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## Coordination of 'Legal' and 'Compliance': New Pressures on the Board



By MICHAEL W. PEREGRINE

A series of developments threaten to blur the important distinction between the corporation's legal and compliance functions. These developments arise from federal regulatory action, media and public discourse, policy statements from compliance industry leaders, and new surveys reflecting the increasing prominence of the general counsel. They also arise from circumstances of great industry change, like health care. If left unaddressed, they could lead to significant organizational risk, e.g., leadership disharmony, misallocation of executive resources, ineffective risk management, and the loss of the attorney-client privilege in certain circumstances. The governing board is obligated to address this risk by working with executive leadership to assure clarity between the roles of general counsel and chief compliance officer.

The positions of general counsel and chief compliance officer are both of great significance to the regulated corporation, regardless of industry or choice of entity (e.g., for-profit v. nonprofit). The value they contribute to the corporation's legal compliance commitment is enhanced when they work collegially, cooperatively and in a coordinated manner. Their collective or-

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ganizational value has grown with increasing levels of regulatory enforcement action. Issues within this construct can and do arise relating to roles and responsibilities, reporting structures and other forms of coordination, and the interpersonal relationships between legal and compliance staffs. These are issues that dedicated, experienced general counsel and compliance officers are normally well equipped to resolve by themselves.

Yet the relationship between legal and compliance is inherently subject to a highly sensitive fissure; the inescapable fact that many, if not most, of the activities mandated by the compliance plan (e.g., monitoring, prevention and education) include some level of legal analysis. The performance of many of the compliance plan's duties thus requires coordination with the general counsel.<sup>1</sup> How best to structure this coordination without marginalizing the important role of the compliance officer is a highly sensitive and controversial issue, which sometimes can require executive management—and ultimately board—attention.<sup>2</sup> It is an issue that has become markedly more complex with the advent of several key developments.

### Key Developments

**Government Positions.** The first, and perhaps most pronounced, of these developments has been efforts of the federal government to encourage (and, in some cases, to require) that the positions of compliance officer and general counsel be separate organizational positions held by separate officers; that the compliance officer not report to the general counsel; and that the compliance officer have a direct reporting relationship to the governing board.<sup>3</sup> Much of the enforcement re-

<sup>1</sup> R. William "Bill" Ide and Crystal J. Clark, "The Chief Legal Officer's Critical Role in the Compliance Function", Bloomberg BNA Corporate Law & Accountability Report, June 27, 2014 (henceforth, "Ide and Clark"). "Lawyers are a critical component in identifying legal risks, preparing the substantive training materials and in assisting with the education required to prevent violations of law." Id.

<sup>2</sup> See, e.g., *The Health Care Director's Compliance Duties: A Continued Focus of Attention and Enforcement* at 12 -25; ©2010, 2011, Office of Inspector General, U.S. Department of Health and Human Services and the American Health Lawyers Association.

<sup>3</sup> See, e.g., Deloitte, *In Focus: Compliance Trends Survey 2013*, COMPLIANCE WEEK, Aug. 2013; John G. Browning,

lated activity in this regard has arisen from the health care and pharmaceutical industries, through corporate integrity agreements with the Department of Health & Human Services Office of Inspector General.<sup>4</sup> These CIAs typically include terms requiring the appointment of a compliance officer, who is a member of senior management, reports directly to the chief executive officer and to the board (or committee thereof) and who shall not be subordinate to the general counsel or chief financial officer.

Outside of the corporate integrity agreement process, there appears to be a clear trend—while certainly not universal—among many corporations to follow the government’s lead and adopt the “separate relationship” structure, for a variety of valid and appropriate reasons.<sup>5</sup> This type of structure is championed by the compliance officer industry as providing what its leadership perceives as a necessary level of independence for the compliance officer.

