BOSTON SCIENTIFIC CORP
Form 10-Q
November 08, 2011
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2011
OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)OF THE SECURITIES EXCHANGE ACT OF 1934

Commission File No. 1-11083
BOSTON SCIENTIFIC CORPORATION
(Exact name of registrant as specified in its charter)

DELAWARE	04-2695240
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

ONE BOSTON SCIENTIFIC PLACE, NATICK, MASSACHUSETTS 01760-1537
(Address of principal executive offices) (zip code)
(508) 650-8000
(Registrant's telephone number)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).Yes þ No o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer þ	Accelerated filer o	Non-Accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ
Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Shares outstanding as of October 31, 2011
Common Stock, $.01 par value	1,481,505,741

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PART I
FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

BOSTON SCIENTIFIC CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

	Three Months Ended September 30,		Nine Months Ended September 30,	
in millions, except per share data	2011	2010	2011	2010
Net sales	$1,874	$1,916	$5,774	$5,804
Cost of products sold	680	623	1,999	1,939
Gross profit	1,194	1,293	3,775	3,865
Operating expenses:				
Selling, general and administrative expenses	629	634	1,866	1,897
Research and development expenses	229	230	665	714
Royalty expense	36	39	140	147
Amortization expense	97	129	325	381
Goodwill impairment charges			697	1,817
Intangible asset impairment charges	9	5	21	65
Contingent consideration expense	6		18	
Acquisition-related milestone				(250)
Restructuring charges	22	5	77	98
Gain on divestiture	(8)		(768)	
	1,020	1,042	3,041	4,869
Operating income (loss)	174	251	734	(1,004)
Other income (expense):				
Interest expense	(62)	(91)	(210)	(286)
Other, net	(1)	3	18	(2)
Income (loss) before income taxes	111	163	542	(1,292)
Income tax (benefit) expense	(31)	(27)	208	9
Net income (loss)	$142	$190	$334	$(1,301)
Net income (loss) per common share — basic	$0.09	$0.13	$0.22	$(0.86)
Net income (loss) per common share — assuming dilution	$0.09	$0.12	$0.22	$(0.86)
Weighted-average shares outstanding				
Basic	1,514.4	1,519.8	1,523.1	1,517.0
Assuming dilution	1,524.0	1,529.3	1,532.0	1,517.0

See notes to the unaudited condensed consolidated financial statements.

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BOSTON SCIENTIFIC CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

in millions, except share and per share data	As of September 30, 2011 (Unaudited)	December 31, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	$276	$213
Trade accounts receivable, net	1,237	1,320
Inventories	972	894
Deferred income taxes	409	429
Assets held for sale	5	576
Prepaid expenses and other current assets	314	183
Total current assets	3,213	3,615
Property, plant and equipment, net	1,684	1,697
Goodwill	9,769	10,186
Other intangible assets, net	6,564	6,343
Other long-term assets	272	287
	$21,502	$22,128
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current debt obligations	$4	$504
Accounts payable	256	184
Accrued expenses	1,296	1,626
Other current liabilities	331	295
Total current liabilities	1,887	2,609
Long-term debt	4,259	4,934
Deferred income taxes	1,854	1,644
Other long-term liabilities	1,981	1,645
Commitments and contingencies		
Stockholders' equity		
Preferred stock, $.01 par value - authorized 50,000,000 shares, none issued and outstanding		
Common stock, $.01 par value - authorized 2,000,000,000 shares; issued 1,531,013,482 shares as of September 30, 2011 and 1,520,780,112 shares as of December 31, 2010	15	15
Treasury stock, at cost - 30,000,000 shares as of September 30, 2011	(192)	
Additional paid-in capital	16,318	16,232
Accumulated deficit	(4,488)	(4,822)
Accumulated other comprehensive loss, net of tax	(132)	(129)
Total stockholders' equity	11,521	11,296
	$21,502	$22,128

See notes to the unaudited condensed consolidated financial statements.

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BOSTON SCIENTIFIC CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

in millions	Nine Months Ended September 30, 2011	2010
Cash provided by (used for) operating activities	$659	$(124)
Investing activities:		
Purchases of property, plant and equipment, net of proceeds	(221)	(209)
Proceeds from sales of publicly traded and privately held equity securities and collections of notes receivable	2	1
Payments for acquisitions of businesses, net of cash acquired	(370)	
Payments relating to prior-period acquisitions		(4)
Payments for investments in companies and acquisitions of certain technologies	(10)	(5)
Proceeds from business divestitures, net of costs	1,426	
Cash provided by (used for) investing activities	827	(217)
Financing activities:		
Proceeds from long-term borrowings, net of debt issuance costs		973
Payments on long-term borrowings	(1,250)	(900)
Proceeds from borrowings on credit facilities	425	200
Payments on borrowings from credit facilities	(425)	(200)
Payments for acquisitions of treasury stock	(192)	
Proceeds from issuances of shares of common stock	22	28
Cash (used for) provided by financing activities	(1,420)	101
Effect of foreign exchange rates on cash	(3)	
Net increase (decrease) in cash and cash equivalents	63	(240)
Cash and cash equivalents at beginning of period	213	864
Cash and cash equivalents at end of period	$276	$624
Supplemental Information		
Non-cash operating activities:		
Stock-based compensation expense	$96	$122

See notes to the unaudited condensed consolidated financial statements.

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NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE A – BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements of Boston Scientific Corporation have been prepared in accordance with accounting principles generally accepted in the United States (U.S. GAAP) and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) considered necessary for fair presentation have been included. Operating results for the three and nine months ended September 30, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011. For further information, refer to the consolidated financial statements and footnotes thereto included in Item 8 of our 2010 Annual Report filed on Form 10-K.

We have reclassified certain prior year amounts to conform to the current year's presentation. See Note M – Segment Reporting for further details.

Subsequent Events

We evaluate events occurring after the date of our most recent accompanying unaudited condensed consolidated balance sheets for potential recognition or disclosure in our financial statements. We did not identify any material subsequent events requiring adjustment to our accompanying unaudited condensed consolidated financial statements (recognized subsequent events) for the three and nine month periods ended September 30, 2011. Those items requiring disclosure (unrecognized subsequent events) in the financial statements have been disclosed accordingly. Refer to Note K - Commitments and Contingencies for more information.

NOTE B – ACQUISITIONS

During the first quarter of 2011, we completed several acquisitions as part of our priority growth initiatives, targeting the areas of structural heart therapy, deep-brain stimulation, peripheral vascular disease, and atrial fibrillation. Our consolidated financial statements include the operating results for each acquired entity from its respective date of acquisition. We do not present pro forma financial information for these acquisitions given their results are not material to our consolidated financial statements.

Sadra Medical, Inc.

On January 4, 2011, we completed the acquisition of the remaining fully diluted equity of Sadra Medical, Inc. Prior to the acquisition, we held a 14 percent equity ownership in Sadra. Sadra is developing a fully repositionable and retrievable device for percutaneous aortic valve replacement to treat patients with severe aortic stenosis. The acquisition was intended to broaden and diversify our product portfolio by expanding into the structural heart market. We are integrating the operations of the Sadra business into our Interventional Cardiology division. We paid $193 million, net of cash acquired, at the closing of the transaction using cash on hand to acquire the remaining 86 percent of Sadra, and may be required to pay future consideration up to $193 million through 2016 that is contingent upon the achievement of certain regulatory- and revenue-based milestones.

Intelect Medical, Inc.

On January 5, 2011, we completed the acquisition of the remaining fully diluted equity of Intelect Medical, Inc. Prior to the acquisition, we held a 15 percent equity ownership in Intelect. Intelect is developing advanced visualization and programming technology for deep-brain stimulation. We have integrated the operations of the Intelect business into our Neuromodulation division. The acquisition was intended to leverage the core architecture of our Vercise™ platform and advance our technology in the field of deep-brain stimulation. We paid $60 million at the closing of the transaction using cash on hand to acquire the remaining 85 percent of Intelect. There is no contingent consideration related to the Intelect acquisition.

ReVascular Therapeutics, Inc.

On February 15, 2011, we completed the acquisition of 100 percent of the fully diluted equity of ReVascular Therapeutics, Inc. (RVT). RVT has developed an intraluminal chronic total occlusion crossing device enabling endovascular treatment in cases that typically cannot be treated with standard endovascular devices. This acquisition

complements our portfolio of devices for lower extremity peripheral artery disease and we have integrated the operations of RVT into our Peripheral Interventions business. We paid $19 million at the closing of the transaction and may be required to pay future consideration up to $16 million through 2014 that is contingent upon the achievement of certain regulatory- and commercialization-based milestones and revenue.

Atritech, Inc.

On March 3, 2011, we completed the acquisition of 100 percent of the fully diluted equity of Atritech, Inc. Atritech has developed

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a device designed to close the left atrial appendage of the heart. The WATCHMAN® Left Atrial Appendage Closure Technology, developed by Atritech, is the first device proven to offer an alternative to anticoagulant drugs for patients with atrial fibrillation and at high risk for stroke. The acquisition was intended to broaden our portfolio of less-invasive devices for cardiovascular care by expanding into the areas of atrial fibrillation and structural heart therapy. We are integrating the operations of the Atritech business into our existing business, leveraging expertise from both our Electrophysiology and Interventional Cardiology divisions in the commercialization of the WATCHMAN® device. We paid $98 million, net of cash acquired, at the closing of the transaction and may be required to pay future consideration up to $275 million through 2015 that is contingent upon achievement of certain regulatory-based milestones and revenue.

Purchase Price Allocation

The components of the aggregate preliminary purchase price as of the acquisition date for acquisitions consummated in the first quarter and first nine months of 2011 are as follows (in millions):

Cash, net of cash acquired	$370
Fair value of contingent consideration	287
Prior investments	55
	$712

As of the respective acquisition dates, we recorded total contingent consideration liabilities of $287 million, representing the estimated fair value of the contingent consideration we expected to pay to the former shareholders of the acquired companies based upon the achievement of certain regulatory- and commercialization-related milestones and revenue. The fair value of the contingent consideration liabilities was estimated by discounting, to present value, contingent payments expected to be made. In certain circumstances, we utilized a probability-weighted approach to determine the fair value of contingent consideration related to the expected achievement of milestones. We used risk-adjusted discount rates ranging from two to 20 percent to derive the fair value of the expected obligations, which we believe are appropriate and representative of market participant assumptions.

Prior to our acquisition of the remaining equity ownership in Sadra and Intelect, we held equity interests in these companies of 14 and 15 percent, respectively, carried at an aggregate value of $11 million, and a note receivable carried at a value of $6 million. As a result of re-measuring these investments to fair value, estimated at $55 million as of the respective acquisition dates, we recorded a gain of $38 million in other, net in the accompanying unaudited condensed consolidated statements of operations during the first quarter of 2011.

We accounted for these acquisitions as business combinations and, in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification™ (ASC) Topic 805, Business Combinations, we have recorded the assets acquired and liabilities assumed at their respective fair values as of the acquisition date. The following summarizes the aggregate preliminary purchase price allocation as of September 30, 2011 (in millions):

Goodwill	$271
Amortizable intangible assets	97
Indefinite-lived intangible assets	468
Deferred income taxes	(124)
	$712

Transaction costs associated with these acquisitions were expensed as incurred through selling, general and administrative costs in the accompanying unaudited condensed consolidated statements of operations and were not material for the three and nine months ended September 30, 2011.

We allocated the aggregate preliminary purchase price to specific intangible asset categories as of September 30, 2011 as follows:

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	Amount Assigned (in millions)	Weighted Average Amortization Period (in years)	Range of Risk-Adjusted Discount Rates used in Purchase Price Allocation
Amortizable intangible assets			
Technology - core	$77	7.0	22.6 %
Technology - developed	20	9.0	25.0 %
	97	7.4	
Indefinite-lived intangible assets			
Purchased research and development	468		23.6% - 30.0%
	$565		

Core technology consists of technical processes, intellectual property, and institutional understanding with respect to products and processes that we will leverage in future products or processes and will carry forward from one product generation to the next. Developed technology represents the value associated with marketed products that have received regulatory approval. The amortizable intangible assets are being amortized on a straight-line basis over their assigned estimated useful lives.

Purchased research and development represents the estimated fair value of acquired in-process research and development projects which have not yet reached technological feasibility. These indefinite-lived intangible assets will be tested for impairment on an annual basis, or more frequently if impairment indicators are present, in accordance with U.S. GAAP and our accounting policies described in our 2010 Annual Report filed on Form 10-K, and amortization of the purchased research and development will begin upon completion of the related projects. During the second quarter of 2011, as a result of changes in the timing and amount of the expected cash flows related to certain acquired in-process research and development projects, we tested the related intangible assets for impairment and recorded a $12 million intangible asset impairment charge in the accompanying unaudited condensed consolidated statements of operations. We performed our annual impairment testing during the third quarter of 2011 and did not identify any in-process research and development assets whose carrying values exceeded their fair values. We estimate that the total cost to complete the in-process research and development programs acquired in the first quarter of 2011 is between $150 million and $200 million and expect material net cash inflows from the products in development to commence in 2014-2016, following the respective launches of these technologies in the U.S. and our Europe/Middle East/Africa (EMEA) region.

We believe that the estimated intangible asset values represent the fair value at the date of each acquisition and do not exceed the amount a third party would pay for the assets. We used the income approach, specifically the discounted cash flow method and excess earnings method, to derive the fair value of the amortizable intangible assets and purchased research and development. These fair value measurements are based on significant unobservable inputs, including management estimates and assumptions and, accordingly, are classified as Level 3 within the fair value hierarchy prescribed by ASC Topic 820, Fair Value Measurements and Disclosures.

