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CORPORATE LAW COMPLIANCE PROGRAMS: A NECESSARY BY-PRODUCT OF THE RECENT ORGANIZATIONAL SENTENCING GUIDELINES

On November 1, 1991, the Guidelines for Sentencing of Organizations became effective. These new Guidelines punish organizations, including corporations convicted of federal crimes, with far greater severity than previously.¹ The Guidelines allow for mitigation of these severe penalties if the defendant corporation has "an effective program to prevent and detect violations of law".² Corporate law compliance programs meet this definition.

This article provides an analysis of how the new Guidelines affect the computation of fines. It addresses how a corporation can decrease these potential fines by implementing a compliance program or re-structuring their existing program. This Article lists the elements of an effective compliance program under the new Guidelines and the various personnel who should be involved in its structuring.

Prior to the implementation of the Guidelines, voluntary compliance programs were often dismissed as self-serving publicity ploys.³ Even the courts failed to develop a coherent, legal framework within which to assess and reward corporate self-regulatory endeavors.⁴ For the most part, courts have followed the common-law admonition that an employer's instructions to its employees would not necessarily relieve

the company of liability for employee acts that contravene those instructions.⁵ Now, the Guidelines have changed the way courts handle corporate criminal liability. Corporate America will receive greater leniency at sentencing for legal and regulatory violations if they exhibit internal mechanisms for preventing, detecting, and reporting criminal activity. The Guidelines punish culpable corporate conduct while simultaneously encouraging corporations to detect and disclose possible criminal behavior. Emphasis is now directed to corporate behavior leading up to conviction, rather than an employee's act imputed to the corporation.

A convicted corporation without a qualifying compliance program may subject itself to shareholder suits based upon a breach of fiduciary duty theory. Shareholders would allege that a compliance program would have prevented the criminal offense from occurring and/or that the corporation would have been fined at a much lower rate. Corporations are left with little choice but to structure rigorous law-compliance programs in conformity with the dictates of the Guidelines.

A. NECESSITY FOR IMPLEMENTING LAW COMPLIANCE PROGRAMS

The Guidelines rely upon the "carrot and stick" approach. The carrot rewards the corporation that initiates an effective compliance program while the stick severely punishes those who do not. The approach is propelled by an increasing reliance on corporate criminal prosecutions to curb perceived corporate excess and to respond to troubled areas in banking, environmental, finance, and defense procurement. There is a trend towards greater corporate prosecutions.⁶

Corporations are vicariously liable, even for the activities of disloyal employees. The recent corporate troubles involving securities violations at Drexel, Burnham, Lambert, and Salomon Brothers are classic examples of how the actions of a few employees can jeopardize the good standing of large corporations. The establishment of a compliance program is the first line of defense against the actions of any "rogue" employee that may impute criminal liability.

To understand how relatively few individuals can endanger an entire corporation, one must examine the principals of corporate criminal liability. A corporation is an artificial person that has "no soul to be damned, and no body to be kicked."⁷ It is comprised of the shareholders (owners who vote in the

directors); the directors (employees who oversee operations); the officers (employees who manage the corporation); and other agents (employees who implement policies). A corporation is 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.⁸ 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."⁹ Even "low level" employees can impute criminal liability upon a corporation.¹⁰

Though the employee must have an intent to benefit the corporation, an actual benefit need not occur.¹¹ The employee's primary motive for personal profit would not relieve the corporation of liability, if the corporation received some benefit. Intention to benefit the corporation is only relevant if intent is a specific element of the crime.¹²

Under the Collective Knowledge Doctrine, corporate liability may arise even though no single employee intended to commit the offense or know the existence of the operative facts leading to the violation.¹³ Imputed liability is so broad under the federal system that "within the scope of employment" is a term of art signifying little more than that the employee's crime must be committed in connection with their performance of some job related activity.¹⁴

To complement expanded corporate criminal liability, penalties have been drastically increased. Over the last decade, Congress has repeatedly increased criminal sanctions for "white collar" offenses by corporate defendants. In 1990, the maximum penalty for criminal antitrust violations sky rocketed tenfold to \$10,000,000.¹⁵ The Guidelines up the ante for corporate misdeeds. Utilizing the Guidelines' Offense Level Fine Table ("Table"), fines can reach \$72,500,000 exclusive of restitution.¹⁶ The sentencing judge has the authority to impose even greater fines outside the Table

where there is no cap. Should the Guidelines fine exceed the maximum fine authorized by a specific statute, the statute controls.

