What Compliance Officers Need to Know About Board Responsibilities

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1

1

Agenda

- Corporate Governance Responsibilities of Board Members
- Review and Oversight of the Compliance Program
- Compliance Officer and the Board

2

2

Corporate Governance Responsibilities General

- Activities and affairs of a corporation shall be conducted, and all corporate powers shall be exercised, by or under the direction of the board of directors.
- Board may delegate the management of the activities of the corporation to any person or persons, management company, or committee however composed, **provided that the activities and affairs of the corporation shall be managed and all corporate powers shall be exercised under the ultimate direction of the board.** *California Corporations Code § 5210*
- The oversight responsibilities of a director are personal – no director may vote by proxy. *California Corporations Code §5211(c)*

3

3

Corporate Governance Responsibilities General

- Each director breached his/her fiduciary duty when board delegated investment function to corporate treasurer without any board oversight:

  Total abdication of the supervisory role…is improper…A director who fails to acquire the information necessary to supervise investment policy or consistently fails even to attend the meetings at which such policies are considered has violated his fiduciary duty to the corporation. While a director is of course, permitted to rely upon the expertise of those to whom he has delegated investment responsibility, such reliance is a tool for interpreting the delegate's reports not an excuse for dispensing with or ignoring such reports. **A director whose failure to supervise permits negligent mismanagement by others to go unchecked has committed an independent wrong against the corporation, …** *Stern v. Lucy Webb Hayes National Training School for Deaconesses*, 381 F. Supp 1003 (U.S. Dist. Ct. D.C. 1974).

4

4

Corporate Governance Responsibilities
Duty of Care

- Director shall perform his/her duties, including duties as a member of any committee of the board upon which the director may serve:
  - In ***good faith***;
  - In a manner that director believes to be in the ***best interest of the corporation***; and
  - With ***such care***, including reasonable inquiry, ***as an ordinarily prudent person*** in a like position would use under similar circumstances. *California Corporations Code §5231(a)*
- The conscientious pursuit by directors of principles of best practices is the foremost approach to the duty of care and best prophylactic against director liability.

5

5

Corporate Governance Responsibilities
Duty of Care

- ***Use reasonable care*** in making organizational decisions.
- ***Exercise degree of skill and diligence*** that reasonably can be expected from someone of his/her knowledge and expertise.
- ***Attend meetings and diligently review materials*** provided in advance of the meetings and at meetings.
- Examine, understand, and continually monitor:
  - All governance documents, policies and any limitations on authority
  - Corporate purposes, mission, and vision
  - Organizational structure, activities and key management personnel
  - Financial statements and reports
  - Key laws that impact organizational activities

6

6

Corporate Governance Responsibilities
Duty of Inquiry

- ***Cannot be passive*** and must actively participate in decisions.
- Must ***make reasonable inquiries*** regarding potential decisions.
  - Healthy skepticism and questioning
  - Asking for clarification regarding issues and impact of decisions
  - What would an ordinarily prudent person ask or want to know under similar circumstances?
- ***Reliance on others*** for information and answers:
  - Reliable and competent officers and employees;
  - Legal counsel, accountants and others with professional or expert competence; and
  - Board committees as to matters within their designated authority. *California Corporations Code §5231(b)*

Corporate Governance Responsibilities
Duty of Loyalty

- Directors must ***set aside professional, business, or personal interests*** when acting on behalf of the corporation.
  - Self-Dealing Transactions
  - Interlocking Director Transactions
  - Intermediate Sanctions – Internal Revenue Code §4958
- ***Corporate opportunity doctrine***
  - Cannot seize corporate opportunity for his/her own gain.
  - Present business opportunities to corporations before personal investment.
- Conflicts of Interest Policy
- ***Duty of Confidentiality***

Corporate Governance Responsibilities
Duty of Loyalty

- Case in Point – University Of Maryland Medical System
  - Baltimore Mayor Catherine Pugh, UMMS Board Member sells $500,000 of "Healthy Holly" books to UMMS
  - UMMS donates the books to Baltimore schools and day cares
  - Two Board members resign, 4 are placed on leave
  - UMMS CEO placed on leave, and later resigns, amid accusations of self-dealing and no-bid contracting with board members
  - FBI and IRS raid Pugh's home
  - UMMS received a subpoena for documents in federal investigation
  - Four top executives resign including Chief Administrative Officer, General Counsel, Chief Compliance Officer, and Chief Performance Improvement Officer
  - New Board Conflicts of Interest policy developed
  - Entire Board expected to be replaced