We recorded the excess of the aggregate preliminary purchase price over the estimated fair values of the identifiable assets acquired as goodwill, which is non-deductible for tax purposes. Goodwill was established due primarily to revenue and cash flow projections associated with future technologies, as well as synergies expected to be gained from the integration of these businesses into our existing operations, and has been allocated to our reportable segments based on the relative expected benefit from the business combinations, as follows (in millions):

U.S.	$158
EMEA	105
Inter-Continental	7
Japan	1
	$271

Contingent Payments Related to Prior-Period Acquisitions

Certain of our acquisitions involve contingent consideration arrangements. Payment of additional consideration is generally contingent on the acquired company reaching certain performance milestones, including attaining specified revenue levels, achieving product development targets or obtaining regulatory approvals. We did not make any payments related to prior-period

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acquisitions during the first nine months of 2011, and made payments of $4 million during the first nine months of 2010. As of September 30, 2011, the estimated maximum potential amount of future contingent consideration (undiscounted) that we could be required to make associated with acquisitions consummated prior to 2009 is approximately $260 million. In accordance with accounting guidance applicable at the time we completed those acquisitions, we do not recognize a liability until the contingency is resolved and consideration is issued or becomes issuable. Topic 805 requires the recognition of a liability equal to the expected fair value of future contingent payments at the acquisition date for all acquisitions consummated after January 1, 2009. For those acquisitions completed after 2008, we recorded contingent liabilities representing the estimated fair value of the contingent consideration we expected to pay to the former shareholders of the acquired companies as of the respective acquisition dates. We re-measure these liabilities each reporting period, and report changes in the fair value through a separate line item within our consolidated statements of operations. Increases or decreases in the fair value of the contingent consideration liability can result from accretion of the liability due to the passage of time; changes in the timing and amount of revenue estimates; changes in the expected probability and timing of achieving regulatory or commercialization milestones; changes in discount rates; or payments.

In connection with our first quarter 2011 business combinations, we recorded liabilities of $287 million during the first quarter of 2011, representing the estimated fair value of contingent payments expected to be made at the respective acquisition dates, and recorded expense of $3 million in the third quarter of 2011 and $12 million during the first nine months of 2011 representing the increase in the fair value of these obligations between the respective acquisition dates and September 30, 2011. In addition, related to our 2010 business combinations, we recorded net contingent consideration expense of $3 million in the third quarter of 2011 and $6 million for the nine months ended September 30, 2011, representing the increase in fair value of contingent obligations. The maximum amount of future contingent consideration (undiscounted) that we could be required to make associated with acquisitions completed after 2008 is approximately $760 million. Included in the accompanying unaudited condensed consolidated balance sheets is accrued contingent consideration of $376 million as of September 30, 2011 and $71 million as of December 31, 2010.

Acquisition-related Milestone

In connection with Abbott Laboratories' 2006 acquisition of Guidant Corporation's vascular intervention and endovascular solutions businesses, Abbott agreed to pay us a milestone payment of $250 million upon receipt of an approval from the Japanese Ministry of Health, Labor and Welfare (MHLW) to market the XIENCE V® stent system in Japan. The MHLW approved the XIENCE V® stent system and we received the milestone payment from Abbott in the first quarter of 2010, which was recorded as a gain in the accompanying unaudited condensed consolidated statements of operations.

NOTE C – DIVESTITURES AND ASSETS HELD FOR SALE

In January 2011, we closed the sale of our Neurovascular business to Stryker Corporation for a purchase price of $1.5 billion in cash. We received $1.450 billion at closing, including upfront payments of $1.426 billion, and $24 million which was placed into escrow to be released upon the completion of local closings in certain foreign jurisdictions, of which we had received approximately $10 million as of September 30, 2011. We will also receive an additional $50 million contingent upon the transfer or separation of certain manufacturing facilities, which we expect will be completed over the next 24 months. We are providing transitional services to Stryker through transition services agreements, and will also supply products to Stryker through supply agreements. These transition services and supply agreements are expected to be effective for a period of approximately 24 months from the date of divestiture, subject to extension. Due to our continuing involvement in the operations of the Neurovascular business, the divestiture does not meet the criteria for presentation as a discontinued operation. We acquired the Neurovascular business in 1997 with our acquisition of Target Therapeutics. The 2010 revenues generated by the Neurovascular business were $340 million, or approximately four percent of our 2010 consolidated net sales. We continue to generate net sales pursuant to our supply and distribution agreements with Stryker; however, these net sales are at significantly lower levels and at reduced gross profit margins as compared to periods prior to the divestiture.

In accordance with ASC Topic 360-10-45, Impairment or Disposal of Long Lived Assets, we have presented separately the assets of the Neurovascular business transferred to Stryker at the closing of the transaction as ‘assets held for sale’ in the accompanying unaudited condensed consolidated balance sheets for both periods presented. Pursuant to the divestiture agreement, Stryker did not assume any liabilities recorded as of the closing date associated with the Neurovascular business. The assets held for sale included in the accompanying unaudited condensed consolidated balance sheets attributable to the divestiture consist of the following:

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(in millions)	As of September 30, 2011	December 31, 2010
Inventories	$2	$30
Property, plant and equipment, net		4
Goodwill		478
Other intangible assets, net		59
	$2	$571

We also classified as ‘assets held for sale’ certain property, plant and equipment unrelated to the Neurovascular business that we intend to sell within the next twelve months having a net book value of $3 million as of September 30, 2011 and $5 million as of December 31, 2010.

As of September 30, 2011, the assets classified as ‘assets held for sale’ related to the Neurovascular divestiture represent inventories that will transfer to Stryker upon the completion of local closings in certain foreign jurisdictions. We recorded a pre-tax gain of $760 million ($530 million after-tax) during the first quarter of 2011 associated with the closing of the transaction. We also deferred a gain of $27 million in the accompanying unaudited condensed consolidated balance sheets to be recognized upon the release of escrowed funds and the performance of certain activities under the transition services agreements. During the third quarter of 2011, we recognized $8 million of this deferred gain and expect to recognize the remaining $19 million throughout 2011 and 2012.

NOTE D – GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill Impairment Charges

2011 Charge

We test our April 1 goodwill balances during the second quarter of each year for impairment, or more frequently if indicators are present or changes in circumstances suggest that impairment may exist. Based on market information that became available to us toward the end of the first quarter of 2011, we concluded that there was a reduction in the estimated size of the U.S. implantable cardioverter defibrillator (ICD) market, which led to lower projected U.S. Cardiac Rhythm Management (CRM) results compared to prior forecasts and created an indication of potential impairment of the goodwill balance attributable to our U.S. CRM business unit. Therefore, we performed an interim impairment test in accordance with U.S. GAAP and our accounting policies and recorded a non-deductible goodwill impairment charge of $697 million, on both a pre-tax and after-tax basis, associated with this business unit during the first quarter of 2011.

We used the income approach, specifically the discounted cash flow (DCF) method, to derive the fair value of the U.S. CRM reporting unit, as described in our accounting policies in our 2010 Annual Report filed on Form 10-K. We updated all aspects of the DCF model associated with the U.S. CRM business, including the amount and timing of future expected cash flows, terminal value growth rate and the appropriate market-participant risk-adjusted weighted average cost of capital (WACC) to apply.

As a result of physician reaction to study results published by the Journal of the American Medical Association regarding evidence-based guidelines for ICD implants and U.S. Department of Justice (DOJ) investigations into hospitals’ ICD implant practices and the expansion of Medicare recovery audits, among other factors, we estimated the U.S. CRM market would experience negative growth rates in the mid-single digits in 2011, as compared to 2010. Due to these estimated near-term market reductions, as well as the economic impact of physician alignment to hospitals, recent demographic information released by the American Heart Association indicating a lower prevalence of heart failure, and increased competitive and other pricing pressures, we lowered our estimated average U.S. CRM net sales growth rates within our 15-year DCF model from the mid-single digits to the low-single digits. Partially offsetting these factors are increased levels of profitability as a result of cost-reduction initiatives and process efficiencies within the U.S. CRM business, including those associated with our 2011 Restructuring plan, described in Note G - Restructuring-related Activities. The impact of the reduction in the size of the U.S. ICD market, and the related reduction in our forecasted 2011 U.S. CRM net sales, as well as the change in our expected sales growth rates

thereafter as a result of the trends noted above were the key factors contributing to the first quarter 2011 goodwill impairment charge.

In the second quarter of 2011, we performed our annual goodwill impairment test for all of our reporting units. In conjunction with our annual test, the fair value of each reporting unit exceeded its carrying value, with the exception of our U.S. CRM reporting unit. Based on the remaining book value of our U.S. CRM reporting unit following the goodwill impairment charge recorded during the first quarter of 2011, the carrying value of our U.S. CRM reporting unit exceeded its fair value, due primarily to the value of amortizable intangible assets allocated to this reporting unit. The remaining book value of our U.S. CRM amortizable

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intangible assets was approximately $3.3 billion as of September 30, 2011. In accordance with ASC Topic 350, Intangibles – Goodwill and Other and our accounting policies, we tested our U.S. CRM amortizable intangible assets for impairment on an undiscounted cash flow basis as of March 31, 2011, in conjunction with the goodwill impairment charge, and determined that these assets were not impaired. The assumptions used in our annual goodwill impairment test performed during the second quarter of 2011 related to our U.S. CRM reporting unit were substantially consistent with those used in our first quarter interim impairment test; therefore, it was not deemed necessary to proceed to the second step of the impairment test.

We continue to identify four reporting units with a material amount of goodwill that are at higher risk of potential failure of the first step of the impairment test in future reporting periods. These reporting units include our U.S. CRM reporting unit, which holds $782 million of allocated goodwill; our U.S. Cardiovascular reporting unit, which holds $2.3 billion of allocated goodwill; our U.S. Neuromodulation reporting unit, which holds $1.3 billion of allocated goodwill; and our EMEA region, which holds $4.0 billion of allocated goodwill, each as of September 30, 2011. As of the most recent assessment, the level of excess fair value over carrying value for these reporting units identified as being at higher risk (with the exception of the U.S. CRM reporting unit, whose carrying value continues to exceed its fair value) ranged from approximately eight percent to 15 percent. On a quarterly basis, we monitor the key drivers of fair value for these reporting units to detect events or other changes that would warrant an interim impairment test. The key variables that drive the cash flows of our reporting units are estimated revenue growth rates, levels of profitability and terminal value growth rate assumptions, as well as the WACC rate applied. These assumptions are subject to uncertainty, including our ability to grow revenue and improve profitability levels. For each of these reporting units, relatively small declines in the future performance and cash flows of the reporting unit or small changes in other key assumptions may result in the recognition of significant goodwill impairment charges. For example, keeping all other variables constant, a 50 basis point increase in the WACC applied to the reporting units, excluding acquisitions, would require that we perform the second step of the goodwill impairment test for our U.S. CRM reporting unit, and a 100 basis point increase would require that we perform the second step of the goodwill impairment test for our U.S. Neuromodulation, U.S. Cardiovascular and EMEA reporting units. In addition, keeping all other variables constant, a 100 basis point decrease in perpetual growth rates would require that we perform the second step of the goodwill impairment test for our U.S. CRM reporting unit, and a 200 basis point decrease in perpetual growth rates would require that we perform the second step of the goodwill impairment test for our U.S. Neuromodulation and EMEA reporting units. The estimates used for our future cash flows and discount rates represent management's best estimates, which we believe to be reasonable, but future declines in the business performance of our reporting units may impair the recoverability of our goodwill balance. Future events that could have a negative impact on the fair value of the reporting units include, but are not limited to:

- decreases in estimated market sizes or market growth rates due to greater-than-expected declines in procedural volumes, pricing pressures, product actions, product sales mix, disruptive technology developments, government cost containment initiatives and healthcare reforms, and/or other economic or regulatory conditions;
- declines in our market share and penetration assumptions due to increased competition, an inability to develop or launch new products, and market and/or regulatory conditions that may cause significant launch delays or product recalls;
- decreases in our profitability due to an inability to successfully implement and achieve timely and sustainable cost improvement measures consistent with our expectations, increases in our market-participant tax rate, and/or changes in tax laws;
- declines in revenue as a result of loss of key members of our sales force and other key personnel;
- negative developments in intellectual property litigation that may impact our ability to market certain products or increase our costs to sell certain products;
- the level of success of on-going and future research and development efforts and increases in the research and development costs necessary to obtain regulatory approvals and launch new products;
- increases in our market-participant risk-adjusted WACC; and
- changes in the structure of our business as a result of future reorganizations or divestitures of assets or businesses.

Negative changes in one or more of these factors could result in additional impairment charges.

2010 Charge

The ship hold and product removal actions associated with our U.S. ICD and cardiac resynchronization therapy defibrillator (CRT-D) products, which we announced on March 15, 2010, and the forecasted corresponding financial impact on our operations created an indication of potential impairment of the goodwill balance attributable to our U.S. CRM reporting unit during the first quarter

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of 2010. Therefore, we performed an interim impairment test in accordance with U.S. GAAP and our accounting policies and recorded an estimated non-deductible goodwill impairment charge of $1.817 billion, on both a pre-tax and after-tax basis, associated with our U.S. CRM reporting unit.

Intangible Asset Impairment Charges

2011 Charges

During the third quarter of 2011, we recorded a $9 million intangible asset impairment charge attributable to lower projected cash flows associated with certain technologies. During the second quarter of 2011, we recorded a $12 million intangible asset impairment charge associated with changes in the timing and amount of the expected cash flows related to certain acquired in-process research and development projects. We have recorded these amounts in the intangible asset impairment charges caption in our accompanying unaudited condensed consolidated statements of operations. We do not believe that these impairments, or the factors causing these impairments, will have a material impact on our future operations or cash flows.

2010 Charges

During the first quarter of 2010, due to lower than anticipated net sales of one of our Peripheral Interventions technology offerings, as well as changes in our expectations of future market acceptance of this technology, we lowered our sales forecasts associated with the product. In addition, during the third quarter of 2010, as part of our initiatives to reprioritize and diversify our product portfolio, we discontinued one of our internal research and development programs to focus on those with a higher likelihood of success. As a result of these factors, and in accordance with U.S. GAAP and our accounting policies, we tested the related intangible assets for impairment and recorded a $60 million charge in the first quarter of 2010 and a $5 million charge in the third quarter of 2010 to write down the balance of these intangible assets to their fair value. We recorded these amounts in the intangible asset impairment charges caption in our accompanying unaudited condensed consolidated statements of operations. We do not believe that these impairments, or the factors causing these impairments, will have a material impact on our future operations or cash flows.

NOTE E – FAIR VALUE MEASUREMENTS

Derivative Instruments and Hedging Activities

We develop, manufacture and sell medical devices globally and our earnings and cash flows are exposed to market risk from changes in foreign currency exchange rates and interest rates. We address these risks through a risk management program that includes the use of derivative financial instruments, and operate the program pursuant to documented corporate risk management policies. We recognize all derivative financial instruments in our consolidated financial statements at fair value in accordance with ASC Topic 815, Derivatives and Hedging. In accordance with Topic 815, for those derivative instruments that are designated and qualify as hedging instruments, the hedging instrument must be designated, based upon the exposure being hedged, as a fair value hedge, cash flow hedge, or a hedge of a net investment in a foreign operation. The accounting for changes in the fair value (i.e. gains or losses) of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and, further, on the type of hedging relationship. Our derivative instruments do not subject our earnings or cash flows to material risk, as gains and losses on these derivatives generally offset losses and gains on the item being hedged. We do not enter into derivative transactions for speculative purposes and we do not have any non-derivative instruments that are designated as hedging instruments pursuant to Topic 815.

