

PLUS: PHARMA'S TAUZIN SEALS A DEAL PAGE 16

CAPITAL THINKING

BUSINESS, FINANCE, POLITICS—AND THE LAW



FOR SOME
IN BUSINESS,
REFORM MAY
NOT BE AS
SCARY AS
HAD BEEN
FEARED

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WELCOME

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Reform Is in the Air

If there's a word—and a concept—that dominates this issue of *Capital Thinking*, it's clearly "reform." Opening the cover story, for example, Richard Sine writes: "The most dramatic health care reform the nation has ever seen is starting to shape up." In a related sidebar, Patton Boggs attorney Laurence Freedman notes that "proponents are counting on Medicare and Medicaid fraud recoveries as a major source of funding for health care reform"—a case of reform underwriting reform. A few pages later, Freedman's colleague Todd Cranford adds that "Congress is intent on moving forward with regulatory reform legislation." Also in this issue, Patton Boggs attorneys Denise Vanison, William McGinley and Harry Silver look at reform efforts targeted at immigration, campaign finance and false claims.

Reform, of course, is in the mind of the reformer: reasonable people can mount reasonable argu-

ments on either side of any issue. Which may be why anything approaching true reform (whatever that may actually be) takes so long to achieve.

But today's political and economic climate is clearly made for reform, and eventually some sort of consensus will be reached—at least for a while. As PhRMA CEO Billy Tauzin notes on page 16, explaining his group's support for health care reform, "We collectively decided that if reform was done with our principles in mind...we ought to support progress toward a good bill."

Our mission, as these discussions continue, is not so much to chronicle the debate, but to provide insights, not only on the direction the debate is taking, but on the impact—financially, legally, ethically—that direction may have on you and your business. Turn the page to watch the debates unfold.

MIKE WINKLEMAN, *Editorial Director*

“I think we’re going to continue to see a push to make the program more efficient...and fully utilized.”

—Brett Palmer, on the Small Business Administration’s Small Business Investment Company program

CURRENCY

BY JENNIFER PILLA TAYLOR & JOHN W. MILLIGAN

Give IP Its Due

When evaluating a takeover target, acquirers often focus their due diligence on hard assets such as land, buildings and inventories. But evaluating a target’s intellectual property, even if it is less tangible, is just as important in preventing serious legal trouble down the road.

Take the case of Greatbatch, a New York-based implantable medical products manufacturer founded by William Greatbatch, co-inventor of the pacemaker. Greatbatch has gobbled up seven other companies in the past year alone as it seeks to expand its business to include orthopedic and vascular products. The acquisition spree has boosted its patent portfolio to more than 650 active patents from about 200.

For every takeover, the company deployed a team that included its in-house IP attorney as well as several scientists who delved into the target company’s portfolio, specifically looking into issues such as patent exclusivity, ownership rights and potential infringement claims. Key to the success of the patent portfolio review, says Greatbatch General Counsel Tim McEvoy, was involving scientists with specific expertise in the target company’s field—even if it meant hiring outside experts.

“Intellectual property is really the lifeblood of this company,” says McEvoy. “It was essential that we get this right.” —J.P.T. CT

\$3 Billion Found Under the Couch

Once largely ignored by venture capitalists, a \$3 billion pool of federal money set aside to help small business is suddenly attracting a lot of attention.

With private investors on the sidelines, VCs are increasingly willing to go the extra mile to tap into the Small Business Administration’s Small Business Investment Company program. Under the program, VC firms that acquire an SBIC license may borrow from the government pool and use that to invest in a small business.

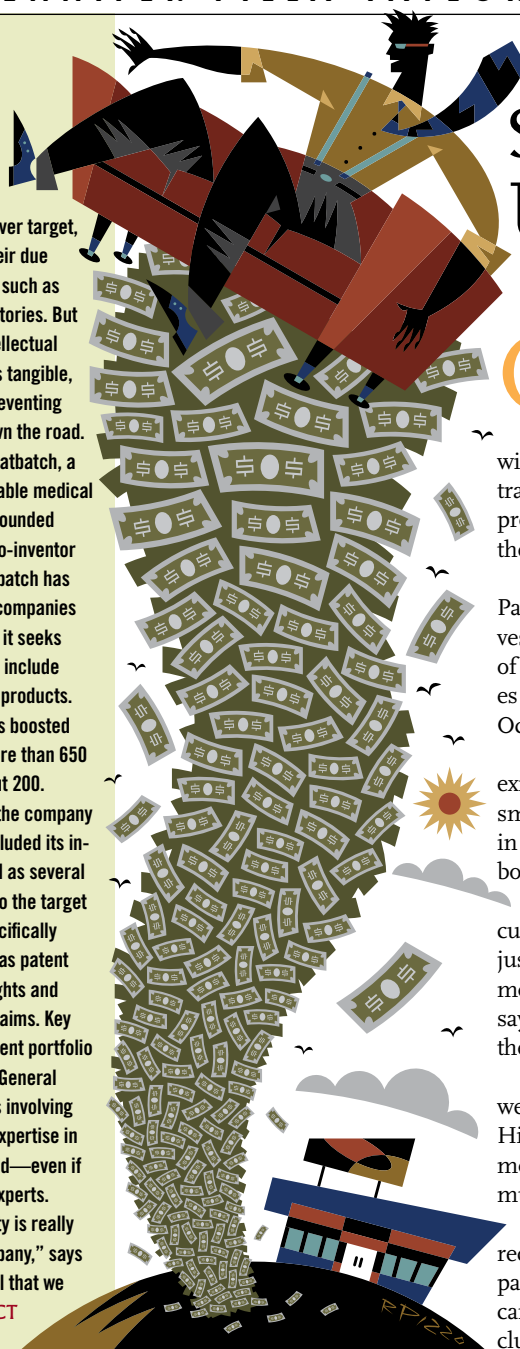
The SBA issued just six SBIC licenses in FY 2008, says Brett Palmer, president of the National Association of Small Business Investment Companies, which advocates for the lower middle market of the private equity industry, including SBICs. However, 11 licenses were issued in FY 2009; there should be seven more by the end of October. An additional 25 SBIC applications are in the pipeline.