The popularity of this approach notwithstanding, it presents certain potential concerns.<sup>6</sup> One such concern is that the focus on compliance officer “independence” obscures the need for compliance programs to have leadership from, coordination of or other connection to, the general counsel.<sup>7</sup> In this regard, it should be noted that the influential “Cheek Report” of the American Bar Association recommended as a basic corporate governance policy that the general counsel “have primary responsibility for assuring the implementation of an effective legal compliance system under the oversight of the board of directors.”<sup>8</sup>

Another concern arises from the (dubious) perspective that the compliance officer should not have a reporting relationship to the general counsel.<sup>9</sup> The government’s expectation in this regard is that the board should receive unfiltered advice from the compliance officer, without interference or interpretation from superior officers (e.g., ostensibly, the general counsel).<sup>10</sup>

*Why Chief Compliance Officers are More Important Than Ever*, D MAGAZINE, July-Aug. 2013 (henceforth, “Browning”).

<sup>4</sup> Recent examples would be corporate integrity agreements entered into between the Department of Health & Human Services, Office of Inspector General and (a) Amedisys, Inc. (effective 4/22/14, posted 5/23/14); and (b) Calloway Laboratories, Inc. (amended and restated, effective 5/15/14).

<sup>5</sup> See, e.g., Browning, *supra*; Gregory J. Millman and Ben DiPietro, “More Compliance Chiefs Get Direct Line to Boss,” *The Wall Street Journal*, Jan. 15, 2014;

<sup>6</sup> See, generally, Michele DeStefano, “Creating a Culture of Compliance: Why Departmentalization May Not Be the Answer,” 10 *Hastings Bus. L.J.* 71 (Winter 2014).

<sup>7</sup> “The time has come to clarify once and for all that although a chief compliance officer need not be the chief legal officer, it is the chief legal officer who has ultimate responsibility for making legal determinations concerning an entity’s compliance with laws . . .” Ide and Clark, *supra*.

<sup>8</sup> ABA Task Force on Corporate Responsibility, 59 *Bus. Law* 145 (2003) (henceforth, “Cheek Report”).

<sup>9</sup> Health Industry CIAs typically provide that the CCO not be subordinate to the GC or CFO.

<sup>10</sup> See, e.g., Daniel R. Levinson, Trustee Engagement and Hospital Success, *Trustee* (July/Aug. 2010); Michael W. Peregrine and Joshua T. Buchman, “Managing the General Counsel/Compliance Officer Relationship” 34 *AHLA Connections*, October 2011. A related concern of the government is an abuse of the attorney-client privilege; i.e., that a compliance officer-to-general counsel reporting relationship could result

One of the underlying premises here is that the general counsel somehow has at least a potential, if not actual, conflict of interest with respect to advice that the compliance officer may provide to management or the board.<sup>11</sup>

However, this perspective ignores at least three critical professional responsibility obligations of the general counsel: to (a) serve the interests of the client at all times; (b) to ‘report up the ladder’ actual or potential violations of law by the corporation or its agents of which the general counsel is aware and, most importantly; (c) when alleged to have participated in a compliance violation, to engage independent counsel to report directly to the board to investigate the violation.<sup>12</sup> This concern has been exacerbated by recent published comments of a leading compliance industry thought leader, challenging the prophylactic effects on lawyer conduct of the rules of professional responsibility.<sup>13</sup> Such uninformed positions completely ignore the substantial evolution in the professional responsibility rules of lawyers over the last 12 years,<sup>14</sup> and the significant disciplinary risks associated with violation of these rules.<sup>15</sup>

The third, and potentially most significant of these potential concerns relates to the preservation of the attorney-client privilege when the chief compliance officer is not the general counsel. A primary goal of a compliance program is to facilitate the determination of whether a law or regulation has been violated by the corporation and/or its agents. That determination by necessity may require a legal analysis conducted under the attorney-client privilege. In a recent published article, a leading corporate lawyer argues persuasively that the forced separation of the compliance and legal functions jeopardizes the ability to preserve the privilege in connection with corporate compliance based investigations.<sup>16</sup> According to this view, the general counsel need not be the compliance officer, but must be directly involved in the legal analysis arising from the compliance concern.<sup>17</sup> To exclude the general counsel from the process, or to cause the compliance officer to engage its own counsel, creates significant potential privilege risks to the corporation.<sup>18</sup> ***This is a concern that***

in the improper cloaking (and thus concealment) of all compliance activity under the privilege.