Currency Hedging

We are exposed to currency risk consisting primarily of foreign currency denominated monetary assets and liabilities, forecasted foreign currency denominated intercompany and third-party transactions and net investments in certain subsidiaries. We manage our exposure to changes in foreign currency exchange rates on a consolidated basis to take advantage of offsetting transactions. We use both derivative instruments (currency forward and option contracts), and non-derivative transactions (primarily European manufacturing and distribution operations) to reduce the risk that our earnings and cash flows associated with these foreign currency denominated balances and transactions will be adversely affected by foreign currency exchange rate changes.

Designated Foreign Currency Hedges

All of our designated currency hedge contracts outstanding as of September 30, 2011 and December 31, 2010 were cash flow hedges under Topic 815 intended to protect the U.S. dollar value of our forecasted foreign currency denominated transactions. We record the effective portion of any change in the fair value of foreign currency cash flow hedges in other comprehensive income (OCI) until the related third-party transaction occurs. Once the related third-party transaction occurs, we reclassify the effective portion of any related gain or loss on the foreign currency cash flow hedge to earnings. In the event the hedged forecasted transaction

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does not occur, or it becomes no longer probable that it will occur, we reclassify the amount of any gain or loss on the related cash flow hedge to earnings at that time. We had currency derivative instruments designated as cash flow hedges outstanding in the contract amount of $2.302 billion as of September 30, 2011 and $2.679 billion as of December 31, 2010.

We recognized net losses of $28 million in earnings on our cash flow hedges during the third quarter of 2011 and $74 million for the first nine months of 2011, as compared to net gains of $5 million during the third quarter of 2010 and net losses of $22 million for the first nine months of 2010. All currency cash flow hedges outstanding as of September 30, 2011 mature within 36 months. As of September 30, 2011, $74 million of net losses, net of tax, were recorded in accumulated other comprehensive income (AOCI) to recognize the effective portion of the fair value of any currency derivative instruments that are, or previously were, designated as foreign currency cash flow hedges, as compared to net losses of $71 million as of December 31, 2010. As of September 30, 2011, $48 million of net losses, net of tax, may be reclassified to earnings within the next twelve months.

The success of our hedging program depends, in part, on forecasts of transaction activity in various currencies (primarily Japanese yen, Euro, British pound sterling, Australian dollar and Canadian dollar). We may experience unanticipated currency exchange gains or losses to the extent that there are differences between forecasted and actual activity during periods of currency volatility. In addition, changes in foreign currency exchange rates related to any unhedged transactions may impact our earnings and cash flows.

Non-designated Foreign Currency Contracts

We use currency forward contracts as a part of our strategy to manage exposure related to foreign currency denominated monetary assets and liabilities. These currency forward contracts are not designated as cash flow, fair value or net investment hedges under Topic 815; are marked-to-market with changes in fair value recorded to earnings; and are entered into for periods consistent with currency transaction exposures, generally one to six months. We had currency derivative instruments not designated as hedges under Topic 815 outstanding in the contract amount of $1.872 billion as of September 30, 2011 and $2.398 billion as of December 31, 2010.

Interest Rate Hedging

Our interest rate risk relates primarily to U.S. dollar borrowings, partially offset by U.S. dollar cash investments. We have historically used interest rate derivative instruments to manage our earnings and cash flow exposure to changes in interest rates by converting floating-rate debt into fixed-rate debt or fixed-rate debt into floating-rate debt.

We designate these derivative instruments either as fair value or cash flow hedges under Topic 815. We record changes in the value of fair value hedges in interest expense, which is generally offset by changes in the fair value of the hedged debt obligation. Interest payments made or received related to our interest rate derivative instruments are included in interest expense. We record the effective portion of any change in the fair value of derivative instruments designated as cash flow hedges as unrealized gains or losses in OCI, net of tax, until the hedged cash flow occurs, at which point the effective portion of any gain or loss is reclassified to earnings. We record the ineffective portion of our cash flow hedges in interest expense. In the event the hedged cash flow does not occur, or it becomes no longer probable that it will occur, we reclassify the amount of any gain or loss on the related cash flow hedge to interest expense at that time. In the first quarter of 2011, we entered interest rate derivative contracts having a notional amount of $850 million to convert fixed-rate debt into floating-rate debt, which we designated as fair value hedges.We terminated these hedges during the third quarter of 2011 and received total proceeds of approximately $80 million, which included approximately $5 million of accrued interest receivable. The carrying amount of our $850 million senior notes maturing in January 2020 include unamortized gains of $74 million as of September 30, 2011, related to the terminated interest rate derivative contracts, which represents the effective portion of these contracts as of the termination date, less amounts amortized. We will amortize this gain into earnings as a reduction of interest expense over the remaining term of the hedged debt, in accordance with Topic 815. We had no interest rate derivative contracts outstanding as of September 30, 2011 or December 31, 2010.

In prior years, we terminated certain interest rate derivative contracts, including fixed-to-floating interest rate contracts, designated as fair value hedges, and floating-to-fixed treasury locks, designated as cash flow hedges. We are amortizing the gains and losses of these derivative instruments upon termination into earnings over the term of the hedged debt. The carrying amount of certain of our senior notes included unamortized gains of $2 million as of

September 30, 2011 and December 31, 2010, and unamortized losses of $4 million as of September 30, 2011 and $5 million as of December 31, 2010, related to the fixed-to-floating interest rate contracts. In addition, we had pre-tax net gains within AOCI related to terminated floating-to-fixed treasury locks of $7 million as of September 30, 2011 and $8 million as of December 31, 2010.

During the third quarter and first nine months of 2011, we recognized in earnings less than $1 million of net gains related to our previously terminated interest rate derivative contracts. As of September 30, 2011, we had $4 million of net gains, net of tax, recorded in AOCI to recognize the effective portion of these instruments, as compared to $5 million of net gains as of December

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31, 2010. As of September 30, 2011, less than $1 million of net gains, net of tax, may be reclassified to earnings within the next twelve months from amortization of our previously terminated interest rate derivative contracts.

Counterparty Credit Risk

We do not have significant concentrations of credit risk arising from our derivative financial instruments, whether from an individual counterparty or a related group of counterparties. We manage our concentration of counterparty credit risk on our derivative instruments by limiting acceptable counterparties to a diversified group of major financial institutions with investment grade credit ratings, limiting the amount of credit exposure to each counterparty, and by actively monitoring their credit ratings and outstanding fair values on an on-going basis. Furthermore, none of our derivative transactions are subject to collateral or other security arrangements and none contain provisions that are dependent on our credit ratings from any credit rating agency.

We also employ master netting arrangements that reduce our counterparty payment settlement risk on any given maturity date to the net amount of any receipts or payments due between us and the counterparty financial institution. Thus, the maximum loss due to credit risk by counterparty is limited to the unrealized gains in such contracts net of any unrealized losses should any of these counterparties fail to perform as contracted. Although these protections do not eliminate concentrations of credit risk, as a result of the above considerations, we do not consider the risk of counterparty default to be significant.

Fair Value of Derivative Instruments

The following presents the effect of our derivative instruments designated as cash flow hedges under Topic 815 on our accompanying unaudited condensed consolidated statements of operations during the third quarter and first nine months of 2011 and 2010 (in millions):

	Amount of Pre-tax Gain (Loss) Recognized in OCI (Effective Portion)	Amount of Pre-tax Gain (Loss) Reclassified from AOCI into Earnings (Effective Portion)	Location in Statement of Operations
Three Months Ended September 30, 2011			
Currency hedge contracts	$29	$(28)	Cost of products sold
	$29	$(28)	
Three Months Ended September 30, 2010			
Interest rate hedge contracts		$1	Interest expense
Currency hedge contracts	$(173)	5	Cost of products sold
	$(173)	$6	
Nine Months Ended September 30, 2011			
Currency hedge contracts	$(77)	$(74)	Cost of products sold
	$(77)	$(74)	
Nine Months Ended September 30, 2010			
Interest rate hedge contracts		$2	Interest expense
Currency hedge contracts	$(56)	(22)	Cost of products sold
	$(56)	$(20)	

We recognized in earnings a $5 million gain related to the ineffective portion of hedging relationships for the third quarter and first nine months of 2011, related to our interest rate derivative contracts. The amount of gain (loss) recognized in earnings was de minimis for the third quarter and first nine months of 2010.

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Derivatives Not Designated as Hedging Instruments	Location in Statement of Operations	Amount of Gain (Loss) Recognized in Earnings (in millions) Three Months Ended September 30, 2011	2010	Amount of Gain (Loss) Recognized in Earnings (in millions) Nine Months Ended September 30, 2011	2010
Currency hedge contracts	Other, net	$8	$(40)	$2	$(67)
		$8	$(40)	$2	$(67)

Losses and gains on currency hedge contracts not designated as hedged instruments were substantially offset by net losses from foreign currency transaction exposures of $12 million during the third quarter of 2011, net gains of $43 million during the third quarter of 2010, net losses of $11 million for the first nine months of 2011 and net gains of $59 million for the first nine months of 2010. As a result, we recorded a net foreign currency loss of $4 million during the third quarter of 2011, a $3 million gain during the third quarter of 2010, a $9 million loss for the first nine months of 2011, and an $8 million loss for the first nine months of 2010, within other, net in our accompanying unaudited condensed consolidated statements of operations.

Topic 815 requires all derivative instruments to be recognized at their fair values as either assets or liabilities on the balance sheet. We determine the fair value of our derivative instruments using the framework prescribed by ASC Topic 820, Fair Value Measurements and Disclosures, by considering the estimated amount we would receive or pay to transfer these instruments at the reporting date and by taking into account current interest rates, foreign currency exchange rates, the creditworthiness of the counterparty for assets, and our creditworthiness for liabilities. In certain instances, we may utilize financial models to measure fair value. Generally, we use inputs that include quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; other observable inputs for the asset or liability; and inputs derived principally from, or corroborated by, observable market data by correlation or other means. As of September 30, 2011, we have classified all of our derivative assets and liabilities within Level 2 of the fair value hierarchy prescribed by Topic 820, as discussed below, because these observable inputs are available for substantially the full term of our derivative instruments.

The following are the balances of our derivative assets and liabilities as of September 30, 2011 and December 31, 2010:

(in millions)	Location in Balance Sheet (1)	As of September 30, 2011	December 31, 2010
Derivative Assets:			
Designated Hedging Instruments			
Currency hedge contracts	Prepaid and other current assets	$25	$32
Currency hedge contracts	Other long-term assets	17	27
		42	59
Non-Designated Hedging Instruments			
Currency hedge contracts	Prepaid and other current assets	41	23
Total Derivative Assets		$83	$82
Derivative Liabilities:			
Designated Hedging Instruments			
Currency hedge contracts	Other current liabilities	$80	$87
Currency hedge contracts	Other long-term liabilities	63	71
		143	158
Non-Designated Hedging Instruments			
Currency hedge contracts	Other current liabilities	18	31

Total Derivative Liabilities	$161	$189

(1) We classify derivative assets and liabilities as current when the remaining term of the derivative contract is one year or less.

Other Fair Value Measurements

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Recurring Fair Value Measurements

On a recurring basis, we measure certain financial assets and financial liabilities at fair value based upon quoted market prices, where available. Where quoted market prices or other observable inputs are not available, we apply valuation techniques to estimate fair value. Topic 820 establishes a three-level valuation hierarchy for disclosure of fair value measurements. The categorization of financial assets and financial liabilities within the valuation hierarchy is based upon the lowest level of input that is significant to the measurement of fair value. The three levels of the hierarchy are defined as follows:

- Level 1 – Inputs to the valuation methodology are quoted market prices for identical assets or liabilities.
- Level 2 – Inputs to the valuation methodology are other observable inputs, including quoted market prices for similar assets or liabilities and market-corroborated inputs.
- Level 3 – Inputs to the valuation methodology are unobservable inputs based on management's best estimate of inputs market participants would use in pricing the asset or liability at the measurement date, including assumptions about risk.

Assets and liabilities measured at fair value on a recurring basis consist of the following as of September 30, 2011 and December 31, 2010:

	As of September 30, 2011				As of December 31, 2010			
(in millions)	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Assets								
Money market and government funds	$145			$145	$105			$105
Currency hedge contracts		$83		83		$82		82
	$145	$83		$228	$105	$82		$187
Liabilities								
Currency hedge contracts		$161		$161		$189		$189
Accrued contingent consideration			$376	376			$71	71
		$161	$376	$537		$189	$71	$260

Our investments in money market and government funds are generally classified within Level 1 of the fair value hierarchy because they are valued using quoted market prices. These investments are classified as cash and cash equivalents within our accompanying unaudited condensed consolidated balance sheets, in accordance with U.S. GAAP and our accounting policies.

In addition to $145 million invested in money market and government funds as of September 30, 2011, we had $12 million in short-term time deposits and $119 million in interest bearing and non-interest bearing bank accounts. In addition to $105 million invested in money market and government funds as of December 31, 2010, we had $16 million of cash invested in short-term time deposits, and $92 million in interest bearing and non-interest bearing bank accounts.

Changes in the fair value of recurring fair value measurements using significant unobservable inputs (Level 3) during the first nine months of 2011, which relate solely to our contingent consideration liability, were as follows (in millions):

Balance as of December 31, 2010	$(71)
Contingent consideration liability recorded	(287)
Fair value adjustments	(18)
Balance as of September 30, 2011	$(376)

Refer to Note B - Acquisitions for a discussion of the changes in the fair value of our contingent consideration liability.

Non-Recurring Fair Value Measurements

We hold certain assets and liabilities that are measured at fair value on a non-recurring basis in periods subsequent to initial recognition. The fair value of a cost method investment is not estimated if there are no identified events or changes in circumstances that may have a significant adverse effect on the fair value of the investment. The aggregate carrying amount of our cost method investments was $16 million as of September 30, 2011 and $43 million as of December 31, 2010. The decrease was due primarily

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to our first quarter 2011 acquisitions of the remaining fully diluted equity of companies in which we held a prior equity interest, described further in Note B - Acquisitions.