An SBIC-licensed fund can borrow as much as three times its existing capital from the SBA. That money has to be used to fund small businesses with up to \$18 million net worth or \$6 million in after-tax income in the prior two years. The fund typically takes both a debt and equity interest in that business, says Palmer.

Getting an SBIC license has traditionally taken a year. But the current administration and Congress are working to cut the wait to just a few months. It has also loosened some restrictions on how the money is used. “So far we’ve been very pleased with the changes,” says Palmer. “I think we’re going to continue to see a push to make the program more efficient and effective and fully utilized.”

Patton Boggs partner Phil Feigen says he now gets calls on a weekly basis from people interested in obtaining an SBIC license. His advice to them: act quickly. “It’s not so much that the pool of money is going to run out, but that the SBA can only handle so much at once,” he says. “You need to get in line early.”

While the 51-year-old SBIC program has been underutilized in recent years, its track record is notable—and encouraging to companies looking to tap into it. The long roster of well-known American companies that have benefited from early SBIC financing includes Intel, Federal Express and Staples. —J.P.T. CT



Political Speech vs. “Bureaucrats”

The U.S. Supreme Court seems likely to overturn the ban on corporate money that was a central tenet of campaign finance reform, says William McGinley, of counsel at Patton Boggs.

In *Citizens United v. Federal Elections Commission*, conservative nonprofit Citizens United sought to broadcast a documentary critical of then-presidential candidate Hillary Clinton during the run-up to the 2008 presidential primaries. The case hinges on the constitutionality of a provision in the McCain-Feingold campaign finance law prohibiting certain corporate-funded political ads from being aired during a campaign season.

Rather than opining on that narrow provision as expected last June, the Court took the rare step of ordering re-arguments focusing on whether certain Court precedents upholding the the ban on

campaign spending by corporations—which includes not just for-profit companies but also trade associations and many nonprofits—should be overturned.

During the September 9 hearing, Chief Justice Roberts stated, “We don’t put our First Amendment rights in the hands of FEC bureaucrats.” The statement spurred many observers to predict that Justice Roberts and Justice Alito might be swing votes in a ruling that favors Citizens United, McGinley says.

Lifting that ban could be a game-changer for the congressional races coming up next year. McGinley says he’ll post updates on the case in his new political law blog, expressadvocacy.com, which tracks news and offers analysis on issues ranging from campaign finance laws to lobbying regulations to ethics. —*J.P.T. CT*

“We don’t put our First Amendment rights in the hands of FEC bureaucrats.”

REAL ESTATE : BUYING TIME

When the global credit crunch slammed into the U.S. economy with the destructive force of a Category 5 hurricane, among the victims were just about every kind of commercial real estate project imaginable. Money is to real estate what jet fuel is to a Boeing 777, so when the credit markets froze up, a lot of properties were in danger of crashing.

These are hectic times for attorneys who specialize in real estate workouts, including Patton Boggs partner Allan Goldstein, who says the current real estate crisis is the worst he has seen in over 20 years of private practice. Goldstein’s goal is to forge a deal between borrower and lender that prevents a property from being dumped on the market as

a distressed asset. “Many lenders I have worked with have taken the position that they don’t want the property back,” he explains. Thus, lenders are often willing to modify financial covenants, lower interest rates and rework the loan to keep the asset in the hands of its original owners.

Goldstein says the credit crunch has impacted a wide variety of commercial properties, including high-rise office towers, hotels, multifamily units and retail stores. Although many commercial banks are still reluctant to lend, and the complete shutdown of the securitization market for commercial real estate loans has deprived developers and investors of another vital funding source, Goldstein believes the crisis is slowly beginning to ease. “I think we’re through the worst,” he says. “I’d like to think that at some point the real estate market would bounce back like the stock market has.”

Until then, Goldstein tries to keep good properties from being dumped on the market in the kind of fire sale that hurts borrower and lender alike. “We’re trying to buy some time and ride out the storm until the market improves,” he says. “We’re trying to keep the thing alive.” —*J.W.M. CT*



TOP TEN

THINGS TO KNOW ABOUT THE AMENDED FALSE CLAIMS ACT

BY HARRY SILVER

- 1▶ You no longer have to present a false claim to the government to be subject to the FCA.
- 2▶ You no longer have to do business with the government to be subject to the FCA.
- 3▶ Proof of intent to defraud the United States is now irrelevant under the FCA.
- 4▶ The retention of funds obtained by means of an inadvertent overpayment is subject to the FCA.
- 5▶ Whistleblowers may initiate an FCA suit in return for 15%-30% of any recovery by the government.
- 6▶ A judicial determination of an FCA violation requires the imposition of potentially ruinous financial penalties.
- 7▶ The possibility of a percentage of a huge recovery has encouraged whistleblower suits.
- 8▶ Protection of whistleblowers against retaliation has been extended to contractors and employees of contractors.
- 9▶ The use of Civil Investigative Demands by the Department of Justice and the sharing of information with other agencies, states and whistleblowers has been made easier.
- 10▶ The lack of an effective compliance program is considered to constitute “reckless disregard.”



VANISON "Until the government raises the cap on the H-1B visa program, there are several alternatives that may prove useful."

IMMIGRATION

America Needs Talent

Some companies still must look overseas for special skills.

BY DENISE VANISON
PATTON BOGGS

Recruiting top talent from abroad is a perpetual challenge for American businesses that rely overwhelmingly on H-1B visas to employ foreign workers. Many U.S. businesses have been advocating an increase in work visas and, in particular, an expansion of the H-1B visa program. However, any hope of such immediate immigration reform has been dimmed by President Obama's recent announcement that the government's focus on health care reform and strengthening the economy will push back any immigration overhaul efforts until 2010, at the earliest.

The focus of much of the ire surrounding immigrant workers is the H-1B visa program, one of the main tools used to employ foreign workers. The H-1B is a non-immigrant visa that permits a sponsoring U.S. company to employ a foreign individual for up to six years. To qualify for H-1B status, a prospective employee must have at least a bachelor's degree (or the equivalent) in a specialty occupation, such as engineering, accounting or mathematics. Employers may apply for H-1B visas beginning on April 1 of each year to be effective at the beginning of the fiscal year on October 1.