Punishment under the Guidelines is derived from a multi-step calculation. The initial step determines the fine that is to be assessed against the corporation, calculated by the seriousness of the crime, the pecuniary gain to the defendant corporation and the pecuniary loss to the victim. The next step examines the culpability of the defendant corporation and formulates a score that modifies the culpability upward for aggravating circumstances and downwards for mitigating circumstances. Finally, the Culpability Score is then applied to a fine multiplier which yields the sentencing range.

a) Appropriate Fine Determination.

Upon a finding of guilt, a court will order full restitution in addition to any fine. To arrive at the ultimate fine, the court must go through a series of calculations. Initially, the judge determines a "base fine" by first analyzing the nature and seriousness of the crime. Accordingly, if the crime is very serious, the base fine will be commensurate; if the crime is not serious, the base fine will not be as steep. This system of assessing a base fine corresponding to the serious nature of the crime is set forth in the Table. Certain crimes such as money laundering, bid-rigging or bribery have special instructions and do not follow the same calculations for determining the base fine as set forth in the Table.¹⁷

The court will use the base fine prescribed unless the pecuniary gain to the organization is greater or unless the pecuniary loss to the victim is greater. The pecuniary loss to the victim will only be considered if such a loss was caused intentionally, knowingly, or recklessly by the defendant corporation.¹⁸ Therefore, the court will assess a fine against the corporation equal to the base fine in the Table, the pecuniary gain to the organization or the pecuniary loss to the victim, whichever is the greatest amount. By doing so, a corporation will

be deterred from obtaining a financial reward through criminal conduct. Prior to the new Guidelines, the sentencing court was not required to calculate the pecuniary gain or loss.

b) Culpability Score and Fine Range Determination.

Once the base fine is calculated, the court then focuses on determining the appropriate corporate culpability by formulating the Culpability Score.¹⁹ This score will determine the corresponding amounts by which the court will multiply the base fine. These "multipliers" consist of two ranges: a minimum multiplier and a maximum multiplier. For example, a Culpability Score of zero (0) could subject the base fine to a minimum multiplication of 0.05 to a maximum multiplication of 0.20. But a Culpability Score of ten (10) would significantly raise the multiplier to a minimum of 2.00 or a maximum of 4.00. Hence, lowering the Culpability Score is crucial because the lower the score, the lower the fine range.

The court discerns the Culpability Score by focusing on the steps taken by the corporation prior to the commission of the criminal act. The score is a numerical ranking that will vary based upon specified criteria, which includes mitigation and aggravation. Consequently, mitigation will reduce the fine because it will lower the Culpability Score, which will lower the multiplier. Conversely, aggravation will increase the amount of the fine because it will increase the Culpability Score, which will increase the multiplier. A convicted corporation starts with a base Culpability Score of five points.

For mitigation, the court will look to the following factors: that the corporation maintained a compliance program that was effectively communicated to the employees, and that the crime contradicted corporate policy²⁰ (subtract 3 points from the Culpability Score); that the corporation voluntarily disclosed the possible offense to the authorities²¹ (subtract 5 points from the Culpability Score); that the corporation fully coop-

erated with the investigation²² (subtract 2 points from the Culpability Score); or that the corporation accepted responsibility for the offense²³ (subtract 1 point from the Culpability Score).

Aggravation will be found if the corporation has a prior criminal history,²⁴ (add 2 points to the Culpability Score); or has violated any judicial order, injunction or probation²⁵ (add 2 points to the Culpability Score); or has impeded, aided, abetted, or encouraged obstruction of justice²⁶ (add 3 points to the Culpability Score); or whether top management had any involvement in the violation. There can be no compliance credit if high level management "participated in, condoned, or was willfully ignorant of the offense".²⁷ High level management is defined as individuals who have substantial control over the organization or who have a substantial role in the making of policy within the organization. The term includes directors, executive officers, top managers in areas such as sales, administration, or finance and individuals with substantial ownership and trusts.²⁸ Participation of lower level employees with "substantial authority" raises a rebuttable presumption that the corporation did not have an effective compliance program.