During the first nine months of 2011, we recorded $718 million of losses to adjust our goodwill and certain other intangible asset balances to their fair value. We wrote down goodwill attributable to our U.S. CRM reporting unit, discussed in Note D – Goodwill and Other Intangible Assets, with a carrying amount of $1.479 billion to its implied fair value of $782 million, resulting in a non-deductible goodwill impairment charge of $697 million in the first quarter of 2011. In addition, during the second quarter of 2011, as a result of changes in the timing and amount of the expected cash flows related to certain acquired in-process research and development projects, we recorded a $12 million intangible asset impairment charge representing a decrease in the estimated fair value of the related intangible assets. Further, during the third quarter of 2011, we recorded a $9 million intangible asset impairment charge attributable to lower projected cash flows associated with certain technologies. In addition, during the first quarter of 2011, we recorded $15 million of losses to write down certain cost method investments. These fair value measurements were calculated using unobservable inputs, primarily using the income approach, specifically the DCF method, which are classified as Level 3 within the fair value hierarchy. The amount and timing of future cash flows within these analyses was based on our most recent operational budgets, long-range strategic plans and other estimates.

During the first nine months of 2010, we recorded $1.882 billion of losses to adjust our goodwill and certain other intangible asset balances to their fair values, and $5 million of losses to write down certain cost method investments. We wrote down goodwill attributable to our U.S. CRM reporting unit with a carrying amount of $3.296 billion to its implied fair value of $1.479 billion, resulting in a net write-down of $1.817 billion. In addition, we recorded a loss of $60 million in the first quarter of 2010 to write down certain of our Peripheral Interventions intangible assets to their estimated fair values, and a loss of $5 million in the third quarter of 2010 to write off the remaining value associated with certain other intangible assets. These fair value measurements were calculated using unobservable inputs, primarily using the income approach, specifically the DCF method, which are classified as Level 3 within the fair value hierarchy. The amount and timing of future cash flows within these analyses was based on our most recent operational budgets, long range strategic plans and other estimates.

The fair value of our outstanding debt obligations was $4.667 billion as of September 30, 2011 and $5.654 billion as of December 31, 2010, which was determined by using primarily quoted market prices for our publicly-registered senior notes, classified as Level 1 within the fair value hierarchy. This decrease was due primarily to debt repayments of $1.250 billion during the first nine months of 2011, as well as an increase in the market price for our publicly-traded senior notes. Refer to Note F – Borrowings and Credit Arrangements for a discussion of our debt obligations.

NOTE F – BORROWINGS AND CREDIT ARRANGEMENTS

We had total debt of $4.263 billion as of September 30, 2011 and $5.438 billion as of December 31, 2010. During the first nine months of 2011, we prepaid the remaining $1.0 billion of our term loan and paid $250 million of our senior notes at maturity. The debt maturity schedule for the significant components of our debt obligations as of September 30, 2011 is as follows:

	Payments due by Period						
(in millions)	2011	2012	2013	2014	2015	Thereafter	Total
Senior notes				$600	$1,250	$2,350	$4,200
				$600	$1,250	$2,350	$4,200

Note: The table above does not include unamortized discounts associated with our senior notes, or amounts related to interest rate contracts used to hedge the fair value of certain of our senior notes.

Term Loan and Revolving Credit Facility

During the first nine months of 2011, we prepaid the remaining $1.0 billion of our term loan maturities without premium or penalty.

We maintain a $2.0 billion revolving credit facility, maturing in June 2013, with up to two one-year extension options subject to certain conditions. Any revolving credit facility borrowings bear interest at LIBOR plus an interest margin of between 1.55 percent and 2.625 percent, based on our corporate credit ratings (currently 2.05 percent). In addition, we are required to pay a facility fee based on our credit ratings and the total amount of revolving credit commitments, regardless of usage, under the agreement (currently 0.45 percent). In July 2011, Fitch Ratings upgraded our corporate credit rating to BBB-, an investment-grade rating and Moody's Investors Service raised our Ba1 rating outlook to positive from stable. The Fitch upgrade has resulted in a slightly favorable reduction in the facility fee and the interest rate on the facility. Any borrowings under the revolving credit facility are unrestricted and unsecured. In the third quarter of 2011, we borrowed $175 million under the facility and subsequently repaid the

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borrowed amounts during the third quarter of 2011. There were no amounts borrowed under our revolving credit facility as of September 30, 2011 or December 31, 2010.

Our revolving credit facility agreement requires that we maintain certain financial covenants, as follows:

	Covenant Requirement	Actual as of September 30, 2011
Maximum leverage ratio (1)	3.5 times	1.5 times
Minimum interest coverage ratio (2)	3.0 times	9.0 times

(1) Ratio of total debt to consolidated EBITDA, as defined by the agreement, as amended, for the preceding four consecutive fiscal quarters.

(2) Ratio of consolidated EBITDA, as defined by the agreement, as amended, to interest expense for the preceding four consecutive fiscal quarters.

The credit agreement provides for an exclusion from the calculation of consolidated EBITDA, as defined by the agreement, through the credit agreement maturity, of up to $258 million in restructuring charges and restructuring-related expenses related to our previously announced restructuring plans, plus an additional $300 million for any future restructuring initiatives, including our recently announced 2011 Restructuring program. As of September 30, 2011, we had $361 million of the combined restructuring charge exclusion remaining. In addition, any litigation-related charges and credits are excluded from the calculation of consolidated EBITDA until such items are paid or received; and up to $1.5 billion of any future cash payments for future litigation settlements or damage awards (net of any litigation payments received); as well as litigation-related cash payments (net of cash receipts) of up to $1.310 billion related to amounts that were recorded in the financial statements as of March 31, 2010 are excluded from the calculation of consolidated EBITDA. As of September 30, 2011, we had $1.832 billion of the combined legal payment exclusion remaining.

As of and through September 30, 2011, we were in compliance with the required covenants. Our inability to maintain compliance with these covenants could require us to seek to renegotiate the terms of our credit facilities or seek waivers from compliance with these covenants, both of which could result in additional borrowing costs. Further, there can be no assurance that our lenders would grant such waivers.

Senior Notes

We had senior notes outstanding in the amount of $4.2 billion as of September 30, 2011 and $4.450 billion as of December 31, 2010. In January 2011, we paid $250 million of our senior notes at maturity.

Other Arrangements

We also maintain a $350 million credit and security facility secured by our U.S. trade receivables. In August 2011, we extended the maturity of this facility to August 2012. There were no amounts borrowed under this facility as of September 30, 2011 or December 31, 2010. In January 2011, we borrowed $250 million under this facility and used the proceeds to prepay $250 million of our term loan, and subsequently repaid the borrowed amounts during the first quarter of 2011.

In addition, we have accounts receivable factoring programs in certain European countries that we account for as sales under ASC Topic 860, Transfers and Servicing. These agreements provide for the sale of accounts receivable to third parties, without recourse, of up to approximately 330 million Euro (translated to approximately $445 million as of September 30, 2011). We have no retained interests in the transferred receivables, other than collection and administrative responsibilities and, once sold, the accounts receivable are no longer available to satisfy creditors in the event of bankruptcy. We de-recognized $387 million of receivables as of September 30, 2011 at an average interest rate of 2.5 percent, and $363 million as of December 31, 2010 at an average interest rate of 2.0 percent. Further, we have uncommitted credit facilities with two commercial Japanese banks that provide for borrowings and promissory notes discounting of up to 18.5 billion Japanese yen (translated to approximately $240 million as of September 30, 2011). We de-recognized $188 million of notes receivable as of September 30, 2011 at an average interest rate of 1.8 percent and $197 million of notes receivable as of December 31, 2010 at an average interest rate of 1.7 percent. De-recognized accounts and notes receivable are excluded from trade accounts receivable, net in the accompanying

unaudited condensed consolidated balance sheets.

NOTE G – RESTRUCTURING-RELATED ACTIVITIES

On an on-going basis, we monitor the dynamics of the economy, the healthcare industry, and the markets in which we compete;

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and we continue to assess opportunities for improved operational effectiveness and efficiency, and better alignment of expenses with revenues, while preserving our ability to make the investments in research and development projects, capital and our people that are essential to our long-term success. As a result of these assessments, we have undertaken various restructuring initiatives in order to enhance our growth potential and position us for long-term success. These initiatives are described below.

2011 Restructuring plan

On July 26, 2011, our Board of Directors approved, and we committed to, a restructuring initiative (the 2011 Restructuring plan) designed to strengthen operational effectiveness and efficiencies, increase competitiveness and support new investments, thereby increasing shareholder value. Key activities under the plan include standardizing and automating certain processes and activities; relocating select administrative and functional activities; rationalizing organizational reporting structures; and leveraging preferred vendors. Among these efforts, we are expanding our ability to deliver best-in-class global shared services for certain functions and divisions at several locations in emerging markets. This action is intended to enable us to grow our global commercial presence in key geographies and take advantage of many cost-reducing and productivity-enhancing opportunities. In addition, we are undertaking efforts to streamline various corporate functions, eliminate bureaucracy, increase productivity and better align corporate resources to our key business strategies. Activities under the 2011 Restructuring plan were initiated in the third quarter of 2011 and are expected to be substantially complete within the next 24 months.

We estimate that the 2011 Restructuring plan will result in total pre-tax charges of approximately $155 million to $210 million, and that approximately $150 million to $200 million of these charges will result in future cash outlays. We have recorded related costs of $15 million since the inception of the plan, and are recording a portion of these expenses as restructuring charges and the remaining portion through other lines within our consolidated statements of operations.

The following provides a summary of our expected total costs associated with the plan by major type of cost:

Type of cost	Total estimated amount expected to be incurred
Restructuring charges:	
Termination benefits	$125 million to $150 million
Other (1)	$20 million to $40 million
Restructuring-related expenses:	
Other (2)	$10 million to $20 million
	$155 million to $210 million

(1) Includes primarily consulting fees and costs associated with contractual cancellations.

(2) Comprised of other costs directly related to the 2011 Restructuring plan, including program management, accelerated depreciation, retention and infrastructure-related costs.

2010 Restructuring plan

On February 6, 2010, our Board of Directors approved, and we committed to, a series of management changes and restructuring initiatives (the 2010 Restructuring plan) designed to focus our business, drive innovation, accelerate profitable revenue growth and increase both accountability and shareholder value. Key activities under the plan include the integration of our Cardiovascular and CRM businesses, as well as the restructuring of certain other businesses and corporate functions; the centralization of our research and development organization; the re-alignment of our international structure to reduce our administrative costs and invest in expansion opportunities including significant investments in emerging markets; and the re-prioritization and diversification of our product portfolio. Activities under the 2010 Restructuring plan were initiated in the first quarter of 2010 and are expected to be substantially complete by the end of 2012.

We estimate that the 2010 Restructuring plan will result in total pre-tax charges of approximately $165 million to $185 million, and that approximately $150 million to $160 million of these charges will result in cash outlays, of

which we have made payments of $135 million to date. We have recorded related costs of $166 million since the inception of the plan, and are recording a portion of these expenses as restructuring charges and the remaining portion through other lines within our consolidated statements of operations.

The following provides a summary of our expected total costs associated with the plan by major type of cost:

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Type of cost	Total estimated amount expected to be incurred
Restructuring charges:	
Termination benefits	$95 million to $100 million
Fixed asset write-offs	$10 million to $15 million
Other (1)	$50 million to $55 million
Restructuring-related expenses:	
Other (2)	$10 million to $15 million
	$165 million to $185 million

(1) Includes primarily consulting fees and costs associated with contractual cancellations.

(2) Comprised of other costs directly related to the 2010 Restructuring plan, including accelerated depreciation and infrastructure-related costs.

Plant Network Optimization program

In January 2009, our Board of Directors approved, and we committed to, a Plant Network Optimization program, which is intended to simplify our manufacturing plant structure by transferring certain production lines among facilities and by closing certain other facilities. The program is a complement to our 2007 Restructuring plan, discussed below, and is intended to improve overall gross profit margins. Activities under the Plant Network Optimization program were initiated in the first quarter of 2009 and are expected to be substantially complete by the end of 2012.

We expect that the execution of the Plant Network Optimization program will result in total pre-tax charges of approximately $130 million to $145 million, and that approximately $110 million to $120 million of these charges will result in cash outlays, of which we have made payments of $62 million to date. We have recorded related costs of $115 million since the inception of the plan, and are recording a portion of these expenses as restructuring charges and the remaining portion through cost of products sold within our consolidated statements of operations. The following provides a summary of our estimates of costs associated with the Plant Network Optimization program by major type of cost:

Type of cost	Total estimated amount expected to be incurred
Restructuring charges:	
Termination benefits	$35 million to $40 million
Restructuring-related expenses:	
Accelerated depreciation	$20 million to $25 million
Transfer costs (1)	$75 million to $80 million
	$130 million to $145 million

(1) Consists primarily of costs to transfer product lines among facilities, including costs of transfer teams, freight, idle facility and product line validations.

2007 Restructuring plan

In October 2007, our Board of Directors approved, and we committed to, an expense and head count reduction plan (the 2007 Restructuring plan). The plan was intended to bring expenses in line with revenues as part of our initiatives to enhance short- and long-term shareholder value. The transfer of production lines contemplated under the 2007 Restructuring plan was completed as of December 31, 2010; all other major activities under the plan were completed as of December 31, 2009. The execution of this plan resulted in total pre-tax expenses of $427 million and required cash outlays of $380 million, of which we have paid $373 million to date.