The biggest drawback to the H-1B visa, and the target of reform measures, is the annual cap. The United States Citizenship and Immigration Services grants only 65,000 H-1B visas to bachelor's degree holders and an additional 20,000 visas to individuals with master's degrees or higher. The visas are typically in such great demand that last year alone, more than 123,000 applications were filed within two days.

Though some critics believe that the H-1B program displaces American workers, the reality is that companies sometimes have no choice but to consider a broader pool of candidates. Several of my clients require employees with expertise in highly specialized areas of knowledge and would have a very limited selection if they were restricted to U.S. workers.

An expansion of the H-1B program would provide U.S. companies with more prospective employees in technical fields

and more workers with coveted international experience. Immigration proponents argue that in a free market society, companies should have the right to choose the most qualified candidate for the job, regardless of nationality.

Until the government raises the cap on the H-1B visa program, there are several alternatives that may prove useful to employers. First is the L-1 visa, an option for companies operating both in the U.S. and abroad that want to transfer foreign workers to the U.S. for up to seven years. This visa is used mainly for executives/managers and employees

with specialized knowledge; unlike the H-1B, there is no limit on the number of L-1 visas granted.

The TN visa is another option, created as part of the North American Free Trade Agreement for Canadians and Mexicans to work in the U.S. in specific professions, most of which require a college degree. The TN visa can be renewed indefinitely in three-year increments.

Employers should also consider the O-1 visa, which was created for individuals with extraordinary ability in the arts, sciences, education, business and athletics. "Extraordinary ability" is demonstrated by sustained national or international acclaim. There is no cap on the number of O-1 visas, and O-1 status may be extended indefinitely. Another important aspect of O-1 visa status is its lack of a minimum education level requirement. While the standard may seem high, last year approximately 9,000 people came to this country on O-1 visas, so it is clearly not an impossibly high bar.

E-1 and E-2 visas, known respectively as "treaty trader" and "treaty investor" visas, are also attractive alternatives, but are limited to citizens of countries that maintain a treaty of navigation and commerce with the United States. Those seek-

Though some critics believe the H-1B program displaces American workers, the reality is that sometimes companies may have no choice but to consider a broader pool of candidates.

ing an E visa must fill supervisory, executive or highly specialized positions at U.S.-based operations owned by an individual or company from the same treaty country. E visas are not subject to a quota and can be renewed indefinitely as long as the qualifying relationships, job responsibilities, and levels of trade or investment continue.

Finally, those companies wishing to hire Australians may find the E-3 visa useful. The E-3 visa is similar to the H-1B, but is limited to Australians. To be eligible, an Australian citizen must possess a bachelor's degree or higher (or its equivalent) in a specialty occupation and the occupation must require that specific degree. There is a 10,500 cap on the E-3 visa; however, unlike the H-1B cap, it has never been reached.

While I am hopeful that the H-1B cap will be raised eventually, we have no way of knowing exactly when this may occur. Until that time, employers should consider other viable options to hire the highly qualified foreign workers they need to remain competitive. **CT**

DENISE VANISON is a partner in Patton Boggs' Immigration practice.

Better Schools, Better Roads—Better Jobs

We need to make a long-term investment not just in America's infrastructure, but also in its most valuable asset: its workforce.

BY ED SMITH

ULLICO

Private investment in public infrastructure is an idea whose time has certainly come. Roads, bridges, transit systems, schools, electric grids and waste treatment plants across this country are in urgent need of repair and improvement. All the while, our record unemployment rate means there is an army of skilled laborers out there who are ready to do that work. The problem is, cash-strapped local, state and federal governments—even

with the benefit of stimulus funding—simply don't have the money necessary to pay for these important projects.

Foreign financiers were the first to recognize the opportunity presented by this funding gap, pouring billions into American public infrastructure projects over the past several years in exchange for a healthy return for their investors. More recently, several of this country's preeminent investment firms—Goldman Sachs,



SMITH The nation's infrastructure is "in urgent need of repair... Our record unemployment rate means there is an army of skilled laborers ready to do the work."

ROADWORK "Cash-strapped governments don't have the money for these projects."



bridge, where a private entity would pay the government a large lump sum up front and commit to a long-term lease that requires it to operate, maintain and improve the bridge. In exchange, the investors behind the private entity would benefit from the steady stream of toll revenue. Or, maybe we'll be financing the construction of a new wastewater treatment plant, hospital or college dormitory that would then be leased back to a public body.

In all projects, though, the jobs created will pay fair wages and offer benefits such as training programs, whole-family health insurance and guaranteed pensions. The privatization of public works projects is one way to help improve our country's backbone of infrastructure, but it does not need to be done on the backs of American workers.

I had the chance recently to hear President Obama speaking to a group of autoworkers in Orangetown, Ohio, about the current state of the economy and how tough the recession has been on working people. He told them that he would not rest until everyone who wanted to work had a job. Then he paused and said, "And I'm not talking about just any jobs. I'm talking about good-paying jobs with benefits."

Let's make sure that, when the private sector puts people to work upgrading America's infrastructure, the jobs created are good jobs. Because that's not just good for the labor movement, it's good for America. **CT**

JP Morgan and the Carlyle Group—have gotten into the game as well.

The trend is a positive one if it means our children will learn in better-equipped school buildings and our homes and businesses will be powered by energy sources that do less harm to the environment. But if it also means that good public-sector jobs are replaced with private-sector ones that offer low pay and no benefits—as often happens when traditional government functions are privatized—then it will be as disastrous as allowing people to drive their cars over a crumbling bridge at rush hour or drink water that's been processed at a dilapidated treatment plant.

We need to make a long-term investment not just in our country's transportation, communications, education and utilities systems, but also in its most valuable asset: the American workforce.

That's why at ULLICO, we're so excited about a new investment program we'll be launching early next year that will help strengthen America's infrastructure, while creating jobs that allow hard-working people to have a decent quality of life, and generating a reliable return for our investors.

For 32 years, we've run the J for Jobs Fund, which has helped finance \$30 billion worth of private-sector construction projects—hotels, restaurants and residential communities—built by union workers. Our investments have created 500 million work-hours while yielding a long-term, steady profit for our clients, the vast majority of which are union pension funds.

