

Evaluation of Corporate Compliance Programs: Practical Considerations Based on DOJ's Updated Guidance

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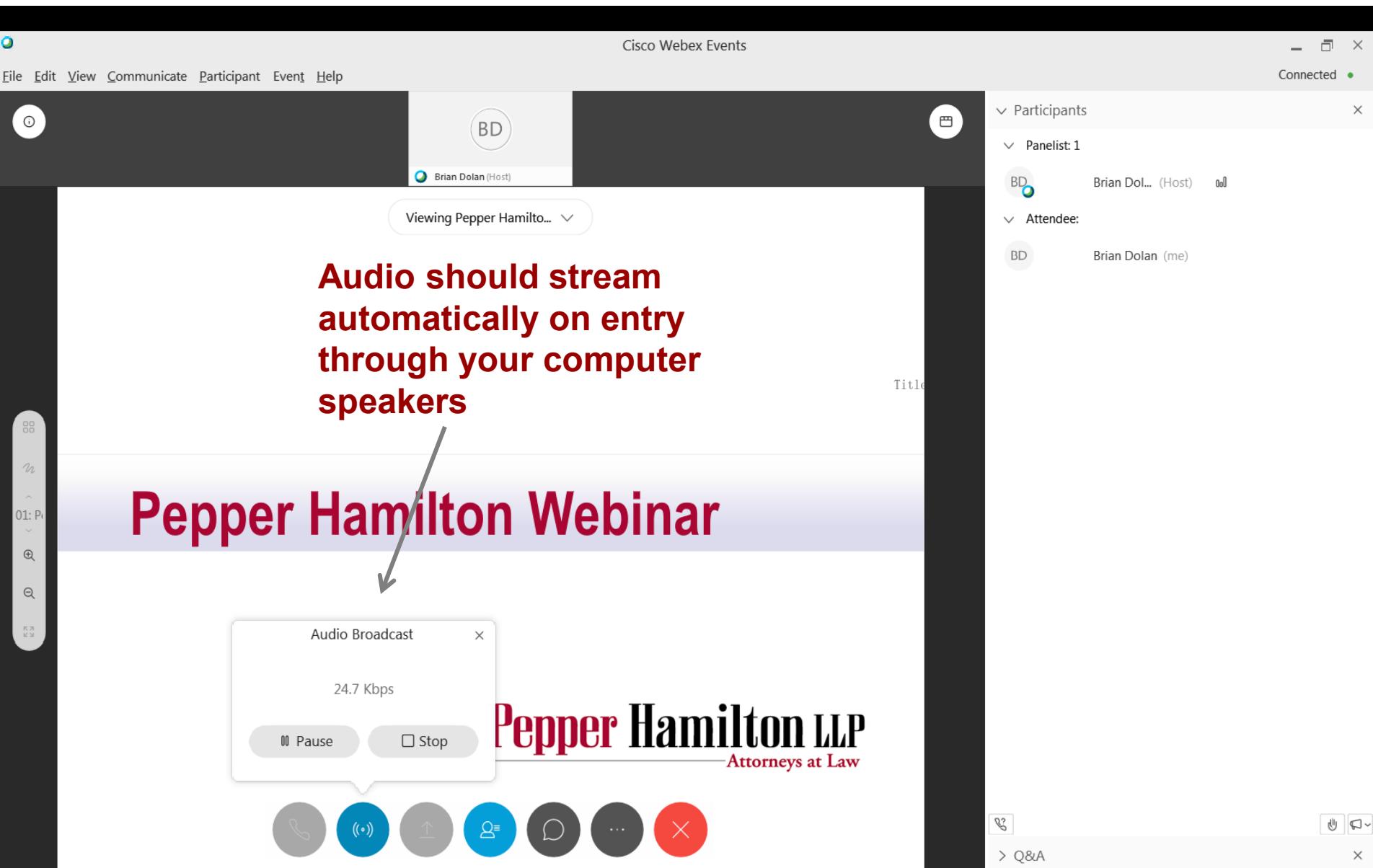