Willful ignorance may be considered an aggravating factor, since it is doubtful that high level management can exercise due care absent an awareness and knowledge of the criminal statutes applicable to their activities. Accordingly, the implementation of a compliance program is necessary, if not to qualify for sentence mitigation, then to dodge an aggravation determination at sentencing.

While the absence of a compliance program is not itself an aggravating circumstance, the Guidelines direct the court to impose probation "if, at the time of sentencing, an organization, having fifty or more employees, does not have an effective program to prevent and detect violations of law."²⁹ Further, the court has the discretion to employ experts at the corporation's expense to create, impose and oversee a compliance program for the defendant corporation.³⁰ Such action will likely result in the imposition of extra monetary and reporting requirements on

the defendant corporation.

The Culpability Score determines the applicable multipliers which yields the sentencing range. In determining the fine amount within the applicable range, the court may consider the corporation's role in the offense and the need for adequate deterrence.³¹ The higher the role, the higher the fine. However, where the fine exceeds the maximum fine authorized by the statutory offense, it is the maximum amount of the statutory fine that is applicable.

The court may also consider any collateral consequences of conviction, including any civil obligations arising from the corporate conduct.³² However, any collateral consequences that make victims whole do not provide a basis for fine reduction within the fine range.³³ All fines are exclusive of restitution.

B. DRAFTING AN EFFECTIVE LAW COMPLIANCE PROGRAM

An effective law compliance program must incorporate and address several points specifically enunciated in the Guidelines.³⁴

First, corporations must have established compliance standards and procedures to be followed by its employees and agents that are reasonably capable of reducing the prospect of criminal conduct.³⁵ Each corporation must tailor its compliance program to its specific needs. 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, anti-trust 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.³⁶

Secondly, specific high level personnel must have overall responsibility for compliance.³⁷ This means assigning a high level manager to oversee compliance for their department to ensure against po-

tential criminal exposure. 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 criminal violations but takes actions to prevent its discovery, the corporation and/or the individuals may be subjected to charges of obstruction of justice³⁸ or misprision of a felony.³⁹ Higher level corporate officials who had no involvement in the original misconduct are at particular risk of committing these crimes. **Defense counsel involved in any internal investigation should be sensitive to ethical and legal obligations that prohibit assistance to continuing criminal activity.**⁴⁰

Third, corporations must use due care not to delegate substantial discretionary authority to individuals with a propensity to engage in illegal activities.⁴¹ This may require a due diligence background check on employees before they are put into positions of authority.

Fourth, corporations must take steps to communicate effectively 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 needs to be communicated to its employees through training or publications.⁴²

Fifth, corporations must take reasonable measures to achieve compliance such as internal audits, and disciplinary mechanisms. Care must be taken to avoid the fear of retribution. There needs to be some effective way to report suspected illegal conduct, such as hotlines or ombudspersons.⁴³

Sixth, the standards must be enforced by appropriate disciplinary mechanisms, including, as appropriate, discipline of individuals responsible for the failure to detect an offense.⁴⁴

Seventh, after an offense has been detected, the corporation must take all reasonable measures to appropriately respond and to prevent similar offenses, including any necessary modifications to its compliance program.⁴⁵

Finally, the Guidelines will take into account other relevant factors to deter-

mine whether a compliance program is effective, such as: (1) corporate size; (2) likelihood that certain offenses may occur because of the corporate business; and (3) prior corporate history.⁴⁶

Even if a corporation has a pre-existing compliance program, the Guidelines impose greater comprehensive compliance burdens creating the need for corporations to reassess their programs. Under the Guidelines a compliance program must be comprehensive and tailored to the specific corporation. Drafting a compliance program should require input from numerous participants that may include: (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) 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 who is familiar with the Guidelines and can oversee the drafting of the compliance program. Furthermore, outside counsel must also determine whether the compliance program interferes with existing contractual or legal rights of employees. 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. As a result of the Guideline's imposition of greater compliance burdens, corporations need to evaluate their existing programs to determine their overall effectiveness.⁴⁷

CONCLUSION

The imposition of the new Guidelines for Sentencing of Organizations 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 presence of a compliance program. When a corporation creates, implements and oversees such a program, courts will likely deduce that the

defendant corporation has made a good faith attempt to prevent any 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 should implement a compliance program or re-evaluate and redraft their current program to meet the new Guideline requirements.