<sup>11</sup> See, e.g., Ide and Clark, *supra*.

<sup>12</sup> See, e.g., American Bar Association Model Rules of Professional Conduct 1.6 (“Confidentiality of Information”); 1.7 (“Conflict of Interest-Current Client”); and 1.13 (b) (“Organization as Client”) with respect to amendments adopted in response to the Cheek Report recommendations; Ide and Clark, *supra*.

<sup>13</sup> Donna Boehme, “When Compliance and Legal Don’t See Eye to Eye”; *Corporate Counsel* (Online), May 8, 2014. Also note in that regard recent SEC enforcement action against compliance officers, e.g., Penson Financial Services.

<sup>14</sup> See, e.g., Ide and Clark, *supra*; the Cheek Report, *supra* (in particular, its discussion of proposed amendments to Model Rules 1.6 and 1.13).

<sup>15</sup> See, e.g., American Bar Association Model Rules of Professional Conduct 8.5 (a) (“Disciplinary Authority”).

<sup>16</sup> Ide and Clark, *supra*.

<sup>17</sup> *Id.* “The entity’s ability to confide in its chief legal officer under attorney-client privilege regarding compliance issues protects the innocent against unfounded allegations and encourages open disclosure of violations and potential violations so they can be addressed and properly remedied.” *Id.*

<sup>18</sup> *Id.*

**should go to the heart of the board's compliance plan oversight obligations.**

*Corporate Guardian.* A second, and more subtle, development has been a series of public comments by compliance industry thought leaders suggesting that the role of “guardian of the corporate reputation” is exclusively reserved for the corporate compliance officer.

The general theme of these comments is that the compliance officer is the organizational “subject matter expert” for ethics and culture, as well as compliance<sup>19</sup>; that the position carries a broad portfolio to counsel corporate leadership on matters of both compliance and culture<sup>20</sup>; and that the compliance officer is responsible for the “cultivation of ethical leadership”<sup>21</sup>. This ‘jurisdictional claim’ appears to be premised on the questionable perspective that “lawyers tell you whether you **can** do something, and compliance tells you whether you **should**”.<sup>22</sup>

The inference is that the general counsel, by virtue of her specialized training and organizational duties, lacks the traits needed to advise clients on matters of ethics, culture and on what is “the right thing to do.” Yet, the compliance commentators appear to ignore (or dismiss) the extent to which the general counsel is specifically empowered to provide such advice by virtue of the rules of professional responsibility. Two such rules come immediately to mind in this regard.

The primary example can be found in Rule 2.1 (“Advisor”) which provides that in rendering advice on behalf of the client, a lawyer may refer not only to law but to other considerations such as **moral, economic, social and political factors**, that may be relevant to the client’s situation. [Emphasis added].<sup>23</sup> A related, more foundational example can be found in the basic summary of the lawyer’s responsibilities contained in the “Preamble” to the Rules. This sets forth the basic obligation of the lawyer to always act in the best interests of the organization. The Preamble also contains several important references to the lawyer’s role as an officer of the legal system; as a public citizen having “a special responsibility for the quality of justice”; and to the need to be guided by personal conscience and the approbation of professional peers.<sup>24</sup> All of these elements provide the general counsel a strong basis from which to advise on matters of ethics and culture.

The compliance leader perspective is also contrary to long standing public discourse on the lawyer’s role as a primary guardian of the organizational reputation. For example, the estimable Ben Heineman, Jr. has spoken authoritatively on how the legal training and experience of the general counsel provide her with a strong sense

<sup>19</sup> Donna Boehme, “5 New Year’s Compliance Resolutions for Boards in 2014,” *Corporate Counsel* (Online) January 2, 2014; Browning, *supra*; Michael Volkov, *An Independent CCO is a Compliance Program Requirement, Corruption, Crime, & Compliance*, April 8, 2013.

<sup>20</sup> Donna Boehme, “Making the CCO an Independent Voice in the C-Suite”; *Corporate Counsel* (Online), March 19, 2013; PwC and Compliance Week, *Broader Perspectives; Higher Performance*, Compliance Week, June 2012.