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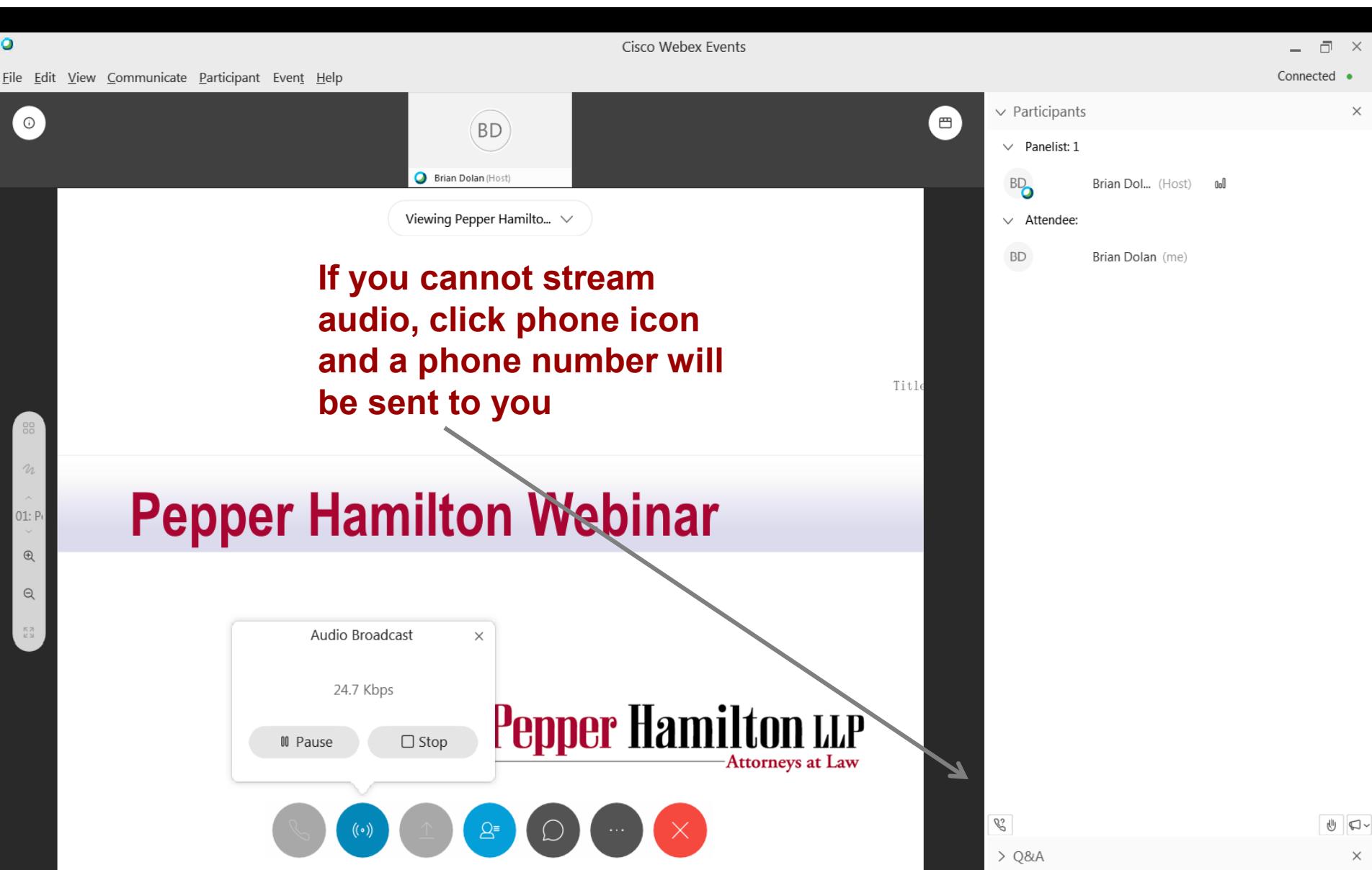
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Q&A

