are rendered in a bold, serif typeface.

# Costs of Noncompliance: Monetary to Reputational

## ➤ Direct Costs

- Settlements
- Criminal Fine
- Appointment of Compliance Monitor
- Prejudgment Interest
- Disgorgement of Profits
- Burden on the Company (defense costs, executive time, lost resources)
- Asset Forfeiture

## ➤ Collateral Costs

- Lawsuit by Parties Harmed by Misconduct
- Derivative Lawsuit by Shareholders
- Class Action Lawsuits by Investors
- Tax Law Implications Regarding Improper Payments

## ➤ Costs to Continuing Business

- Ineligibility for Necessary Licenses or Permits
- Ban From Doing Business with Governmental Entities
- Suspension or Debarment from Agency/World Bank/UN/IMF Activities
- Prison Sentence

## ➤ Reputational and Market Costs

- Loss of Reputation or Goodwill
- Negative Effect on Stock Price
- Impact on Mergers & Acquisitions

# Costs of Noncompliance: Weighing Voluntary Disclosure

## Benefits

- “[A] *voluntary disclosure may result in no action being taken against a company*, or the company may secure other preferred dispositions . . . . In this, as in so many other areas, doing the right thing . . . also makes good business sense.” (Lanny Breuer, Assistant Attorney General, Nov. 12, 2009)
- “I can assure you that the Department’s *commitment to meaningfully reward voluntary disclosures and full and complete cooperation* will continue to be honored in both letter and spirit. I am committed to no less.” (Lanny Breuer, Assistant Attorney General, Nov. 17, 2009)
- The U.S. Sentencing Guidelines provide for *reduced penalties for companies that self-report violations and cooperate with government investigations*. Self-reporting may help companies and individuals avoid maximum penalties.

## Disadvantages

- There is substantial debate about how meaningful the benefits from voluntary disclosure really are. For example, *compare* Omega Advisors, which *did not make a self-disclosure and paid \$500,000*, with Schnitzer Steel, which *voluntarily disclosed its improper conduct and paid a total of \$15.2 million*, and Vetco, which also *voluntarily disclosed its conduct to the government, and paid fines totaling \$26 million*—at the time the largest criminal fine in the history of the FCPA. The level of potential cooperation discounts is impossible to foresee.
- Voluntary disclosure makes the government aware of improper conduct that it *otherwise may have never discovered*.
- The SEC often takes the position that *disgorgement of ill-gotten profits is non-negotiable, regardless of a voluntary disclosure*.

# Costs of Noncompliance: It Is Ultimately Less Costly to Comply

## Companies Are Increasingly Recognizing That

### *Cutting Costs in Compliance Will Not Cut Costs Overall*

- A survey of compliance professionals reported that, despite the financial crisis:
  - 36% anticipated budget cuts in 2008, but by end of 2009 only 27% reported budget cuts
  - 26% reported compliance-budget *increases* in 2009
  - 33% expect compliance-budget *increases* in 2010(Health Care Compliance Association & the Society of Corporate Compliance and Ethics, Dec. 2009)
- ***Cutting compliance costs may raise red flag in eyes of regulators***—especially, as survey points out, when other companies may be *increasing* their compliance budgets
  - Recommendation from Hon. Ruben Castillo, Vice-chairman of U.S. Sentencing Commission, and Gary Grindler, Deputy Assistant AG: ***“Don’t cut back on compliance.”*** (Compliance Week, Compliance Tips From People Who Know, Sept. 15, 2009)
- ***DOJ:*** “We recognize the issues of costs to companies to implement robust compliance programs, to hire outside counsel to conduct in-depth internal investigations, and to forego certain business opportunities that are tainted with corruption. ***Those costs are significant and we are very aware of that fact. The cost of not being FCPA compliant, however, can be far higher.***” (Lanny Breuer, Assistant Attorney General, Nov. 17, 2009)
- ***In re Dow Chemical (2010):*** The court dismissed a shareholder derivative action against Board members largely because the Dow Board had “set up policies to prevent improper dealing with third parties,” particularly a code of ethics that prohibited any unethical payments to third parties.

# Silos of Exposure

- **Regulatory Exposure:** Companies should implement an integrated approach to Healthcare Fraud; Health, Safety, and Welfare laws; Anti-Money Laundering requirements; Antitrust laws; the Foreign Corrupt Practices Act; Government Contracts provisions, including the False Claims Act; Trade Regulations; and other requirements.
- **Ethical Understanding:** To successfully navigate today's complex risk environment, companies should see that employees internalize core ethical principles and understand general, company-specific, and employee-specific risks. Ethical employees are equipped to respond to diverse risks.
- **Evolving Regulations:** Companies should understand and keep abreast of changing DOJ, SEC, HHS, and other administrative and congressional regulatory and enforcement priorities.