<sup>21</sup> Donna Boehme, “When Compliance and Legal Don’t See Eye to Eye”; *Corporate Counsel* (Online), May 8, 2014.

<sup>22</sup> *Id.*; Browning, *supra*.

<sup>23</sup> American Bar Association Model Rules of Professional Conduct Rule 2.1.

<sup>24</sup> American Bar Association Model Rules of Professional Conduct: Preamble and Scope.

of ethical issues.<sup>25</sup> This background well-positions her to play an important role in the formation of the corporate conscience and moral construct. Heineman has described the role of the general counsel as the “lawyer-statesman”, the essence of which is the responsibility to “move beyond the first question — ‘is it legal?’ — to the ultimate question — ‘is it right?’”<sup>26</sup> Other prominent legal voices, while not directly endorsing the “lawyer-statesman” vision, subscribe to the core concept that no one voice — but rather many voices (the general counsel included) — contribute to the creation and implementation of the culture, values and integrity of a company.<sup>27</sup>

It is in this context that compliance officer claims to be the “subject matter expert” on corporate culture and ethics—to the express exclusion of the general counsel and other corporate officers—appear as divisive as they are unfounded.

*Job Descriptions.* The third significant development is efforts by compliance industry commentators to extend the portfolio of the CCO, to a point where it appears to conflict with the expanding role of the general counsel.

Recent surveys confirm the core areas of responsibility for compliance officers to include such matters as managing policies across the organization; establishing codes of corporate conduct; whistleblower protection; monitoring the “complaints and incidents hotline”; third party risk management; training, monitoring, and assuring compliance program effectiveness.<sup>28</sup> In this regard they support efforts of “business leaders in embedding integrity processes deep into business operations”<sup>29</sup>; i.e., the task of integrating the different substantive areas of an organization’s compliance with regulation, policy and procedure into a coherent compliance program.<sup>30</sup>

However, new compliance industry efforts appear to project a broader, more multidisciplinary portfolio for the CCO, which is “neither a subset or extension of legal”.<sup>31</sup> As one prominent compliance authority states, “The CCO mandate is ambitious, broad, and complex; no less than to oversee the organization’s ability to ‘pre-

<sup>25</sup> Ben W. Heineman, Jr., “The General Counsel as Lawyer-Statesman,” Harvard Law School Program on the Legal Profession: A Blue Paper.

<sup>26</sup> *Id.*, at 7. “It is ludicrous to suggest, as ‘some do,’ that the GC ‘only worries’ about what is ‘legal’ and the chief compliance officer worries about what is ‘right,’ the whole ‘what-is-right’ set of issues is at the center of the role of the modern, broad-based general counsel as wise counselor and leader.” Benjamin W. Heineman, Jr., “Don’t Divorce the GC and Compliance Officer,” Harvard Law School Forum on Corporate Governance and Financial Regulation, December 26, 2010 (henceforth, “Heineman, Don’t Divorce”).

<sup>27</sup> Robert C. Weber, “Convocation on Lawyer Independence Challenges and In House Corporate Counsel”; Keynote Address, New York State Institute on Professionalism in the Law and New York State Judicial Institute, November 9, 2012 at 15-18.

<sup>28</sup> Deloitte, *In Focus: Compliance Trends Survey 2013*, Compliance Week, Aug. 2013; SAI Global/Baker & McKenzie 2013 Global Compliance and Ethics Benchmarking Survey (<http://www.saiglobal.com/compliance>).

<sup>29</sup> “Heineman, Don’t Divorce,” *supra*.

