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U.S. Sentencing Guidelines

Changes Coming in Company Compliance Programs: The U.S. Sentencing Commission Adjusts the Rules

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Unlike the federal sentencing guidelines for individuals, which have had hundreds of amendments, the guidelines that govern the imposition of sentences for organizations have been fairly static. Since their original promulgation almost 20 years ago, in 1991, the organizational guidelines had undergone only one set of substantive changes, in 2004. That relatively uninterrupted history has now changed, and this may be a sign of more changes in the future.

Following publication of proposed amendments earlier this year, the U.S. Sentencing Commission voted April 7 to amend the guidelines in ways ranging from relatively technical and minor to highly significant. Unless Congress votes to override the Commission's action, which is unlikely, the new amendments will take effect Nov. 1.

In addition to a number of somewhat less significant revisions is one of special significance that could change the way companies manage their approach to compliance and ethics programs. The guidelines, although only technically a guide for sentencing by federal judges, have, in the area of compliance and ethics programs, taken on global significance as the most important template for such programs, so changes that originate here may reverberate around the world.

Credit Despite Involvement Of High-Level Personnel

Probably the most important change announced by the Sentencing Commission relates to the potential for a company to get credit for its compliance/ethics program even when senior employees are involved in an offense. Currently, guidelines Section 8C2.5(f)(3)(A)

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blocks credit for a company's compliance/ethics program if someone within ''high-level personnel'' of the organization or of a business unit of 200 or more people ''participated in, condoned, or was willfully ignorant of the offense'' for which the company is seeking credit for its compliance/ethics program.

High-level personnel are defined by the guidelines as personnel with ''substantial control over the organization or who have a substantial role in the making of policy within the organization'' or, in the case of high-level personnel of a business unit of 200 or more people, someone with a comparable level of authority in that business unit. In short, the ''credit blocker'' embedded in Section 8C2.5(f)(3)(A) comes into play when senior people—either of the entire company or of the unit where the misconduct occurred—were involved in the offense. If they were, the company cannot get credit for its compliance/ethics program.

The guidelines also contain a similar provision creating a ''rebuttable presumption'' against credit for the compliance/ethics program if ''substantial authority personnel'' are involved. See Section 8C2.5(f)(3)(B)(ii). Substantial authority personnel includes high-level personnel, but is also meant to include a class of personnel with significant responsibilities, for example mid-level managers, who are lower in the corporate hierarchy than high-level personnel. The definitions of ''high-level'' and ''substantial authority'' personnel are set out at U.S.S.G. § 8A1.2, n. 3.

Where did these provisions come from—in one case blocking credit if high-level personnel are involved and in the other making it hard to get credit if substantial authority personnel are involved—and what led to their modification this year? Some history is useful.

The two provisions in question, and especially the absolute ''credit blocker'' when high-level personnel are involved, have long been controversial. In the late 1980s, the Sentencing Commission considered various approaches to drafting organizational guidelines, including a ''Chicago School'' law and economics approach called ''Optimal Penalties''—imposing penalties large enough to cause a theorized rational corporate decision maker to conclude that the costs of a contemplated crime outweigh its benefits. The Commission thought this approach was too theoretical and impractical and, after weighing other options, eventually settled on a ''carrot and stick'' approach with a formula for setting penalties that enhanced punishment for more culpable companies (e.g., when senior people were involved) but, on the other hand, mitigated penalties for less culpable companies (i.e., those with strong compliance programs, that voluntary disclosed misconduct and that cooperated).

However, once the Commission decided to go with the carrot-and-stick approach, several commentators and stakeholders, such as the Department of Justice, worried that companies would use the guideline penalty mitigators to evade punishment that in some cases would be deserved.

