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Should We Separate the General Counsel & The Chief Compliance Officer?

Grant A. Ostlund

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Grant Ostlund

April 19, 2016

Contents

I. Introduction	page 4
II. Legal Sources of Corporate Compliance	page 5
III. The Role of the General Counsel	page 14
IV. The Role of the Chief Compliance Officer	page 20
V. Compliance Obligations of the Board of Directors and Senior Management	page 26
VI. CCO Reporting to GC	page 28
VII. Standalone CCO and GC	page 32
VIII. Conclusion	page 36

Should We Separate the General Counsel & The Chief Compliance Officer?

Grant Ostlund

April 19, 2016

This Paper is submitted to Dean Booznag in partial satisfaction of Healthcare Fraud and Corruption.

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I. Introduction

The state of the compliance function today is the culmination of a roughly twenty year expansion fueled by new laws, regulations, and agency guidance.¹ The provenance of these programs and systems of control currently advocated by regulators are diverse. Fundamentally, however, compliance programs are designed to monitor and deter wrongdoing within an organization through the implementation of policies and procedures² Enforcement falls “within the purview of numerous federal and state agencies,” and as result, compliance programs are an amalgamation that reflect the prescriptions and preferences of multiple agencies with varying degrees of civil and criminal oversight authority.³

In response to the deluge of new compliance-related laws and guidance, companies must grapple with defining the role of the compliance function and determining where within the organization the department should be located. This debate extends beyond the common concerns that accompany corporate resource allocation because of the effect that the compliance department has on the legal position of an organization and because government has demonstrated certain preferences. In large organizations, the compliance department either reports to the general counsel (GC) in some subordinate position, or exists apart from the GC as an equal, board-level reporting entity. The much more limited resources of smaller organizations commonly necessitate that the duties of the GC and CCO to be located in a single office and/or person.⁴

¹ Michele DeStefno, *Creating a Culture of Compliance: Why Departmentalization May Not Be the Answer*, 10 HASTINGS BUS. L.J. 71, 87 (2014).

² Miriam Hechler Baer, *Governing Corporate Compliance*, 50 B.C. L. REV. 949, 960 (2009).

³ *Id.* at 958.

⁴ Michele DeStefno, *supra* note 1, at 72.

This paper will begin with an explanation of the legal sources of corporate compliance and why it has experienced such explosive growth over the last decade. This section will also explain the basic divide between the government and industry over whether the corporate compliance program should be compartmentalized. It will then examine the debate over whether the Chief Compliance Officer (CCO) should report to the General Counsel (GC), or whether the CCO should be a standalone senior-level position reporting directly to the Board of Directors (hereinafter, “the Board”). After discussing the respective compliance roles and reporting obligations of the GC, the CCO, the Board and senior management, this paper will examine the risks and benefits of both a consolidated and a bifurcated reporting structure. This paper concludes that adopting an independent reporting structure, and empowering each with executive authority, is the preferred structure for satisfying a company’s legal, ethical, and compliance obligations.

II. Legal Sources of Corporate Compliance

A corporation is a legal entity that has that authority to act as a single person.⁵ Since the “corporate person” is a fictitious legal construct, under a *respondeat superior* standard of corporate criminal and civil liability, the corporation assumes liability for the illegal and/or negligent acts of its employees.⁶ To mitigate the effects of such liability, it is prudent for management to develop and implement systems that are ordered first, to deterring misconduct; and second, to identifying any residual malfeasance. Identifying misconduct, illustrates that an organization is committed to cultivating ethical norms and allows a company to cooperate with any government investigation.⁷

⁵ BLACK'S LAW DICTIONARY (10th ed. 2014)

⁶ See John, Hasnas, *Managing the Risks of Legal Compliance: Conflicting Demands of Law and Ethics*, 39 LOY. U. CHI. L.J. 507 (2008).

⁷ *Id.*

The sources for corporate compliance are the common law, regulatory guidance, civil settlement and deferred prosecution agreements between industry and enforcement agencies, , and the federal sentencing guidelines.

A. In re Caremark

In *In re Caremark*, a 1996 shareholder derivative suit, the Court of Chancery of Delaware held that directors are obligated to ensure that their corporation maintains an effective “information and reporting system . . . and that failure to do so under some circumstances may, in theory, render a director liable for losses caused by non-compliance with applicable legal standards.”⁸ Under this standard, directors possess a duty to ensure the implementation of an effective compliance program, however, the composition of that program remains a question of business judgment.⁹ In *Caremark* shareholders brought suit against the directors alleging that their failure to monitor the business practices of the organization effectively allowed fraudulent behavior that resulted in a criminal indictment and significant fines.¹⁰ The final settlement against the organization was “huge” by standards of the time however, the court held that a demonstration of a good faith effort to implement an effective compliance program insulated the directors’ personal liability for breach of their fiduciary duty of care.¹¹ In *Stone v. Ritter*, the Delaware Supreme Court adopted the *Caremark* test as the standard under which directors can satisfy their duty of care by establishing, in good faith, a system of reporting and monitoring.¹² Importantly, corporate law does not impose liability where illegal behavior occurs despite best efforts at effective compliance.

⁸ *In re Caremark Int’l Inc. Derivative Litigation*, 698 A.2d 959, 970 (Del. Ch. 1996).

⁹ *Id.*

¹⁰ *Id.* at 960.

¹¹ *Id.* at 971.

¹² *Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006).

As a result, while *Caremark* is the seminal case of director liability to shareholders for failure to monitor, a breadth of other civil and criminal laws punish wrongful corporate behavior irrespective of the presence of corporate oversight, taking monitoring into account only at the penalty stage.¹³ Professor Bullard notes that the liability directors and managers face as a result of administrative penalties and criminal charges is greater “than by the prospect of private *Caremark* liability under state corporate law.”¹⁴ Even while most cases involving corporate misdeeds settle, it is the federal sentencing guidelines that apply to business organizations that better inform directors performance of their oversight responsibilities.¹⁵

B. United States Organizational Sentencing Guidelines, DOJ Memorandum, and US Attorney’s Manual

First promulgated in 1991, the United States Organizational Sentencing Guidelines seek to encourage organizations and their agents to develop and implement “internal mechanism for preventing, detecting, and reporting criminal conduct.”¹⁶ The Sentencing Guidelines reflect that organizations act through their agents and thus are vicariously liable for the actions of those agents.¹⁷ To encourage greater self-policing by organizations, the Sentencing Guidelines offer incentives to organizations to adopt compliance programs to prevent, detect, and sanction criminal misconduct.¹⁸ First, the Sentencing Guidelines enumerate components of an “effective compliance program,”¹⁹ And direct that prosecutors and judges should employ an assessment of the effectiveness of the compliance program in determining the organization’s fine²⁰.²¹ There

¹³ Mercer Bullard, *Caremark’s Irrelevance*, 10 BERKELEY BUS. L.J. 15, 25 (2013).

¹⁴ *Id.* at 27.

¹⁵ *In re Caremark*, *supra* note 8.

¹⁶ U.S. Sentencing Guidelines Manual Ch. 8, introductory cmt. (2015).

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ *Id.* at §8B2.1.

²⁰ *Id.* at §8C2.4.

²¹ *Id.* at §8C2.5.

fine may be mitigated if the organization had an effective compliance program in place at the time of the misconduct,²² and/or if the organization self-reported the offense to the appropriate government authority.²³

In September of 2015, Deputy Attorney General Sally Yates issued what is commonly known as the “Yates Memo,”²⁴ which represents the latest in a series of DOJ memorandum regarding prosecution of corporations. This began in 1999 with the “Holder Memo,”²⁵ providing general guidance on bringing charges against corporations. This guidance was further developed in the “Thompson Memo”²⁶ (2003), the “McNulty Memo”²⁷ (2006), and the “Filip Memo”²⁸ (2008). The guidance contained in these memos sets forth principles for charging corporations²⁹ that DOJ incorporated into the U.S. Attorney Memo’s Manual in the Principles of Federal Prosecution of Business Organizations, and are now binding on all federal prosecutors.³⁰

The Yates Memo precludes corporate settlements that are not accompanied by holding individual employees who engaged in the illegal behavior. Because corporate crime cannot occur absent the acts of its employees, individual accountability is the new and important lever through

²² *Id.* at §8C2.5(f)(1).

²³ *Id.* at §8C2.5(g)(1).