<sup>30</sup> *Id.*

<sup>31</sup> Donna Boehme, “When Compliance and Legal Don’t See Eye to Eye”; *Corporate Counsel* (Online), May 8, 2014.

vent and detect misconduct' ”<sup>32</sup> Or, put another way, “Compliance’s mandate is to find, fix and prevent problems, and to support a culture of transparency and accountability.”<sup>33</sup>

This point of view is being used to justify greater compliance officer involvement in matters such as internal investigations, corporate governance, conflict of interest resolution, the development of codes of ethics, and similar areas of organizational administration. “On a Venn diagram, Compliance would not be a subset of legal but instead would touch a piece of Legal, a piece of HR, a piece of Audit, and would have significant interfaces with many other functions of the organization—and, of course, deep connection into the business operations.”<sup>34</sup>

Perhaps much of that is true, efficient and appropriate. But a specific concern arises from the perspective that “[compliance officers] tell you what is legally appropriate and what is legally inappropriate . . .”<sup>35</sup> Many legal commentators view the compliance function as centered around legal analysis conducted by the general counsel or outside counsel under the protection of the attorney-client privilege. Moreover, “that the vast majority of compliance activities involve tasks (e.g., prevention and education) where a lawyer’s role in interpreting, explaining and performing risk assessments is critical.”<sup>36</sup> Thus, the potential for significant organizational conflict and confusion—and possibly risk—may arise from the failure to recognize or adequately analyze legal issues, or from the potential loss of the attorney-client privilege.

The debate over roles and responsibilities is significantly exacerbated by the extent to which the term “compliance” continuously appears in the public milieu in the form of “shorthand.” In this way, the term appears to reference some sort of broad organizational commitment to adherence with applicable law; i.e., more as a state of corporate consciousness than as an executive-level job description; e.g., **We are a compliance-focused corporation**. To the extent that “compliance” is used loosely in the business and governance media, it serves to confuse corporate leadership about the real distinctions between accepted legal and compliance components. That could lead to unfortunate legal consequences for the organization in the context of a significant legal or regulatory crisis, should leadership turn first to the compliance officer and not to the general counsel.<sup>37</sup>

Expansive definitions of the compliance function are also at odds with new surveys that depict the expanding organizational prominence of the general counsel. These new surveys lend empirical support to the view

that the general counsel of a sophisticated enterprise (such as a health care system) has highly consequential responsibilities, and thus should occupy a position of hierarchical importance within the organization. The surveys reflect an evolving role for the general counsel, by which he/she is increasingly viewed as a leading and valued member of the executive team. The general counsel’s responsibilities are perceived as extending beyond traditional legal tasks to include governance and risk management, and providing material contributions toward the development of business strategy.<sup>38</sup>

## The Board’s Role

As developments cause the roles and responsibilities of the compliance officer and the general counsel to become increasingly blurred, the board has an obligation to establish clarity and reduce the potential for organizational risk. The failure to clearly delineate the respective duties of these key corporate officers can create administrative waste and inefficiency; increase internal confusion and tension; jeopardize application of the attorney-client privilege, and “draw false distinctions between organizational and legal risk.”<sup>39</sup>

There’s no “one size fits all” solution; no clear pathway across industry lines. There’s also no other forum that promises near-term relief from this controversy; no movement toward the development of “best practices” or other form of accord between the compliance officer and corporate counsel constituencies. If clarity is to be achieved—as it must—the initiative should come, at the organizational level, from the board. And the board clearly has the basis for doing so, from several perspectives.

Foremost is the long-accepted governance principle that the board has a specific obligation to support the organizational prominence of the general counsel. This is most typically manifested through policies designed to provide direct board oversight over the general counsel’s job status and compensation; access to the board generally and in executive session, and in connection with reporting relationships with internal and external lawyers of the corporation. The Cheek Report in particular calls for a primary role in assuring the implementation and operation of an effective corporate compliance program.<sup>40</sup> To the extent that an expanded role for the CCO would serve to encroach upon, or limit the authority of the general counsel, the board would surely be expected to act.

An additional perspective comes from the U.S. Sentencing Commission, and its highly respected guidelines on what constitutes an effective corporate compliance program. These guidelines specifically assign two primary compliance oversight roles to the board: first, that the board shall be knowledgeable about the content and operation of the compliance; and second, that it shall exercise reasonable oversight with respect to the

<sup>32</sup> Donna Boehme, “Making the CCO an Independent Voice in the C-Suite”; *Corporate Counsel* (Online), March 19, 2103.

<sup>33</sup> Donna Boehme, “When Compliance and Legal Don’t See Eye to Eye”; *Corporate Counsel* (Online), May 8, 2014.