We recorded restructuring charges pursuant to our restructuring plans of $22 million in the third quarter of 2011, $5 million in the third quarter of 2010, $77 million in the first nine months of 2011, and $98 million in the first nine months of 2010. In addition, we recorded expenses within other lines of our accompanying unaudited condensed consolidated statements of operations related to our restructuring initiatives of $7 million in the third quarter of 2011, $13 million in the third quarter of 2010, $32 million in

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the first nine months of 2011, and $41 million in the first nine months of 2010.
The following presents these costs by major type and line item within our accompanying unaudited condensed consolidated statements of operations, as well as by program:

Three Months Ended September 30, 2011

(in millions)	Termination Benefits	Accelerated Depreciation	Transfer Costs	Fixed Asset Write-offs	Other	Total
Restructuring charges	$12				$10	$22
Restructuring-related expenses:						
Cost of products sold		$2	$5			7
Selling, general and administrative expenses		2	5			7
	$12	$2	$5		$10	$29

(in millions)	Termination Benefits	Accelerated Depreciation	Transfer Costs	Fixed Asset Write-offs	Other	Total
2011 Restructuring plan	$9				$6	$15
2010 Restructuring plan	1				4	5
Plant Network Optimization program	2	$2	$5			9
	$12	$2	$5		$10	$29

Three Months Ended September 30, 2010

(in millions)	Termination Benefits	Accelerated Depreciation	Transfer Costs	Fixed Asset Write-offs	Other	Total
Restructuring charges	$2			$1	$2	$5
Restructuring-related expenses:						
Cost of products sold		$2	$10			12
Selling, general and administrative expenses					1	1
		2	10		1	13
	$2	$2	$10	$1	$3	$18

(in millions)	Termination Benefits	Accelerated Depreciation	Transfer Costs	Fixed Asset Write-offs	Other	Total
2010 Restructuring plan	$2			$1	$3	$6
Plant Network Optimization program	2	$2	$8			12
2007 Restructuring plan	(2)		2			
	$2	$2	$10	$1	$3	$18

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Nine Months Ended September 30, 2011

(in millions)	Termination Benefits	Accelerated Depreciation	Transfer Costs	Fixed Asset Write-offs	Other	Total
Restructuring charges	$49				$28	$77
Restructuring-related expenses:						
Cost of products sold		$8	$20			28
Selling, general and administrative expenses					4	4
		8	20		4	32
	$49	$8	$20		$32	$109

(in millions)	Termination Benefits	Accelerated Depreciation	Transfer Costs	Fixed Asset Write-offs	Other	Total
2011 Restructuring plan	$9				$6	$15
2010 Restructuring plan	32	$1			26	59
Plant Network Optimization program	8	7	$20			35
	$49	$8	$20		$32	$109

Nine Months Ended September 30, 2010

(in millions)	Termination Benefits	Accelerated Depreciation	Transfer Costs	Fixed Asset Write-offs	Other	Total
Restructuring charges	$66			$8	$24	$98
Restructuring-related expenses:						
Cost of products sold		$6	$32			38
Selling, general and administrative expenses					3	3
		6	32		3	41
	$66	$6	$32	$8	$27	$139

(in millions)	Termination Benefits	Accelerated Depreciation	Transfer Costs	Fixed Asset Write-offs	Other	Total
2010 Restructuring plan	$61			$8	$23	$92
Plant Network Optimization program	4	$6	$20			30
2007 Restructuring plan	1		12		4	17
	$66	$6	$32	$8	$27	$139

Termination benefits represent amounts incurred pursuant to our on-going benefit arrangements and amounts for "one-time" involuntary termination benefits, and have been recorded in accordance with ASC Topic 712, Compensation – Non-retirement Postemployment Benefits and ASC Topic 420, Exit or Disposal Cost Obligations. We expect to record additional termination benefits related to our 2011 Restructuring plan, 2010 Restructuring plan and Plant Network Optimization program in 2011 and 2012 when we identify with more specificity the job classifications, functions and locations of the remaining head count to be eliminated. Other restructuring costs, which represent primarily consulting fees, are being recorded as incurred in accordance with Topic 420. Accelerated depreciation is being recorded over the adjusted remaining useful life of the related assets, and production line transfer costs are being recorded as incurred. We have incurred cumulative restructuring charges related to our 2011 Restructuring plan, 2010 Restructuring plan and Plant Network Optimization program of $207 million and restructuring-related costs of $89 million since we committed to each plan. The following presents these costs by major type and by plan:

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(in millions)	2011 Restructuring plan	2010 Restructuring plan	Plant Network Optimization	Total
Termination benefits	$9	$96	$35	$140
Fixed asset write-offs		11		11
Other	5	51		56
Total restructuring charges	14	158	35	207
Accelerated depreciation			20	20
Transfer costs			60	60
Other	1	8		9
Restructuring-related expenses	1	8	80	89
	$15	$166	$115	$296

We made cash payments of $24 million in the third quarter of 2011 and $92 million in the first nine months of 2011 associated with restructuring initiatives pursuant to these plans, and have made total cash payments of $201 million related to our 2011 Restructuring plan, 2010 Restructuring plan and Plant Network Optimization program since committing to each plan. Each of these payments was made using cash generated from operations, and are comprised of the following:

(in millions)	2011 Restructuring plan	2010 Restructuring plan	Plant Network Optimization	Total
Three Months Ended September 30, 2011				
Termination benefits		$9	$1	$10
Transfer costs			5	5
Other	$4	5		9
	$4	$14	$6	$24
Nine Months Ended September 30, 2011				
Termination benefits		$34	$2	$36
Transfer costs			20	20
Other	$4	32		36
	$4	$66	$22	$92
Program to Date				
Termination benefits		$80	$2	$82
Transfer costs			60	60
Other	$4	55		59
	$4	$135	$62	$201

We also made cash payments of $1 million during the third quarter of 2011 and $3 million during the first nine months of 2011 associated with our 2007 Restructuring plan and have made total cash payments of $373 million related to the 2007 Restructuring plan since committing to the plan in the fourth quarter of 2007.

The following is a rollforward of the restructuring liability associated with our 2011 Restructuring plan, 2010 Restructuring plan and Plant Network Optimization program, since the inception of the respective plan, which is reported as a component of accrued expenses included in our accompanying unaudited condensed consolidated balance sheets:

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	2011 Restructuring plan			2010 Restructuring plan			Plant Network Optimization	
(in millions)	Termination Benefits	Other	Subtotal	Termination Benefits	Other	Subtotal	Termination Benefits	Total
Accrued as of December 31, 2008								
Charges							$22	$22
Cash payments								
Accrued as of December 31, 2009							22	22
Charges				$66	$28	$94	4	98
Cash payments				(45)	(20)	(65)		(65)
Accrued as of December 31, 2010				21	8	29	26	55
Charges	$9	$4	$13	32	24	56	8	77
Cash payments		(4)	(4)	(34)	(32)	(66)	(2)	(72)
Accrued as of September 30, 2011	$9	$—	$9	$19	$—	$19	$32	$60

The remaining restructuring liability associated with our 2007 Restructuring plan was $7 million as of September 30, 2011 and $10 million as of December 31, 2010.

NOTE H – SUPPLEMENTAL BALANCE SHEET INFORMATION

Components of selected captions in our accompanying unaudited condensed consolidated balance sheets are as follows:

Trade accounts receivable, net

(in millions)	As of September 30, 2011	December 31, 2010
Accounts receivable	$1,341	$1,445
Less: allowance for doubtful accounts	(75)	(83)
Less: allowance for sales returns	(29)	(42)
	$1,237	$1,320

The following is a rollforward of our allowance for doubtful accounts for the third quarter and first nine months of 2011 and 2010:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in millions)	2011	2010	2011	2010
Beginning balance	$67	$72	$83	$71
Net charges to expenses	12	6	1	17
Utilization of allowances	(4)		(9)	(10)
Ending balance	$75	$78	$75	$78

During the first quarter of 2011, we reversed $20 million of previously established allowances for doubtful accounts against long-outstanding receivables in Greece. These receivables had previously been fully reserved as we had

determined that they had a high risk of being uncollectible due to the economic situation in Greece. During the first quarter of 2011, the Greek government converted these receivables into bonds, which we were able to monetize, reducing our allowance for doubtful accounts as a credit to selling, general and administrative expenses. We continue to monitor the European economic environment for any collectibility issues related to our outstanding receivables in this region.

Inventories

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	As of	
(in millions)	September 30, 2011	December 31, 2010
Finished goods	$658	$622
Work-in-process	97	95
Raw materials	217	177
	$972	$894

Property, plant and equipment, net

	As of	
(in millions)	September 30, 2011	December 31, 2010
Land	$119	$119
Buildings and improvements	911	919
Equipment, furniture and fixtures	2,033	1,889
Capital in progress	263	241
	3,326	3,168
Less: accumulated depreciation	1,642	1,471
	$1,684	$1,697

Depreciation expense was $75 million for the third quarter of 2011, $72 million for the third quarter of 2010, $215 million for the first nine months of 2011, and $221 million for the first nine months of 2010.

Accrued expenses

	As of	
(in millions)	September 30, 2011	December 31, 2010
Legal reserves	$130	$441
Payroll and related liabilities	440	436
Accrued contingent consideration	8	9
Other	718	740
	$1,296	$1,626

Other long-term liabilities

	As of	
(in millions)	September 30, 2011	December 31, 2010
Legal reserves	$139	$147
Accrued income taxes	1,076	1,062
Accrued contingent consideration	368	62
Other long-term liabilities	398	374
	$1,981	$1,645

Accrued warranties

We offer warranties on certain of our product offerings. Approximately 85 percent of our warranty liability as of September 30, 2011 related to implantable devices offered by our CRM business, which include defibrillator and pacemaker systems. Our CRM products come with a standard limited warranty covering the replacement of these devices. We offer a full warranty for a portion of the period post-implant, and a partial warranty over the substantial remainder of the useful life of the product. We estimate the costs that we may incur under our warranty programs based on the number of units sold, historical and anticipated rates of warranty claims and cost per claim, and record a liability equal to these estimated costs as cost of products sold at the time the product sale occurs. We reassess the adequacy of our recorded warranty liabilities on a quarterly basis and adjust these amounts as necessary. The current portion of our warranty accrual is included in other accrued expenses in the table above and the non-current portion of our warranty accrual is included in other long-term liabilities in the table above. Changes in our product warranty accrual during

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the first nine months of 2011 and 2010 consisted of the following (in millions):

	Nine Months Ended September 30,	
	2011	2010
Beginning Balance	$43	$55
Provision	4	12
Settlements/reversals	(12)	(22)
Ending Balance	$35	$45

NOTE I – COMPREHENSIVE INCOME

The following table provides a summary of our comprehensive income (loss):

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in millions)	2011	2010	2011	2010
Net income (loss)	$142	$190	$334	$(1,301)
Foreign currency translation adjustment	(44)	34	2	(51)
Net change in unrealized gains and losses on derivative financial instruments, net of tax	35	(114)	(5)	(23)
Comprehensive income (loss)	$133	$110	$331	$(1,375)

Refer to Note E – Fair Value Measurements for more information on our derivative financial instruments.

NOTE J – INCOME TAXES

Tax Rate

The following table provides a summary of our reported tax rate:

	Three Months Ended September 30,		Percentage Point Increase (Decrease)
	2011	2010	
Reported tax rate	(27.9)%	(16.6)%	(11.3)%
Impact of certain receipts/charges*	48.0 %	33.4 %	14.6 %
	20.1 %	16.8 %	3.3 %

	Nine Months Ended September 30,		Percentage Point Increase (Decrease)
	2011	2010	
Reported tax rate	38.4 %	(0.7)%	39.1 %
Impact of certain receipts/charges*	(21.8)%	20.9 %	(42.7)%
	16.6 %	20.2 %	(3.6)%

*These receipts/charges are taxed at different rates than our effective tax rate.

The change in our reported tax rate for the third quarter and first nine months of 2011, as compared to the same periods in 2010, relates primarily to the impact of certain receipts and charges that are taxed at different rates than our effective tax rate. In 2011, these receipts and charges included a gain on our divestiture of the Neurovascular business, a non-deductible goodwill impairment charge, other intangible asset impairment charges and restructuring- and acquisition-related charges and credits. Our reported tax rate was also affected by discrete tax items, related primarily to a release of valuation allowances resulting from a change in our expected ability to realize certain deferred tax assets, changes in various state tax laws, the resolution of various uncertain tax positions resulting from closing agreements with the Internal Revenue Service (IRS), the resolution of various uncertain tax

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positions resulting from the expiration of the statute of limitations for assessing tax in certain jurisdictions, and the finalization of our 2010 U.S. Federal tax return. In 2010, these receipts and charges included goodwill and intangible asset impairment charges, a gain associated with the receipt of an acquisition-related milestone payment, and restructuring-related charges. In 2010, our reported tax rate was also affected by discrete tax items, related primarily to the re-measurement of an uncertain tax position resulting from a favorable court ruling issued in a similar third-party case and the resolution of an uncertain tax position resulting from a favorable taxpayer motion issued in a similar third-party case.

As of September 30, 2011, we had $935 million of gross unrecognized tax benefits, of which a net $830 million, if recognized, would affect our effective tax rate. As of December 31, 2010, we had $965 million of gross unrecognized tax benefits, of which a net $859 million, if recognized, would affect our effective tax rate.

We are subject to U.S. Federal income tax as well as income tax of multiple state and foreign jurisdictions. We have concluded all U.S. federal income tax matters through 2000 and substantially all material state, local, and foreign income tax matters through 2001.

On December 17, 2010, we received Notices of Deficiency from the IRS reflecting proposed audit adjustments for Guidant Corporation for the 2001-2003 tax years. The incremental tax liability asserted by the IRS for these periods is $525 million plus interest. The primary issue in dispute is the transfer pricing in connection with the technology license agreements between domestic and foreign subsidiaries of Guidant. We believe we have meritorious defenses for our tax filings and, on March 11, 2011, we filed petitions with the U.S. Tax Court contesting these Notices of Deficiency. On May 20, 2011, the IRS filed its answer to our petition.

In February 2011, we received Revenue Agent's Reports from the IRS reflecting proposed adjustments for the Guidant 2004-2006 tax years. The reports propose transfer pricing adjustments based on positions substantially similar to those subject to our U.S. Tax Court proceedings for Guidant Corporation's 2001-2003 tax years. The statute of limitations for Guidant Corporation's 2004-2006 tax years expires in December 2011 and we anticipate receiving a Notice of Deficiency for these tax years prior to the expiration of the relevant statute of limitations. We believe we have meritorious defenses for our tax filings and will petition the Tax Court to contest the proposed IRS adjustments.

In September 2011, we received a Notice of Deficiency from the IRS reflecting proposed audit adjustments for Boston Scientific Corporation for the 2006-2007 tax years. The incremental tax liability asserted by the IRS for these periods is $154 million plus interest. The adjustments proposed by the IRS are based on positions substantially similar to those subject to our U.S. Tax Court proceedings for Guidant Corporation's 2001-2003 tax years and we intend to file a timely petition to the U.S. Tax Court contesting this assessment.

We believe that our income tax reserves associated with these matters are adequate and the final resolution will not have a material impact on our financial condition or results of operations. However, final resolution is uncertain and could have a material impact on our financial condition or results of operations.

We recognize interest and penalties related to income taxes as a component of income tax expense. We recognized tax benefits related to interest of $4 million in the third quarter of 2011 and $3 million in the third quarter of 2010. We recognized tax expense related to interest of $12 million in the first nine months of 2011 and $10 million in the first nine months of 2010. We had $303 million accrued for gross interest and penalties as of September 30, 2011 and $285 million as of December 31, 2010.