²⁴ Memorandum from Sally Quillian Yates, Deputy Attorney Gen., U.S. Dep’t Justice, Individual Accountability for Corporate Wrongdoing (Sept. 9, 2015), <https://www.justice.gov/dag/file/769036/download>.

²⁵ Memorandum from Eric Holder, Deputy Attorney Gen., U.S. Dep’t of Justice, Bringing Criminal Charges Against Corporations (June 16, 1999), <http://www.justice.gov/sites/default/files/criminal-fraud/legacy/2010/04/11/charging-corps.PDF>

²⁶ Memorandum from Larry D. Thompson, Deputy Attorney Gen., U.S. Dep’t of Justice, Principles of Federal Prosecution of Business Organizations (Jan. 20, 2003), http://www.americanbar.org/content/dam/aba/migrated/poladv/priorities/privilegewaiver/2003jan20_privwaiv_dojthomp.authcheckdam.pdf.

²⁷ Memorandum from Paul J. McNulty, Deputy Attorney Gen., U.S. Dep’t of Justice, Principles of Federal Prosecution of Business Organizations (Dec. 12, 2006), available at https://www.justice.gov/sites/default/files/dag/legacy/2007/07/05/mcnulty_memo.pdf.

²⁸ Memorandum from Mark Filip, Deputy Attorney Gen., U.S. Dep’t of Justice, on Principles of Federal Prosecution of Business Organizations (Aug. 28, 2008), <https://www.justice.gov/sites/default/files/dag/legacy/2008/11/03/dag-memo-08282008.pdf>.

²⁹ Brandon L. Garrett, *The Metamorphosis of Corporate Criminal Prosecutions*, 101 VA. L. REV. ONLINE 60, 101 (2016).

³⁰ See U.S. Dep’t of Justice, U.S. Attorneys’ Manual § 9-28.210 (2015), <http://www.justice.gov/usam/united-states-attorneys-manual>.

which to the government seeks to obtain change in corporate behavior.³¹ The memo sets forth guidance, in the form of six principles, on the means by which culpable individuals are to be held accountable in corporate cases.³² Importantly, this guidance applies to criminal as well as civil enforcement actions undertaken by DOJ.³³ Consistent among the principles and the document as a whole is the instruction that the DOJ considers sentence mitigation contingent on an organization's disclosure of misconduct and cooperation with any investigation.³⁴

The US Attorney's Manual gives prosecutors the discretion, in certain instances, to choose whether or not to prosecute offenders for violations of federal criminal law.³⁵ Prosecutors should consider, among other things, the deterrent effect of prosecution and its impact of the public.³⁶ Deferred prosecution agreements (DPAs) "occupy an important middle ground between declining prosecution and obtaining the conviction of a corporation."³⁷ When DOJ enters into a DPA with an organization, a prosecutor typically brings but does not prosecute charges against an organization. After the organization pays the agreed upon monetary settlement and successfully completes the terms of the agreement, the prosecutor drops the charges.³⁸ DPAs are intended to "promote compliance with applicable law and to prevent recidivism." DPAs often require the rehabilitated company to adopt specific compliance programs, which has the effect of making them more complaint. Compliance programs

³¹ See Yates Memo, *supra* note 24.

³² *Id.*

³³ *Id.*

³⁴ *Id.*

³⁵ U.S. Attorneys' Manual, *supra* note 30, at § 9-28.200.

³⁶ *Id.*

³⁷ *Id.*

³⁸ U.S. Attorneys' Manual, *supra* note 30, at § 9-28.1100.

frequently adopt as “best practice” elements of deferred prosecution agreements into their compliance programs.³⁹

C. HHS OIG Corporate Integrity Agreements and DOJ Deferred Prosecution Agreements

The Department of Health and Human Services (HHS) is the administrative agency that regulates organizations, providers, and individuals in the healthcare industry. HHS provides instruction for crafting and implementing compliance programs through agency regulations and guidance.⁴⁰ In addition, the Medicare Medicaid Patient and Program Protection Act of 1987 gave HHS the discretion to exclude any individual or entity that engages in fraud and other misconduct.⁴¹ In the mid 1990’s HHS Officer of Inspector General (OIG), began entering into Corporate Integrity Agreements (CIAs) with organizations under investigation for violations of the False Claim Act.⁴² OIG now utilizes CIAs to resolve investigations arising under a variety of civil false claim circumstances.⁴³ In exchange for OIG’s agreement not to pursue exclusion from Medicare, Medicaid, or other Federal Health Services, organizations agree to adopt the elements set forth in the agreement.⁴⁴ CIAs are tailored to the specific organization, however, they contain many common features, for example the obligation to hire a compliance officer, retain an independent review organization, and establish a confidential disclosure program.⁴⁵

³⁹ See Christopher A. Wray & Robert K. Hur, *Corporate Criminal Prosecution in a Post-Enron World: The Thompson Memo in Theory and Practice*, 43 AM. CRIM. L. REV. 1095, 1138 (2006).

⁴⁰ See e.g. OIG Compliance Program Guidance for Pharmaceutical Mfrs., 68 FED. REG. 23731 (May 5, 2003), Office of Inspector Gen. of the Dep’t of Health and Human Servs. & Am. Health Lawyers Ass’n., *The Health Care Director’s Compliance Duties: A Continued Focus of Attention and Enforcement* (2011), http://oig.hhs.gov/compliance/compliance-guidance/docs/health_care_directors_compliance_duties.pdf.

⁴¹ 42 U.S.C. §1320a-7(b), See Tracy D. Hubbell, Amy C. Mauro, & Dan Moar, *Health Care Fraud*, 43 AM. CRIM. L. REV. 603, 657 (2006).

⁴² Cristie Ford & David Hess, *Can Corporate Monitorship Improve Corporate Compliance?*, 34 IOWA J. CORP. L. 679, 686 (2009).

⁴³ See Dept. of Health & Human Serv’s, Office of Inspector Gen., *Corporate Integrity Agreements*, <http://www.oig.hhs.gov/compliance/corporate-integrity-agreements/index.asp> (last visited April 12, 2016) (describing history and features of CIAs).

⁴⁴ *Id.*

⁴⁵ *Id.*

CIAAs are not law, but rather are agreements entered into outside the judicial system for the purpose of avoiding more serious punitive actions. However, “CIAAs can impose more rigorous compliance standards upon a corporation than the law itself does. In effect, CIAAs create “private legislation” promulgated by an administrative agency over the assenting organization.”⁴⁶ While only binding on the organization that has entered into the agreement, CIAAs communicate what HHS deems to be best practices, which leads to the adoption of “industry-wide standards that may never have been approved by the legislature.”⁴⁷

DOJ uses deferred prosecution agreements (DPAs)⁴⁸ to obtain corporate cooperation and get offending organizations to change their behavior to help mitigate future misconduct.⁴⁹ Use of DPAs have increased over time for a variety of reasons, including concern about the collateral effect that large judgment or criminal conviction will have on an organization.⁵⁰ However, the main driver of DPAs is the desire to obtain an organization’s full cooperation. In 2015 this point was reiterated in the Yates Memo that stated that organizations must provide DOJ with all of the relevant facts and cooperate with a DOJ investigation in order to be eligible for cooperation credit which is taken into consideration by U.S. attorneys’ when deciding whether or not to enter into a DPA.⁵¹

D. Enron and the Sarbanes-Oxley Act of 2002

⁴⁶ Sharon Finnegan, *supra* note 46.

⁴⁷ *Id.* at 661.

⁴⁸ See e.g. Deferred Prosecution Agreement, *United States v. HSBC Bank*, 2013 WL 3306161 (E.D.N.Y. Dec. 11, 2102).

⁴⁹ Symposium, *Too Big to Jail: Overcoming the Roadblocks to Regulatory Enforcement: Deferred Prosecution and Non-Prosecution Agreements and the Erosion of Corporate Criminal Liability*, 72 MD. L. REV. 1295, 1303 (2013).

⁵⁰ *Id.* at 1312 (pointing out that while concern about collateral effects was a concern for DOJ, the section of the Thompson Memo, (*supra*, note 26) that dealt with deferred prosecution agreements was under VI dealing with corporate compliance.)

⁵¹ See Yates Memo, *supra*, note 24.