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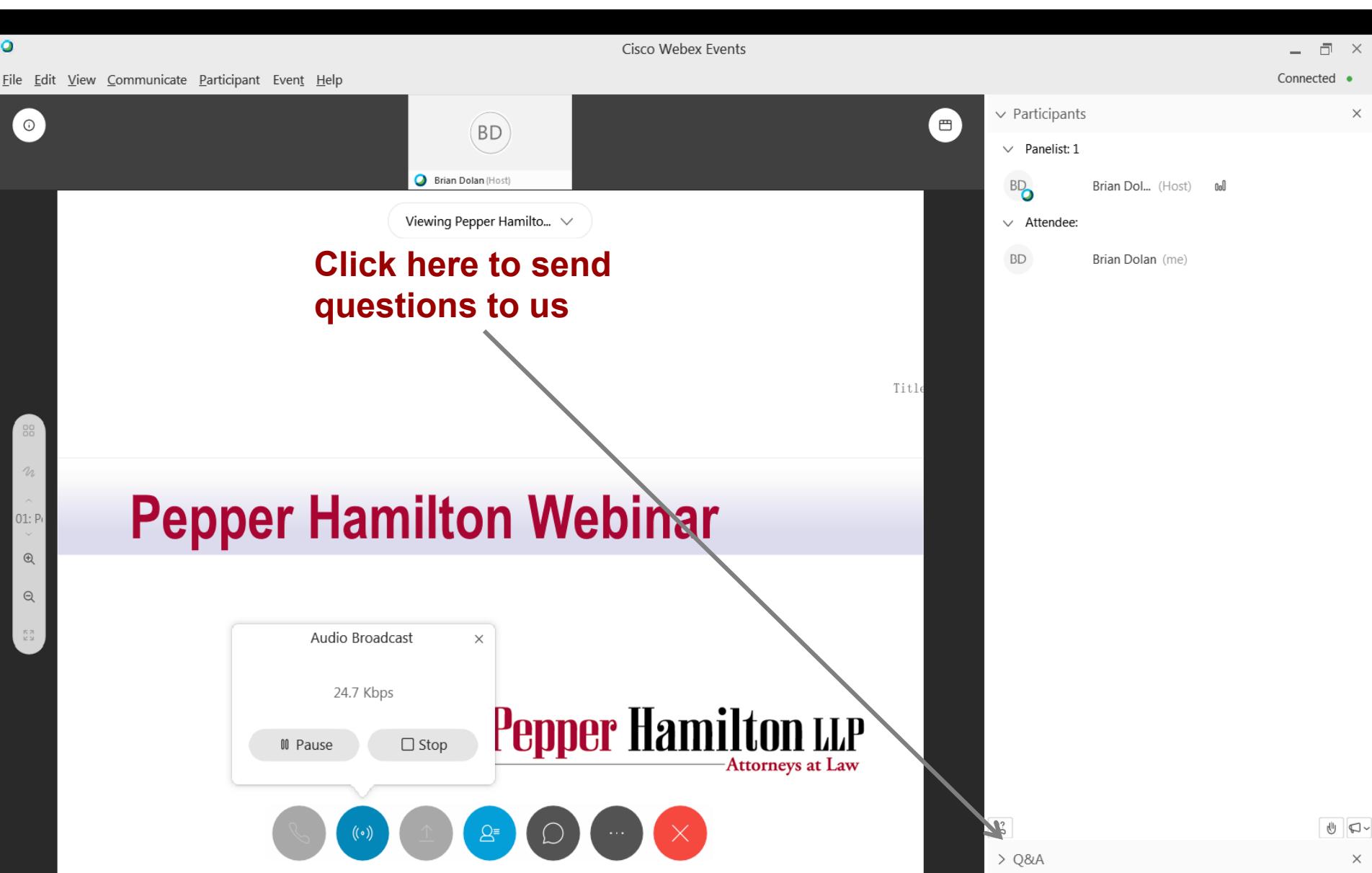
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The webinar will be starting at 12:00pm ET. There is currently no audio until we start.