The ''credit blocker'' contained in Section 8C2.5(f)(3)(A), blocking penalty reduction for the compliance/ethics program if high-level personnel are involved, and the rebuttable presumption against credit in Section 8C2.5(f)(3)(B)(ii) if substantial authority personnel are involved, were adopted at the Department of Justice's urging to help address these concerns. The authors of this article (one was the staff member who led the task force at the Sentencing Commission that developed the organizational guidelines, the other a close observer of corporate compliance and co-author of the first book on corporate compliance in 1988) felt that the provision was too strict and too broad. For example, in a very large company with business operations and tens of thousands of employees around the world, the involvement in an offense of, say, a single sales director in a business unit of 200 people could negate credit for the company's entire program—even if the company had done a spectacular job in promoting it and even if the company's compliance program was responsible for discovering and voluntarily disclosing the misconduct. As a matter of fairness, it did not seem right to provide the same level of sanction to this company and one just like it but that had not worked to develop a serious, worldwide compliance/ethics program.

The Story Continues. In 2003, the Sentencing Commission created an Ad Hoc Advisory Group to consider whether, after a period of more than 10 years, any changes should be made to the requirements for a creditworthy program set out in guidelines Section 8C2.1. The Advisory Group considered recommending that the high-level personnel credit blocker be in some way eased, but the Department of Justice still had qualms, so no change was recommended.

At this point, to understand the recent changes, a second piece of history is relevant. Although the Advisory Group made no recommendation regarding the credit blocker, it did focus on another phenomenon that had been taking place in the management of in-house compliance/ethics programs. Many companies that developed such programs in the wake of the organizational guidelines had adopted a two-tier management structure, whereby a senior officer, such as the general counsel, would bear the title of ''chief compliance officer,'' but a subordinate would actually manage the operation of the program on a day-to-day basis. The Advisory Group was concerned that this arrangement, though otherwise permissible under Section 8C2.1, could lead to important information (e.g., the fact that the compliance/ethics program was receiving insufficient support from certain senior personnel, or lacked sufficient resources) being ''filtered'' by the officer who was hierarchically positioned between the day-to-day compliance official, on the one hand, and management and especially the board, on the other.

In 2004, the Commission seemed to agree with these concerns and amended the guidelines so that for the first time this two-tier management structure for the compliance/ethics program was specifically addressed. The guidelines now provide in Section 8B2.1 that the individual having ''day-to-day operational responsibility for the compliance and ethics program shall report periodically to high-level personnel and, as appropriate, to the [board].'' The commentary to Section 8B2.1 goes on to say, ''the individual(s) with day-to-day operational responsibility for the program typically should, no less than annually, give the [board] . . . information on the implementation and effectiveness of the compliance and ethics program.''

In the years since the organizational guidelines were adopted, there had been very few cases in which companies that were sentenced in federal courts received credit for their programs. One potential explanation for this was that the blocker was eliminating compliance

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programs from consideration. Also during this period there was increasing awareness in the compliance and ethics community that compliance officers were not being appropriately positioned and empowered to be effective. See *Leading Corporate Integrity: Defining the Role of the Chief Ethics and Compliance Officer* (August 2007), http://www.corporatecompliance.org/Content/NavigationMenu/Resources/Surveys/CECO_Definition_8-13-072.pdf); *Perspectives of Chief Ethics and Compliance Officers on the Detection and Prevention of Corporate Misdeeds: What the Policy Community Should Know* (RAND; 2009), http://www.rand.org/pubs/conf_proceedings/2009/RAND_CF258.pdf.

The 2010 amendments to the guidelines bring together these two pieces of history: the concerns about the rigidity of the high-level personnel credit blocker, and the concerns about empowering the person with day-to-day operational responsibility for compliance/ethics. A new subsection (C) has been added to Section 8C2.5(f)(3) providing that credit for the compliance/ethics program *can be* awarded even if senior people are involved if four conditions are met:

i. ''*the individual or individuals with operational responsibility for the compliance and ethics program . . . have direct reporting obligations to the governing authority*,'' i.e., the board or relevant committee of the board;

ii. ''*the compliance and ethics program detected the offense before discovery outside the organization or before such discovery was reasonably likely*'';

iii. ''*the organization promptly reported the violation to the appropriate authorities*''; and

iv. ''*no individual with operational responsibility for the compliance and ethics program participated in, condoned or was willfully ignorant of the offense*.''