In the late 1990's and early 200's high profile accounting scandals brought down several large organizations that roiled markets and led Congress to enact the Sarbanes-Oxley Act of 2002 ("SOX").⁵² SOX was designed to reform the way U.S. businesses operate and make it harder for officers to perpetuate the type of accounting fraud that led to the collapse of Enron and others.⁵³ During Enron's bankruptcy proceedings, it emerged that in-house and external counsel had raised concerns about the legality of specific transactions, but that these concerns were either dismissed by superiors or never made it up the reporting chain. For example, in one instance several lawyers expressed concern to Ben Glisan, Enron's financial officer, about an equity position that appeared to be in violation of SEC regulations.⁵⁴ Glisan, however, confirmed "Enron's confidence in Enron's conclusions concerning the effect" of the position and effectively suppressed the matter.⁵⁵ The lawyers' suspicions were later vindicated when Glisan pled guilty to wire fraud and securities fraud in connection with that equity position.⁵⁶

Section 307 of SOX sets forth general guidelines governing attorneys working for public companies and instructs the SEC to implement rules mandating that attorneys report suspected material violations of securities law.⁵⁷ Additionally, section 307 imposes investigatory obligations on the GC, or as the law identifies the position, the "Chief Legal Officer" (CLO). SOX requires attorneys to report "evidence of a material violation of the securities laws or breach of fiduciary duty or similar violation by the company or an agent thereof," to either the

⁵² Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 11, 15, 18, 28, and 29 U.S.C.).

⁵³ 148 CONG. REC. S10563 (daily ed. Oct. 16, 2002) (statement of Sen. Levin).

⁵⁴ Final Report of Neal Batson, Court-Appointed Exam'r, app. C, at 140-45, *In re Enron Corp.*, No. 01-16034 (Bankr. S.D.N.Y. filed Nov. 4, 2003).

⁵⁵ *Id.*

⁵⁶ Milton C. Regan, Jr., *Ethics in Corporate Representation: Teaching Enron*, 74 FORDHAM L. REV. 1139, 1231 (Dec. 2005).

⁵⁷ See 15 U.S.C. §7245.

CEO, or the CLO.⁵⁸ Upon receiving a report of malfeasance from whom the regulations denote as the “reporting attorney,” the CLO must launch an inquiry into whether a violation has in fact occurred, or is about to occur.⁵⁹ The CLO is required to take all reasonable steps to respond appropriately to the allegation and shall advise the reporting attorney of his or her actions and findings.⁶⁰

If after concluding the investigation, the CLO determines that no material violation has occurred or will occur, he or she is required to apprise the reporting attorney as to the basis of his or her conclusion.⁶¹ Importantly, the CLO may, in lieu of conducting an inquiry into the alleged malfeasance, “refer a report of evidence of a material violation to a qualified legal compliance committee,” so long as the committee had been constituted prior to the initial report.⁶² SEC regulations define a qualified legal compliance committee as a committee formed by a public company consisting of at least a member of the Board audit committee, or if none exists then a member of an equivalent Board of independent directors, and two or more members of the Board not employed by the company.⁶³ The qualified legal compliance committee is tasked with, among other things, investigating suspected material violations of law and reporting findings to the CLO, CEO and the Board. This committee exists to advise company leadership and ensure misconduct is adequately monitored

If the reporting attorney perceives that the CLO or CEO has failed to provide a sufficient explanation as to why he or she concluded that no material violation has in fact occurred, that attorney is required to elevate his or her concern further “up the ladder.”⁶⁴ SEC regulations

⁵⁸ *Id.*

⁵⁹ 17 C.F.R. §205.3(b)(2) (2003).

⁶⁰ *Id.*

⁶¹ *Id.*

⁶² *Id.*

⁶³ *Id. at* §205.2(k).

⁶⁴ *Id. at* §205.3(b)(3).

provide that the reporting attorney shall report the evidence of the material violation to the Board’s audit committee, or some other Board committee comprised solely of external directors, or the Board itself, if no such committee of external directors exists.⁶⁵ Additionally, the regulations define the “trigger for an attorney’s obligation to report up-the-ladder” as an objective, rather than subjective standard involving “credible evidence” that a material violation has occurred.

These statutes, regulations, and guidance, along with additional instructions from industry regulators form the basis of corporate compliance obligations and government oversight.

III. The Role of the General Counsel

The GC is the organization’s highest ranking legal counselor. The GC’s assists an organization to become more efficient and compliant, however, such involvement must not compromise the ability of the GC to “vigorously defend the organization after potential violations of the law have been identified.”⁶⁶

A. Dual Roles of Partner and Protector

Today’s GC, and other in-house lawyers, have responsibilities far beyond providing legal advice to an organization. The GC is involved with all aspects of an organization and often interacts directly with the Board and senior management as an advisor and a colleague.⁶⁷ Former General Electric GC Ben W. Heineman, Jr. has identified the often conflicting dual roles that the

⁶⁵ *Id.*

⁶⁶ J. Reginald Hill, Jenifer C. Peters, & Sheila W. Sawyer, *The Relationship between Compliance Officer, In-House Counsel, and Outside Counsel: An Essential Partnership for Managing and Mitigating Regulatory Risk*, AM. HEALTH LAWYERS ASS’N. FRAUD AND COMPLIANCE FORUM 4 (Oct. 6-7 2014).

⁶⁷ *Id.* at 3.

GC plays as both a partner of business function leaders and guardian of the corporation's integrity.⁶⁸

Senior managers often call upon the GC, who has the unique skill set acquired with a legal education, to aid in navigating and evaluating business decisions. This can take the form of performing "traditional" legal activities, such as helping to negotiate deals or draft contracts, or can result in the GC acting in a business capacity, such as aiding leadership in making strategic decisions.⁶⁹ Notably, business units increasingly call upon the GC to act as a "transaction facilitator."⁷⁰ The GC can help a Board structure business transactions, such as mergers or asset divestures, and provide legal perspective on how the deal will affect other segments of the organization.⁷¹ Given the complexity of modern business, it is typically advantageous and cost effective to involve in-house lawyers in projects early on.⁷² The degree to which the business side of an organization invites the GC to participate in strategic decision-making varies depending on the company and upon the GC relationship with his or her business colleagues. However, Heineman observes that business leaders embrace a GC who helps them to "get things done."⁷³

The GC also acts as the guardian of a corporation's reputation. It is valuable for an organization to maintain a positive reputation in order to gain customers' trust and, in theory at least, create value for shareholders.⁷⁴ Customers rely on the reputation of an organization to

⁶⁸ Ben W. Heineman, Jr., *In the Beginning*, CORPORATE COUNSEL 1 (April 2006).

⁶⁹ Ben W. Heineman, Jr., *Caught in the Middle*, CORPORATE COUNSEL 2 (April 2007).

⁷⁰ Sarah Helene Duggin, *The Pivotal Role of the General Counsel on Promoting Corporate Integrity and Professional Responsibility*, 51 ST. LOUIS L.J. 989, 1006 (2007)

⁷¹ *Id.*

⁷² *Id.* at 1007.

⁷³ Ben W. Heineman, Jr., *supra* note 72.

⁷⁴ R. William Ide III & Douglace H. Yarn, *Public Independent Fact-Finding: A Trust-Generating Institution for an Age of Corporate Illegitimacy and Public Mistrust*, 56 VAND. L. REV. 1113, 1127 (2003).

make judgments about the quality of an organization's products and services.⁷⁵ The Board expects the GC to protect an organization's reputation for trustworthiness by enacting controls to ensure "strict adherence to financial, legal and ethical rules."⁷⁶ Shareholders delegate the authority to monitor the operations and management of an organization to the Board.⁷⁷ Misconduct tarnishes the reputation of the organization and can lead to shareholders losing confidence in the Board.⁷⁸

Every level of an organization plays a role in ensuring compliance with the law and ethical norms. The Board and the CEO are expected to establish a "tone at the top" that reflects a commitment to compliance.⁷⁹ Despite its somewhat nebulous connotation, the government takes this expectation seriously. Former SEC Commissioner Cynthia Glassman stated that improving the "tone at the top" of organizations was one of the five main goals of SOX when it was enacted in 2002.⁸⁰ Because the GC has "comprehensive responsibility for the legal aspects of an entity's operation," it falls to him or her, along with the CCO, to implement systems to promote that tone at the top.⁸¹

B. Challenges Facing Today's GC

In addition to the practical difficulties posed to a GC who subsists simultaneously in a legal and business capacity, these lawyers face legal and ethical challenges related to the scope

⁷⁵ *Id.*

⁷⁶ Ben W. Heineman, Jr., *supra* note 71.