Now we'll be applying a similar model to the public sector as we establish our infrastructure program. The types of projects we'll participate in will vary widely. It could be an existing toll

ED SMITH is the president of Washington, D.C.-based ULLICO, a union-owned insurance and financial services firm founded in 1925. More than 30 years ago he joined the Laborers' International Union of North America as a member of the Local 773 in Cairo, Illinois, as a construction craft laborer.

INCENTIVE TRUSTS

Sound "Financial Parenting"

Successful entrepreneurs are often concerned about the impact the wealth they have accumulated will have on their families. Innovative trusts can be structured to pass on values as well as wealth.

**BY JAMES McNAIR
PATTON BOGGS**

Trusts are appropriate vehicles for administering assets for future generations. Unfortunately, many families have experienced problems with the traditional trust. Descendants can become non-productive "trust fund babies" who contribute little to their families or society. Beneficiaries may anticipate that income from the trust will

enable them not to work for a living. These individuals tend to avoid academic challenges, often drop out of school, and do not participate in business, leaving them unmotivated, unaccomplished and ultimately unhappy. Ironically, the entrepreneur's success may well contribute to the failure of his or her descendants.

To avoid those problems, some successful businesspeople are turning to innovative “incentive” trusts. These trusts are designed to communicate and pass on the values that are important to the entrepreneur, such as education, productivity, integrity and accomplishment, thereby benefiting descendants without making them dependent on the family’s wealth.

Traditional trusts usually distribute assets to beneficiaries based on a timetable—typically one-third at age 25, another third at 35 and the balance at 40. Incentive trusts, by contrast, require that the beneficiaries achieve performance standards established by the grantor if they want to be entitled to trust distributions.

The incentive trust incorporates such standards in “distribution guidelines” adopted by the trustees. If the grantor considers education to be important, the trust might pay for college, but only if the beneficiary maintains a certain grade point average and makes steady progress toward earning a degree. The incentives do not have to focus on the traditional measures of academic or financial performance; they can also be designed to encourage qualities such as industriousness, risk-taking and giving back to the community. For example, incentives can be designed to reward socially valuable work—such as public service or special-needs counseling. The goal is to support and encourage family members to lead happy, productive lives and excel in whatever field they choose.

In the majority of cases, these incentives will take effect with the grandchildren, rather than the children. As a general rule, the entrepreneur’s children have grown up seeing their parents work hard to build their business and accumulate wealth. The grandchildren, however, are more likely to have grown up in a privileged environment, and thus see little connection between work and reward. Therefore, they are the ones who need the “financial parenting” of the incentive trust.

Large incentive trusts typically extend over a long period of time, so it is critical to build in flexibility to allow the trust to adapt to changing realities in the family and in society. This flexibility can be incorporated through two mechanisms:

A statement of purpose. This should be a high-level, brief statement—perhaps just one page—of the values that the grantor wants the trust to encourage. Rather than legal detail, it should provide a handful of principles to guide future decision-making about the trust—much like the U.S. Constitution provides broad guidance for courts.

A board of trustees. This board decides how the distribution guidelines should evolve over time, based on the principles laid out in the statement of purpose. The makeup of the board is key: the board should include representatives of the beneficiaries, any charities involved, the asset manager and the administrative trustee. Any changes to the distribution guidelines should require a unanimous vote, so that all stakeholder views are represented. Beneficiaries can submit proposals to the board

asking for distribution adjustments, much like submitting a grant proposal. For example, in a recent case, a young beneficiary who had completed college wanted to accept a low-paying internship at a prestigious publishing firm in New York—a position that could not support her in the city. This type of post-college internship was not covered by the original distribution guidelines. However, the internship was clearly important to a successful career in the publishing field, and was in line with the spirit of the statement of purpose. Accordingly, the board revised the distribution guidelines to provide her a stipend.

Overall, the incentive trusts provide an effective vehicle for balancing the various interests of stakeholders, ensuring the sound stewardship of the family’s assets and promoting the values that are important to the grantor over the long run. Ultimately, such trusts can help entrepreneurs leverage the fruits of their own success in order to help future generations achieve and succeed in their own right. **CT**

JAMES MCNAIR is a partner in Patton Boggs’ Estate Planning and Wealth Preservation practice.



Pinning Down Reform



The most dramatic health care reform the nation has ever seen is starting to shape up, and business is starting to like—or at least, no longer quite hate—what it sees.

After months of intense lobbying and dramatic confrontation, a reform bill is gaining ground that steers a careful narrow path. It includes the greatly expanded coverage and key insurance regulations that the Obama administration most wants to see. But it also avoids many of the measures that business most feared, such as the public insurance option or the employer mandate to provide coverage.

The fate of this bill, arising from the Senate Finance Committee, was uncertain as *Capital Thinking* went to press. But thanks to all the hard policy work done this year, it is possible to ascertain what measures are gaining support on both sides of the aisle, as well as within the business community. As a result, it's also possible to gauge the likely impact of those measures on business, whether they pass in this legislative round or in those to come.

As they've tracked the progress of various measures, business has found reform to be a "moving target," says Todd Tuten, health care partner at Patton Boggs. There are competing proposals, each with hundreds of interrelated parts. And their impacts will vary from business to business, depending on its size, the composition of its workforce, and its current insurance offerings.

REFORM IS BACK IN THE RING


As recently as August, the prospects for comprehensive health care reform seemed to be on the ropes. A deadline for legislation set by President Obama expired, and congressional representatives found themselves being shout-

ed down by reform opponents at town hall meetings in their home districts during the summer recess.

Then, in late August, the passing of Senator Edward Kennedy—a lifetime reform advocate and an acknowledged master of compromise—added a note of sobriety to the debate. In early September, President Obama delivered a policy address that added meat to what some political allies had criticized as vague principles for reform. Finally, in mid-September, Senate Finance Committee Chair Max Baucus released his "mark" on health care legislation, which largely adopted Obama's principles. The race began to craft a bill that would earn 60 votes on the Senate floor, enough to overcome a potential filibuster.

The business community responded with a cautious enthusiasm. The U.S. Chamber of Commerce called the Baucus proposal "the best effort to date" coming from Congress. The National Federation of Independent Business applauded Baucus for giving "small business' needs a high priority." And the American Benefits Council called the bill "a critical step toward a comprehensive solution to the nation's health care problems."