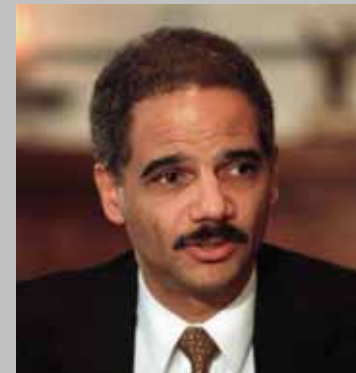


# Healthcare Fraud: Pressing Issue, Aggressive Enforcement

- **Crisis-Level Fraud:** According to some estimates, every year more than **\$200 billion** of healthcare spending is lost to fraud, approximately **10% of total healthcare spending**.
- **Enforcement:** 2009 witnessed more than **\$5 billion** in settlements and judgments, and the **DOJ has nearly 1,000 pending civil cases**.
- **FBI Investigations:** As of June 2009, the FBI was pursuing **more than 2,400 active healthcare fraud investigations**.
- **DOJ/HHS Task Force:** Fighting healthcare fraud is a “top priority” of the government, as evidenced by a newly formed joint task force—known as the Health Care Fraud Prevention and Enforcement Action Team, or HEAT.
- **Healthcare Fraud Enforcement Act of 2009:** Proposed legislation strengthens fraud prevention by recommending increased sentences, expanding the definition of “health care fraud offense,” improving whistleblower claims, and increasing antifraud funding.

*“We will **strike back against . . . fraudulent schemes**” that undermine Medicare and contribute to rising health costs. *“We will work . . . to **root out the few who corrupt the system and taint the good reputations of health professionals everywhere.**”**

- Attorney General Eric Holder (June 24, 2009)



# Healthcare Fraud: Historic Settlements

- **Pfizer:** In September 2009, Pfizer agreed to pay **\$2.3 billion, the largest healthcare settlement in the history of the DOJ**, to resolve criminal and civil liability arising from the illegal promotion of certain pharmaceutical products. The settlement included a **\$1.195 billion criminal fine, the largest criminal fine ever imposed in the United States for any matter.**
- **Eli Lilly:** In January 2009, Eli Lilly paid **\$1.4 billion** to settle criminal and civil suits related to its off-label marketing of the anti-psychotic drug Zyprexa.
- **AstraZeneca:** In October 2009, AstraZeneca announced that it had set aside **\$520 million** as part of a tentative agreement to resolve a federal investigation into its marketing practices.



# False Claims Act: Healthcare Fraud Recoveries

## Enormous False Claims Act Recoveries from Healthcare Fraud

- Healthcare fraud matters composed two-thirds of FCA recoveries in FY 2009, bringing in **\$1.6 billion** of the total \$2.4 billion recouped.
- This year's haul from the **healthcare sector alone is just above that for total false claims recoveries in 2008**, when the government took in \$1.54 billion.
- Official FCA figures do not reflect total dollar values because they do not include criminal recoveries or money disbursed to the states (about 45% of all money collected in Medicaid cases).
- The government registered its biggest returns from the pharmaceutical and medical-device industries, which accounted for **\$867 million** in settlements over alleged off-label marketing. A record settlement involving Medicaid false claims recovered **\$540 million** from the state and city of New York.



# False Claims Act: Procurement and Federal Contracting

- Procurement fraud settlements and judgments in FY 2009 totaled more than **\$608 million**, representing one quarter of the \$2.4 billion in FCA recoveries
  - \$325 million settlement with Northrop Grumman in **military-procurement-fraud** case (Apr. 2009)
  - \$128 million settlement with NetApp Inc. and NetApp. U.S. Public Sector Inc. for **best-price violations** (Apr. 2009)
  - \$26 million settlement with APL Ltd. in case accusing APL of knowingly **over-charging and double-billing the Department of Defense** to transport containers from ports to destinations in Iraq and Afghanistan (Feb. 2009)
- On January 29, 2009, the Senate Committee on Homeland Security & Government Affairs created the **Ad Hoc Subcommittee on Contracting Oversight**
  - It has “broad oversight authority over all aspects of federal contracting.” (Sen. Claire McCaskill, Chairman, Subcommittee on Contracting Oversight)
  - Hearing on “Improving the Ability of Inspectors General to Detect, Prevent, and Prosecute Contracting Fraud” (Apr. 21, 2009)
  - Hearing on “Achieving the President’s Objectives: New OMB Guidance to Combat Waste, Inefficiency, and Misuse in Federal Government Contracting” (Oct. 28, 2009)