We are on mute and will be starting in a few minutes.

Email dolanb@pepperlaw.com if interested in receiving a CLE form.

Overview

The DOJ's updated guidance addresses how prosecutors will evaluate all corporate compliance programs in all industries.

I. Background

- History of DOJ's prosecution of corporations
- History of DOJ's guidance on corporate compliance programs
- Purpose of DOJ's updated guidance

II. Three Fundamental Questions

1. *Design: Is your corporate compliance program designed appropriately?*
2. *Implementation: Has your corporate compliance program been effectively implemented?*
3. *Results: Does your corporate compliance program work in practice?*

Background

USAM 9-28.000 – Principles of Federal Prosecution of Business Organizations (the “Filip” Factors)

- ▶ Helps guide DOJ decisions on whether to bring criminal charges against a corporation, or negotiate a plea or other agreement.
- ▶ Two of the factors focus on the corporation’s compliance program:
 - Existence and Effectiveness of Pre-Existing Compliance program (measured “at time of the offense, as well as at the time of a charging decision.” 9-28.800)
 - Remedial Actions (including “any efforts to implement an adequate and effective corporate compliance program or to improve an existing one . . .” 9-28.1000)

Background

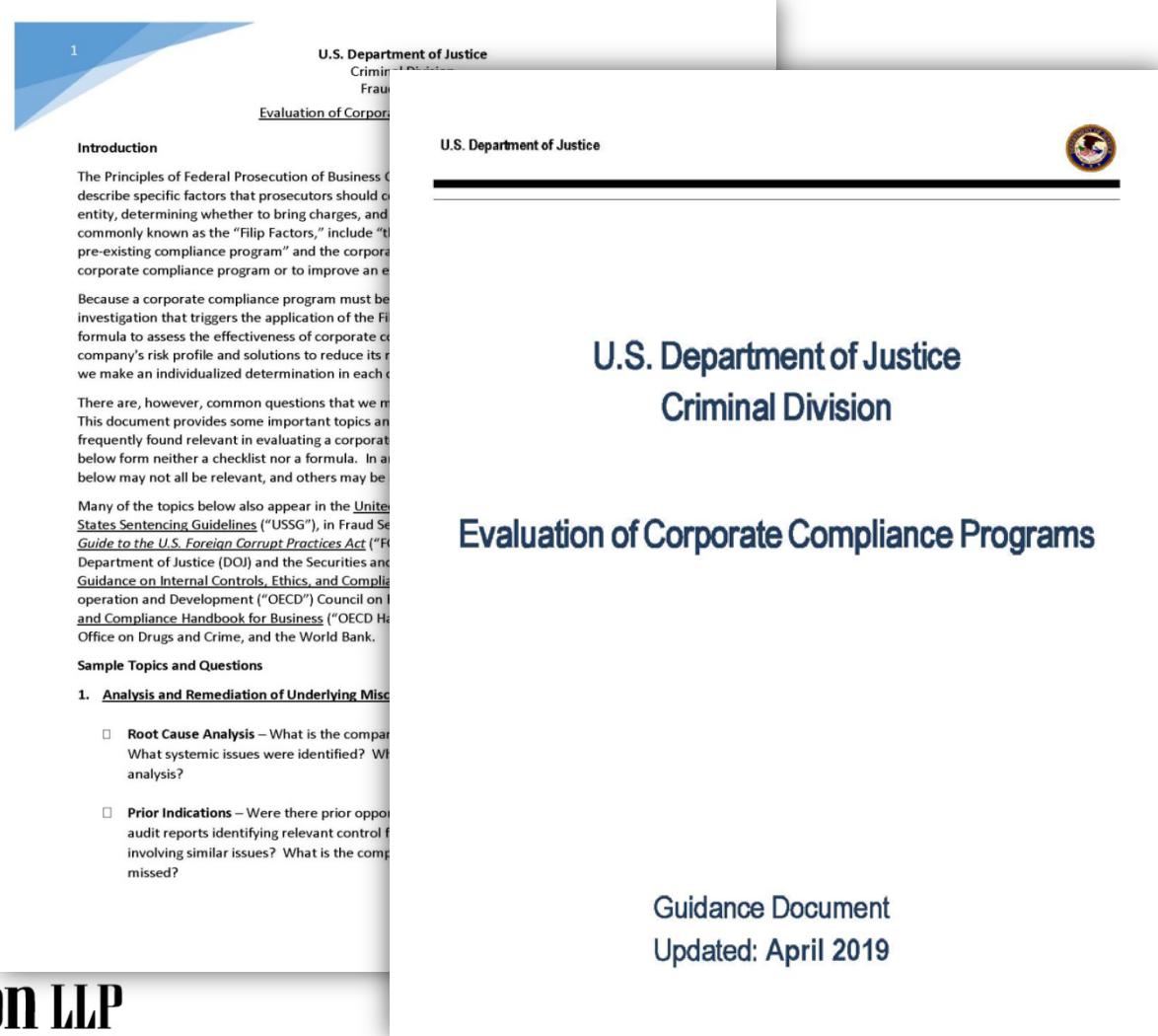
DOJ's Increasing Expertise and Focus on Corporate Compliance Programs ("Compliance Initiative")

- ▶ In 2012, DOJ and SEC published a resource guide to the FCPA, with a focus on compliance program expectations.
- ▶ In 2015, Hui Chen hired as a full time compliance expert to consult on Fraud section cases. Chen sat in on every Filip Factor compliance presentation.
- ▶ Public appearances by Andrew Weismann (former, Chief of Criminal Fraud section) and Leslie Caldwell (former, Assistant AG Criminal division) discussed the importance of corporate compliance programs and the metrics that DOJ uses to evaluate them.



Background

“Informal List of Questions” to Formal Guidance Document



The image shows a screenshot of a document titled "Evaluation of Corporate Compliance Programs" from the U.S. Department of Justice, Criminal Division. The document is dated April 2019. It includes an introduction, sample topics and questions, and a list of topics from various guidelines. The introduction discusses the "Five Factors" for corporate prosecution and the evaluation of corporate compliance programs. The sample topics and questions section includes items like "Root Cause Analysis" and "Prior Indications". The document also mentions the "U.S. Sentencing Guidelines", "Fraud Section", "Foreign Corrupt Practices Act", "Department of Justice (DOJ) and the Securities and Exchange Commission (SEC) Guidelines", "Guidance on Internal Controls, Ethics, and Compliance", "Organization for Economic Cooperation and Development (OECD) Council on Integrity and Compliance Handbook for Business", "U.S. Office of Drugs and Crime", and the "World Bank". The document is presented in a formal, professional layout with a blue header and footer.

U.S. Department of Justice
Criminal Division
Evaluation of Corporate Compliance Programs

Introduction

The Principles of Federal Prosecution of Business Criminals describe specific factors that prosecutors should consider when evaluating whether to bring charges against a corporation. The factors, commonly known as the “Five Factors,” include “the existence of an effective pre-existing compliance program” and the corporation’s willingness to implement or improve an effective corporate compliance program or to improve an existing one.

Because a corporate compliance program must be evaluated in the context of the entire investigation that triggers the application of the Five Factors, the formula to assess the effectiveness of corporate compliance programs must take into account the company’s risk profile and solutions to reduce its risk. We make an individualized determination in each case.

There are, however, common questions that we may be asked about the evaluation of corporate compliance programs. This document provides some important topics and questions that are frequently found relevant in evaluating a corporate compliance program, but it is not a checklist or a formula. In addition, the topics listed below may not all be relevant, and others may be relevant in a particular case.