If comprehensive health care reform does pass this year, many observers say it will be because of key lessons the Obama administration learned from the failure of President Bill Clinton to pass reform legislation in 1994. Perhaps the most important was to take a more inclusive approach—one that ensured that business interests were heard. "In 1994, the plan was constructed outside of public view," says Billy Tauzin, a Republican congressman in the Clinton era who is now the director of PhRMA, the drug manufacturers' association. "Congress was presented with



As business tracks a "moving target," it is also warming to the prospect of comprehensive reform. But not every company will be affected equally.

BY RICHARD SINE

ILLUSTRATION BY PAUL VISMARA



STOPPING FRAUD TO PAY FOR REFORM

When, earlier this year, the United States racked up two \$1 billion-plus settlements from drug manufacturers for alleged fraudulent drug marketing, estimates that fraud costs the nation more than \$60 billion annually gained new credence. And proponents are counting on Medicare and Medicaid fraud recoveries as a major source of funding for health care reform, says Laurence Freedman, a partner in Patton Boggs' health care practice.

Passed in May, the Fraud Enforcement and Recovery Act broadens the federal whistleblower act to "ensure that it reaches every corner of the health care industry, or any industry that receives federal money," Freedman says. The bill also provides substantial additional funding for enforcement to increase the number of fraud investigations and speed cases toward expected recoveries.

Despite the publicity that has accompanied the pharmaceutical marketing cases, the bulk of the dollars wasted in fraud are likely the result of smaller-scale, blatantly criminal activities, says Laura F. Laemmle-Weidenfeld, a partner at Patton Boggs. A typical example is when a medical equipment provider, existing only on paper, charges for products never delivered to beneficiaries. But these smaller operations may not attract the attention of whistleblowers or lawyers seeking a big payday.

A new multicity Medicare fraud strike task force group, also announced in May, may put a dent in such operations, she says. —R.S.

a take-it-or-leave-it option, and we decided to leave it. ... Obviously the difference this time is that many of us were invited into the discussion, including the great American public." (See also our Q&A with Tauzin on p. 16.)

Obama's laissez-faire philosophy gave Baucus the room to conduct his extraordinary, months-long dialogue with stakeholders ranging from big unions and big health care players like Tauzin to his colleagues on the other side of the aisle. He had notable successes, such as convincing Tauzin's group to help reduce drug spending by \$80 billion over the next decade.

But as of press time, it was unknown whether Democrats could obtain even the single Republican vote required to claim bipartisanship in the Senate. Even the support of some fiscally conservative House Democrats was uncertain, notes Tuten.

DEMOCRATS' BACKUP PLAN

The reconciliation bill, due to Senate rules, is not vulnerable to filibuster. But the bill would have to be limited to measures that would have a demonstrable budgetary impact. This would rule out insurance reform, but it could include initiatives such as expansion of Medicaid for the poor, subsidies to help low-income people buy insurance, and Medicare payment and delivery reform.

Business has put the issue of cost control front-and-center, and the Medicare reforms could have a powerful impact on costs, says Lu Zawistowich, a senior public policy advisor at Patton Boggs. These initiatives include proposals to remove Medicare payment decisions from Congress and to give Medicare to a new, politically independent board; refusing to pay for services and treatments that result from medical errors; and studying the comparative effectiveness of treatments. "Congress is saying that public programs such as Medicare should be paying for quality," Zawistowich says, "and we need to be holding providers accountable for the services they're providing."

Some of these measures have already been demonstrated to reduce costs in smaller-scale tests, Zawistowich adds. And in the long run, she suggests, many of them are likely to be adopted by private insurers, further reducing the cost of health care.

Even if only the budget reconciliation bill passes this year, Tuten believes, Democrats will trumpet their accomplishments so far: expanding coverage for children, funding health information technology (through the stimulus package), reducing the number of uninsured, and reforming the delivery of health care under Medicare and Medicaid. "In any other context, that would have been an ambitious agenda and would certainly constitute significant progress. I do expect the Democrats will ultimately take half a loaf, declare victory and continue working," Tuten says.

THE GREAT EQUALIZER

Yet comprehensive insurance reform is likely to pass sooner or later, says Jennifer Bell, a senior policy advisor at Patton Boggs. A broad bipartisan consensus has emerged in support of consumer protection regulations, such as prohibiting higher premiums or denial based on health history, or the rescinding of health coverage. Other measures have also attracted a degree of bipartisan support, though as of now the details are uncertain.

Currently, it appears that many of these initiatives will have an equalizing impact on business. That is, companies that have paid the most for health care—or offered the most generous benefits—may see their costs decrease, while those that have paid the least will have to chip in more.

Here are a few of those measures, and some indications of their potential impact on business:

■ **INSURANCE MARKET REFORMS** Today's health insurance market discriminates heavily against individuals and small businesses. All the legislative proposals require states to create new marketplaces, or "exchanges," where buyers can compare prices and benefits, and all plans would be required to cover certain basic benefits. These exchanges would first be open to individuals and the smallest businesses, and then to larger businesses in subsequent years.

These reforms may have the biggest impact on businesses that offer no or very low-cost insurance, says John Jonas, a Patton Boggs partner who established the firm's health care practice. "For many [small] employers, exchanges will be a good thing, because insurance will be easier to buy and more standardized. The disadvantage is that even if there is no employer mandate, the pressure will increase on all businesses to provide health insurance. Assuming there is an individual mandate, employees are likely to go to their employer and say, 'Where is my insurance?' You'll no longer be able to hide behind the excuse that 'No one will sell it to me,' or 'It would be disproportionately expensive because I'm a small business.'"

The reforms aim to make coverage more affordable for small businesses by boosting their purchasing power and spurring competition among insurers. But these savings will be somewhat offset by the basic benefits requirements, which will effectively require businesses to buy more robust packages, Jonas says. For example, a current House proposal requires providing dental and vision plans for children under 21.

The effects of this standardization will vary depending on the composition of the company's workforce, Jonas notes. Companies with young and healthy workforces have benefited from the insurers' discriminatory rating system. They will likely see their costs increase as they are forced to pay prices closer to a national or regional average. By the same principle, companies with disproportionately older or sicker workforces will see their costs go down.

