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SUMMARY REPORT

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When the Government Knocks – The Role of Corporate Compliance/Ethics Programs in Enforcement

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Over the course of many years working as an adviser on corporate compliance/ethics—and formerly in my role with the US Sentencing Commission where, as deputy general counsel, I led the development of the organizational sentencing guidelines—I have seen close-up the role that compliance/ethics (“C&E”) programs play when companies get “in trouble.” Here is what I have learned from these experiences.

Do C&E Programs Matter?

As most companies are now aware, the Federal Sentencing Guidelines for Organizations promise a significant reduction in penalties for a company convicted of a crime *if it has a qualifying C&E program*.¹ The US Department of Justice (DOJ) also says prosecutors should weigh a company’s C&E program before making a decision on whether to charge that company criminally. Various agencies from Health and Human Services (through the Office of Inspector General Guidance Practices²), to the Department of Commerce (see its guidance on the formation of an Export Management Compliance Program³), say that C&E programs are important.

But are compliance/ethics programs *actually* important when, as some of these government pronouncements explicitly say and others imply, a company has a compliance problem? Does the government really give credit for programs or is all of this just talk?

Different Governmental Personnel, Different Approaches

It is important to keep in mind that the government is not THE GOVERNMENT—by which I mean that enforcement is not conducted by a monolithic entity. Enforcement approaches vary from agency to agency. Even within the Justice Department, its various divisions take differing approaches—some are more pro-C&E programs than others.

Within the Justice Department, the Environment Division is perhaps most specific that having a good C&E program can mean the difference between an administrative and a criminal case. The Antitrust Division, at the other end of the spectrum, says that a C&E program will not be considered in resolving a case; voluntary disclosure—being the first one in the door to divulge the conspiracy—is all that matters. The Criminal Division plays it in the middle, saying prosecutors should *consider* before making a charging decision what kind of C&E program the company had in place at the time of the offense.

Publicly Available Evidence Is Limited, but C&E Programs Can Play Important Roles

The Conference Board recently produced a study, *Ethics and Compliance Enforcement Decisions—the Information Gap*,⁴ that sheds light on what prosecutors actually do. The study found that if the government is taking pre-offense C&E programs into account as promised by the Criminal Division—that is, if it is evaluating the C&E program a company had in place at the time of the offense before making a charging decision—this activity is opaque at best. There are few cases or even press releases that evidence the Justice Department’s crediting C&E programs.

Although public information is spotty at best, my personal experience is that C&E programs do matter to the government but are more likely to shape the contours of a settlement than prevent criminal charges entirely (although I am aware of a few non-public cases where this has happened). Given the paucity of public information, however, it would be helpful if the Justice Department *said* more about what it does in considering C&E programs.

The most obvious example of a case where a US prosecutor took a C&E program into account at the pre-charging stage involved Mellon Bank. In 2004, I was hired by the US Attorney for

Pittsburgh to evaluate Mellon's C&E program expressly for this purpose. Ultimately, Mellon was not criminally charged, and the deferred prosecution agreement (DPA) that was agreed to required specific, compliance program-related remedial actions that were based on our review.

Most of my experience in this area comes from being retained as a monitor or "independent consultant" (the terms can vary, agreement to agreement) pursuant to a DPA or consent agreement that the company has entered into with the government. In these cases, I evaluate the company's C&E program (or a portion of it—e.g., FCPA compliance) and report back to the government on where things stand. What I have seen in these kinds of cases is:

- The quality of the company's C&E program can significantly influence the agreement's terms in the first place; and
- Even if a company ends up with a DPA and a monitor, how difficult the experience of having a monitor is for the company will depend hugely on how good (or bad) its C&E program is when the third-party monitor/consultant begins work.

The C&E Program Can Shape Settlement Terms

With respect to the first point—that the nature of the existing C&E program can influence the terms of the settlement—one can see how this works from some publicly available agreements. For example, in the GE/Invision case, GE was merely required to extend its *already existing* FCPA program to its newly acquired business, Invision.⁵ Similarly, Costco's 2009 settlement on options backdating reflects an understanding of some of the details of its C&E program, as does the Wabtec settlement in 2008, with respect to that company's C&E program.