Many of the topics below also appear in the [United States Sentencing Guidelines](#) (“USSG”), in Fraud Section 8G1.4 of the Sentencing Guidelines, in the [U.S. Foreign Corrupt Practices Act](#) (“FCPA”), in the [DOJ’s Corporate Leniency Policy](#), in the [DOJ and the Securities and Exchange Commission \(SEC\) Guidelines](#), in the [Guidance on Internal Controls, Ethics, and Compliance](#), in the [OECD’s “Guidelines for Multinational Enterprises”](#), in the [OECD’s “Guidelines for the Operation and Development \(“OECD”\) Council on Integrity and Compliance Handbook for Business \(“OECD Handbook for Business”\)](#), in the [U.S. Office on Drugs and Crime](#), and the [World Bank](#).

Sample Topics and Questions

1. Analysis and Remediation of Underlying Misconduct

- Root Cause Analysis** – What is the company’s underlying problem? What systemic issues were identified? What is the company doing to remediate the analysis?
- Prior Indications** – Were there prior opportunities for the company to identify potential misconduct? Did audit reports identifying relevant control failures or other potential issues exist? Were there prior investigations involving similar issues? What is the company doing to remediate the prior indications?

Guidance Document
Updated: April 2019

Background

Key Changes in DOJ's "Updated" Guidance Document

- ▶ Prior "list of questions" is now a formal "Guidance Document."
- ▶ The updated guidance expands its use to all Criminal Division sections (previously limited only to the Fraud section) with citations to Criminal Division documents.
- ▶ Adds additional transparency on how the Criminal Division instructs its prosecutors to evaluate compliance programs during investigations.

Caution: The updated guidance is NOT a best practices document! It is NOT a checklist or magic formula!

Background

Purpose of DOJ's "Updated" Guidance Document

"To assist prosecutors in making informed decisions as to whether, and to what extent, the corporation's compliance program was effective at the time of the offense, and is effective at the time of a charging decision or resolution, for purposes of determining the appropriate":

1. Form of resolution or prosecution
2. Monetary penalty (if any)
3. Additional compliance obligations, if any, to be imposed as part of a corporate criminal resolution (e.g., monitorship or reporting obligations)

"Because a corporate compliance program must be evaluated in the specific context of a criminal investigation, the Criminal Division does not use any rigid formula to assess the effectiveness of corporate compliance programs.... There are, however, common questions that we may ask in the course of making an individualized determination."

Background

“Three Fundamental Questions” (See JM §9-28.800)

1. **Design** - “Is the corporation’s compliance program well designed?”
2. **Implementation** - “Is the program being applied earnestly and in good faith?” In other words, is the program being implemented effectively?
3. **Results** - “Does the corporation’s compliance program work in practice?”

Design of Corporate Compliance Programs

“The critical factors in evaluating any program are whether the program is adequately designed for maximum effectiveness in preventing and detecting wrongdoing by employees and whether corporate management is enforcing the program or is tacitly encouraging or pressuring employees to engage in misconduct.”

Factors prosecutors will consider in evaluating a compliance program's design:

1. Internal Corporate Risk Assessment
2. Policies and Procedures
3. Training and Communication
4. Confidential Reporting Structure and Investigation Process
5. Third Party Management

Design of Corporate Compliance Programs

Internal Corporate Risk Assessment

“Prosecutors should consider whether the program is appropriately designed to detect the particular types of misconduct most likely to occur in a particular corporation’s line of business and complex regulatory environment.”

How to conduct and use a risk assessment:

1. Determine the **specific** compliance risks your company faces.
 - Analyze company-specific factors
 - Determine metrics and gather information
2. Tailor your compliance program to address those risks.
 - Create a “risk spectrum” specific to your company
 - Devote compliance resources according to the risk spectrum
3. Conduct periodic updates.
 - Update policies based on lessons learned
 - Account for risks discovered through past misconduct

Design of Corporate Compliance Programs

Policies and Procedures

“Any well-designed compliance program entails policies and procedures that give both content and effect to ethical norms and that address and aim to reduce risks identified by the company as part of its risk assessment process.”

How to draft effective policies and procedures:

1. Engage with key stakeholders
 - Solicit input from relevant management
 - Consult specific business units likely to be impacted
2. Monitor legal and regulatory changes.
 - Assign an individual with sufficient expertise to stay up to date on changes
 - Develop relationship with outside counsel or other experts
3. Demonstrate your company’s commitment to compliance.
 - Implement a Code of Conduct that makes clear the company’s full commitment to compliance with all relevant laws
 - Appoint and train senior employees to act as “gatekeepers” who will control the process

Design of Corporate Compliance Programs

Training and Communication

“Another hallmark of a well-designed compliance program is appropriately tailored training and communications.”

