

**CORPORATE CASUAL GIVES WAY TO SUITS WITH STRIPES AND CUFFS:
TIME TO REDESIGN THAT DATED CORPORATE COMPLIANCE
PROGRAM AND NOT FALL PREY TO STYLE**

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White collar corporate prosecution is in vogue. Congress recently passed a broad overhaul of corporate fraud, securities and accounting laws aimed to curb corporate abuses.¹ The legislation was enacted in an effort to restore investors faith in corporate America.² It punishes acts of corporations and individuals that previously were not criminal, and dramatically increases penalties for criminal acts related to corporate fraud.³

The Government's aggressive pursuit of the death penalty against Arthur Andersen serves notice to other companies that corporate misbehavior will not be tolerated. Incredibly, the acts of only a few employees lead to the corporate giant's demise. Arthur Andersen's collapse resulted from its own failure to effectively monitor and govern itself, compounded by its failure to respond effectively to wrong doing once it was discovered. Internal checks and balances were ineffective. Though corporate corruption is not new, the number of cases now being investigated and prosecuted by the government greatly increases the need for effective internal compliance programs.

To understand how a few individuals can endanger an entire corporation, one must examine the principles of corporate criminal liability. A corporation is an artificial person that has "no soul to be damned, and no body to be kicked."⁴ It is comprised of shareholders, directors, officers and other agents, such as employees, who implement policies. A corporation may be criminally liable for the acts or omissions that its employees and agents commit. These acts or omissions must be effected through the scope of their employment and accompanied by an intent to benefit the corporation.⁵ The doctrine of imputed liability provides that corporations can, "be held responsible

for and charged with the knowledge and purposes of their employees and agents, acting within the authority conferred upon them.”⁶ Even the acts of “low level” employees can result in criminal liability being imputed to a corporation.⁷ An effective corporate compliance program can mitigate a corporation’s criminal liability.

I. Department of Justice’s View of Corporate Compliance Programs

The U.S. Department of Justice (“DOJ”) recognizes the importance of an effective compliance program.⁸ One of the factors that DOJ considers in determining whether to prosecute a corporation is the existence and adequacy of the corporation’s compliance program.⁹ The critical factors that DOJ examines in evaluating any compliance program are “whether the program is adequately designed for maximum effectiveness in preventing and detecting wrongdoing by employees and whether corporate management is enforcing the program or is tacitly encouraging or pressuring employees to engage in misconduct to achieve business objectives.”¹⁰

According to DOJ policy, “the prosecutor should consider the comprehensiveness of the compliance program, the extent and pervasiveness of the criminal conduct; the number and level of the corporate employees involved; the seriousness, duration, and frequency of the misconduct, and any remedial actions taken by the corporation, including restitution, disciplinary action, and revisions to corporate compliance programs. Prosecutors should also consider the promptness of any disclosure of wrongdoing to the government and the corporation’s cooperation in the government’s investigation.”¹¹

With regard to the disclosure made by the corporation, DOJ will look at its completeness “including, if necessary, a waiver of the attorney-client and work product protections, both with respect to its internal investigation and with respect to communications between specific officers,

directors, and employees and counsel. Such waivers permit the government to obtain statements from possible witness, subjects, and targets, without having to negotiate individual cooperation or immunity agreements.”¹²

II. The United States Sentencing Guidelines, View on Effective Corporate Compliance Programs

The Sentencing Guidelines for Organizations (“Guidelines”) also recognize the importance of effective corporate compliance programs.¹³ The Guidelines, which apply to all federal felonies and Class A misdemeanors committed by organizational offenders, provide a novel sentencing approach.¹⁴ Rather than focusing on punishment and incapacitation, the Guidelines are geared toward deterrence. Specifically, the Guidelines provide benefits to organizations that have an “effective program to prevent and detect violations of law.”¹⁵ In fact, an “effective program to prevent and detect violations of law” may result in the reduction of the fine assessed against an organization. These fine reductions can range from \$2,500.00 to \$36,500,000.00.¹⁶ Furthermore, having an “effective program to prevent and detect violations of law” can save an organization the expense of being placed on probation.

Terms and conditions of probation can be quite onerous for a corporation. For example, the court must include an order of restitution, notice to victims of the offense, or an order requiring the corporation to reside, or refrain from residing, in a specified place or area.¹⁷ Additionally, the court may order the company, at its own expense and in the format and media specified by the court, to publicize the nature of the offense committed, the fact of conviction, the nature of the punishment imposed, and the steps that will be taken to prevent the recurrence of similar offenses.¹⁸ The court may order a corporation to make periodic submissions to the court or probation officer that disclose

its financial condition, results of business operations, and accounting for the disposition of all funds received.¹⁹ The court may also require the corporation to submit to a reasonable number of regular or unannounced examinations of its books and records by the probation officer or experts engaged by the court and allow the expert to interrogate knowledgeable individuals within the company.²⁰ The cost of any such experts engaged by the court is paid by the corporation.²¹ Furthermore, the court may order the corporation to develop and submit to the court a program to prevent and detect violations of law, including a schedule for implementation.²²