9

9

Corporate Governance Responsibilities
Duty of Oversight

- *Graham v. Allis Chalmers Manufacturing Co.*, 188 A.2d 125 (Del. 1963)
  - Shareholders sued the board of directors for not stopping employees from violating the federal antitrust law.
  - Court acknowledged ***fiduciary duty to "monitor"*** corporate activities and identified 3 basic characteristics associated with duty:
    - Duty arises from fiduciary responsibility ***to oversee management action***.
    - Duty is passive – ***only arises when "something occurs to put them on suspicion that something is wrong"*** and no duty to "install a system of corporate espionage to ferret out wrongdoing: (the ***"Red Flag Rule"***)."
    - Duty only is to stop corporate actions that are illegal.

10

10

Corporate Governance Responsibilities
Duty of Oversight

- *In re Caremark International Inc. Derivative Litigation*, 964 A.2d 106 (Del Ch. 1996)
  - Caremark International's shareholders sued board of directors for breach of fiduciary duty for the failure to prevent payments made by employees in exchange for patient referrals in violation of the anti-kickback law, which resulted in settlement payment of $250 million.
  - Directors ***cannot assume that the corporation is operating in compliance with the law***; instead, it has an ***obligation to invest in monitoring systems*** that are ***suitable to identify legal violations***.

11

11

Corporate Governance Responsibilities
Duty of Oversight

- *In re Caremark International Inc. Derivative Litigation (cont.)*
  - "But is important that the board exercise a good faith judgement that the corporation's information and reporting system is in concept and design adequate to assure the board that appropriate information will come to its attention in a timely manner as a matter of ordinary operations, so that it may satisfy its responsibility."
  - "And obviously too, no rationally designed information and reporting system will remove the possibility that the corporation will violate laws or regulations or that senior officers or directors may nevertheless sometimes be misled or otherwise fail reasonably to detect acts material to the corporation's compliance with the law."

12

12

Corporate Governance Responsibilities
Duty of Oversight

- *In re Caremark International Inc. Derivative Litigation (cont.)*
  - Based on the duty of care, to find liability:
    - Board must have ***failed to provide reasonable oversight*** in a "sustained or systematic" fashion; and
    - ***Information reporting system*** on which the board relied must have been an ***"utter failure"***.
  - Any "rational board" would install an information reporting system to take advantage of the benefits offered to corporations under the ***federal organizational sentencing guidelines***
    - Lower fines on a corporation if determined that it had in place an "effective program to prevent and detect violations of law."

13

13

Corporate Governance Responsibilities
Duty of Oversight

- *Stone v. Ritter, 911 A.2d 362 (Del. 2006)*
  - Delaware Supreme Court reformulated Caremark standard as a two-part test, where ***liability arises under the duty of good faith*** and stems from either:
    - ***Utter failure to implement any reporting or information system*** or controls, or
    - Having implemented such system or controls, ***consciously failing to monitor*** or oversee its operations.
  - Intent requirement – Imposition of liability requires a showing that the ***directors knew or should have known that they were not discharging their fiduciary obligations.***
  - *Marchand* *(2018)* and *Clovis* *(2019)* cases – Duty is further elevated for mission critical risks or when operating in highly regulated environment.

14

14

Corporate Governance and Business Judgement Rule

- Directors may ***not be held liable for unfavorable outcomes*** or "bad decisions" when he/she ***acts in good faith*** and in the same manner ***as a reasonably prudent person.***
  - Insulate from court intervention those management decisions which are made by directors in good faith in what the directors believe is in the organization's best interest.
  - Limit retroactive judicial "second guessing" even if the directors were wrong and the court would have disagreed with the action. *Lee v. Interinsurance Exchange, 50 Cal. App. 4th 694, 714 (1996).*
- Director will not receive protection for any breach of his/her fiduciary duty when acting in bad faith or fraudulently. *Desaigoudar v. Meyercord, 108 Cal. App. 4th 173, 188 (2003)*