It is reasonably possible that within the next 12 months we will resolve multiple issues including transfer pricing, research and development credit and transactional related issues with foreign, federal and state taxing authorities, in which case we could record a reduction in our balance of unrecognized tax benefits of up to approximately $30 million.

NOTE K – COMMITMENTS AND CONTINGENCIES

The medical device market in which we primarily participate is largely technology driven. Physician customers, particularly in interventional cardiology, have historically moved quickly to adopt new products and new technologies. As a result, intellectual property rights, particularly patents and trade secrets, play a significant role in product development and differentiation. However, intellectual property litigation is inherently complex and

unpredictable. Furthermore, appellate courts can overturn lower court patent decisions.

In addition, competing parties frequently file multiple suits to leverage patent portfolios across product lines, technologies and geographies and to balance risk and exposure between the parties. In some cases, several competitors are parties in the same proceeding, or in a series of related proceedings, or litigate multiple features of a single class of devices. These forces frequently drive settlement not only for individual cases, but also for a series of pending and potentially related and unrelated cases. In addition, although monetary and injunctive relief is typically sought, remedies and restitution are generally not determined until

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the conclusion of the trial court proceedings and can be modified on appeal. Accordingly, the outcomes of individual cases are difficult to time, predict or quantify and are often dependent upon the outcomes of other cases in other geographies. Several third parties have asserted that certain of our current and former product offerings infringe patents owned or licensed by them. We have similarly asserted that other products sold by our competitors infringe patents owned or licensed by us. Adverse outcomes in one or more of the proceedings against us could limit our ability to sell certain products in certain jurisdictions, or reduce our operating margin on the sale of these products and could have a material adverse effect on our financial position, results of operations and/or liquidity.

In particular, although we have resolved multiple litigation matters with Johnson & Johnson, we continue to be involved in patent litigation with them, particularly relating to drug-eluting stent systems. Adverse outcomes in one or more of these matters could have a material adverse effect on our ability to sell certain products and on our operating margins, financial position, results of operations and/or liquidity.

In the normal course of business, product liability, securities and commercial claims are asserted against us. Similar claims may be asserted against us in the future related to events not known to management at the present time. We are substantially self-insured with respect to product liability claims and intellectual property infringement, and maintain an insurance policy providing limited coverage against securities claims. The absence of significant third-party insurance coverage increases our potential exposure to unanticipated claims or adverse decisions. Product liability claims, securities and commercial litigation, and other legal proceedings in the future, regardless of their outcome, could have a material adverse effect on our financial position, results of operations and/or liquidity. In addition, the medical device industry is the subject of numerous governmental investigations often involving regulatory, marketing and other business practices. These investigations could result in the commencement of civil and criminal proceedings, substantial fines, penalties and administrative remedies, divert the attention of our management and have an adverse effect on our financial position, results of operations and/or liquidity.

We generally record losses for claims in excess of the limits of purchased insurance in earnings at the time and to the extent they are probable and estimable. In accordance with ASC Topic 450, Contingencies, we accrue anticipated costs of settlement, damages, losses for general product liability claims and, under certain conditions, costs of defense, based on historical experience or to the extent specific losses are probable and estimable. Otherwise, we expense these costs as incurred. If the estimate of a probable loss is a range and no amount within the range is more likely, we accrue the minimum amount of the range. Our accrual for legal matters that are probable and estimable was $269 million as of September 30, 2011 and $588 million as of December 31, 2010, and includes estimated costs of settlement, damages and defense. The decrease in our accrual is due primarily to the payment of $296 million to the U.S. Department of Justice (DOJ) in order resolve the criminal investigation of Guidant Corporation related to an alleged violation of the Food, Drug and Cosmetic Act occurring prior to our acquisition of Guidant, discussed in our 2010 Annual Report filed on Form 10-K and in the concluded matters below. We continue to assess certain litigation and claims to determine the amounts, if any, that management believes will be paid as a result of such claims and litigation and, therefore, additional losses may be accrued and paid in the future, which could materially adversely impact our operating results, cash flows and/or our ability to comply with our debt covenants.

In management's opinion, we are not currently involved in any legal proceedings other than those disclosed in our 2010 Annual Report filed on Form 10-K, our Quarterly Reports filed on Form 10-Q for the quarters ended March 31, 2011 and June 30, 2011, or specifically identified below, which, individually or in the aggregate, could have a material effect on our financial condition, operations and/or cash flows. Unless included in our legal accrual or otherwise indicated below, a range of loss associated with any individual material legal proceeding cannot be estimated.

Patent Litigation

Litigation with Johnson & Johnson (including its subsidiary, Cordis Corporation)

On April 13, 1998, Cordis Corporation filed suit against Boston Scientific Scimed, Inc. and us in the U.S. District Court for the District of Delaware, alleging that our former NIR® stent infringed three claims of two patents (the Fischell patents) owned by Cordis and seeking damages and injunctive relief. On May 2, 2005, the District Court entered judgment that none of the three asserted claims was infringed, although two of the claims were not invalid. The District Court also found the two patents unenforceable for inequitable conduct. Cordis appealed the non-infringement finding of one claim in one patent and the unenforceability of that patent. We cross appealed the finding that one of the two claims was not invalid. Cordis did not appeal as to the second patent. On June 29, 2006, the Court of Appeals upheld the finding that the claim was not invalid, remanded the case to the District Court for additional factual findings related to inequitable conduct, and did not address the finding that the claim was not infringed. On August 10, 2009, the District Court reversed its finding that the two patents were unenforceable for inequitable conduct. On August 24, 2009, we asked the District Court to reconsider and on March 31, 2010, the District Court denied our request for reconsideration. On April 2, 2010, Cordis filed an appeal and on April 9, 2010, we filed a cross appeal. On June 6,

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2011, oral arguments were heard before the U.S. Court of Appeals for the Federal Circuit. On September 28, 2011, the Federal Circuit Court affirmed the District Court's findings of non-infringement and enforceability.

On each of May 25, June 1, June 22 and November 27, 2007, Boston Scientific Scimed, Inc. and we filed a declaratory judgment action against Johnson & Johnson and Cordis Corporation in the U.S. District Court for the District of Delaware seeking a declaratory judgment of invalidity of four U.S. patents (the Wright and Falotico patents) owned by them and of non-infringement of the patents by the PROMUS® coronary stent system, supplied to us by Abbott Laboratories. On February 21, 2008, Johnson & Johnson and Cordis filed counterclaims for infringement seeking an injunction and a declaratory judgment of validity. On June 25, 2009, we amended our complaints to allege that the four patents owned by Johnson & Johnson and Cordis are unenforceable. On January 20, 2010, the District Court found the four patents owned by Johnson & Johnson and Cordis invalid. On February 17, 2010, Johnson & Johnson and Cordis appealed the District Court's decision. The oral argument on appeal occurred on January 11, 2011 and on June 7, 2011 the U.S. Court of Appeals for the Federal Circuit affirmed the decision of the U.S. District Court for the District of Delaware, finding all four Johnson & Johnson patents to be invalid. On July 21, 2011, Johnson & Johnson and Cordis filed a petition for rehearing or rehearing en banc. On September 15, 2011, the Federal Circuit Court denied Cordis' petition for rehearing or rehearing en banc.

On January 15, 2010, Cordis Corporation filed a complaint against us and Boston Scientific Scimed, Inc. alleging that the PROMUS® coronary stent system, supplied to us by Abbott, infringes three patents (the Fischell patents) owned by Cordis. On March 11, 2010, we filed an answer to the complaint along with counterclaims of invalidity and non-infringement. The suit was filed in the U.S. District Court for the District of Delaware and seeks monetary and injunctive relief. A liability trial is scheduled to begin on July 30, 2012.

On September 22, 2009, Cordis Corporation, Cordis LLC and Wyeth Corporation filed a complaint for patent infringement against Abbott Laboratories, Abbott Cardiovascular Systems, Inc., Boston Scientific Scimed, Inc. and us alleging that the PROMUS® coronary stent system, supplied to us by Abbott, infringes a patent (the Llanos patent) owned by Cordis and Wyeth that issued on September 22, 2009. The suit was filed in the U.S. District Court for the District of New Jersey seeking monetary and injunctive relief. On September 22, 2009, we filed a declaratory judgment action in the U.S. District Court for the District of Minnesota against Cordis and Wyeth seeking a declaration that the patent is invalid and not infringed by the PROMUS® coronary stent system, supplied to us by Abbott. On January 19, 2010, the Minnesota District Court transferred our suit to the U.S. District Court for the District of New Jersey and on February 17, 2010, the Minnesota case was dismissed. On July 13, 2010, Cordis filed a motion to amend the complaint to add an additional patent, which the New Jersey District Court granted on August 2, 2010. Cordis filed an amended complaint on August 9, 2010. On September 3, 2010, we filed an answer to the amended complaint along with counterclaims of invalidity and non-infringement. On May 27, 2011, the District Court granted our motion to bifurcate damages from liability in the case. On October 26, 2011, the District Court granted Cordis' motion to add the Promus Element stent system to the case.

Other Stent System Patent Litigation

On May 19, 2005, G. David Jang, M.D. filed suit against us alleging breach of contract relating to certain patent rights covering stent technology. The suit was filed in the U.S. District Court for the Central District of California seeking monetary damages and rescission of the contract. After a Markman ruling relating to the Jang patent rights, Dr. Jang stipulated to the dismissal of certain claims alleged in the complaint with a right to appeal. In February 2007, the parties agreed to settle the other claims of the case. On May 23, 2007, Jang filed an appeal with respect to the remaining patent claims. On July 11, 2008, the Court of Appeals vacated the District Court's consent judgment and remanded the case back to the District Court for further clarification. On June 11, 2009, the District Court ordered a stay of the action pursuant to the parties' joint stipulation. On August 30, 2011, the District Court entered a stipulated judgment that we did not infringe the Jang patent. Jang filed an appeal on September 21, 2011.

On October 5, 2009, Dr. Jang served a lien notice on us seeking a portion of any recovery from Johnson & Johnson for infringement of the Jang patent, and on May 25, 2010, Dr. Jang filed a formal suit in the U.S. District Court for the Central District of California. On June 5, 2010, we answered denying the allegations and on July 2, 2010, we filed a motion to transfer the action to the U.S. District Court for the District of Delaware. On August 9, 2010, the Central California District Court ordered the case transferred to Delaware. On September 30, 2011, the Delaware District Court granted our motion for judgment on the pleadings and entered judgment in favor of us on October 3, 2011.

On March 16, 2009, OrbusNeich Medical, Inc. filed suit against us in the U.S. District Court for the Eastern District of Virginia alleging that our VeriFLEX™ (Liberté®) bare-metal coronary stent system infringes two U.S. patents (the Addonizio and Pazienza patents) owned by it. The complaint also alleged breach of contract and misappropriation of trade secrets and seeks monetary and injunctive relief. On April 13, 2009, we answered denying the allegations and filed a motion to transfer the case to the U.S. District

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Court for the District of Minnesota as well as a motion to dismiss the state law claims. On June 8, 2009, the case was transferred to the U.S. District Court for the District of Massachusetts. On September 11, 2009, OrbusNeich filed an amended complaint against us. On October 2, 2009, we filed a motion to dismiss the non-patent claims and, on October 20, 2009, we filed an answer to the amended complaint. On March 18, 2010, the Massachusetts District Court dismissed OrbusNeich's unjust enrichment and fraud claims, but denied our motion to dismiss the remaining state law claims. On April 14, 2010, OrbusNeich filed a motion to amend its complaint to add another patent (another Addonizio patent). On January 21, 2011, OrbusNeich moved for leave to amend its complaint to drop its misappropriation of trade secret, violation of Massachusetts Business Practices Act and unfair competition claims from the case. On July 8, 2011, OrbusNeich filed a motion to amend its complaint to include allegations that our ION™ coronary stent system infringes two additional patents. On August 31, 2011, the Massachusetts District Court granted OrbusNeich's motion to amend.

On November 17, 2009, Boston Scientific Scimed, Inc. filed suit against OrbusNeich Medical, Inc. and certain of its subsidiaries in the Hague District Court in the Netherlands alleging that OrbusNeich's sale of the Genous stent infringes a patent owned by us (the Keith patent) and seeking monetary damages and injunctive relief. A hearing was held on June 18, 2010. In December 2010, the case was stayed pending the outcome of an earlier case on the same patent. On February 4, 2011, we filed an appeal. On July 5, 2011, the Hague Court of Appeals dismissed OrbusNeich's motion to deny jurisdiction regarding cross-border provisional relief.

On September 27, 2010, Boston Scientific Scimed, Inc., Boston Scientific Ltd., Endovascular Technologies, Inc. and we filed suit against Taewoong Medical, Co., Ltd., Standard Sci-Tech, Inc., EndoChoice, Inc. and Sewoon Medical Co., Ltd for infringement of three patents on stents for use in the GI system (the Pulnev and Hankh patents) and against Cook Medical Inc. (and related entities) for infringement of the same three patents and an additional patent (the Thompson patent). The suit was filed in the U.S. District Court for the District of Massachusetts seeking monetary damages and injunctive relief. On December 2, 2010, we amended our complaint to add infringement of six additional Pulnev patents, bringing the total number of asserted patents to ten. In January 2011, the defendants answered the complaint, denying infringement and counterclaiming for invalidity and unenforceability of the asserted patents. On September 22, 2011, we amended the complaint to add Chek-Med Systems d/b/a GI Supply as a defendant.

Other Patent Litigation

On May 27, 2011, Body Science LLC filed suit against us in the United States District Court for the Northern District of Illinois, alleging that our Latitude® Patient Management System and Latitude® Blood Pressure Monitor infringes two U.S. patents (the Besson patents) owned by them. On July 27, 2011, Body Science amended its complaint to add several cardiac resynchronization therapy defibrillator (CRT-D) and implantable cardioverter defibrillator (ICD) devices that are compatible with the Latitude® Patient Management System.