Moreover, Dennis McInerney, the Chief of the Fraud Section at DOJ's Criminal Division—the section responsible for the Foreign Corrupt Practices Act and other corporate crime enforcement—confirmed this principle with respect to the appointment of monitors under settlements with his section. At a May 24, 2010, conference McInerney said, "People shouldn't assume that if you have a DPA or an NPA that you automatically get a monitor. I'd say about 50 percent of our deferred prosecution agreements in the Fraud Section required a monitor being appointed, and about 30 percent of the non-prosecution agreements involved a monitor." Why? He explained, "If you have already established an excellent compliance program, then it will be less likely that we'll install a compliance monitor, which can come at some cost to the company."⁶

The Department of Justice's charging policy, in which it says pre-offense C&E programs should be considered, states that efforts to strengthen the program *following* the discovery of the misconduct should also be considered, and I have seen this happen. For example, in an FCPA matter in which I currently serve as an "independent consultant" under an agreement with the SEC, the company was able to keep the matter a non-criminal one, and

under the jurisdiction of the SEC rather than the DOJ, in part because it made a strong initial showing that it had revamped its FCPA compliance program to be best in class since the events underpinning the offense first became known.

How the Monitor Views the Existing C&E Programs Will Determine How Difficult the Monitorship Experience Is for the Company

Even companies with strong C&E programs may end up with a DPA or consent agreement requiring a third-party review, but the experience that follows can be night and day depending on what kind of shape the C&E program is in once the monitor walks through the door. In one case with which I am familiar, the monitor saw that the C&E program had not penetrated the workforce at all. It was, to him, window dressing, and it led to a nightmare for senior management, occupying huge amounts of their time, and ultimately to an extension of the monitorship.

In other cases in which I have been involved, the C&E program is in excellent shape, and the third-party review becomes a very positive experience whereby the company's good work is documented for a potentially skeptical prosecutor or regulator, and the only recommendations made are ways to further refine and sometimes even streamline an already strong effort.

What Does the Government Look For?

As noted, the government is not a monolith—different agencies, divisions within the Department of Justice, and—here let us add—individual prosecutors, do not operate in lockstep. They have their own approaches to C&E programs. As a result, what the government "looks for" in a C&E program can vary. A good rule of thumb in presenting the company's C&E program to the government when an issue has come about is to follow the framework in the Federal Sentencing Guidelines⁷ (FSG)—it is a familiar framework for many agencies. It is adopted by reference in the DOJ charging policy and does a good job of capturing a holistic C&E approach.

This approach obviously needs to be modified if the company is in front of an agency that has its own model (for example the Commerce Department's standards for export control), though the models followed by a number of agencies build on the FSG; therefore, adapting is not hard.

Attention also needs to focus on the nature of the misconduct in question. If the issue is Medicare billing, compliance controls to ensure accurate billing are obviously relevant; if it is the Foreign Corrupt Practices Act, the government will want to see that your company has best practice controls relating to FCPA.

Design, Implementation, and Impact Reviews

At this point, we should consider how the government learns about the C&E program. There are three levels of possible evaluation—*design*, *implementation* and *impact* (or effectiveness). With a design review, the government looks at a description of how the

program works and judges its comprehensiveness but doesn't get into whether the company is actually implementing this design (implementation analysis), let alone whether any of it is really working (impact analysis).

Many C&E program presentations to the government seem to stay at this design-only level—they consist of the company's description of how the program works. At a pre-settlement stage, this may be all that the government is willing to get into. But if your company has evidence that helps show that the program is actually being implemented and, much more importantly, is having an impact, this can significantly advance your cause because prosecutors are professionally inclined to be skeptical, and evidence along these lines can counter that expectable skepticism. Benchmarking survey data, audit results bearing on the topic at issue, or a C&E program evaluation by a credible third-party can be very useful. Counsel may be reluctant to share this kind of information, however, especially if it is protected under attorney/client privilege; but it can be influential because it goes beyond requiring the prosecutor to rely on the company's mere say-so as to the effectiveness of its C&E program.

In the Mellon case, discussed above, I was hired to analyze the company's C&E program to help the US Attorney decide whether to charge the company criminally for what was certainly criminal misconduct by some of its employees. We did this review through interviews and document reviews. It allowed us to get a good appreciation of the program's design, some feel for how well the design was being implemented, and perhaps only an impression of actual effectiveness (an impression created inferentially from the information we gleaned on design and implementation).

The Mellon case notwithstanding, most pre-settlement evaluations to date have not involved a third-party review—although perhaps this will change in the future. Most likely, the government's understanding of your program at the pre-settlement stage will derive from your company's presentation of it.

A company presentation like this can persuade the government to drop the case if the matter is not deemed very serious or is a bit obscure. For example, in one case with which I am familiar, a company's presentation of its C&E program led the prosecutor to drop potential charges over a minor error under the Endangered Species Act. If the charges are more serious, the C&E program usually will only shape the terms of eventual settlement, not eliminate the issue altogether. Still, this can be very important with respect to the settlement's impact on the company—it can mean the difference between having a true "monitor" or a less invasive "independent consultant." And it can mean the difference between a wide-open mandate for the third-party evaluator and a much narrower one.

What Do Monitors Do?