15

15

Individual Accountability

- On September 9, 2015, the Department of Justice released guidelines regarding "Individual Accountability for Corporate Wrongdoing" (the "Yates Memo")
- Policy prioritizes the prosecution of individual corporate employees
  - "Individual wrongdoers must be held personally accountable for the actions they cause corporations to take"
- To receive credit, the organization must investigate and identify responsible individuals within the organization
- Both criminal and civil corporate investigations will focus on individuals from the inception of the investigation
- November 2018 Revision - Rosenstein
  - "In order for a company to receive any consideration for cooperation under this section, the company must identify all individuals ***substantially involved in or responsible*** for the misconduct at issue, regardless of their position, status or seniority, and provide to the Department all relevant facts relating to that misconduct."

16

16

Strategic Approaches to Board Oversight

- Challenge of limited time and many demands for the Board's attention
- Requires strategic and efficient use of Board's sources, resources, time and attention
  - Various "Eyes & Ears"
  - A system of checks and balances
- Audit & Compliance Committee
  - Chair of Committee reports regularly to the Board of Directors
  - This report should provide enough substance for the Board to meet its fiduciary responsibilities, especially the Duty of Oversight.
  - Committee minutes and materials are available to the Board.
  - See video from OIG Chief Counsel - https://youtu.be/fndbDclELds

17

17

OIG Corporate Integrity Agreements – Board Obligations

- Responsible for the review and oversight of matters related to compliance with Federal health care program requirements and the obligations of the CIA
  - Meet at least quarterly to review and oversee the compliance programs, including performance of Compliance Officer and Compliance Committee
  - Submitting to the OIG a description of the documents and other materials reviewed
  - Adopt resolution that organization has implemented an effective compliance program to meet Federal health care program requirements and the obligations of the CIA

18

18

Strategic Approaches to Board Oversight

- General Counsel Report
- Reports from Chief Compliance Officer
  - Unfettered, anytime access by/to the Chief Compliance Officer
- Internal Audit
- External Audit
  - Also evaluates the compliance environment
- Executive Sessions
  - Fulfilling board duties may require discussion without management

19

19

Review and Oversight of Compliance Program

- Based on the legal principles and resources as described, the Board:
  - Has an affirmative ***duty to reasonably oversee implementation and operation of*** an effective program for ***operational compliance*** with key federal and state laws.
  - Must assure that the Compliance Program has ***effective systems in place to regularly report on*** the results of the ***Compliance Program's work*** (including internal audit) to the Board of Directors (or a committee thereof).
  - Is entitled to ***rely***, in good faith, ***on officers and employees as well as corporate professional experts/advisors*** (when Board believes confidence in experts is warranted) regarding compliance, Compliance Program, and the effectiveness of the Compliance Program

20

20

Review and Oversight of Compliance Program

- Use recognized public resources as benchmarks for structure/scope
  - Federal Sentencing Guidelines
  - OIG's voluntary compliance guidance
  - Corporate Integrity Agreements
- Use Compliance Expert to assist in identification of risk areas, insight into best practices, and consultation of other substantive or investigative matters
- Evaluate the adequacy, independence, and performance of the compliance, legal, audit, human resources, and quality functions

21

21

Review and Oversight of Compliance Program

- Reports to the Board
  - Risk assessment, mitigation plans, and corrective actions
  - Metrics
  - Internal and external investigations
  - Serious issues raised in internal and external audits
  - Allegations of material fraud or senior management misconduct
  - Management exceptions to Code of Conduct and expense reimbursement policy
  - Information on significant regulatory changes and enforcement activities

22

22

Healthcare-Specific Risks and Oversight Areas

- False Claims
- Anti-Kickback Statute
- Physician Self-Referral (Stark Laws)
- Information Security
- Privacy and Data Security Laws and Regulations
- Tax Exemption Laws and Regulations
- Other Laws

Monitor enforcement climate carefully, but don't permit limited law enforcement to give green light to unlawful behavior.