How to train employees and communicate your compliance plan:

1. Customize your compliance training.
 - Tailor the training to the audience's size, sophistication, and expertise
 - Offer both in-person and online training
 - Consider providing practical advice and the use of case studies
2. Utilize risk-based training strategies.
 - Focus training on high-risk and control employees
 - Provide extra training to supervisory employees
3. Ensure the effectiveness of the training.
 - Test employees at the conclusion of training
 - Require employees to certify their understanding

Design of Corporate Compliance Programs

Confidential Reporting Structure and Investigation Process

“Another hallmark of a well-designed compliance program is the existence of an efficient and trusted mechanism by which employees can anonymously or confidentially report allegations of a breach of the company’s code of conduct, company policies, or suspected or actual misconduct.”

How to design your reporting/investigation process:

1. Take proactive measures to encourage disclosures.
 - Create a hotline or email account that permits **anonymous** reporting
 - Implement and enforce anti-retaliation policies
2. Identify a trusted “point person” to perform initial complaint intakes.
 - Train the individual to screen complaints
 - Ensure the individual has sufficient authority and independence to effectively evaluate incoming complaints
3. Develop guidelines for when and how to investigate complaints.
 - Identify the most likely topics of complaints and decide ahead of time how they should be investigated and by whom
 - Consider using an outside investigator

Design of Corporate Compliance Programs

Third Party Management

“A well-designed compliance program should apply risk-based due diligence to its third-party relationships....based on the size and nature of the company or transactions.”

How to manage third-party relationships:

1. Determine/Document the business rationale for using a third-party.
 - Avoid the use of unnecessary third-parties
 - Ensure ability to justify all payments to third-parties
2. Perform substantial due diligence before any engagement.
 - Know their reputations and applicable relationships
 - Exclude third parties who do not pass diligence
3. Document the complete terms of third-party relationships.
 - Enter contracts that describe all services to be provided
 - Agree on the compensation terms ahead of time
4. Continue to monitor third-parties during and after engagements.
 - Periodically audit all third parties
 - Take serious action against third-parties when issues are identified

Implementation of Corporate Compliance Programs

“Even a well-designed compliance program may be unsuccessful in practice if implementation is lax or ineffective. Prosecutors are instructed to probe specifically whether a compliance program is a ‘paper program’ or one ‘implemented, reviewed, and revised, as appropriate, in an effective manner.’”

Factors prosecutors will scrutinize in evaluating a compliance program's implementation:

1. Commitment by Management
2. Autonomy and Resources
3. Incentives and Discipline

Implementation of Corporate Compliance Programs

Commitment by Management

“The effectiveness of a compliance program requires a high-level commitment by company leadership to implement a culture of compliance from the top. The company’s top leaders – the board of directors and executives – set the tone for the rest of the company.”

How to demonstrate sufficient commitment by management:

1. Lead by example (with concrete actions).
 - Management should clearly articulate the company’s ethical standards to subordinates
 - Rigorous compliance with the letter of corporate compliance policies
2. Emphasize compliance in high leverage situations.
 - Do not tolerate greater compliance risks in pursuit of new business
 - Emphasize compliance even if it impedes business objectives
3. Hold regular compliance sessions with the board.
 - The board should hold periodic executive/private sessions with compliance personnel
 - Provide regular reports and compliance documentation to the board

Implementation of Corporate Compliance Programs

Autonomy and Resources

“[P]rosecutors should address the sufficiency of the personnel and resources within the compliance function, in particular, whether those responsible for compliance have: (1) sufficient seniority within the organization; (2) sufficient resources, namely, staff to effectively undertake the requisite auditing, documentation, and analysis; and (3) sufficient autonomy from management, such as direct access to the board of directors or the board’s audit committee.”

Practical considerations for staffing and resourcing your compliance program:

1. Hire an experienced chief compliance officer.
 - Do not simply add obligations onto another, existing full time employee
 - Empower the CCO to “effectively detect and prevent misconduct”
 - Hire a CCO with experience to identify potential risk transactions
2. Evaluate, document, and budget for compliance needs.
3. Open direct lines from the compliance function to the board.
 - Give compliance a “seat at the table”

Implementation of Corporate Compliance Programs

Incentives and Discipline

“Another hallmark of effective implementation of a compliance program is the establishment of incentives for compliance and disincentives for non-compliance.”

How to properly incentivize/discipline employees:

1. Implement a program that rewards employees for compliance.
 - Consider awarding promotions or bonuses to employees who demonstrate ethical leadership or drive compliance improvements
 - Include a compliance metric for bonus calculation and/or advancement
2. Clearly articulate the disciplinary process (in writing).
 - Describe the investigation process and the spectrum of possible discipline
3. Discipline should be serious and consistently applied
 - Discipline should be designed to deter future violations
 - Managers should receive the same (or more severe) discipline than subordinates
 - Similar instances of misconduct should be punished consistently

Results of Corporate Compliance Programs

“[O]ne of the most difficult questions prosecutors must answer in evaluating a compliance program following misconduct is whether the program was working effectively at the time of the offense, especially where the misconduct was not immediately detected.”