“An implicit goal of the organizational sentencing guidelines was to encourage the development of internal programs designed to prevent and detect violations of law.”²³ The lofty goals of the Guidelines to create incentives for a more healthy, values-based way of doing business in America is arguably making modest progress.²⁴ Over the last decade it appears that many corporations have made good faith, substantial efforts to create compliance programs that are fully supported by organizational management and implemented through substantive internal changes in personnel practices, organizational structure, and business operating practices.²⁵

Yet even in light of the benefits offered by the Guidelines to implement an “effective program to prevent and detect violations of law” and the consequences of not having such a program, many companies are not implementing these programs. Fiscal Year 2000, the United States Sentencing Commission, the commission that implements the Guidelines and studies their utilization, received detailed culpability score information from 133 cases involving organizations sentenced under the guidelines.²⁶ Not a single one of these organizations had an “effective program to prevent and detect violations of law.”²⁷ Only fourteen (14) of them had a compliance program, and theirs were not effective.²⁸

III. Implementation of an Effective Corporate Compliance Policy

For companies desiring to develop an effective compliance program, the Guidelines provide a framework to develop these internal programs to prevent and detect violations of law.²⁹ An effective compliance program must incorporate and address several points specifically enunciated in the Guidelines.

First, a corporation must have established compliance standards and procedures, to be followed by its employees and agents, which are reasonably capable of reducing the prospect of criminal conduct.³⁰ Each corporation must tailor its compliance program to its specific needs. “Compliance programs should be designed to detect the particular types of misconduct most likely to occur in a particular corporation’s line of business.”³¹ Each department within the corporation must conduct a survey and determine its potential criminal exposure. A large corporation, for instance, may have several areas to examine, such as, antitrust compliance, environmental compliance, employment law compliance, work place safety laws, corporate and security laws, and the avoidance of product liability. Furthermore, all industry practice or regulatory standards must be incorporated into any compliance program. Failure to do so weighs against a finding of effective compliance.³²

Second, specific high level personnel must have overall responsibility for compliance.³³ This means assigning a high level manager to oversee compliance for each department. The details for overseeing such a compliance program must be included as part of the manager’s job description. When a corporation, through its agents or employees, becomes aware of a potential criminal violation but takes actions to prevent its discovery, the corporation and/or the individuals may be subjected to charges of obstruction of justice³⁴ or misprision of a felony.³⁵ Higher level corporate

officials who had no involvement in the original misconduct are at particular risk of committing these crimes. Counsel involved in any internal investigation should be sensitive to ethical and legal obligations that prohibit assistance to continuing criminal activity.³⁶

Third, a corporation must use due care not to delegate substantial discretionary authority to individuals with a propensity to engage in illegal activities.³⁷ This may require a due diligence background check on employees before they are put into positions of authority.

Fourth, a corporation must take steps to effectively communicate its standards and procedures to all employees and other agents. The corporation must develop policies defining the standards, rules, and procedures to be followed by its employees. Afterwards, this policy must be communicated to its employees through training or publications.³⁸ In considering whether or not a compliance program is effective, DOJ will evaluate whether the corporation's employees were adequately informed about the compliance program and were convinced of the corporation's commitment to it.³⁹

Fifth, a corporation must take reasonable measures to achieve compliance such as internal audits and disciplinary mechanisms. DOJ, when evaluating a compliance program for effectiveness, will examine whether “the corporation has provided for a staff sufficient to audit, document, analyze, and utilize the results of the corporation’s compliance efforts.”⁴⁰ Furthermore, care must be taken to avoid the fear of retribution. There needs to be some effective way to report suspected illegal conduct, such as a hotlines or ombudsman.⁴¹ By avoiding retaliatory acts, an organization can insulate itself from new legislation which creates a cause of action to protect of a whistle-blower against retaliation in fraud cases.⁴² Specifically, an employee who prevails in an action for retaliation in fraud cases is entitled to all relief necessary to make the employee whole.⁴³ These damages likely

include reinstatement with the same seniority status that the employee would have had, but for the discrimination; back pay, with interest; and compensation for any special damages sustained as a result of the discrimination, including litigation costs, expert witness fees, and reasonable attorney fees.⁴⁴

Sixth, the standards must be enforced by appropriate disciplinary mechanisms, including, as appropriate, discipline of individuals responsible for the failure to detect an offense.⁴⁵

Seventh, after an offense has been detected, the corporation must take all reasonable measures to appropriately respond to and prevent similar offenses, including any necessary modifications to its compliance program.^{46 1}

Even a corporation with a pre-existing compliance program must re-assess it in light of new legislation, aggressive attitudes, Guideline amendments and , greater comprehensive compliance burdens. Under the Guidelines, a compliance program must be “comprehensive”. Drafting a compliance program requires input from numerous participants, including: (1) the chief executive officer, to determine policy decisions; (2) the chief financial officer, to determine the program’s effect on internal and external audits; (3) other high level management, to provide input on their individual areas; (4) corporate counsel, since counsel must ultimately interpret and enforce the compliance program; and (5) outside counsel familiar with the Guidelines who can oversee the drafting of the compliance program. Outside legal advise also may be needed to determine whether the compliance program interferes with existing contractual or legal rights of employees.