Government Enforcement

- DOJ recovered more than $3 BILLION in False Claims Act cases in FY19
- Of the $3 billion in settlements and judgements, $2.6 billion involved the health care industry
- Tenth consecutive year that the department's civil healthcare fraud settlements and judgments have exceeded $2 billion
- 633 *qui tam* suits filed this past year – an average of more than 12 new cases every week

Compliance Officer and the Board

Federal Sentencing Guidelines – Organizations (FSGO)

- Chapter 8B2. Effective Compliance & Ethics Programs. Outlines minimally required components of an "effective compliance and ethics program" (attached)

Basic elements

- Policies and procedures (addressing program operation and substantive risks)
- High-level oversight of program (board, management, compliance officer)
- Screening out of people who don't play by the rules
- Education (both about program and substantive risks)
- Monitoring and auditing (including use of complaint mechanisms to identify problems)
- Promotion and enforcement (FSGs require both incentives to perform and discipline for failures)
- Appropriate response to misconduct (corrective action, disclosure, discipline, etc.)
- Risk assessment

Compliance Officer and the Board

U.S. Department of Justice (DOJ) Evaluation of Corporate Compliance Programs – https://www.justice.gov/criminal-fraud/page/file/937501

US Department of Health & Human Services (HHS) Office of Inspector General (OIG) Compliance Program Guidance -- https://oig.hhs.gov/compliance/compliance-guidance/compliance-resource-material.asp

- Hospital
- Home Health Agencies
- Hospice
- Ambulance
- DME
- Clinical Laboratories
- Nursing facilities
- Physicians/Small group physicians
- Billing companies
- Pharmaceuticals
- Medicare + Choice

Corporate Integrity Agreements

Deferred Prosecution Agreements

Compliance Officer and the Board

Role of the Board (FSGs: "Knowledgeable about content and operation; exercise reasonable oversight regarding implementation and effectiveness").

- Get basic education on compliance programs
- Define scope of the program
- Approve key policies and procedures
- Align incentives
- Require regular, substantive reporting (metrics) by management and compliance officer
- Monitor corrective action plans (be skeptical of CAPs that rely primarily on education)
- Read the newspaper. Ask questions!

Tip: Add compliance expertise to board or appropriate committee.

27

27

Compliance Officer and the Board

Role of Compliance Officer

- Work effectively with: Board, Management and Peers (legal, human resources, internal audit, quality, risk services, etc.)
- Work within limits of organization's resources
- Have appropriate (fair) expectations
- Design/redesign program with input from management, employees, peers and experts
- Develop policies, procedures and educational content
  - Structural → OSGs
  - Substantive → high risk areas
- Clearly articulate what needs to be done (metrics/scorecards)
- Monitor management performance
- Report to management and board on management execution
- Be respectful of management and board time. Answer their questions.

28

28

Compliance Officer and the Board

Compliance Officer Reporting

Note: It is important to understand that the Compliance Officer is responsible for the compliance function. Management is responsible for compliance (to execute the program).

- Reports to Board (committee) and/or CEO
- Regular executive sessions
- Reasonable severance package
- Minimize conflicting responsibilities
- Educated compliance officer

29

29

Compliance Officer and the Board

Align incentives (element of 6A. of FSGs)

- Incentive compensation
- Merit increases/promotional opportunities
- Transparency
- Performance evaluation
- Recognition
- Keeping promises

30

30

Compliance Officer and the Board

Management and Board reporting — written reports

Purpose is to inform, report and educate

- Issues/Investigations (internal and external)
- Audit reports (summary), highlighting past due items
- Annual work plan progress
- Key metrics
  - high risk areas
  - Program operations
- Recent developments (law changes, enforcement changes, industry issues, etc.)

31

31

Compliance Officer and the Board

Management and Board reporting — oral reports

Highlight

- New investigations/issues
- New reports/tools
- Key messages

Respond to management/board questions

32

32

Compliance Officer and the Board

Management and Board reporting — minutes

Purpose: To reflect topics, deliberations and actions in meeting and demonstrate that participants are effectively fulfilling their role

- General topic area
- Issues
- Questions/deliberations
- Action

See The Basic Principles of Corporate Minute Taking by Michael Peregrine

https://s3-us-east-2.amazonaws.com/mwe.media/wp-content/uploads/2019/04/05155828/governance-notes-peregrine.pdf

33

33

Questions?

34

34

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35

35