⁷⁷ Gregory Todd Jones, *Trust, Institutionalization, & Corporate Reputations: Public Independent Fact-Finding From A Risk Management Perspective*, 13 U. MIAMI BUS. L. REV. 121, 128 (2006).

⁷⁸ *Id.*

⁷⁹ Cynthia A. Koller, Laura A. Paterson, Elizabeth A. Scalf, *When Moral Reasoning and Ethics Training Fail: Reducing White Collar Crime Through the Control of Opportunities for Deviance*, 28 ND J. L. ETHICS & PUB POL'Y 549, 507 (2014).

⁸⁰ Cynthia Glassman, SEC Comm'r, Remark's Before the European Corporate Governance Summit: An SEC's Commissioner's View: The Post-Sarbanes Oxley Environment for Foreign Issuers (March 2, 2005).

⁸¹ Sarah Helene Duggin, *The Pivotal Role of the General Counsel in Promoting Corporate Integrity and Professional Responsibility*, 51 ST. LOUIS L.J. 989, 1033 (2007).

of confidentiality and attorney-client privilege. The Rules of Professional Responsibility maintain that it is incumbent upon the GC, and any other lawyer employed or retained by an organization, to recognize the organization as the client.⁸² The GC does not represent the constituents with whom he or she regularly communicates, including officers, directors, or the board.⁸³ While this distinction may be understood by the GC and the constituents intellectually, in reality the demarcation can become obfuscated as personal relationships and loyalties among the parties develop.⁸⁴

One commentator notes that it may be “psychologic[aly] awkward” for the GC to owe the organization professional allegiance, but have a duty to the individual manager with whom he or she works on a daily basis.⁸⁵ This can further complicate confusion about the GC’s role within an organization. For example, it is not unusual for a GC to be involved in strategic planning or become a corporate director. There are many benefits to the GC acting in such a dual capacity, however such a position can weaken the effectiveness of the GC as a manager and a lawyer.⁸⁶ For example, if the GC is also on the Board, the Board’s ability to monitor the legal function becomes more difficult.⁸⁷ At the same time, occupying this dual position increases the risk that attorney-client privilege will not attach to communications. Privilege “covers only those communications made between the corporate lawyer and the client intended to be confidential and [that] are made for the primary purpose of obtaining legal advice or assurance,

⁸² MODEL RULES OF PROF’L CONDUCT R. 1.13(a) (2003) (stating “a lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents”).

⁸³ Michael W. Peregrine & Joshua T. Buchman, *Managing the General Counsel/ Compliance Officer Relationship*, AM. HEALTH LAWYERS ASS’N CONNECTION, 34 (October 2011).

⁸⁴ Deborah A. DeMott, *Colloquium: Ethics in Corporate Representation: The Discrete Roles of General Counsel*, 74 FORDHAM L. REV. 955, 956 (Dec. 2005).

⁸⁵ Susanna M. Kim, *Dual Identities and Dueling Obligations: Preserving Independence in Corporate Representation*, 68 TENN. L. REV. 179, 194 (2001).

⁸⁶ *Id.* at 230.

⁸⁷ *Id.*

as opposed to business advice.”⁸⁸ At a Board meeting, a GC/Board member can quickly slip into a situation where he or she simultaneously offers a business decision and a legal opinion.⁸⁹ Additionally, the Board can interpret a statement to be business advice, when it is in fact a legal opinion.⁹⁰ For this reason, as the GC assumes a greater managerial role, he or she must exercise caution not to compromise privilege or give the false impression that privilege extends to conversations that do not in fact qualify.

C. GC’s Reporting Requirements and Remembering that the Organization is the Client

In 2003, the ABA House of Delegates updated the Model Rules to support greater corporate governance practices.⁹¹ The ABA amended Rule 1.13 to require a lawyer to report to a higher corporate authority malfeasance of which he or she becomes aware regardless of whether it relates to his or her reputation.⁹² Prior to the 2003 Amendment, Rule 1.13 only required a lawyer to report misconduct if the misconduct “was related to the [lawyer’s] representation.”⁹³ Under the current rule, a lawyer has greater reporting obligations designed to encourage him or her “to tuck action to prevent or rectify corporate misconduct.”⁹⁴

These updates coincide with the passage of SOX and the imposition of section 307 requirements mandating reporting suspect violations of law to the CLO, and Board.⁹⁵ As discussed above, SOX draws lawyers across an organization and “requires them to go through

⁸⁸ *Id.* at 239.

⁸⁹ *Id.* at 240.

⁹⁰ *Id.* at 241.

⁹¹ See Report of the Am. Bar Ass’n Task Force on Corporate Responsibility, SK083 ALI-ABA 99 (March 31, 2003), available at <http://www.abanet.org/leadership/2003/journal/119c.pdf>

⁹² MODEL RULES OF PROF’L CONDUCT R. 1.13(f) (2003).

⁹³ MODEL RULES OF PROF’L CONDUCT R. 1.13 (1993).

⁹⁴ Lawrence A. Hamermesh, *Preliminary Report of the Am. Bar Ass’n Task Force on Corporate Responsibility*, 58 BUS. LAW. 1., available at SSRN: <http://ssrn.com/abstract=321701>.

⁹⁵ 15 U.S.C. §7245

the general counsel—unless the attorney reasonably believes that a report to the chief legal officer or to the chief legal officer and the CEO would be futile.”⁹⁶

In order for a GC to remain effective and objective, he or she must have the “sufficient status and independence” to recognize potential threats to the organization and take corrective action that may be adverse to senior management and the Board.⁹⁷ The Model Rules of Professional Conduct provide that when dealing with a corporate constituent whose interest the lawyer knows or reasonably should know is adverse to that of the organization, the lawyer must inform that party that he or she represents the organization.⁹⁸

Appropriately identifying the organization as the client is equally important when the GC, or other internal lawyer, is discussing legal matters with employees.⁹⁹ Like any client, an organization can choose to waive privilege if it desires. The ramifications of the failure to identify the organization as client is somewhat unclear, however, if privilege is challenged; it is in the best interest of the organization to produce a clear record of client identification.¹⁰⁰

A strong and independent GC is best equipped to avoid role confusion or the perception of impropriety. Integration into the top echelons of an organization, along with unencumbered access to the Board, enables a GC to fulfil his or her obligations as business partner and guardian of a corporation’s reputation. The duties of the GC are made ever less onerous when accompanied by personal relationships and unfettered contact with the Board.

⁹⁶Sarah Helene Duggin, *The Pivotal Role of the General Counsel on Promoting Corporate Integrity and Professional Responsibility*, 51 ST. LOUIS L.J. 989,1028.

⁹⁷ Report of the Task Force in Lawyer’s Role in Corporate Governance, New York City Bar, 1, 96 (Nov. 2006).

⁹⁸MODEL RULES OF PROF’L CONDUCT, *supra* note 95.

⁹⁹ See *Upjohn v. U.S.*, 449 U.S. 383, 394 (1981) (Holding that communications between an organization’s employees and counsel, are privileged when the communication occurs for the purpose of obtaining legal information).

¹⁰⁰ See *U.S. v. Ruehle*, 583 F.3d 600 (9th Cir. 2009) (Reversing a decision by the district court to grant defendant-employee’s motion to suppress information on the grounds that while failure to disclose organization as client may violate the attorney’s rules of conduct, it does void privilege because that is determined by the content of the information).

IV. The Role of the Chief Compliance Officer

At its most elemental, the CCO is responsible for developing the policies to ensure ethical and legally compliant behavior within a company, as well as procedures to detect, mitigate, and sanction ethical or legal malfeasance after it has occurred.¹⁰¹ The precise duties of the CCO vary across industries and companies, but generally, the CCO is delegated the proactive responsibility of implementing a compliance program composed of the elements of the Federal Sentencing Guidelines and the reactive function of monitoring for adherence to that program.¹⁰²

A. Background and Scope of Today's CCO

Understanding the different mentality of the two roles may be helpful to illustrate how the GC and CCO are distinct. One commentator noted that a corporate lawyer is trained and employed to craft the law to best serve his or her client.¹⁰³ It is natural, therefore, for such a lawyer to resist cooperation with government, except perhaps if doing so will help him or her to mitigate a client's penalty.¹⁰⁴ Underlying compliance, is the obligation to report credible evidence of misconduct to the appropriate regulating agency.¹⁰⁵ Therefore, while the CCO and the GC are similar, the CCO is focused on compliance detection, and resolution, whereas the GC's "duty is to protect [an organization's] liability profile."¹⁰⁶

¹⁰¹ Michael W. Peregrine, *supra* note 86.