The small-business lobby, the National Federation on Independent Business, praised the Baucus proposal for taking "significant steps to reform the rules for [insurance] markets to help increase choice, competition and, ultimately, reduce costs."

■ **EMPLOYER CONTRIBUTIONS** As a consensus emerges among Democrats and centrist Republicans that individuals should be required to purchase insurance, proposals to require employers to provide coverage have receded. Instead, there is a broad agreement to require firms above a certain size that don't provide insurance to pay subsidies. Much of the concern by business has centered on how large an employer must be to be forced to pay, and the size of the subsidy. Here is an area where, as Bell says, "when you change the jots and tittles, it can have a huge impact on business."

Besides small businesses, the companies most concerned about employer contributions employ armies of lower-wage workers. For example, in the retail and other service industries, Jonas notes, many employees whose family members work in companies with richer benefits choose to be covered under the spouse's plan. And many of the lowest-wage employees are covered by public plans.

After insurance reform, these employers will be forced to cover, or pay subsidies for, those now on public plans. New regulations will effectively force these employers to upgrade the quality of the coverage they do offer. And that, Jonas says, will convince many of their employees to leave their spouse's family plan and take up their employer's plan. The bottom line: Service-industry employers will pay more, whether in subsidies or new coverage, while companies offering richer plans will pay less as dependents leave their rolls.

Given what's at stake, retail industry observers were surprised in June when Wal-Mart, America's largest retailer, wrote a letter to President Obama endorsing a federal employer mandate. Wal-Mart—which already covers most of its employees—argued that modest, broad-based coverage would help control health care inflation. At the same time, however, many retailers have taken a harder line. National Retail Federation Vice President Steve Pfister told a House Committee this July that any mandated contribution would amount to a "tax on jobs" during a time of recession. "We are a labor heavy industry that operates on a thin profit margin," Pfister said. "We cannot afford any new labor cost."

■ **NEW TAXES** Some legislative proposals would change the tax treatment of health insurance premiums, which are currently deductible for both employers and employees. The Baucus plan takes a different approach, but with a similar goal: It would levy an excise tax of 35 percent on so-called Cadillac plans costing above \$8,000 for singles and \$21,000 for family plans.

The initiative is meant to control costs as well as raise revenue, Tuten says, because Cadillac plans are thought to encourage health care consumers (and their providers) to overspend on care. Taxing premiums will encourage companies to ratchet back these plans—and to provide them with the political cover to do so. But critics of the levy note that because it is indexed to inflation—not to faster-moving health care costs—it will cover more plans each year. That has spurred the U.S. Chamber of Commerce to charge that it "may well spiral out of control."

As lawmakers search for other ways to pay for the reform, the health care industry is increasingly becoming a target. The Baucus bill calls for billions in annual fees to be levied on insurers, drug companies, device makers and labs. Politically, the health care industry is a more appealing whipping-boy than consumers or business as a whole, Bell notes. But moderate Democrats in particular may be loath to support taxes that likely will be passed on to consumers anyway, she adds.

■ **HEALTH IT** One of the most significant health reforms may have already been approved: the \$19 billion for health care information technology included as part of the stimulus plan earlier this year. To succeed, many of the payment and delivery reforms proposed in the reform legislation will require data to be shared and tracked electronically, Tuten says. Though they require a sizable initial investment, electronic health records are an essential tool to deliver better care at a lower cost.

HARRY AND LOUISE VOTE YES

Even with many details still up in the air, health care reform is attracting much wider support from business than it did under Bill Clinton. Case in point: Charles Kahn, the force behind the "Harry and Louise" industry ads that helped torpedo that last round of reform, is now a supporter of reform (minus the public option).

Kahn, now the president of the Federation of American Hospitals, says cost is still the major issue for business: "Overall, health reform can be good for Americans, but business's view depends in part on where you sit, whether you perceive this is going to increase your cost of doing business."

Still, even as influential players like Baucus have invited business to the table, business representatives like Tauzin have responded with significant concessions to ensure that the reform process moves forward. "I think businesses realize this is a shared problem," Tuten says. "It's not just the government's concern." **CT**

Stouchnings Toward Reform

It's been slower than expected, but a major overhaul of financial regulation is coming. And financial institutions are working hard to insert themselves into the debate.

BY PETER HAAPANIEMI

Last fall, as the stock market plummeted and the economy reeled, *Saturday Night Live* sought the advice of a “financial expert.” “They need to clamp it down and fix it,” the faux expert ranted. “When I wake up tomorrow morning, it better be fixed. Fix it! Fix it! Fix it!”

The comedian's words echoed the urgency being felt across the nation, and in Congress as well. Legislators quickly announced that the reform of financial industry regulations was a top priority. Hearings were held, a flurry of new regulations was suggested, and in June, the Obama administration weighed in with a proposed reform package addressing a range of issues. “If this crisis has taught us anything, it is that risk to our financial system can come from almost any quarter,” U.S. Treasury Secretary Timothy Geithner said at the time. “So we must be able to look in every corner and

across the horizon for dangers.” Reform was expected to come quickly—perhaps by the end of summer.

That original timetable proved to be far too optimistic, largely because health care reform turned out to be more time-consuming than anticipated. But the debate about how best to oversee the country's financial system has continued, and in the coming months it is likely to become louder and livelier.

“Congress is intent on moving forward with regulatory reform legislation,” says Todd Cranford, Of Counsel at Patton Boggs. “There is a lot of pressure to make sure that this kind of financial crisis does not happen again.” Indeed, in the wake of the last year's economic events, regulatory reform appears to a near certainty. Far less certain is the precise shape that reform will take. The debate is likely to involve a range of fundamental issues, from the size and role of government to the



financial competitiveness of the country. Ultimately, it is expected to change the rules for the entire financial services industry.

RISKY SYSTEMS

Throughout 2009, financial regulatory reform has moved forward on several fronts, with agencies, congressional committees and lawmakers weighing in with ideas. The hope among the administration and congressional leaders is to bring these threads together into a comprehensive package. “It seems clear that this reform will be broad in scope,” says Vincent Frillici, senior policy advisor at Patton Boggs. “We’re talking about closing gaps in a regulatory structure that was created 70 years ago after the Great Depression, and updating that structure to reflect the modern financial system.”