Factors prosecutors will consider when determining whether a compliance program was working effectively:

1. Continuous Improvement/Evolution
2. Investigation of Misconduct
3. Analysis and Remediation of Discovered Misconduct

Results of Corporate Compliance Programs

The Threshold Questions

Does the existence of misconduct mean a corporation compliance program does not work?....NO!

“It is important to note that the existence of misconduct does not, by itself, mean that a compliance program did not work or was ineffective at the time of the offense....no compliance program can ever prevent all criminal activity by a corporation’s employees.”

- ▶ But the existence of misconduct does raise questions about how the compliance program was working:
 - How was it detected?
 - What resources were used to investigate it?
 - How thoroughly did the company investigate?
 - What remedial efforts did the company put in place?
- ▶ Key Question: What changes did the company make to its compliance program as a result?

Results of Corporate Compliance Programs

Continuous Improvement/Evolution

“One hallmark of an effective compliance program is its capacity to improve and evolve...[P]rosecutors should consider whether the company has engaged in meaningful efforts to review its compliance program and ensure that it is not stale.”

How to gather information and improve your compliance program:

1. “Self scout” your own compliance program.
 - Conduct periodic internal audits
 - Test your controls and utilize tracking systems
2. Engage with employees.
 - Survey employees to gauge compliance culture
 - Interview employees and third-parties to gather compliance data
3. Use data to update your risk assessment.
 - Review policies, procedures, and practices
 - Focus improvement efforts on high-risk areas

Key Question: There is an abundance of data, how are you using it?

Results of Corporate Compliance Programs

Investigation of Misconduct

“Another hallmark of a compliance program that is working effectively is the existence of a well-functioning and appropriate funded mechanism for the timely and thorough investigation of any allegations or suspicions of misconduct by the company, its employees, or agents.”

How to implement an effective investigation program:

1. Develop and refine investigations SOP.
2. Ensure all investigations are independent and objective.
 - Conduct training for your investigators
 - Avoid conflicts of interest
 - Consider utilizing outside counsel for high risk investigations
3. Document the investigation steps and conclusions.
 - Reflect the timeliness of investigation
 - Demonstrate the investigation was properly resourced and staffed
 - Track discipline and follow-through
4. Determine the root cause of any misconduct.
 - Identify the risk areas for assessment
 - Pinpoint any training or policy gaps that allowed misconduct to occur

Results of Corporate Compliance Programs

Analysis and Remediation of Discovered Misconduct

“[A] hallmark of a compliance program that is working effectively in practice is the extent to which a company is able to conduct a thoughtful root cause analysis of misconduct and timely and appropriately remediate to address the root causes.”

How to ensure misconduct is properly analyzed and remediated:

1. Update/Revise any policies/procedures that failed.
 - Close the gaps that allowed the misconduct to occur
 - Draft new policies, if necessary, to account for new risks
2. Determine why the misconduct was not identified early.
 - Evaluate the effectiveness of processes to detect misconduct
 - Identify the individual(s) who have responsibility for those processes
3. Hold accountable the managers on whose watch the misconduct occurred.
 - Including imposing appropriate (and consistently applied) discipline
 - In addition to discipline imposed on those who committed the misconduct