¹⁰² Jose A. Tabuena, *The Chief Compliance Officer vs the General Counsel: Friend or Foe?*, THE SOCIETY OF CORPORATE ETHICS 3 (Dec. 2006), http://www.corporatecompliance.org/Portals/1/PDF/Resources/past_handouts/CEI/2008/601-3.pdf.

¹⁰³ See Christine Parker, Robert Eli Rosen & Vibeke Lehman Nielsen, *The Two Faces of Lawyer: Professional Ethics and Business Compliance with Regulations*, 22 GEO J. LEGAL ETHICS, 201, 210-13 (2009).

¹⁰⁴ *Id.*

¹⁰⁵ See e.g. OIG Compliance Program Guidance for Pharmaceutical Mfrs., *supra* note 40 (stating that reporting must be completed within 60 days of determining suspected misconduct).

¹⁰⁶ Kush Das, *The Un-Privileged Industry: Assessing the Detriments of an Independent Compliance Office in Healthcare Fraud Litigation*, 27 GEO. J. ETHICS 473, 475 (2014).

There is “a conventional assumption that a firm’s enforcement policies are designed to maximize its profit.”¹⁰⁷ Government is able to shape corporate behavior by using laws and regulations and the *respondeat superior* standard of corporate liability to hold organizations civilly and criminally liable for employee and organization misconduct.¹⁰⁸ Organizations defend against future enforcement by adopting preventive measures that deter agent misconduct.¹⁰⁹

Compliance programs have been around since the 1960s, however, in recent decades they have assumed greater prominence in reaction to increased prosecution and regulatory oversight.¹¹⁰ While in some respects the responsibilities of the compliance function overlap with that of the legal function, the roles are distinct. Both the GC and CCO are responsible for ensuring an organization’s adherence to the law, however, the GC “provides legal advice on how the organization can comply with the law . . . [while the] CCO, by contrast, is a management function which incorporates legal considerations while influencing processes and practices of an organization.”¹¹¹ In reality, the roles often intersect as both functions are involved with the creation and implementation of compliance programs and mitigating risk, however for reasons that will be discussed, understanding the boundaries of each respective function has important operational and legal consequences.¹¹² One commentator recently opined that the CCO’s responsibilities extend beyond prevention and include an obligation to investigate and

¹⁰⁷ Jennifer Arlen & Renier Kraakman, *Controlling Corporate Misconduct: An Analysis of Corporate Liability Regimes*, 72 N.Y.U.L. REV. 687, 699 (1997).

¹⁰⁸ Miriam Hechler Baer, *Governing Corporate Compliance*, 50 B.C. L. REV. 949, 973 (2009).

¹⁰⁹ Jennifer Arlen *supra* note 110, at 701.

¹¹⁰ Miriam Baer, *Confronting the Two Faces of Corporate Fraud*, 66 Fla. L. Rev. 87, 142 (2014).

¹¹¹ Jose A. Tabuena, *supra* note 105.

¹¹² J. Reginald Hill, *supra* note 69, at 4-5.

uncover.¹¹³ In perhaps an over simplification, he continued that “unlike the GC, [] the CCO’s job is to help ensure compliance, rather than just *advise* about it.”¹¹⁴

The scope of a CCO’s authority varies across organizations and industries. In addition to the healthcare and securities compliance, on which this paper is focused, many companies implement anti-trust, employment, and Foreign Corrupt Practices Act compliance programs.¹¹⁵ For example, in *Reserve Supply Corp., v. Owens-Corning Fiberglass Corp.*, the court held that the lower court properly granted summary judgment on claims of price fixing because the pricing was made pursuant to the organization’s anti-trust compliance program.¹¹⁶

The U.S. Foreign Corrupt Practices Act (FCPA) is an anti-corruption law designed to prevent companies with ties to the U.S. from bribing foreign government officials.¹¹⁷ DOJ states that an effective compliance program is essential for compliance with FCPA, in particular to comply with the internal control provisions¹¹⁸ which set forth specific internal accounting controls for preventing bribery.¹¹⁹

B. Expanded Compliance Duties under SOX and the Federal Sentencing Commission Guidelines

In the finance sector, independent compliance functions developed in the 1960’s “out of securities firms’ need to receive advice and support concerning broad responsibility concerning day-to-day conduct of business unit activities” and have in place procedures to promote

¹¹³ Zane Gilmore, *Understanding the Challenges of Consolidating the General Counsel and Corporate Compliance Officer*, INSIDE COUNSEL (June 3, 2014), <http://www.insidecounsel.com/2014/06/03/understanding-the-challenges-of-consolidating-the->

¹¹⁴ *Id.*

¹¹⁵ Michele DeStefno, *supra* note 1, at 97.

¹¹⁶ *Reserve Supply Corp., v. Owens-Corning Fiberglass Corp.*, 971 F.2d 37, 47 (7th Cir. 1992).

¹¹⁷ 15 U.S.C. §§ 78dd-1, et seq (2012).

¹¹⁸ 15 U.S.C. §78m(b)(2)

¹¹⁹ See U.S. Dep’t of Justice & SEC, A Resource Guide to the U.S. Foreign Corrupt Practices Act 43 (2012), available at <http://www.sec.gov/spotlight/fcpa/fcpa-resource-guide.pdf>.

compliance with all applicable laws and regulations.¹²⁰ From these, and other nascent compliance functions, evolved rigorous compliance programs ordered toward protecting consumers, employees, and the public.¹²¹ The role of the CCO within a financial institution is particularly challenging because of the ever accelerating introduction of intricate financial products and the proliferation of complex laws and regulations enacted in response to the recent financial crises and scandals.¹²² These burdens, which have exponentially expanded compliance risks and obligations, are compounded by the linear trajectory of compliance budget increases.¹²³ In seeking to comply with the profusion of new requirements and best practices, the SEC encourages compliance officials not to become bogged down in minutia, but rather use their skills and experience to identify important issues and provide the firm and its employees with timely and constructive solutions.¹²⁴

Pursuant to its mandate in SOX, the Federal Sentencing Commission set forth the requirements of an effective compliance and ethics program.¹²⁵ SOX specifically instructed the Commission to update the Federal Sentencing Guidelines such as to make them “sufficient to deter and punish organizational criminal misconduct.”¹²⁶ Broadly, the Guidelines are intended to achieve two objectives. First, they are intended to ensure that organizations sentenced for violation of the law are “justly punished.”¹²⁷ Second, the Guidelines offer incentives for

¹²⁰Sec. Indus. Ass’n Compliance & Legal Div., *White Paper on the Role of Compliance* 1 (2005).

¹²¹Code of Professional Conduct for Compliance and Ethics Professionals, Society of Corporate Compliance and Ethics.

¹²²Sec. Indus. Ass’n Compliance & Legal Div, *supra* note 123, at n. 1.

¹²³ Daniel M. Gallagher, SEC Comm’r., Remarks at The Evolving Role of Compliance in the Securities Industry Presentation (May 12, 2014) <https://www.sec.gov/News/Speech/Detail/Speech/1370541797850>.

¹²⁴Id.

¹²⁵ United States Sentencing Commission Guidelines Manual § 8. B2., comment. (background).

¹²⁶ See 28 U.S.C. 994.