Of course, subsection (i) begs an important question: What are the ''direct reporting obligations'' to the board that the operational compliance/ethics person must have to satisfy this important new provision? The good news is that the Commission has provided at least some guidance in accompanying commentary. A new Note 11 says this language means that the operational person has ''*express authority to communicate personally*'' to the board (A) ''*promptly*'' about actual or potential ''*criminal conduct*,'' and (B) ''*no less than annually, on the implementation and effectiveness of the . . . program*.''

By its express language, this new commentary clearly appears designed to ensure that the person who is actually running the compliance and ethics program has direct, personal contact with the board—something that the existing guidelines may imply but do not explicitly require. Because the commentary refers to having ''authority'' to report to the governing authority (or board), an initial question arises as to whether the compliance officer *may* report or *must* report to the board. The wiser course for companies here clearly is to mandate such reporting, to ensure that it actually happens.

Experience makes clear that compliance officers should not be put in the position of having to fight their way into the board when, for example, an allegation involving a member of the senior team makes going to the board at once professionally sensitive and exceedingly important. If the matter is left to the ''discretion'' of the compliance officer, the officer can be in the untenable posture of having to make a bet on his or her job security. A mandatory reporting requirement obviates this problem by making clear that going to the board is not a matter of choice. The compliance officer's reporting mandate should be written, and the board and the corporate secretary should be made aware of the provision.

There also remains the question of who should report. If the chief compliance officer is a stand-alone function, not combined with other functions like the general counsel or head of human resources, then this position would clearly qualify as ''*the individual or individuals with operational responsibility for the compliance and ethics program.*'' But if the officer merely has the compliance operations under him or her, but has other significant responsibilities (such as the general counsel) and is not doing the direct work of managing the program, then it appears to be the clear intent of the new guideline language that the immediate subordinate, who is doing the hands-on work, must personally report.

It is also important to recognize who will probably be making the determination of program effectiveness. As the Commission has noted, few organizational cases involving large companies get to the point of sentencing. Certainly for these companies the key is not sentencing but the ability to convince prosecutors and regulators that the company deserves lenient treatment. In the criminal context, this means that DOJ will be making the crucial determination. Given the likely skepticism of a prosecutor, a company would be well advised to have this reporting language fully documented (considering that the commentary refers to ''express'' authority), and have the person running the program on a hands-on basis appearing personally before the board or a committee of the board. It would not be wise in this context to have the face-to-face report replace the usual written reports to the board, however. A written record of the board's diligence in this area remains essential, so the board should be on a first-name basis with the compliance officer but also be receiving a substantive written report. Written materials are much more credible to prosecutors than oral history would be.

Responding Appropriately to Misconduct

Under the ''seven steps'' of the original sentencing guidelines framework for a creditworthy compliance/ethics program set forth in Section 8C2.1, the seventh step—directing an organization to ''respond appropriately'' once misconduct has occurred—was never elaborated on in a complementary ''application note'' as is the case with most other provisions in the Section 8C2.1 framework. The 2010 amendments add such an application note, Note 6, which identifies three concepts that the note indicates may be relevant to responding appropriately.

The first concept set forth in the new application note is that the organization should ''*take reasonable steps, as warranted under the circumstances, to remedy the harm resulting from the criminal conduct*.'' The idea that organizations should respond to criminal conduct by remedying harm caused by the misconduct is fair, rational, and consistent with Part B of the organizational guidelines, which already directs courts to order restitution or other remedial steps in virtually all cases.

On the other hand, making remediation a potentially required element of a creditworthy compliance/ethics program—potentially required because the note says, cryptically, that this applies ''*as warranted*''—raises in-

teresting implications. In a complex fraud, for example, where the identity of victims and the degree of their harm may be subject to debate, does this mean the company must nevertheless pay victims right away, before any collateral cases are heard, to get credit for its compliance/ethics program?