¹The Guidelines also authorize DOJ to take into account other relevant factors in determining whether a compliance program is effective, including: (1) corporate size; (2) likelihood that certain offenses may occur because of the corporate business; and (3) prior corporate history.

Additionally, outside counsel must determine whether the compliance program could be interpreted as creating new procedures for the corporation to follow before an employee may be terminated.

CONCLUSION

The imposition of the Guidelines for Sentencing of Organization mandates that corporations need to assess or reassess their potential liability. Under the Guidelines, mitigating and aggravating circumstances will be taken into account when calculating the appropriate fine for criminal violations. One of the key factors in determining both aggravation and mitigation is the absence or existence of an effective compliance program. When a corporation creates, implements and oversees such a program, courts likely will conclude that the defendant corporation made a good faith attempt to prevent criminal violations from occurring. Conversely, a corporation that does not have a compliance program will be penalized with a steep fine and a court imposed program. Accordingly, corporations that have no compliance program should implement one, and even corporations with compliance programs in place must re-assess and re-evaluate their programs to ensure that they meet Guideline requirements. The consequences of failing to do so are not pretty. Just ask Arthur Andersen.

END NOTES

1. Sarbanes-Oxley Act of 2002, H.R. 3763
2. President Bush Signs Corporate Corruption Bill, President George W. Bush, July 30, 2002, www.whitehouse.gov/news/releases/2002/07/20020730.html,
3. Sarbanes-Oxley Act of 2002, H.R. 3763
2. See J. Coffee, *No soul to Damn; No Body to Kick: An Unscandalized Inquiry Into Problem of Corporate Punishment*, 79 *Mitch. L. Rev.* 388 (1981).
5. *New York Central and Hudson River Railroad Co. v. United States*, 212 U.S. 481 (1909).
6. *Id.* at 494-95.
7. *Standard Oil Co. of Texas v. U.S.*, 307 F.2d 120, 127 (5th Cir. 1962).
8. U.S. Attorney's Manual, Title 9, Criminal Resource Manual 162, Federal Prosecutions of Corporations.
9. *Id.* at II(A)(5).
10. *Id.* at VII(B).
11. *Id.*
12. *Id.* at VI(B).
13. *See United States Guidelines Manual*, Chapter Eight– Sentencing of Organizations
14. Diana E. Murphy, *The Federal Sentencing Guidelines for Organizations: A Decade of Promoting Compliance and Ethics*, 87 *Iowa Law Review* 697, 702 (2002).
15. U.S.S.G. § 8A1.2, cmt. n.3(k).
16. A corporation receives a 3 offense level reduction if the offense occurred despite an effective program to prevent and detect violation of law. U.S.S.G. § 8C2.5(f). A 3 offense level reduction can result in a fine reduction from \$2,500.00 to \$36,500,000.00 depending on the organizations overall offense level as calculated under the Sentencing Guidelines.
17. U.S.S.G. §8D1.3(b)
18. U.S.S.G. §8D1.4(a)
19. U.S.S.G. §8D1.4(b)(1)
20. U.S.S.G. §8D1.4(b)(2)(A)
21. U.S.S.G. §8D1.4(b)(2)(A)
22. U.S.S.G. §8D1.4(c)(1)
23. *Id.*
24. *See John R. Steer, Changing Organizational Behavior – The Federal Sentencing Guidelines Experiment Begins to Bear Fruit*, ().
25. *Id.*

26. U.S. Sentencing Commission's 2000 Annual Report, Table 54.
27. *Id.*
28. *Id.*
29. U.S.S.G. §8A1.2 – Commentary (k)(1)-(7).
30. *Supra*, Section 8A1.2 - Commentary (k)(1).
31. U.S. Attorney's Manual, Title 9, Criminal Resource Manual 162, Federal Prosecutions of Corporations, VII(B).
32. *Supra*, Section 8A1.2 - Commentary (k)(7).
33. *Supra*, Section 8A1.2 - Commentary (k)(2)
34. 18 U.S.C.A. 1505, 1515 (Supp. 1989).
35. 18 U.S.C.A. 4 (1969).
36. See R. Ogren, *The Voluntary Disclosure Program in Gov't Procurement Fraud Investigations*, 28 (1988).
37. Section 8A1.2 - Commentary (k)(3).
38. Section 8A1.2 - Commentary (k)(4).
39. U.S. Attorney's Manual, Title 9, Criminal Resource Manual 162, Federal Prosecutions of Corporations, VII(B).
40. U.S. Attorney's Manual, Title 9, Criminal Resource Manual 162, Federal Prosecutions of Corporations, VII(B).
41. Section 8A1.2 - Commentary (k)(5).
42. 18 U.S.C. 1514
43. 18 U.S.C. §1514A(c)(1).
44. 18 U.S.C. § 1514A(c)(2)(A) - (B).
45. Section 8A1.2 - Commentary (k)(6).
46. Section 8A1.2 - Commentary (k)(7).