¹²⁷ Price Waterhouse Coopers, LLP, *Best Practices and Practical Tips for Your Compliance & Ethics Program*, Association of Corporate Counsel, Ass’n of Corporate Counsel, Northeast Chapter 15 (2014) <https://www.acc.com/chapters/ne/upload/Best-Practices-Practical-Tips-for-Your-Compliance-Ethics-Program-3.pdf>.

organizations to detect and address violations and to put systems in place to help prevent future malfeasance.¹²⁸ One report provided that “[o]rganizations can mitigate potential fines by as much as 95% by demonstrating that they have ‘effective’ compliance and ethics programs.”¹²⁹

The Guidelines require organizations to delegate responsibility for compliance and ethics programs to specific “high-level personnel”.¹³⁰ Additionally, the Guidelines instruct companies to assign employees “the day-to-day operational responsibility for the compliance and ethics program,” with periodic reporting obligation to high-level personnel.¹³¹ Importantly, the Guidelines require that these designated individuals be given sufficient resources and authority to successfully carry out their compliance obligations.¹³² The Guidelines make it clear that to qualify for sentencing mitigation, the compliance function must actually be operational – supplied with sufficient resources and personnel who have a clear line of reporting to higher-level personnel.¹³³ DOJ reinforced this sentiment in the Yates Memo.¹³⁴ It states that to be eligible for “cooperation credit, organizations must provide [DOJ] with all relevant facts about the individuals involved in the corporate misconduct. The Guidelines, and the Yates Memo, fall short, however, of mandating how specifically organizations structure their compliance programs and/or their relationship to the GC.¹³⁵

The scope of the CCO’s duties, and the obligations of the compliance function that he or she oversees, varies by organization. In some industries, for example financial services, the CCO typically has a developed understanding of the various business units, while in other

¹²⁸ *Id.*

¹²⁹ *Id.*

¹³⁰ United States Sentencing Commission Guidelines Manual §§ 8B2.1(b)(2)(B)-(C).

¹³¹ *Id.*

¹³² *Id.*

¹³³ *Id.*

¹³⁴ Yates Memo, *supra* note 24, at 3.

¹³⁵ *Id.*

industries, “CCO’s may depend on so-called specialists in the business who have the responsibility to determine that the company is in compliance.”¹³⁶ Increasingly, many compliance obligations are fulfilled by colleagues or external consultants located outside of the compliance function.¹³⁷ Specialized compliance obligations, for example data privacy, are typically managed within specific operational functions, with the CCO providing oversight, but not direct managerial authority.¹³⁸

The Guidelines recognize the limitations that size and resources have on an organization. While smaller organizations are required to “demonstrate the same degree of commitment to ethical conduct and compliance with the laws as larger organizations,” they are expected to do so while devoting less resources.¹³⁹ A smaller organization can demonstrate that organization’s commitment to ethical conduct by adopting simple procedures to accomplish obligations that, for a larger organization, could only be demonstrated by adopting a more formal processes.¹⁴⁰ For example, large organizations are expected to develop programs and hire dedicated compliance and ethics personnel, whereas small organizations could meet the same requirements by conducting training through informal staff meetings and monitoring “through walk-arounds” conducted by business personnel.¹⁴¹ These comments simply reinforce that the Guidelines are less concerned about observing a specific compliance structure, than they are about promoting a more ethical corporate culture through expanded oversight.

The CCO position is dynamic and uniquely straddles the legal and business worlds. As the CCO role grows to meet increasingly complex requirements, so does the potential for the

¹³⁶ Price, Waterhouse, Coopers, *Moving Beyond the Baseline: Leveraging the Compliance Function to Gain and Competitive Edge*, PWC STATE OF COMPLIANCE SURVEY 6 (2015)

¹³⁷ *Id.* at 7

¹³⁸ *Id.*

¹³⁹ United States Sentencing Commission Guidelines Manual § 8B2.1, comment. (n 2).

¹⁴⁰ *Id.*

¹⁴¹ *Id.*

CCO to bring real value to his or her organization through mitigating the effect of illegal and unethical behavior.

V. Compliance Obligations of the Board of Directors and Senior Management

As discussed, compliance obligations and best practices come from a variety of sources. *Caremark* held that directors owe a fiduciary duty of care to the organization that requires, among other things, that the Board act in good faith to ensure that a proper system of oversight and reporting is in place.¹⁴² The specific form of the compliance program is a matter of business judgement, however, the failure of directors to oversee the adoption of an adequate system of reporting could expose the organization, and individual directors, to liability.¹⁴³

A. Director Duties

The *Caremark* duties are impressive on paper, however in practice, they rarely lead to director liability.¹⁴⁴ Companies and directors face far greater consequences under the Organizational Sentencing Guidelines and from regulators, than they do under *Caremark*.¹⁴⁵ In *Stone v. Ritter*, the Delaware Supreme Court adopted the *Caremark* holding as the standard under Delaware corporate law.¹⁴⁶ Citing *Caremark*, the court provided that “a claim that directors are subject to personal liability for employee failures is “possibly the most difficult theory in corporate law upon which a plaintiff may hope to win a judgment.”¹⁴⁷

¹⁴² *Caremark*, *supra* note 8 (holding a “director’s obligation includes a duty to attempt in good faith to assure that a corporate information and reporting system, which the board concludes is adequate, exists, and that failure to do so under some circumstances may, in theory at least, render a director liable for losses caused by non-compliance with applicable legal standards”).

¹⁴³ *Id.* at 971.

¹⁴⁴ *See* Mercer Bullard, *supra* note 13, at 20.

¹⁴⁵ *Id.*

¹⁴⁶ *Stone*, *supra* note 12, at 362.

¹⁴⁷ *Id.* at 369.

The Organizational Sentencing Guidelines provide directors with incentives for establishing and maintain an effective compliance program.¹⁴⁸ Additionally, the promulgation of the Yates Memo put increased pressure on directors with its focus on individuals.¹⁴⁹ The Memo makes clear that DOJ will not permit directors to leverage company settlements to allow the individual directors to escape criminal or civil liability.¹⁵⁰ A corporate resolution will be permitted to serve a release for civil or criminal liability only under extraordinary circumstances and requires written approval from the relevant Assistant Attorney General.¹⁵¹

As with so many facets of compliance, CIAs and DPAs are fertile resources for discerning what the government deems important parts of an effective compliance apparatus. CIA's typically have a section that enumerates the Board's compliance obligations. The 2015 CIA that OIG entered into with Daiichi Sankyo, Inc. states that the Board, or a committee thereof, has oversight authority over matters related to compliance with the federal health care program requirements.¹⁵² This obligation requires the Board to meet at least quarterly to review the company's compliance program.¹⁵³ Additionally, for each reporting period of the CIA, each member of the Board must sign a resolution attesting to oversight of the compliance program.¹⁵⁴

Industry leaders stress the importance of attracting directors with compliance backgrounds and encourage broader formation of "discrete compliance committees."¹⁵⁵ While dedicated compliance committees may be prevalent in certain industries, or among the largest

¹⁴⁸ U.S. Sentencing Guidelines, *supra* note 16.

¹⁴⁹ Yates Memo, *supra* note 24.

¹⁵⁰ *Id.* at 5.

¹⁵¹ *Id.*

¹⁵² *See e.g.* Daiichi Sankyo CIA, *supra* note 47, at 6.

¹⁵³ *Id.*

¹⁵⁴ *Id.*

¹⁵⁵ Michael D. Greenberg, *Culture, Compliance, and the C-Suite*, RAND CENTER FOR CORPORATE ETHICS AND GOVERNANCE, 26 (2013).

sector participants, their existence is by no means ubiquitous.¹⁵⁶ At a recent compliance symposium hosted by the RAND Corporation, one participant estimated that only around twenty percent of corporations in the United States have Board-level compliance committees, however he failed to state how many of the organizations had organizationally adopted that structure and how many did so to satisfy a settlement condition.¹⁵⁷

C. Management’s Reporting Obligations

In addition to the fiduciary duties that all directors and senior management owe to the organization, SOX imposes on them more formalized reporting requirements.¹⁵⁸ Currently the CEO and CFO of all publically traded companies must certify the accuracy of financial reports quarterly or annually.¹⁵⁹ Additionally, those officers, or persons similarly situated, must attest to the existence of effective internal controls within the organization, and any deficiencies in their “design or operation” that could expose the organization to risk.¹⁶⁰ The signing officers must certify that they have disclosed these deficiencies to the firm’s auditor and the Board’s audit committee.¹⁶¹ These requirements indicate that the personal liability of those with oversight authority, namely senior management and directors, is a serious and pervasive reality.¹⁶²

VI. CCO Reporting to GC

The relationship between GC and CCO functions can be organized in a number of ways. Recently, there has been much discussion over the reporting relationship between the GC and

¹⁵⁶ *Id.*

¹⁵⁷ *Id.*

¹⁵⁸ 15 USCS §7241

¹⁵⁹ *Id.*

¹⁶⁰ *Id.*

¹⁶¹ *Id.*

¹⁶² Stacey English & Susannah Hammond, *Cost of Compliance 2015*, THOMPSON REUTERS 8 (2015).