(GDC 2009 Year-End False Claims Act Update, Jan. 8, 2010)



# Government Contracts: Federal Acquisition Regulation (“FAR”) and Federal Enforcement and Recovery Act (“FERA”)

➤ **FAR’s Mandatory Disclosure Rule for Contractors (Dec. 2008):**

- FAR requires mandatory, “timely” disclosure by government contractors of “credible evidence” of violations of certain criminal laws and the civil FCA, and of “significant” contract overpayments, with some exceptions.
- FAR provides that mandatory disclosure will not preclude contractors from meeting requirements for “reduced damages” (double instead of treble) for cooperation and voluntary disclosure if person committing violation furnishes all known information within 30 days of obtaining the information.

➤ **FERA significantly expanded scope of FCA (May 2009):**

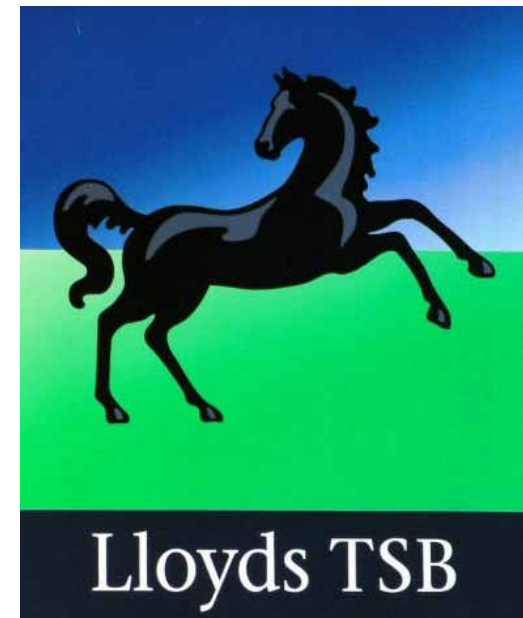
- FERA provides substantial funding for federal fraud detection and enforcement (including \$165 million in 2010 and 2011).
- It authorizes Attorney General to delegate his authority to issue Civil Investigative Demands.
- The Act imposes FCA liability even if company did not specifically intend to defraud the government directly and submitted the false claim only to a non-governmental entity.
- It extends to any fraudulent claim for government money or property whether or not the government has title to, or physical custody of, the money or property.
- By defining “obligation” to include “the retention of any overpayment,” FERA opens up new avenues of exposure for federal contractors or grantees who knowingly retain government “overpayments.”

(GDC 2009 Year-End False Claims Act Update, Jan. 8, 2010)

**Amendments give DOJ “a powerful tool in its efforts to pursue those who cause losses to the United States.”**  
(Tony West, Assistant Attorney General, Nov. 19, 2009)

# Trade Sanctions: Historic Settlements

- **Credit Suisse:**  
In December 2009, Credit Suisse agreed to pay a record fine of **\$536 million** after admitting it violated U.S. sanctions by hiding decades of booming business with Iranian banks. It was the **largest penalty in the history** of the U.S. Treasury's Office of Foreign Asset Controls ("OFAC").
- **Lloyds TSB:**  
In January 2009, Lloyds agreed to forfeit **\$350 million** to U.S. authorities for criminally hiding information and illicitly dealing with Iranian and Sudanese customers. And in December 2009, Lloyds settled with OFAC for \$217 million in connection with allegations arising out of the same pattern of conduct. OFAC determined that this fine was satisfied by Lloyds's prior \$350 payment.



# Trade Sanctions: Economic Sanctions Enforcement Guidelines

On November 9, 2009, OFAC released its Economic Sanctions Enforcement Guidelines as a final rule.

- The Guidelines set forth OFAC policy regarding enforcement responses to and potential penalties arising out of violations of U.S. economic sanctions.
- The rule confirms that **OFAC expects companies to maintain risk-based compliance programs**. OFAC will consider the strength of compliance programs in determining appropriate enforcement responses.
- Financial institutions must employ **OFAC's consolidated risk matrix**.
- The rule encourages **voluntary disclosure**.
- Under the rule, sets of **similar violations** addressed in single pre-penalty notices are considered single violations for purposes of the up-to-25% reduction in penalty amount for a first violation.