If you do end up with a settlement and a third-party evaluator, the obvious next question is, how does the monitor evaluate your program?

WHAT TO KNOW BEFORE THE GOVERNMENT KNOCKS: The Role of Compliance and Ethics Programs

Ten Key Observations

1. Government pronouncements say C&E programs matter to enforcement outcomes, but little public data is available and non-public experience shows actual practice is more complex than these pronouncements may suggest.
2. Enforcement approaches to C&E programs vary among—and even within—government agencies.
3. C&E programs do matter to the government but are more likely to influence the details of a settlement than prevent criminal charges entirely; although sometimes—especially in less serious cases—charges can be avoided with a persuasive showing.
4. The company's C&E program, both as it existed at the time of the offense and how it has been strengthened since the offense, may influence the severity of the DPA's terms.
5. Even a company with a strong C&E program may end up with a DPA and monitor, but the quality of the C&E program can affect how onerous the monitoring experience is for the company.
6. The type of information the government may consider in evaluating C&E programs can vary.
7. Three kinds of C&E program evaluation potentially can be relevant in an enforcement context: Design, Implementation, and Impact.
8. Prosecutors often consider discipline for code of conduct violations and the positioning of the Chief Ethics and Compliance Officer as indicators of the C&E program's validity.
9. Consider in advance how to demonstrate the efficacy of your company's C&E program.
10. A company that has not previously evaluated its C&E program can be susceptible to unpleasant surprises if a monitor is appointed to do just that.

Because different agencies and prosecutors have differing approaches, the terms of settlements can vary too. In many health-care related agreements, a series of audits will be required. In some cases—and this can sometimes be negotiated for—the terms will be narrow and the evaluation will be almost a check the box exercise. In one case where I served as an independent third-party under an agreement with the Agency for International Development, the task was split. Part One was a check the box undertaking to verify that certain policies had been put in place. Part Two was much more open-ended. We had to evaluate the adequacy and effectiveness of the company's overall C&E program. In short, this latter part involved design, implementation, and impact analysis.

And in my experience—doing reviews under agreements with DOJ, the SEC, the US Air Force and others—the likelihood that the review will involve some testing of whether the program is *actually working* (impact analysis) is fairly high.

I use a variety of techniques to do this kind of evaluation, including document reviews, audits of files, scheduled and unscheduled confidential interviews (the latter occur when we are on site in a

business location and we simply pick people out of an organizational chart to interview, based on job function without advance warning) and confidential focus groups.

Being Prepared—What If the Government Does Knock on Your Door?

How can you be ready if your company finds itself dealing with the government across the table over a non-compliance issue?

Let's start with what they say. Prosecutors and regulators routinely say at conferences and even in the Department of Justice corporate charging policy (in the US Attorneys Manual⁸) that they will credit only "real" programs—not "paper ones." As my colleague Joe Murphy has said, though, it can take a lot of paper to prove you don't have a paper program.

So, one initial word of advice is, think ahead about how you would evidence your C&E program if you ever needed to. You can assume that the "presentation" of the program during negotiations would most likely occur through documents and a few "witnesses" (the use of witnesses will be strongly influenced by the advice of your company's own counsel). I would focus preparedness in these three areas:

- The basic details of the program. Following the federal sentencing guidelines framework as a point of reference, how does your program work?
- Why is your program "best practice"? Even if the government's review of your program stays at the "design" only stage, they still will want to be convinced that your program compares well with what other leading companies are doing. A company I recently worked for as a third-party reviewer under a consent decree involving FCPA issues found that at the pre-settlement stage prosecutors were well aware of the kind of FCPA practices other companies had.
- Why do you think it is working? To the extent your lawyers will let you show some of the potentially sensitive information that bears witness to your program's effectiveness (e.g., audits, survey results, a report by a credible third-party), this can be particularly persuasive because it helps demonstrate your assertions about the program.

Keep in mind that two time periods are relevant. First, what was in place at the *time of the offense*? Second, what have you done to improve the program *since*? The first piece can be trickier to prove because negotiations with the government sometimes occur years after the events in question took place, but both time periods may be important to the government—both are potentially important in the US Attorneys Manual, which contains the DOJ charging policy (the Federal Sentencing Guidelines also say both time periods are relevant—the first time period relates to potential fines and the second to the need for imposing corporate "probation.")

Another thing prosecutors routinely say is that they expect tough discipline of wrongdoers. This is not surprising. Prosecutors are, after all, people who work professionally to hold others account-

able through punishment. For them, it is intuitive that the program is "real" if it is enforced. The US Attorneys Manual comments extensively on the importance of discipline for C&E infractions. A paragraph discusses this in §9-28.900 (Restitution and Remediation) of the Manual⁹ at some length but it comes up elsewhere, too. I wouldn't necessarily change your company's approach to discipline because of this, but I certainly would be prepared to show how you discipline violators, especially those involved in the instant offense. (For better or worse, prosecutors are more apt to be swayed by toughness toward code of conduct violations than by compassion.)