Questions & Answers

Q&A

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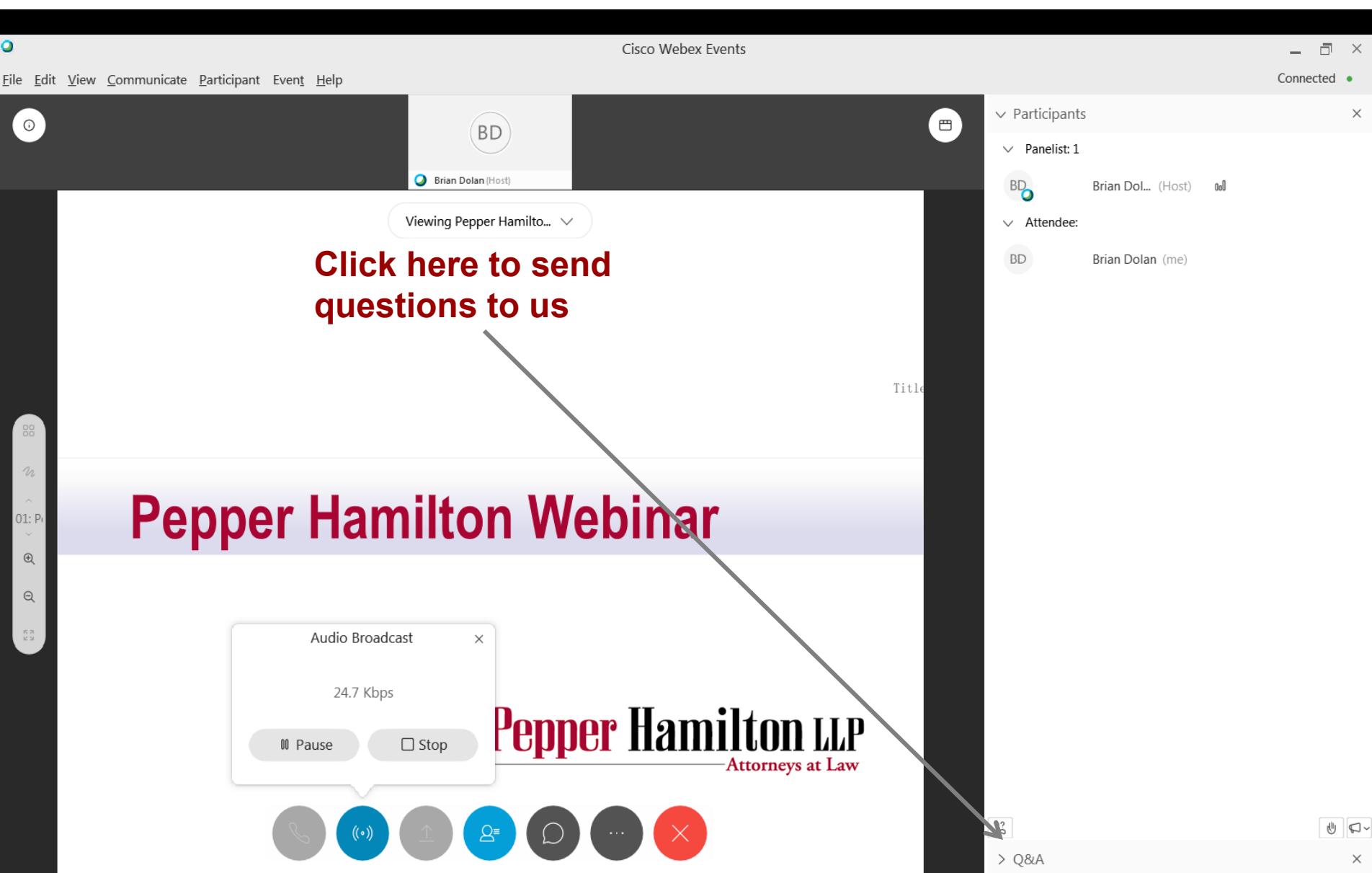
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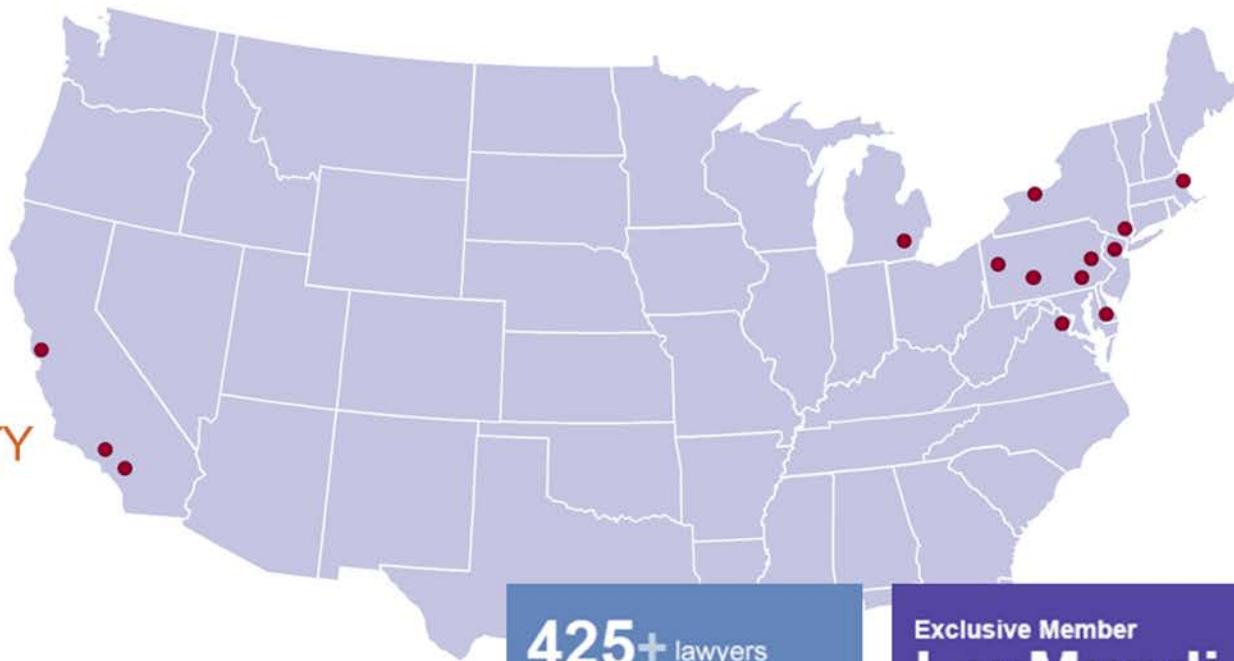
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