CCO, specifically whether the CCO should report to the GC, or whether the CCO should stand alone as a separate board-level reporting function.¹⁶³

The GC and CCO are linked regardless of the structural arrangement. Conventional wisdom veers toward consolidating, or subordinating the CCO position, on the basis that compliance is largely a legal function and should, therefore, be situated within the legal department.¹⁶⁴ Oftentimes smaller organizations, lack the resources to employ both a GC and CCO, therefore, “as a practical matter one person must wear two hats.”¹⁶⁵ In response to an increase in prosecutions and guidance¹⁶⁶ from various government agencies, many organizations are reevaluating both the one-person-two-hat model and the model whereby the CCO directly reports to the GC.¹⁶⁷

Recent research identified a trend among some companies towards a more traditional hierarchical arrangement between the legal and compliance function motivated by logistics and complexity.¹⁶⁸ In reaction to the increasingly burgeoning regulatory environment in which many companies do business, the legal and compliance functions are evermore entwined. The GC’s access to the Board and senior management, and maybe even more so, his or her role as guardian of the corporation’s integrity¹⁶⁹ elevates the GC to a unique position in the organization.¹⁷⁰ The SEC expects the GC to leverage this station to promote compliance throughout the

¹⁶³ J. Reginald Hill, *supra* note 69.

¹⁶⁴ Zane Gilmore, *Understanding the Challenges of Consolidating the General Counsel and Corporate Compliance Officer*, Inside Counsel (June 3, 2014) <http://www.insidecounsel.com/2014/06/03/understanding-the-challenges-of-consolidating-the->

¹⁶⁵ J. Reginald Hill, *supra* note 69, at 8.

¹⁶⁶ See e.g. Daiichi Sankyo CIA, *Supra* note 47, at 4-5; see also HSBC Deffered Prosecution Aggrement, *supra* note 51.

¹⁶⁷ Michael Volkov, *Compliance in the C-Suite*, RAND CENTER FOR CORPORATE ETHICS AND GOVERNANCE, 76 (2013).

¹⁶⁸ Michael W. Peregrine, *Seeking Clarity at the Crossroads of Legal and Compliance*, CORPORATE COUNSEL (Sept. 2014).

¹⁶⁹ Ben W. Heineman, Jr., *supra* note 72.

¹⁷⁰ Report of the Task Force in Lawyer’s Role in Corporate Governance, New York City Bar, 1, 98 (Nov.2006).

organization.¹⁷¹ Consolidating oversight for the compliance function under the GC, where he or she can transition from advisor to architect, may better enable the GC to support compliance.

Guidance provided in a joint publication of the American Health Lawyers Association (AHLA) and the OIG, recognizes that the ABA's suggestion that the GC become more involved with the compliance function; this contradicts OIG's guidance favoring separation of the functions.¹⁷²

Regardless of the reporting relationship between the GC and CCO, interaction and collaboration between the functions is inevitable and should be encouraged.

While the potential for significant cost saving may prove a compelling enticement to a Board, there are serious risks in adopting a corporate structure whereby the GC and CCO are one individual, or whereby the CCO reports to GC. First, confusion may arise when the GC is the CCO or is his or her supervisor because the company's compliance goals may be at odds with the company's legal objectives.¹⁷³ For example, if a GC becomes aware of a constituent's "legally problematic behavior," he or she has an obligation to respond in a manner that protects the organization.¹⁷⁴ This can conflict with the CCO's obligation to identify the misconduct and put practices in place to prevent future misconduct. If a GC "has direct charge over implementing a corporate compliance program, as opposed to involvement in designing the compliance programs and serving an educative role with the corporation with respect to these requirements," he or she may be unable to be an effective and objective advocate for the corporation.¹⁷⁵

¹⁷¹ *Id.*

¹⁷² Office of Inspector Gen. of the Dep't of Health and Human Servs. & Am. Health Lawyers Ass'n, *supra* note 40, at 17.

¹⁷³ Deborah A. DeMott, *Colloquium: Ethics in Corporate Representation: The Discrete Roles of General Counsel*, 74 *FORDHAM L. REV.* 955, 965 (2005).

¹⁷⁴ *Id.* at 966

¹⁷⁵ *Id.*

Second, subordinating the CCO to the GC can lead to issues concerning the extent to which information and investigations are covered by the attorney-client privilege.¹⁷⁶ Even when the COO is a standalone position reporting directly to the Board, the presence of both functions in an internal investigation may make it difficult to determine when information was obtained for “the purpose of obtaining legal advice,” or when information was simply obtained “pursuant to routine business policies or regulatory requirements.”¹⁷⁷ Liberally invoking privilege risks raising the suspicion of regulators and inviting further investigation.¹⁷⁸ Regulators also may move to compel production of materials, potentially rightly privileged, under the “crime-fraud” exception.¹⁷⁹

The crime-fraud exception is an exception to the attorney-client privilege that allows for the disclosure of information when the client uses or attempts to use the lawyer’s services to perpetrate or cover up a crime.¹⁸⁰ Where the GC has oversight authority over the CCO, or serves simultaneously in both roles, he or she must be attentive to when he or she is acting/communicating in a legal capacity, or in compliance capacity.¹⁸¹

Information obtained by a corporation during the course of an internal investigation for legal purposes is subject to the attorney-client privilege.¹⁸² One commentator remarked that “attorney-client privilege is still the primary evidentiary tool for maintaining the confidentiality of

¹⁷⁶ See e.g. *In re Dom. Drywall Antitrust Litig.*, 2014 WL 5090032, at *1 (E.D. Pa. Oct. 9, 2014).

¹⁷⁷ J. Reginald Hill, *supra* note 69, at 10.

¹⁷⁸ *Id.* at 11.

¹⁷⁹ *Id.*

¹⁸⁰ Sue Michmerhuizen, *Confidentiality, Privilege: A Basic Value in Two Different Applications* Ctr. For Prof'l Responsibility (2007),

http://www.americanbar.org/content/dam/aba/administrative/professional_responsibility/confidentiality_or_attorney_authcheckdam.pdf; see also *Clark v. United States*, 289 U.S. 1, (U.S. 1933).

¹⁸¹ Edward T. Dartley, *The Combined Role of the General Counsel and the Chief Compliance Officer – Opportunities and Challenges*, PRACTICAL COMPLIANCE AND RISK MANAGEMENT FOR THE SECURITIES INDUSTRY, 27 (2014).

¹⁸² Theodore L. Lotchin, *No Good Deed Goes Unpunished? Establishing A Self-Evaluative Privilege for Corporate Internal Investigation*, 446 Wm. & Mary L. Rev. 1137, 1150 (2004).

privileged documents.”¹⁸³ If this privilege is challenged, the court will make a factual determination as to whether the information was truly produced as a result of qualifying confidential relationship.¹⁸⁴ Since it can be hard for an “organization to predict and understand when the attorney-client privilege will apply,” it behooves the GC, and other internal attorneys, to make it clear when they are giving legal advice, and when they are just providing a perspective on a business decision.¹⁸⁵ Involvement of compliance, or another business function need not eschew the protections afforded by privilege, but in light of recent precedent,¹⁸⁶ it should be made clear that the investigation is being “conducted by counsel,” for the “purpose of obtaining legal advice.”¹⁸⁷ In the end, companies may choose to waive privilege in the interest offering transparent and to obtain cooperation credit to avoid

Budget concerns, the desire for effective communication, and efficiency are legitimate reasons to subordinate the CCO to the GC or combine the functions. However, short-term monetary gain should not blind an organization to the risk of the much costlier expense of future prosecution.

VII. Standalone CCO and GC

Currently, formal separation of the CCO and GC is not required by the SEC, HHS, or other government agencies. However, requirements imposed on companies in recent settlements demonstrate that separation is the preferred structure.

A. Office of Inspector General

¹⁸³ *Id.* at 1151.

¹⁸⁴ *Upjohn*, *supra* note 102.

¹⁸⁵ J. Reginald Hill, *supra* note 69, at 11.

¹⁸⁶ *In re Kellogg Brown & Root, Inc.*, 796 F.3d 137 (D.C. Cir. 2015) (holding that work-product produced while investigating a violation of regulations and company policy qualifies for attorney-client privilege because the investigation was conducted in anticipation of litigation).

¹⁸⁷ Stacey Sprenkel, Tina Reynold, & Ian Bausback, *KBR And Maintaining Privilege*, Law 360.com (Sep. 28, 2015), <http://www.law360.com/articles/705213/kbr-and-maintaining-privilege-throughout-investigations>.