Another key issue for many prosecutors is the hierarchical status and positioning of the chief ethics and compliance officer (CECO). It is hard to ignore the fact that many settlements require that the CECO report at the highest level of the company—often to the board. The same thinking that drives these settlement terms also applies to how the government will look at your existing program. There may be little that you as an incumbent CECO can do about this, but the operative equation is this: Higher up = Better. If you are in healthcare, the HHS OIG Guidances indicate that many, if not most, government prosecutors disfavor having the CECO report to the general counsel.

Despite a good showing on the C&E program at the negotiation stage, a deferred prosecution agreement of some kind is likely if the case involves serious misconduct. The terms can be positively influenced by a strong C&E program, but a DPA may result nonetheless, and this frequently means some kind of third-party review. As discussed, third-party reviews vary—some are check the box and some involve technical auditing.

But many entail the kind of *implementation* and *impact* review of the C&E program (or relevant aspect of it—e.g., FCPA) described above. If this is your lot, here is what you should know.

- This is the moment when the degree to which your program has really taken hold—has permeated your company's culture—will truly matter. A third-party reviewer—if he or she is following the intent of the US Attorneys Manual and the FSG—virtually will be required to get to the bottom of this question.
- During the process, be helpful but not pushy; explain what you think, but don't be defensive. If the evaluator is going to make recommendations, they will be "softer" and the process easier if the evaluator believes that the company is only too eager to improve.

Evaluate Your C&E Program

Understanding how C&E programs come into play when companies get into "trouble" makes a strong argument for formally evaluating one's C&E program NOW—before trouble ever hits. The sentencing guidelines already require program evaluation for creditworthy programs—which is another reason to do it—but the benefits go beyond simply meeting the guidelines.

A pre-offense evaluation provides evidence, if it is ever needed, to

prove at the settlement stage that the program is not just paper, but that it really works. A pre-offense evaluation also helps a company avoid unhappy surprises if a monitor is appointed and required to test the C&E program. When I have a monitor-type role, I am hoping that what I find will help get the company out of the difficulty that my being there represents; I am hoping for positive findings. But when a monitor finds that mid-level managers don't support the C&E program; that the training is, in fact, not well received; that there is a star culture in which some people seem to get a pass for not playing by the rules; and so on; the company is the one that bears the burden. Knowing how the C&E program is truly functioning—before trouble ever strikes—helps avoid unexpected findings like these.

A final word to the wise. Recently, organizations (some that sound as though they are non-profits, but aren't) have been conferring highly publicized corporate "ethics awards" to dozens of companies without any actual testing of the recipient companies' C&E programs.¹⁰ Unfortunately, I have seen firsthand that winning such an award can create false comfort within management that all is well. An award is not a substitute for actual program testing. I would not view such an award as evidence of anything were I operating as a monitor, and I don't recommend waiting till the government is at the door to learn that the basis for your company's award was, in fact, paper thin.

Notes

1. United States Sentencing Commission, <http://www.uscc.gov/orgguide.htm>, (accessed 16 March 2010).
2. US Department of Health and Human Services, Office of Inspector General Guidance Practices, <http://oig.hhs.gov/guidancepractices.asp>, (accessed 16 March 2010).
3. US Department of Commerce, Bureau of Industry and Security, <http://www.bis.doc.gov/complianceand enforcement/emcp.htm>, (accessed 16 March 2010).
4. Ronald E. Berenbeim and Jeffery Kaplan, "Ethics and Compliance Enforcement Decisions – the Information Gap," *The Conference Board* (June 2009).
5. US Securities and Exchange Commission, <http://www.sec.gov/litigation/admin/34-51199.htm>, (accessed 16 March 2010).
6. Christopher Matthews, "Fraud Chief: Effective Compliance Programs Can Prevent Monitors," *Main Justice*, (May 24, 2010), <http://www.mainjustice.com/2010/05/24/fraud-section-chief-effective-compliance-programs-can-prevent-monitors>.
7. United States Sentencing Guidelines §8B2.1. <http://www.uscc.gov/orgguide.htm>.
8. US Attorneys' Manual, http://www.justice.gov/usao/eousa/foia_reading_room/usam/, (accessed 16 March 2010).
9. US Attorneys' Manual, http://www.justice.gov/usao/eousa/foia_reading_room/usam/, (accessed 16 March 2010).
10. "It's All Good—Beware of Consulting Firms Offering Awards for Corporate Ethics," *Slate*, March 19, 2010, <http://www.slate.com/id/2248033/>.