<sup>34</sup> Donna Boehme, “The Real ‘Happy Marriage’ Between the GC and the Compliance Officer”; *Corporate Counsel* (Online), May 2, 2012.

<sup>35</sup> Comments of Roy Snell, *Compliance Today*, Health Care Compliance Association, Dec. 2009.

<sup>36</sup> Ide & Clark, *supra*.

<sup>37</sup> See, e.g., Gregory J. Millman and Samuel Rubinfeld, “Compliance Officer: Dream Career?” *The Wall Street Journal*, Jan. 15, 2014; Gregory J. Millman and Ben DiPietro, “More Compliance Chiefs Get Direct Line to Boss,” *The Wall Street Journal*, Jan. 15, 2014.

<sup>38</sup> KPMG, “Over the Horizon: General Counsel Report 2014”; See also, Michael W. Peregrine, “New Surveys Find Increased Prominence for General Counsel Role,” *Health Lawyers Weekly* (American Health Lawyers Association), June 6, 2014.

<sup>39</sup> “Heineman, Don’t Divorce,” *supra*; Ide and Clark, *supra*, and Varun Mehta, “GC vs. CCO: The Big Debate,” *Corporate Counsel* (on line) March 26, 2014.

<sup>40</sup> Cheek Report, *supra*.

implementation and effectiveness of the compliance and ethics program.<sup>41</sup> The authority to assure clarity between the roles of compliance officer and general counsel would surely arise from these two responsibilities.

Some industry regulators readily recognize the important relationship between the governing board, and the roles of the general counsel and the compliance officer. For example, the Officer of Inspector General, Department of Health and Human Services has joined with the American Health Lawyers Association to prepare three separate monographs addressing various components of the compliance oversight obligations of the “health care director.”<sup>42</sup>

An effective board response could incorporate a series of measures. First would certainly include directing the compliance officer and general counsel, with the support of the CEO and outside advisors, to prepare for CEO and board consideration a set of mutually acceptable job descriptions for their respective positions. This would include a confirmation of the board reporting rights of both officers. It would also include the preparation of a detailed communication protocol that would address such important issues as:

- Coordination of efforts (including regular meetings) to advise the board on the corporation’s legal and compliance profiles;
- Coordination (as appropriate) of respective presentations of the GC and CCO to the board and key committees to assure consistency and to avoid duplicate presentations;
- No restrictions on the CCO’s ability to interact with government regulators;

<sup>41</sup> United States Sentencing Commission Guidelines Manual Sec. 8 B2.1(b)(2)(A).

<sup>42</sup> See, f.n.2, *supra*.

- Authorization of the CCO to engage outside counsel with the understanding that the GC is to be involved (subject to conflict) with the scope and activities of such outside counsel and shall be provided with copies of all related legal advice;
- Coordination between the GC and CCO of all internal reviews and investigations commenced in response to regulatory or ethical concerns; and
- Shared GC/CCO responsibility for proposing and implementing revisions to the organization’s compliance plan.<sup>43</sup>

The perceptive board may also wish to explore, with the support of external advisors, the very sensitive core issues associated with compliance officer independence, and with the hierarchical position of the compliance officer; i.e., should that position be placed in the corporate hierarchy on an equal footing with the corporate legal function, or in some subordinate or other supporting role. The board will also want to use the opportunity to evaluate the themes of the new surveys describing the expanding role of the general counsel, and how those related trends affect the board’s decisions with respect to job description, positional independence and communications.

Boards of corporations in evolving industries (e.g., health care) may also wish to use this opportunity to assure that there is a proper allocation of responsibilities between the general counsel and compliance officer on new statutes and regulations arising specifically from industry change (e.g., the new anti-fraud provisions of the Affordable Care Act).

The board can and should be assertive in adopting measures that support the presence of a vibrant, effective compliance program that teams productively with the general counsel.

<sup>43</sup> See, e.g., Michael W. Peregrine and Joshua T. Buchman, “Managing the General Counsel/Compliance Officer Relationship” 34 *AHLA Connections*, October, 2011.