The second idea set out in the new ''responding appropriately'' application note is that ''*reasonable steps . . . may include self-reporting and cooperation with authorities*.'' Again, this is consistent with other currently existing guidelines. See U.S.S.G. § 8C2.5(g) (providing fine mitigation for self-reporting offenses and cooperation). It is also consistent with a requirement in the guidelines that an organization must disclose criminal conduct within a reasonably prompt period of time—assuming the organization has discovered the misconduct—to get credit for its compliance/ethics program for that offense. See U.S.S.G. § 8C2.5(f)(2).

The third concept set out in the ''responding appropriately'' application note does introduce something new. The guideline itself already provides that responding appropriately includes ''making any necessary modifications to the organization's compliance and ethics program.'' The new application note elaborates that in ''*assessing the compliance and ethics program and making modifications . . . to ensure the program is effective . . . [appropriate steps] may include the use of an outside professional advisor*.'' Certainly many companies do use outside advisers to help assess program effectiveness, but heretofore the guidelines had never signaled specific approval for doing so.

Interestingly, this new note begins with the phrase: ''Subsection (b)(7) has two aspects.'' This might lead one to conclude that these were the only two elements in item 7. Yet nowhere do the guidelines expressly reference investigating allegations of misconduct. If item 7 does not, as many practitioners assume, cover the investigative step, then there would be an odd gap in the guidelines coverage, leaping from possible reports (reporting system) or indications of violations (e.g., audits and monitoring), to taking remedial steps, without ever determining if there were actually a violation. A more reasonable interpretation would be that this is implicit in item 7, but this is an issue the Commission might want to consider for a technical correction in the future.

Minor Changes to Probation Provisions

Under the guidelines, organizational probation—a means by which the court maintains jurisdiction over a company—is a form of punishment that can be imposed in addition to a fine and restitution. It is typically imposed to ensure either payment of a financial sanction or organizational changes including requiring a company to adopt a compliance/ethics program. Currently, the guidelines contain a policy statement that sets out possible ''conditions of probation.'' See U.S.S.G. § 8D1.4. Under this section, the court is directed to choose from two different menus of possible probation conditions. The correct menu depends on the reason probation is being imposed, whether, for example, to secure payment of financial penalties or to bring about organizational reform. Under the 2010 amendments, the divided menu approach is dropped and all conditions are deemed applicable, regardless of the basis for probation.

In making this change, the Commission dropped its originally proposed reference to corporate monitors, which had been opposed by the corporate community. However, the decision not to specifically mention ''monitors'' may not matter. The guideline probation conditions already contemplate that an ''expert'' may be appointed to examine records and interview employees. See U.S.S.G. § 8D1.4(b)(2) (to be redesignated (b)(5) with the amendments). Moreover, there is precedent for monitors in the probation setting. For example, Con Edison, the utility in New York City, was placed on probation and had a court-appointed ''monitor.''

As technical as the change to the probation provisions is, it may be viewed as even less significant by large companies, given how rarely organizational probation is imposed on them. Deferred prosecution agreements—another means by which the prosecutor and court can maintain jurisdiction over a company after the offense—have, in recent years, become the remedy of choice for federal prosecutors when dealing with large companies. When DPAs are used, this means no criminal conviction and therefore no possibility of imposing corporate probation. However, this recent historical pattern could be changing. In a case involving Guidant Corporation's alleged fraud in the sale of heart defibrillators, the Obama administration's Justice Department opted to pursue a criminal conviction, albeit for two misdemeanors, as part of a new ''get tough on corporate crime'' approach. And on April 27, the district court in Minnesota with jurisdiction in the case one-upped the government in ''toughness'' by rejecting the proposed deal with Guidant because it did not require corporate probation. See ''Judge Rejects Plea Deal on Guidant Heart Device,'' *New York Times*, April 28, 2010 (at B1).

Other Observations

One change the Commission did not make is to add references to ''document retention'' to the guidelines. The proposed amendments had two such references, intended to illustrate the kinds of policies and risks compliance programs entail, but some commentators (including the authors) noted that while records management is important, it could be unwise for the guidelines to suggest that it is more important than other risk areas.

Of particular importance for the future of compliance and ethics is that the Commission has indicated an ongoing interest in this area. This could foretell future review of the program guidelines by the Commission, with new proposals and refinements for these standards.

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