For Congress, a fundamental issue is strengthening the ability to manage systemic risk. By and large, regulation has been handled in a fragmented fashion, with each agency focusing on its specific area of responsibility. During the credit crisis, no regulatory authority had a big-picture perspective, which meant that no one really knew how bad things were getting until it was nearly too late. Thus, says Micah Green, a partner at Patton Boggs, “Congress wants to make sure that regulators have all the information they need to identify where the risks are in a timely way, so that they can be on top of it and do whatever is necessary to manage those risks.”

Proposed changes include improved information-sharing across agencies, consolidation of some agencies’ responsibilities and the creation of some kind of entity to manage systemic risk and improve interagency cooperation. That new entity could take the form of a new agency, a council of existing regulators or an existing regulator with expanded powers. The administration hopes to see the Federal Reserve Bank take on the risk-manager role. It has proposed giving the Fed new authority to supervise all firms that could pose a threat to financial stability, even those that do not own banks. But that view is hardly unanimous. “The politics around the Fed right now make that difficult,” says Frillici.

Politicians on both sides of the aisle—including Senate Banking Committee Chairman Christopher Dodd and his Republican counterpart, Richard Shelby—have expressed doubts about the Fed’s ability to take on new responsibilities. Others have pointed to the Fed’s failure to stay on top of large, complex banking organizations in the period leading up to the economic crisis. Yet others see a strengthened Fed as a distasteful expansion of government. Meanwhile, the SEC and FDIC—which would presumably lose some responsibilities to a more powerful Fed—have opposed the

plan, instead suggesting the establishment of a strong oversight council made up of regulatory agency heads.

The Fed’s role in systemic risk oversight has become one of the more controversial points in financial regulatory reform. One possible outcome, says Green: The Fed takes on the oversight role, backed by a council of regulators with advisory powers.

REGULATORS’ LONG ARM

The Obama administration seeks to extend regulatory supervision to “all systematically important institutions, markets and products.” Congress will likely comply, bringing regulatory oversight to more financial products and financial industry players.

One target will be derivatives, which have essentially escaped regulation until now. Various proposals, including the administration’s reform plan, seek to bring products such as credit default swaps and over-the-counter derivatives under the regulatory umbrella. There is fairly broad support for such a move. “For many members of Congress, reform is about fixing the credit default swap problem,” says Frillici. “The prevailing view among many on Capitol Hill is that credit default swaps equals AIG, which equals financial crisis, so they feel strongly that they need to reform the use of derivatives, particularly credit default swaps.”

Congress is likely to require standardized derivatives—relatively simple, widely used instruments—to be traded through a regulated exchange, while complex, customized derivatives will still be traded privately. However, the administration hopes to expand the definition of standardized derivatives and institute capital and margin requirements that will make customized derivatives less attractive, with the goal of moving more derivatives to the exchange model. Much of the discussion will hinge on determining which derivatives qualify as standardized and which are considered customized.

Frillici says that instead of trying to reengineer regulatory oversight of such vehicles, Congress may leave the current regulatory responsibilities in place. “Rather than create more turf battles between regulators, they may say that if you create a derivative and are regulated by the [U.S. Commodity Futures Trading Commission], the CFTC will regulate that derivative, and if the derivative is based on securities, it will come under your regulator,” he says.

A wider regulatory net will also include some previously unregulated institutions such as hedge funds and private equity funds. The administration has proposed requiring SEC registration of all advisors to large hedge funds and other private capital pools. Funds would also have to disclose details about assets under manage-



“If this crisis has taught us anything, it’s that the risk to our financial system can come from almost any quarter. So we must be able to look in every corner and across the horizon for dangers.”

—U.S. Treasury Secretary Timothy Geithner

The Growing Challenge of Compliance

Long before the financial crisis, many observers were calling for the simplification of the regulatory structure that oversees financial institutions. But simplification is probably not on the agenda for this round of reform.

For example, proposals call for new powers for some agencies, the creation of a new Consumer Financial Protection Agency (CFPA), and broader regulations. In many cases, federal rules serve as a “floor,” meaning that individual states can adopt their own stricter laws in those areas. And it remains largely unclear how state and federal regulation will be coordinated.

With the various initiatives that followed the financial crisis, companies

are already seeing increased complexity. For example, Mark Dawson, executive vice president for First United Bank in Oklahoma, points to the new home-appraisal rules that were issued in March, only to be challenged by a proposed congressional moratorium a few months later. “That kind of constant change is very difficult for businesses to manage through,” he says. “The process is happening at such a rapid pace in some areas that we are seeing things that are well-intentioned but have a high potential for unintended consequences.”

With this increasingly complex landscape, “a financial services company will have the possibility of

being audited by a multitude of regulators,” says Patton Boggs partner John Socknat. “The FTC might come in, and then the state attorney general and the state banking department, and soon, the CFPA. So reform is absolutely making compliance more difficult.”

That ultimately translates to increased expense. Audits cost money, as do the numerous adjustments to computer systems and business processes that changing regulations require. And that could lead to yet another unintended consequence, says Dawson: “Shareholders still demand a return, so those business costs will eventually have to be passed on to the consumer.” —P.H.

ment, use of leverage, and trading and investment positions. The SEC would examine funds to monitor compliance and assess risk.

In past years, private equity firms had eluded congressional attempts at regulation. But the financial crisis has changed the political landscape. As Michigan Senator Carl Levin said recently: “If the events of the last year have taught us anything, it’s that we need to regulate firms that are big enough to destabilize our economy if they fail. It’s time to subject financial heavyweights like hedge funds to federal regulation and oversight to protect our investors, markets and financial system.”

CATERING TO CONSUMERS

As the financial crisis unfolded, consumers were hit hard and bankruptcies and home foreclosures dominated the news. As a result, says Green, many officials have concluded that the government needs to do more to keep individuals out of financial trouble.

“The feeling is that while there is a ‘moral hazard’ of the federal government assisting people who potentially borrowed more than they should have,” he says, “keeping people in their homes and protecting the value of other homes in impacted neighborhoods remains a high priority for the administration and Congress.”