OIG enforces federal laws and regulations “enacted to prevent fraud and abuse in the healthcare industry.”¹⁸⁸ OIG cannot bring criminal charges against an organization, but it can refer cases to DOJ and can impose civil monetary penalties under the Civil Monetary Penalties Law¹⁸⁹, the Anti-Kickback Statute¹⁹⁰ and the False Claims Act.¹⁹¹ OIG publishes compliance program guidance for organizations operating in many segments of the health care industry.¹⁹² This guidance is intended to help organizations develop effective internal control to remain compliant with state and federal law.

OIG guidance is not binding, but it provides an insight into preferred best practices. Many of the guidance documents include the same footnote stating that “OIG believes it is generally not advisable for the compliance function to be subordinate to the [pharmaceutical manufacturer’s, hospitals, clinical laboratory’s . . .] general counsel.”¹⁹³ By separating the GC and CCO, “a system of checks and balances is established” helping organizations “more effectively achieve the goals of the compliance program.”¹⁹⁴

Further, OIG’s preference for the bifurcation of GC and CCO function is evident in the CIAs that it has entered into with offending organizations. For example in 2006, Tenet Healthcare Corporation (Tenet) agreed to pay \$900 million to resolve liability for violations of

¹⁸⁸ Wendy c. Goldstein, Sarah K. DiFrancessa & Leah Roffman, *Federal and State Regulation and Enforcement of Pharmaceutical Manufactures’ Advertising and Promotional Activity*, in PHARMACEUTICAL COMPLIANCE AND ENFORCEMENT ANSWER BOOK 2015, 256 (Howard L. Dorfman ed., 2013).

¹⁸⁹ 42 U.S.C. §1320a-7(a).

¹⁹⁰ 42 U.S.C. §1320a-7(b).

¹⁹¹ 31 U.S.C. §§3729-33.

¹⁹² See e.g. OIG Compliance Program Guidance for Pharmaceutical Mfrs., *supra* note 40, OIG Compliance Program Guidance for Hosps. 63 FED. REG 6987 (Feb. 23, 1998).

¹⁹³ See OIG Compliance Program Guidance for Pharmaceutical Mfrs., *supra* note 40 n.13, , OIG Compliance Program Guidance for Hosps., *supra* note 196 n.12, OIG Compliance Program Guidance for Clinical Laboratories, 63 FED. REG. 45076 n.12 (Aug. 24, 2998).

¹⁹⁴ *Id.*

the False Claims Act.¹⁹⁵ Additionally, Tenet entered into a five year long CIA with OIG.¹⁹⁶ The CIA required that Tenet implement and maintain a compliance program overseen by a CCO who is a senior member of management.¹⁹⁷ The CIA stated that the CCO could not be or be subordinate to the CFO, CEO, or GC, and that the CCO must report directly to the Board.¹⁹⁸ Additionally, the CCO was required to deliver quarterly report to the Board on the status of the compliance program.¹⁹⁹ These terms were not unique to the Tenet CIA²⁰⁰, and have continued to be commonly included subsequent in settlements.²⁰¹

The Tenet CIA, however included “unprecedented provision requiring the Quality, Compliance, and Ethic Committee of Tenet’s Board of Directors to undertake a review of the effectiveness of Tenet’s compliance program.”²⁰² Additionally, the CIA included the requirement that Tenet submit annual reports certified by the company’s officers, that the organization was in compliance with Federal health care program requirements.²⁰³

In 2012, OIG held a roundtable meeting with representatives from 32 organizations that entered into CIAs with OIG since 2009.²⁰⁴ With a focus toward future CIAs, OIG solicited feedback on, among other things, the role of the CCO.²⁰⁵ Participants expressed approval of the

¹⁹⁵ See *United States ex rel. Lam v. Tenet Healthcare Corp.*, 287 Fed. Appx. 396 (5th Cir. 2008) (providing background on Tenet’s False Claims Act violations).

¹⁹⁶ See Office of Inspector Gen. of the Dep’t of Health & Human Servs. & Tenet Healthcare Corp., Corporate Integrity Agreement 5 (2006), <http://oig.hhs.gov/fraud/cia/agreements/TenetCIAFinal.pdf>.

¹⁹⁷ *Id.* at 5

¹⁹⁸ *Id.*

¹⁹⁹ *Id.*

²⁰⁰ See e.g. Office of Inspector Gen. of the Dep’t of Health & Human Servs. & Schering-Plough Corp., Corporate Integrity Agreement (2004), http://oig.hhs.gov/fraud/cia/agreements/Schering_Plough_Corporation_07292004.pdf.

²⁰¹ See e.g. Office of Inspector Gen. of the Dep’t of Health & Human Servs. & Pfizer, Corporate Integrity Agreement (2009), http://www.oig.hhs.gov/fraud/cia/agreements/pfizer_inc.pdf.

²⁰² Press Release, Office of Inspector Gen. of the Dep’t of Health & Human Servs., OIG Executes Tenet Corp. Integrity Agreement Unprecedented Provisions Include Bd. Of Directors Review (Sep. 28, 2006), <http://oig.hhs.gov/fraud/docs/press/Tenet%20CIA%20press%20release.pdf>.

²⁰³ See Office of Inspector Gen. of the Dep’t of Health & Human Servs. & Tenet Healthcare Corp., Corporate Integrity Agreement 7 (2006), available at <http://oig.hhs.gov/fraud/cia/agreements/TenetCIAFinal.pdf>.

²⁰⁴ See Office of Inspector Gen. of the Dep’t of Health & Human Servs., *Focus on Compliance: the Next Generation of Corporate Integrity Agreements* (Aug, 2012).

²⁰⁵ *Id.*

requirement that the CCO report directly to the Board, and not the GC.²⁰⁶ Additionally, participants “stated the importance of having the compliance officer be a member of senior management. These suggestions remain features of post-roundtable CIA’s²⁰⁷

B. Department of Justice

DOJ has likewise articulated a preference for separating the GC and CCO positions. DOJ, unlike OIG, is enforcing criminal law. As a result, their guidance is found in the Federal Sentencing Guidelines²⁰⁸ and DPAs²⁰⁹.

Eligibility for sentence mitigation under the Federal Sentencing Guidelines requires “high-level personnel within the organization” to delegate day-to-day operational responsibilities to specific individuals.²¹⁰ These individuals, in turn, are required to periodically report to the high-level personnel about the state of the compliance program.²¹¹ The Guidelines define high-level personnel within the organization as those individuals in controlling or substantial policy-related positions, including directors, the CEO, and other senior management.²¹² In mandating both high-level oversight and requiring that the staff operating the compliance program report directly to the Board, the updated Guidelines help to preserve an “independent voice, free of any potential filtering by senior organization managers.”²¹³

The Guidelines stop short of mandating that the CCO be autonomous from the GC.

However, many business leaders have highlighted the importance of preserving independent

²⁰⁶ *Id.* at 4.

²⁰⁷ *See e.g.* Daiichi CIA, *supra* note 47.

²⁰⁸ Sentencing Commission Guidelines, *supra* note 16.

²⁰⁹ HSBC DPA, *supra* note 51.

²¹⁰ United States Sentencing Commission Guidelines Manual § 8B2.1(b)(2)

²¹¹ *Id.*

²¹² United States Sentencing Commission Guidelines Manual § 8A1.2. Commentary (n.3).

²¹³ Office of Inspector Gen. of the Dep’t of Health and Human Servs. & Am. Health Lawyers Ass’n, *supra* note 40, at 15.

communication between the CCO and the Board as a reason to split the functions.²¹⁴ A CCO who controls the compliance budget and can make personnel decisions, and most importantly Additionally, as OIG has stated many times, a CCO who has direct access to the Board, is a “check” to an organization’s compliance efforts.²¹⁵

Like OIG, as a condition for settlement, DOJ requires that an organization’s CCO be a member of senior management who reports directly to the Board.²¹⁶

VIII. Conclusion

Guidance from agencies articulates a clear preference for bifurcating the roles of CCO and GC. This separation is not now, nor may it ever be, mandated by law, but business judgment and best practices dictate that the Board and senior management should seriously consider bifurcation and be ready to defend a decision to preserve the CCO in a subordinate position to the GC.

²¹⁴ Michael Volkov, *supra* note 170.

²¹⁵ OIG Compliance Program Guidance, *supra* note 196.

²¹⁶ HSBC DPA, *supra* note 51.