Product Liability Related Litigation

Cardiac Rhythm Management

Fewer than 10 individual lawsuits remain pending in various state and federal jurisdictions against Guidant alleging personal injuries associated with defibrillators or pacemakers involved in certain 2005 and 2006 product communications. The majority of the cases in the United States are pending in federal court. On November 7, 2005, the Judicial Panel on Multi-District Litigation established MDL-1708 (MDL) in the U.S. District Court for the District of Minnesota and appointed a single judge to preside over all the cases in the MDL. In April 2006, the personal injury plaintiffs and certain third-party payors served a Master Complaint in the MDL asserting claims for class action certification, alleging claims of strict liability, negligence, fraud, breach of warranty and other common law and/or

statutory claims and seeking punitive damages. On July 12, 2007, we reached an agreement to settle certain claims, including those associated with the 2005 and 2006 product communications, which was amended on November 19, 2007. Under the terms of the amended agreement, subject to certain conditions, we would pay a total of up to $240 million covering up to 8,550 patient claims, including almost all of the claims that have been consolidated in the MDL as well as other filed and unfiled claims throughout the United States. On June 13, 2006, the Minnesota Supreme Court appointed a single judge to preside over all Minnesota state court lawsuits involving cases arising from the product communications. At the conclusion of the MDL settlement in 2010, 8,180 claims had been approved for participation. As a result, we made all required settlement payments of approximately $234 million, and no other payments are due under the MDL settlement agreement. On April 6, 2009, September 24, 2009, April 16, 2010 and August 30, 2010, the MDL Court issued orders dismissing with prejudice the claims of most plaintiffs participating in the settlement; the claims of settling plaintiffs whose cases were pending in state courts have been or will be dismissed by those courts. On April 22, 2010, the MDL Court certified an order from the Judicial Panel on Multidistrict Litigation remanding the remaining cases to their trial courts of origin. In the third quarter of 2011, we entered into a confidential settlement agreement in the two product liability class action lawsuits with respect to the same subject matter.

Securities-Related Litigation

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On October 22, 2010, Sanjay Israni filed a shareholder derivative complaint against us and against certain directors and officers in Massachusetts Superior Court for Middlesex County purportedly seeking to remedy alleged breaches of fiduciary duties that allegedly caused losses to us. The relevant period defined in the complaint is from April 20, 2009 to March 30, 2010. The allegations in the complaint are largely the same as those contained in the shareholder derivative action filed by Rick Barrington. On June 22, 2011, the Court held a hearing on our motion to dismiss. Then, on June 27, 2011, the Court issued an order staying further proceedings in this case pending resolution in one or more of the three related matters discussed in our 2010 Annual Report filed on Form 10-K. On October 14, 2011, in response to our motions the Court lifted the stay and set a hearing on our motion to dismiss. On October 25, 2011, pursuant to a joint stipulation of the parties, the Court dismissed this matter with prejudice.

On September 23, 2005, Srinivasan Shankar, individually and on behalf of all others similarly situated, filed a purported securities class action suit in the U.S. District Court for the District of Massachusetts on behalf of those who purchased or otherwise acquired our securities during the period March 31, 2003 through August 23, 2005, alleging that we and certain of our officers violated certain sections of the Securities Exchange Act of 1934. Four other plaintiffs, individually and on behalf of all others similarly situated, each filed additional purported securities class action suits in the same court on behalf of the same purported class. On February 15, 2006, the District Court ordered that the five class actions be consolidated and appointed the Mississippi Public Employee Retirement System Group as lead plaintiff. A consolidated amended complaint was filed on April 17, 2006. The consolidated amended complaint alleges that we made material misstatements and omissions by failing to disclose the supposed merit of the Medinol litigation and DOJ investigation relating to the 1998 NIR ON® Ranger with Sox stent recall, problems with the TAXUS® drug-eluting coronary stent systems that led to product recalls, and our ability to satisfy U.S. Food and Drug Administration (FDA) regulations concerning medical device quality. The consolidated amended complaint seeks unspecified damages, interest, and attorneys' fees. The defendants filed a motion to dismiss the consolidated amended complaint on June 8, 2006, which was granted by the District Court on March 30, 2007. On April 16, 2008, the U.S. Court of Appeals for the First Circuit reversed the dismissal of only plaintiff's TAXUS® stent recall-related claims and remanded the matter for further proceedings. On February 25, 2009, the District Court certified a class of investors who acquired our securities during the period November 30, 2003 through July 15, 2004. The defendants filed a motion for summary judgment and a hearing on the motion was held on April 21, 2010. On April 27, 2010, the District Court granted defendants' motion and on April 28, 2010, the District Court entered judgment in defendants' favor and dismissed the case. The plaintiffs filed a notice of appeal on May 27, 2010. The oral argument in the First Circuit Court of Appeals was held February 10, 2011. On August 4, 2011, the First Circuit Court of Appeals affirmed the District Court's entry of judgment in favor of the defendants.

On April 9, 2010, the City of Roseville Employees' Retirement System individually and on behalf of purchasers of our securities during the period from April 20, 2009 to March 12, 2010, filed a purported securities class action suit in the U.S. District Court for the District of Massachusetts. The suit alleges that we and certain of our current and former officers violated certain sections of the Securities Exchange Act of 1934 and seeks unspecified monetary damages. The suit claims that our stock price was artificially inflated because we failed to disclose certain matters with respect to our CRM business. An order was issued on July 12, 2010 appointing KBC Asset Management NV and Steelworkers Pension Trust as co-lead plaintiffs and the selection of lead class counsel. The plaintiffs filed an amended class action complaint on September 14, 2010. In the amended complaint, the plaintiffs narrowed the alleged class period from October 20, 2009 to February 10, 2010. On September 20, 2011, the District Court granted our motion to dismiss this action. The plaintiffs filed a notice of appeal on October 17, 2011.

On June 21, 2010, we received a shareholder derivative complaint filed by Rick Barrington individually and on behalf of all others similarly situated against all of our current directors, certain former directors and certain current and former officers seeking to remedy their alleged breaches of fiduciary duties that allegedly caused losses to us during the purported relevant period of April 20, 2009 to March 12, 2010. The allegations in this matter are largely the same

as those asserted in the City of Roseville case. The case was filed in the U.S. District Court for the District of Massachusetts on behalf of purchasers of our securities during the period from April 20, 2009 through March 12, 2010. On October 7, 2010, Mr. Barrington filed an amended complaint. On September 26, 2011, the District Court granted our motion to dismiss this action. Mr. Barrington did not appeal and the time for appeal has expired.

On August 19, 2010, the Iron Workers District Council Southern Ohio and Vicinity Pension Trust filed a putative shareholder derivative class action lawsuit against us and our Board of Directors in the U.S. District Court for the District of Delaware. The allegations and remedies sought in the complaint are largely the same as those in the original complaint filed by the City of Roseville Employees' Retirement System on April 9, 2010. On October 4, 2011, the District Court granted our motion to dismiss this action without prejudice to refile an amended complaint. On October 24, 2011, the plaintiffs filed a motion to stay the proceedings to allow them to make discovery demands before filing an amended complaint.

Governmental Proceedings

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Guidant / Cardiac Rhythm Management

In January 2006, Guidant was served with a civil False Claims Act qui tam lawsuit filed in the U.S. District Court for the Middle District of Tennessee in September 2003 by Robert Fry, a former employee alleged to have worked for Guidant from 1981 to 1997. The lawsuit claims that Guidant violated federal law and the laws of the States of Tennessee, Florida and California by allegedly concealing limited warranty and other credits for upgraded or replacement medical devices, thereby allegedly causing hospitals to file reimbursement claims with federal and state healthcare programs for amounts that did not reflect the providers' true costs for the devices. On December 20, 2010, the District Court granted the parties' motion to suspend further proceedings following the parties advising the Court that they had reached a settlement in principle. We finalized the settlement papers with the parties in September 2011, and we completed our obligations under the settlement agreement on October 4, 2011.

On September 25, 2009, we received a subpoena from the U.S. Department of Health and Human Services, Office of Inspector General (OIG), requesting certain information relating to contributions made by us to charities with ties to physicians or their families. On September 27, 2011, the OIG informed us that it was closing its investigation with no further action. Subsequently, on October 10, 2011, the U.S. District Court for the District of Maryland unsealed a qui tam complaint that relates to the subject matter of the OIG's investigation. The federal government has declined to intervene in that complaint and we have not yet been served with process in the matter.

On March 22, 2010, we received a subpoena from the U.S. Attorney's Office for the District of Massachusetts seeking documents relating to the former Market Development Sales Organization that operated within our CRM business. We are cooperating with this request. Subsequently on October 21, 2011, the U.S. District Court unsealed a qui tam complaint that relates to the subject matter of the U.S. Attorney's investigation. The federal government has not intervened in that complaint and we have not yet been served with process in the matter.

Other Proceedings

On September 28, 2011, we filed a complaint against Mirowski Family Ventures LLC for a declaratory judgment that we have paid all royalties owed and did not breach any contractual or fiduciary obligations arising out of a license agreement. Mirowski answered and filed counterclaims requesting damages.

In December 2010 and September 2011, we received Notices of Deficiency from the IRS assessing additional taxes for Guidant Corporation 2001 - 2003 tax years and for Boston Scientific 2006-2007 tax years, respectively, primarily for transfer pricing adjustments. We have filed and intend to timely file petitions with the U.S. Tax Court contesting Guidant Corporation and Boston Scientific assessments, respectively. Refer to Note J - Income Taxes for more information.

Matters Concluded Since December 31, 2010

On November 2, 2005, the Attorney General of the State of New York filed a civil complaint against Guidant pursuant to the consumer protection provisions of New York's Executive Law, alleging that Guidant concealed from physicians and patients a design flaw in its VENTAK PRIZM® 2 1861 defibrillator from approximately February 2002 until May 23 2005 and by Guidant's concealment of this information, it engaged in repeated and persistent fraudulent conduct in violation of the law. The New York Attorney General sought permanent injunctive relief, restitution for patients in whom a VENTAK PRIZM® 2 1861 defibrillator manufactured before April 2002 was implanted, disgorgement of profits, and all other proper relief. The case was removed from New York State Court in 2005 and transferred to the MDL Court in the U.S. District Court for the District of Minnesota in 2006. On April 26, 2010, the MDL Court certified an order remanding the remaining cases to the trial courts. On or about May 7, 2010, the New York Attorney General's lawsuit was remanded to the U.S. District Court for the Southern District of New York. In

December 2010, Guidant and the New York Attorney General reached an agreement in principle to resolve this matter. Under the terms of the settlement Guidant agreed to pay less than $1 million and to continue in effect certain patient safety, product communication and other administrative procedure terms of the multistate settlement reached with other state Attorneys General in 2007. On January 6, 2011, the District Court entered a consent order and judgment concluding the matter.

In October 2005, Guidant received an administrative subpoena from the DOJ, acting through the U.S. Attorney's office in Minneapolis, issued under the Health Insurance Portability & Accountability Act of 1996 (HIPAA). The subpoena requested documents relating to alleged violations of the Food, Drug, and Cosmetic Act occurring prior to our acquisition of Guidant involving Guidant's VENTAK PRIZM® 2, CONTAK RENEWAL® and CONTAK RENEWAL 2 devices. Guidant cooperated with the request. On November 3, 2009, Guidant and the DOJ reached an agreement in principle to resolve the matters raised in the Minneapolis subpoena. Under the terms of the agreement, Guidant would plead to two misdemeanor charges related to failure to include information in reports to the FDA and we will pay approximately $296 million in fines and forfeitures on behalf of Guidant. We recorded a charge of $294 million in the third quarter of 2009 as a result of the agreement in principle, which represents the

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$296 million charge associated with the agreement, net of a $2 million reversal of a related accrual. On February 24, 2010, Guidant entered into a plea agreement and sentencing stipulations with the Minnesota U.S. Attorney and the Office of Consumer Litigation of the DOJ documenting the agreement in principle. On April 5, 2010, Guidant formally pled guilty to the two misdemeanor charges. On April 27, 2010, the District Court declined to accept the plea agreement between Guidant and the DOJ. On January 12, 2011, following a review of the case by the U.S. Probation office for the District of Minnesota, the District Court accepted Guidant's plea agreement with the DOJ resolving this matter. The Court placed Guidant on probation for three years, with annual reviews to determine if early discharge from probation will be ordered. During the probationary period, Guidant will provide the probation office with certain reports on its operations. In addition, we voluntarily committed to contribute a total of $15 million to our Close the Gap and Science, Technology, Engineering and Math (STEM) education programs over the next three years.

On July 14, 2008, we received a subpoena from the Attorney General for the State of New Hampshire requesting information in connection with our refusal to sell medical devices or equipment intended to be used in the administration of spinal cord stimulation trials to practitioners other than practicing medical doctors. We have responded to the New Hampshire Attorney General's request. In February 2011, we were informed that the investigation has been closed.

In August 2009, we received shareholder letters demanding that our Board of Directors take action against certain directors and executive officers as a result of the alleged off-label promotion of surgical cardiac ablation system devices to treat atrial fibrillation. On March 19, 2010, the same shareholders filed purported derivative lawsuits in the Massachusetts Superior Court of Middlesex County against the same directors and executive officers named in the demand letters, alleging breach of fiduciary duty in connection with the alleged off-label promotion of surgical cardiac ablation system devices and seeking unspecified damages, costs, and equitable relief. The parties agreed to defer action on these suits until after the Board of Director's determination whether to pursue the matter. On July 26, 2010, the Board determined to reject the shareholders' demand. In October 2010, we and those of our present officers and directors who were named as defendants in these actions moved to dismiss the lawsuits. On December 16, 2010, the Massachusetts Superior Court granted the motion to dismiss and issued a final judgment dismissing all three cases with prejudice. The plaintiffs did not appeal and the time for appeal expired.

From time to time, Guidant has responded to and settled various product liability suits relating to the ANCURE Endograft System for the treatment of abdominal aortic aneurysms. The plaintiffs in these suits generally allege that they or their relatives suffered injuries, and in certain cases died, as a result of purported defects in the ANCURE System or the accompanying warning and labeling. Guidant has settled these individual suits for amounts that were not material to us. In 2009, the California state court dismissed four suits on summary judgment. All four dismissals have been upheld by the California Court of Appeals. On December 12, 2010, the U.S. Supreme Court declined to review the dismissals in two cases, and further review in the other two cases was not sought by the plaintiffs. There are currently no pending suits although Guidant has been notified of over 130 potential unfiled claims alleging product liability relating to the ANCURE System. The claimants generally make similar allegations to those asserted in the filed cases discussed above. It is uncertain how many of these claims will ultimately be pursued against Guidant.

On December 17, 2007, Medtronic, Inc. filed a declaratory judgment action in the U.S. District Court for the District of Delaware against us, Guidant Corporation, and Mirowski Family Ventures L.L.C., challenging its obligation to pay royalties to Mirowski on certain cardiac resynchronization therapy devices by alleging non-infringement and invalidity of certain claims of two patents owned by Mirowski and exclusively licensed to Guidant and sublicensed to Medtronic. On November 21, 2008, Medtronic filed an amended complaint adding unenforceability of the patents. A trial was held in January 2010 and on March 30, 2011, judgment was rendered in favor of Medtronic as to non-infringement. We do not intend to appeal.