# Anti-Money Laundering: Trends & Developments

- **Congress Superseded Supreme Court Definition of “Proceeds” in Money Laundering Control Act**
  - In 2009, the Fraud Enforcement and Recovery Act amended the Money Laundering Control Act to define “*proceeds*” to include the “*gross receipts*” of illegal activity, not only net profits.
- **Changes to Requirements of Independent Testing of Compliance Program under Bank Secrecy Act**
  - SEC approved change to FINRA Rule 3310 that *eliminated an exception* that had allowed, in some circumstances, *testing of a company’s AML compliance program* by persons who reported to either the AML compliance officer or persons who performed the AML functions being tested.
  - In proposing the amendment, FINRA cited guidance from the Financial Crimes Enforcement Network, a bureau of the Treasury Department, which had said that the Bank Secrecy Act’s independent-testing provision prohibited AML compliance-program testing by personnel with an interest in the outcome.
- **Four Pillars of an Effective Bank Secrecy Act: Anti-Money Laundering Compliance Program for Financial Institutions Remain the Same**
  1. Tailored internal policies, procedures, and controls
  2. Compliance officer
  3. Ongoing, relevant training of employees
  4. Independent audit program to test compliance programs



# Antitrust: Trends & Developments

## Notable Developments:

- The first part of FY 2009 continued the dramatic pace of huge criminal fines imposed by the DOJ Antitrust Division in recent years, resulting in more than **\$1 billion** in fines for the year.
- Although that pace tapered off in the second half of FY 2009, the Antitrust Division had a strong start to the new FY 2010, imposing **\$229 million** in fines in the first quarter.
- **Individual criminal antitrust defendants**, including foreign nationals, continued to receive substantial, multi-year prison terms in the United States.
- Criminal antitrust **enforcement by jurisdictions outside of the United States expanded**, with the DOJ attempting to take a leading role in the convergence of international enforcement standards.
- **Christine Varney** was appointed head of the Antitrust Division, and her influence is being felt by the DOJ and international antitrust enforcers.



# Foreign Corrupt Practices Act: Aggressive Enforcement Activity

In 2009, the FCPA enforcement explosion continued with 40 new enforcement actions



- 26 new enforcement actions by the DOJ
- 14 new enforcement actions by the SEC
- Approximately 130 other open FCPA investigations



*“Our focus and resolve in the FCPA area will not abate, and we will be intensely focused on rooting out foreign bribery. . . . That will mean investigation and, if warranted, prosecution of corporations to be sure, but also **investigation and prosecution of senior executives**. Effective deterrence requires no less. Indeed, we firmly believe that for our enforcement efforts to have real deterrent effect, **culpable individuals must be prosecuted and go to jail where the facts and the law warrant.**”*

- Lanny A. Breuer, Assistant Attorney General, DOJ (Nov. 12, 2009)



# Foreign Corrupt Practices Act: Trends & Developments

## Notable Developments:

- SEC rolls out **aggressive new enforcement theories**, including “control person” liability
- DOJ expands prosecutorial net to capture **third parties and foreign government officials**
- **DOJ follows the money**, taking aggressive steps to recover the proceeds of foreign bribery
- DOJ and SEC permit **corporate self-monitoring**, allowing companies to report on implementation of compliance policies without the oversight of an external compliance monitor
- “**The year of the FCPA trial**”: Frederic Bourke, William Jefferson, Gerald and Patricia Green, etc.
- Organizational changes at DOJ and the SEC, with the SEC forming a **national specialized unit dedicated to FCPA enforcement**
- DOJ uses **undercover federal agents** to investigate corruption. Speaking about indictments announced yesterday, Lanny Breuer remarked: “[T]he undercover techniques used in this case should cause all would-be FCPA fraudsters to pause and ask: **Am I really paying off a foreign government official or could this be a federal agent?**”

*“FCPA violations have been and will continue to be dealt with severely by the SEC and other law enforcement agencies. Any company that seeks to put greed ahead of the law by making illegal payments to win business should beware that **we are working vigorously across borders to detect and punish such illicit conduct.**”*

- Mary Schapiro, SEC Chairman (Feb. 11, 2009)



# Compliance as Risk Management

- The recent financial turmoil sparked an increase in enforcement activity—and all signs point to this trend continuing.
- Increased enforcement activity underscores the need to manage risk diligently. The costs of not doing so may be higher than ever.
- Today's heightened emphasis on risk requires Boards of Directors to escalate their focus on compliance—a challenging task given the evolving regulatory environment.
- Companies should confront multi-faceted ethical and legal challenges by taking an integrated approach to compliance.
- Compliance officers, general counsels, and outside lawyers can no longer take comfort in acting merely as counselors to targets: We have become targets ourselves.

# Questions?



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