This view has led to new regulations governing the credit card and mortgage industries. The administration, however, decided that something more comprehensive was needed, and proposed the creation of a new federal agency. The Consumer Financial Protection Agency would formulate and enforce consumer protection regulations and oversee financial products and services not currently regulated by the SEC or the CFTC.

The CFPA garnered widespread support upon its introduction. But, as the financial markets have recovered and the opposition has had time to bolster its case, it has become more controversial. Some critics oppose adding a new agency to the array of regulatory organizations already in place, while others feel the agency’s proposed powers are too broad. More fundamentally, some question the wisdom of creating an agency with the relatively narrow mission of protecting consumers from fraud without considering the impact on business and ultimately, the potentially higher costs of credit that are liable to circle back to consumers.

These concerns are likely to be overshadowed by political reali-

ties. “When you talk about derivatives and margin requirements, the average person on Main Street doesn’t really care,” says Green. “But setting up an agency to protect people from what they see as ‘scoundrels’ has a lot of appeal. It will be perceived as something that will be understandable and tangible by voters. So even though it’s controversial, Congress—with an eye to next year’s elections—will probably create an entity of some form that has the authority to act to protect consumers against financial abuse.”

FAIR HEARINGS

When the dust settles and financial reform is passed, “it will definitely be a landmark piece of legislation,” says Green. “But that’s not to say that it will be all over when President Obama takes a pen to this bill in the White House.”

Indeed, the passage of legislation will be just the beginning of a lengthy rule-making process. Once Congress passes new laws, it will be up to government agencies to create rules and regulations that put the legislation into action. In this process, agencies propose rules and affected parties have an opportunity to provide written comments and, often, meet with agency staff to provide input. Typically, after several months of this review period, the agencies adopt and publish final rules, often delaying implementation to give businesses time to comply. Even then, companies can take the agency to court if they feel that a regulation is onerous.

Overall, the process provides numerous opportunities for affected parties to have input into the final rules. And with the controversial and complicated nature of regulatory reform, it is likely to take a considerable amount of time.

“There will be many years of agencies interpreting the legislation, promulgating rules pursuant to the legislation, and then implementing new rules,” says Cranford. He adds that businesses affected by reform should consider getting involved in that process, where they are likely to get a fair hearing. “The reality is that the agencies, Congress and the administration are generally sensitive to the competitive forces that are necessary in a capitalist system. They don’t want to take away that drive to take risks, to excel and to innovate that make our markets so successful,” he says. “They don’t want to make it harder to do business—they just want to make it harder to do bad business.” CT

Q & A

BILLY TAUZIN

**PRESIDENT & CEO
PHARMACEUTICAL RESEARCH AND
MANUFACTURERS OF AMERICA (PhRMA)**

“We can work with any administration...”

While much of the health care industry continues to lobby feverishly on health care reform, drugmakers have made their peace. The Pharmaceutical Research and Manufacturers of America (PhRMA) voiced support early, after pledging to help reduce the nation’s drug costs by up to \$80 billion over the next decade. Billy Tauzin, the former Republican House member from Louisiana who now leads PhRMA, talked to *Capital Thinking* about the group’s stance on reform.

most of the health care players over the last few months. He wanted to determine willingness to absorb some of the cost of reform. So obviously we accepted this invitation. And we wanted to be assured at the end of it that it also had the blessing of the White House, because the House was likely to do something very different, and it would be very important to have both the support of the Senate committee and the White House. We agreed to a very large sum. You’ve heard all this noise about a “sweetheart deal.” It was not. This was a very difficult decision for the companies. Eighty billion is nearly two years of research in America.

“We thought it was important to get to the table early so that we could not only help frame the debate, but also achieve a good outcome.”

HOW DOES YOUR SUPPORT OF REFORM REFLECT PhRMA’S STRATEGY TO DATE?

We collectively decided that if reform was done with our principles in mind—in a way that provided good insurance to more people, that helped people not only get their medicines but take them properly, that respected the private sector and enhanced the opportunity for doctors and patients to make the right decisions ... that we ought to support progress toward a good bill. We thought it was important to get to the table early so that we could not only help frame the debate, but also achieve a good outcome.

WHY DID YOU DECIDE TO WORK WITH SENATOR BAUCUS?

I’ve worked with Senator Baucus as a member of Congress. He’s extraordinarily objective, fair and open-minded. And he’s an extremely hard worker who reaches out to others whom he doesn’t always agree with. That’s a skill set that I think is extraordinarily important now.

YOU WERE IN CONGRESS WHEN BILL CLINTON’S REFORM EFFORTS FAILED. WHAT WAS DIFFERENT BACK THEN?

In 1994, this plan was constructed outside of public view. Congress was asked to take it or leave it, and we decided to leave it...this year, many of us have been invited to the debate, including the great American public at town hall meetings across the country. It’s gotten pretty nasty, but this is the American democratic process, and it generally yields a better result than a group of people sitting in the room making decisions for the rest of us.

IF REFORM MEANS MORE AMERICANS ARE INSURED AND HAVE ACCESS TO MEDICATION, THEN ISN’T THIS A CASE OF ENLIGHTENED SELF-INTEREST?

Keep in mind that people without insurance pay full price. When they get insurance, it will be at a discount through their insurer, so it’s not necessary a big windfall. What we see as a great benefit is the health of our patients. We hear that as many as half of all patients don’t get their prescriptions filled due to lack of insurance, or because the co-pay is too high. More people with chronic diseases are not managing their disease, so they’re becoming more expensive patients, and they’re going to suffer more. If we can get more attention paid to chronic disease, and patients insured in a way they’re more likely to take their medicine, then that would be a big win.

CAN YOU GIVE US SOME INSIGHT INTO THE GENESIS OF YOUR DEAL WITH THE ADMINISTRATION?

First of all, we didn’t negotiate with the administration. We negotiated with Senator Baucus at his request, and Senator Baucus has negotiated with

DO YOU HAVE ANY ADVICE FOR OTHER INDUSTRIES SEEKING TO BE HEARD IN WASHINGTON?

Since I’ve come to PhRMA, we have tried to become a nonpartisan organization. We’ve literally balanced our staff and our activities in a way that we can work with any administration that the American people select. **CT**