ENDNOTES

1. Chapter 8, The Guidelines for Sentencing of Organizations. Published 56 Fed. Reg. 22, 786 (May 16, 1991). Effective date of the regulations, November 1, 1991.
2. Id. at Section 802.5(f).
3. G. Spence, With Justice for None, P. 277 (1988) ("Most see the in-house ethics efforts of corporations being adopted more for public relations than for the good of the public. The truth is, corporations are no more capable of acting ethically than they are acting lovingly").
4. H.L. Pitt and K.A. GROSFAUFMANIS, Minimizing Corporate Civil and Criminal Liability: A Second Look at Corporate Codes of Conduct, Volume 78, Georgetown Law Journal (1956, 1961), June, 1990.
5. Id. at 1560.
6. Cohen, Corporate Crime and Punishment: An Update on Sentencing Practice in the Federal Courts, 1988-90, B.U.L. Rev., March, 1991.
7. See J. Coffee, No soul to Damn; No Body to Kick: An Unscandalized Inquiry Into the Problem of Corporate Punishment, 79 Mich. L. Rev. 388 (1981).
8. New York Central and Hudson River Railroad Co. v. United States, 212 U.S. 481 (1909).
9. Id. at 494-95
10. Standard Oil Co. of Texas v. U.S., 307 F.2d 120, 127 (5th Cir. 1962).
11. Id. at 127.
12. U.S. v. Ridglea State Bank, 357 F.2d 495, 498-99 (5th Cir. 1966).
13. U.S. v. Bank of New England, 821 F.2d 844, 856 (1st Cir. 1987).
14. See Criminal Fine Improvements Act of 1987, Pub. L. No. 185, 101 Stat. 1279.
15. K. Brinckley, Corporate Criminal Liability, Section 3.01 at 40 (1984).
16. Supra, Section 8C2.4(d).
17. Supra, 8C2.4 - Commentary 5.
18. Supra, 8C2.4 (a) (2), (3).
19. Supra, 8C2.5.
20. Supra, 8C2.5 (c).
21. Supra, 8C2.5 (g) (1).
22. Supra, 8C2.5 (g) (2).
23. Supra, 8C2.5 (g) (3).
24. Supra, 8C2.5 (c).
25. Supra, 8C2.5 (d).
26. Supra, 8C2.5 (e).
27. Supra, 8C2.5 (f).
28. Supra, 8A1.2 - Commentary.
29. Supra, 8D1.1 (a) (3).
30. Supra, 8D4.4 (c).
31. Supra, 8C2.8.
32. Supra, 8C2.8 (a) (3).
33. Supra, 8C2.8-Commentary (2).
34. Supra, 8A1.2 - Commentary (k).
35. Supra, 8A1.2 - Commentary (k) (1).
36. Section 8A1.2 - Commentary (k) (7).
37. Section 8A1.2 - Commentary (k) (2).
38. 18 U.S.C.A. 1505, 1515 (Supp. 1989).
39. 18 U.S.C.A. 4 (1969).
40. See R. Ogren, The Voluntary Disclosure Program in Gov't Procurement Fraud Investigations, 28 (1988).
41. Section 8A1.2-Commentary (k) (3).
42. Section 8A1.2-Commentary (k) (4).
43. Section 8A1.2-Commentary (k) (5).
44. Section 8A1.2-Commentary (k) (6).
45. Section 8A1.2-Commentary (k) (7).
46. Section 8A1.2-Commentary (k) (7) (i) (ii) (iii).
47. See B. Klubes, The Department of Defense Voluntary Disclosure Program, Public Contract Law Journal, Vol. 19, No. 3 (1990).

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