On March 22, 2010, we received a subpoena from the U.S. Attorney's Office for the District of Massachusetts seeking documents relating to our March 15, 2010 announcement regarding the ship hold and product removal actions associated with our ICD and CRT-D systems, and relating to earlier recalls of our ICD and CRT-D devices. On April 12, 2011, the U.S. Attorney's Office advised the Company that it was discontinuing its criminal investigation of this matter.

On April 14, 2010, we received a letter from the United Union of Roofers, Waterproofers and Allied Workers Local Union No. 8 (Local 8) demanding that our Board of Directors seek to remedy any legal violations committed by current and former officers and directors during the period beginning April 20, 2009 and continuing through March 12, 2010. The letter alleges that our officers and directors caused us to issue false and misleading statements and failed to disclose material adverse information regarding serious issues with our CRM business. The matter was referred to a special committee of the Board to investigate and then make a recommendation to the full Board. On May 9, 2011, our Board resolved to reject the shareholders' demand.

On December 16, 2010, Kilts Resources LLC filed a qui tam suit against us in the U.S. District Court for the Eastern District of Texas alleging that we marked and distributed our Glidewire product with an expired patent in violation of the false marking statute and seeking monetary damages. On June 17, 2011, the parties entered into a confidential Settlement Agreement.

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On July 1, 2008, Guidant Sales Corporation received a subpoena from the Maryland office of the U.S. Department of Health and Human Services, Office of Inspector General seeking information concerning payments to physicians, primarily related to the training of sales representatives. The U.S. Attorney's Office for the District of Maryland conducted the investigation. On June 28, 2011, the U.S. Attorney's Office advised us that it was no longer investigating our sales training practices.

On August 24, 2010, EVM Systems, LLC filed suit against us, Cordis Corporation, Abbott Laboratories Inc. and Abbott Vascular, Inc. in the U.S. District Court for the Eastern District of Texas alleging that our vena cava filters, including the Escape Nitinol Stone Retrieval Device, infringe two patents (the Sachdeva patents) and seeking monetary damages. On November 15, 2010, we answered the complaint denying the allegations and asserting counterclaims of non-infringement and invalidity. On April 20, 2011, EVM amended the complaint to add an additional Sachdeva patent and the WATCHMAN® device, which we acquired with Atritech in March 2011. On July 11, 2011, the parties entered into a confidential Settlement Agreement.

NOTE L – EARNINGS PER SHARE

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in millions)	2011	2010	2011	2010
Weighted average shares outstanding - basic	1,514.4	1,519.8	1,523.1	1,517.0
Net effect of common stock equivalents	9.6	9.5	8.9	
Weighted average shares outstanding - assuming dilution	1,524.0	1,529.3	1,532.0	1,517.0

Our weighted-average shares outstanding for earnings per share calculations excluded common stock equivalents of 9.2 million for the first nine months of 2010 due to our net loss position in that period.

Weighted-average shares outstanding, assuming dilution, also excludes the impact of 65 million stock options for the third quarter of 2011, 62 million for the third quarter of 2010, 63 million for the first nine months of 2011, and 62 million for the first nine months of 2010, due to the exercise prices of these stock options being greater than the average fair market value of our common stock during the period.

We issued approximately two million shares of our common stock in the third quarter of 2011, three million shares in the third quarter of 2010, ten million shares in the first nine months of 2011, and nine million shares in the first nine months of 2010, following the exercise or vesting of underlying stock options or deferred stock units, or purchase under our employee stock purchase plans. During the third quarter of 2011, we repurchased 30 million shares of our common stock for approximately $192 million, pursuant to the recently authorized share repurchase programs, discussed below.

In May 2011, our Board of Directors and shareholders approved our 2011 Long-Term Incentive Plan (the 2011 LTIP), authorizing up to approximately 145 million shares of our common stock. The 2011 LTIP provides for the grant of restricted or unrestricted common stock, deferred stock units, options to acquire our common stock, stock appreciation rights, performance awards and other stock and non-stock awards. No further grants will be made under our 2003 Long-Term Incentive Plan. In addition, in July 2011, our Board of Directors approved a new share repurchase program authorizing the repurchase of up to $1.0 billion in shares of our common stock and re-approved approximately 37 million shares remaining under a previous share repurchase program. Any repurchased shares may be used for general corporate purposes.

NOTE M – SEGMENT REPORTING

Each of our reportable segments generates revenues from the sale of medical devices. As of September 30, 2011 and December 31, 2010, we had four reportable segments based on geographic regions: the United States; EMEA, consisting of Europe, the Middle East and Africa; Japan; and Inter-Continental, consisting of our Asia Pacific and the Americas operating segments, which include the emerging markets of Brazil, China and India. The reportable segments represent an aggregate of all operating divisions within each segment. We measure and evaluate our reportable segments based on segment net sales and operating income. We exclude from segment operating income

certain corporate and manufacturing-related expenses, as our corporate and manufacturing functions do not meet the definition of a segment, as defined by ASC Topic 280, Segment Reporting. In addition, certain transactions or adjustments that our Chief Operating Decision Maker considers to be non-recurring and/or non-operational, such as amounts related to goodwill and other intangible asset impairment charges; acquisition-, divestiture-, and restructuring-related charges and credits; as well as amortization expense, are excluded from segment operating income. Although we exclude these amounts from segment operating income, they are included in reported consolidated operating income (loss) and are included in the reconciliation below.

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We manage our international operating segments on a constant currency basis. Sales generated from reportable segments and divested businesses, as well as operating results of reportable segments and expenses from manufacturing operations, are based on internally-derived standard currency exchange rates, which may differ from year to year, and do not include intersegment profits. We have restated the segment information for 2010 net sales and operating results based on standard currency exchange rates used for 2011 in order to remove the impact of currency fluctuations. Because of the interdependence of the reportable segments, the operating profit as presented may not be representative of the geographic distribution that would occur if the segments were not interdependent. A reconciliation of the totals reported for the reportable segments to the applicable line items in our accompanying unaudited condensed consolidated statements of operations is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in millions)	2011	2010	2011	2010
Net sales				
United States	$990	$1,077	$3,054	$3,159
EMEA	420	411	1,343	1,343
Japan	203	203	630	644
Inter-Continental	183	168	533	494
Net sales allocated to reportable segments	1,796	1,859	5,560	5,640
Sales generated from divested businesses	34	79	110	255
Impact of foreign currency fluctuations	44	(22)	104	(91)
	$1,874	$1,916	$5,774	$5,804
Income (loss) before income taxes				
United States	$146	$215	$525	$560
EMEA	167	166	554	569
Japan	83	86	281	296
Inter-Continental	67	62	192	187
Operating income allocated to reportable segments	463	529	1,552	1,612
Manufacturing operations	(63)	(65)	(201)	(243)
Corporate expenses and currency exchange	(90)	(61)	(206)	(221)
Goodwill and other intangible asset impairment charges; and acquisition-, divestiture-, and restructuring- related net charges	(39)	(23)	(86)	(1,771)
Amortization expense	(97)	(129)	(325)	(381)
	174	251	734	(1,004)
Other expense, net	(63)	(88)	(192)	(288)
	$111	$163	$542	$(1,292)

NOTE N – NEW ACCOUNTING PRONOUNCEMENTS

Standards Implemented

ASC Update No. 2009-13

In October 2009, the FASB issued ASC Update No. 2009-13, Revenue Recognition (Topic 605) - Multiple-Deliverable Revenue Arrangements. Update No. 2009-13 provides principles and application guidance to determine whether multiple deliverables exist, how the individual deliverables should be separated and how to allocate the revenue in the arrangement among those separate deliverables. We adopted prospectively Update No. 2009-13 as of January 1, 2011. The adoption did not have a material impact on our results of operations or financial position for the three or nine months ended September 30, 2011 and is not expected to have a material impact in subsequent periods.

ASC Update No. 2010-20

In July 2010, the FASB issued ASC Update No. 2010-20, Receivables (Topic 310) - Disclosures about the Credit Quality of

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Financing Receivables and the Allowance for Credit Losses. Update No. 2010-20 requires expanded qualitative and quantitative disclosures about financing receivables, including trade accounts receivable, with respect to credit quality and credit losses, including a rollforward of the allowance for credit losses. We adopted Update No. 2010-20 for our year ended December 31, 2010, except for the rollforward of the allowance for credit losses, for which we included disclosure beginning in our first quarter ended March 31, 2011. Refer to Note A – Significant Accounting Policies to the consolidated financial statements included in our 2010 Annual Report filed on Form 10-K for disclosures surrounding concentrations of credit risk and our policies with respect to the monitoring of the credit quality of customer accounts. In addition, refer to Note H – Supplemental Balance Sheet Information for a rollforward of our allowance for doubtful accounts during the three and nine months ended September 30, 2011 and 2010.

ASC Update No. 2010-29

In December 2010, the FASB issued ASC Update No. 2010-29, Business Combinations (Topic 805) - Disclosure of Supplementary Pro Forma Information for Business Combinations. Update No. 2010-29 clarifies paragraph 805-10-50-2(h) to require public entities that enter into business combinations that are material on an individual or aggregate basis to disclose pro forma information for such business combinations that occurred in the current reporting period, including pro forma revenue and earnings of the combined entity as though the acquisition date had been as of the beginning of the comparable prior annual reporting period only. We were required to adopt Update No. 2010-29 for material business combinations for which the acquisition date is on or after January 1, 2011. The acquisitions we completed in the first nine months of 2011 are not considered material on an individual or aggregate basis and, therefore, are not subject to the disclosure requirements of Update No. 2010-29.

Standards to be Implemented

ASC Update No. 2011-04

In May 2011, the FASB issued ASC Update No. 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. Update No. 2011-04 clarifies the FASB's intent about the application of certain existing fair value measurement and disclosure requirements and changes certain principles or requirements for measuring or disclosing information about fair value. We are required to adopt Update No. 2011-04 for our first quarter ending March 31, 2012 and do not believe its adoption will have a significant impact on our future results of operations or financial position.

ASC Update No. 2011-05

In May 2011, the FASB issued ASC Update No. 2011-05, Comprehensive Income (Topic 820): Presentation of Comprehensive Income. Update No. 2011-05 requires that net income, items of other comprehensive income and total comprehensive income be presented in one continuous statement or two separate consecutive statements. The amendments in this Update also require that reclassifications from other comprehensive income to net income be presented on the face of the financial statements. We are required to adopt Update No. 2011-05 for our first quarter ending March 31, 2012, with the exception of the presentation of reclassifications on the face of the financial statements, which has been deferred by the FASB until further notice. Our adoption of Update No. 2011-05 will not impact our future results of operations or financial position.

ASC Update No. 2011-08

In September 2011, the FASB issued ASC Update No. 2011-08, Intangibles - Goodwill and Other (Topic 350): Testing Goodwill for Impairment. Update No. 2011-08 permits an entity to first assess qualitative factors to determine whether it is "more likely than not" that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. The "more likely than not" threshold is defined as having a likelihood of more than 50 percent. We are required to adopt Update No. 2011-08 for annual and interim goodwill impairment tests after December 15, 2011 and do not believe its adoption will have a significant impact on our future results of operations or financial position.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Introduction

Boston Scientific Corporation is a worldwide developer, manufacturer and marketer of medical devices that are used in a broad range of interventional medical specialties. Our mission is to improve the quality of patient care and the productivity of health care delivery through the development and advocacy of less-invasive medical devices and procedures. This is accomplished through the continuing refinement of existing products and procedures and the investigation and development of new technologies that are least- or less-invasive, reducing risk, trauma, procedure time and the need for aftercare; cost- and comparatively-effective and, where possible, reduce or eliminate refractory drug use. Our strategy is to lead global markets for less-invasive medical devices by developing and marketing innovative products, services and therapies that address unmet patient needs, provide superior clinical outcomes and demonstrate proven economic value. We intend to do so by building and buying products we understand, and selling them through sales forces we already have.

Financial Summary

Three Months Ended September 30, 2011

Our net sales for the third quarter of 2011 were $1.874 billion, as compared to net sales of $1.916 billion for the third quarter of 2010, a decrease of $42 million, or two percent. Excluding the impact of changes in foreign currency exchange rates, which contributed $66 million to our third quarter 2011 net sales as compared to the same period in the prior year, and net sales from divested businesses, our net sales decreased $63 million, or three percent. Declines in constant currency net sales from our Cardiac Rhythm Management (CRM) division of $65 million and our Interventional Cardiology division of $25 million were partially offset by increases in constant currency Endoscopy net sales of $16 million, Neuromodulation net sales of $5 million and Peripheral Interventions net sales of $7 million, as compared to the same period in the prior year.[1] Refer to Business and Market Overview for a discussion of our net sales by business.

Our reported net income for the third quarter of 2011 was $142 million, or $0.09 per share. Our reported results for the third quarter of 2011 included intangible asset impairment charges, acquisition-related charges, divestiture-related net credits, restructuring-related costs, discrete tax items and amortization expense (after-tax) totaling $81 million, or $0.06 per share. Excluding these items, net income for the third quarter of 2011 was $223 million, or $0.15 per share.

Our reported net income for the third quarter of 2010 was $190 million, or $0.12 per diluted share. Our reported results for the third quarter of 2010 included intangible asset impairment charges, restructuring-related costs, discrete tax items and amortization expense (after-tax) totaling $106 million, or $0.07 per share. Excluding these items, net income for the third quarter of 2010 was $296 million, or $0.19 per share.[1] The following is a reconciliation of results of operations prepared in accordance with U.S. GAAP to those adjusted results considered by management. Refer to Quarterly Results for a discussion of each reconciling item:

[1] Sales growth rates that exclude the impact of changes in foreign currency exchange rates and net income and net income per share excluding certain items required by GAAP are not prepared in accordance with generally accepted accounting principles in the United States (U.S. GAAP). Refer to Additional Information for a discussion of management's use of these non-GAAP financial measures.

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in millions, except per share data	Pre-Tax	Tax Impact	After-Tax	Impact per share
GAAP net income	$111	$31	$142	$0.09
Non-GAAP adjustments:				
Intangible asset impairment charges	9	(2)	7	0.01
Acquisition-related charges	8	(1)	7	0.01
Divestiture-related net credits	(7)	2	(5)	0.00
Restructuring-related charges	29	(10)	19	0.01
Discrete tax items		(25)	(25)	(0.02)
Amortization expense	97	(19)		