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New Corporate Sentencing Guidelines Provide Guidance Regarding What Constitutes An Effective Corporate Compliance Program

Martin B. Klotz,
Mei Lin Kwan-Gett
and Michael S. Schachter

WILLKIE FARR & GALLAGHER LLP

On November 1, 2010, amendments to the U.S. Sentencing Guidelines went into effect, amending the sentencing guidelines for corporate organizations. These amendments alter the eligibility for, and provide further guidance on the type of remedial efforts necessary to receive, credit for an effective compliance and ethics program. The amendments deserve careful consideration for two reasons. First, they will affect eligibility for sentencing credit in the event of an actual criminal conviction of a corporation. Second, and more importantly, an effective compliance program and remediation efforts are highly relevant to the Department of Justice's ("DOJ's") decisions to forego prosecution, to offer deferred prosecution and non-prosecution agreements, and to shape the terms of those agreements.¹ The amended Guidelines provide a roadmap for what the government regards as an "effective compliance and ethics program," and implementation of such a program may well allow a corporation to avoid criminal prosecution altogether.

Expanded Eligibility For Effective Compliance And Ethics Program Credit

Under the new Guidelines, organizations are entitled to receive a sentencing credit if they can demonstrate that they have an effective compliance and ethics program. That credit entitles organizations to a three-level decrease in their "culpability score."² The "culpability score" is one of two factors, the other being the organization's "offense level," used to determine the fine range under the Guidelines.³

A three-level culpability score reduction can translate into a significant decrease in the applicable fine range. For instance, with an offense level of 22 and a culpability score of 5, the Guidelines fine range would be between \$1,200,000 and \$2,400,000.⁴ With an effective compliance and ethics program reduction of three levels, and the same offense level, the Guidelines range would be reduced by nearly two-thirds, to \$480,000 to \$960,000.⁵

However, under the pre-amendment Guidelines, organizations were generally barred from receiving a credit for an effective compliance and ethics program where someone within the high-level personnel of an organization "participated in, condoned, or was willfully ignorant of the offense."⁶ The amended Guidelines allow organizations to receive this credit, notwithstanding complicity in the offense by high-ranking organizational personnel.⁷ To do so, the organization must show that it meets four tests:

(i) the individual or individuals with operational responsibility for the compliance and ethics program ... have direct reporting obligations to the governing authority or an appropriate subgroup thereof (e.g., an audit committee of the board of directors);

(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 offense to appropriate governmental authorities; and

(iv) no individual with operational responsibility for the compliance and ethics program participated in, condoned, or was willfully ignorant of the offense.⁸

The application note clarifies the direct reporting obligations necessary to satisfy the amendment:

[A]n individual has 'direct reporting obligations' to the governing authority or an appropriate subgroup thereof if the individual has express authority to communicate personally to the governing authority or appropriate subgroup thereof (A) promptly on any matter involving criminal conduct or potential criminal conduct, and (B) no less than annually on the implementation and effectiveness of the compliance and ethics program.⁹

In short, the Guidelines now require, as an element of an "effective compliance and ethics program," that a corporation's chief compliance officer, or person in a comparable position, report directly to the corporation's board or other governing person or group, rather than to the general counsel or an intermediate executive. Organizations are advised to take particular note of this direct reporting requirement. Given its emphasis in the new Guidelines, the existence of a direct reporting structure is likely to be a factor not just in sentencing, but in the government's broader consideration of an organization's compliance program in making its prosecutive decisions.

If an organization does not already have such a direct reporting structure, and many do not, it should consider adopting one. Such a reporting structure is easily established and the requirement is the only one of the four in the amendment that can be satisfied in advance of any wrongdoing at the organization.

Guidance On Remediation Efforts Necessary For An Effective Compliance And Ethics Program Credit

Under the amended Guidelines, the quality of a company's response to learning of misconduct plays an important role. The Guidelines list seven conditions for establishing an effective program, the last of which is that "[a]fter criminal conduct has been detected, the organization shall take reasonable steps to respond appropriately to the criminal conduct and to prevent further similar criminal conduct, including making any necessary modifications to the organization's compliance and ethics program."¹⁰

The pertinent application note describes two facets the government will weigh:

First, the organization should respond appropriately to the criminal conduct. The organization should take reasonable steps, as warranted under the circumstances, to remedy the harm resulting from the criminal conduct. These steps may include, where appropriate, providing restitution to identifiable victims, as well as other forms of remediation. Other reasonable steps to respond appropriately to the criminal conduct may include self-reporting and cooperation with authorities.

Second, the organization should act appropriately to prevent further similar criminal conduct, including assessing the

compliance and ethics program and making modifications necessary to ensure the program is effective. The steps taken should be consistent with [provisions calling for the organization to follow its compliance and ethics program, periodically assess and modify the program to ensure its effectiveness, and have and publicize a system for reporting or seeking guidance regarding criminal conduct without fear of retaliation] and may include the use of an outside professional advisor to ensure adequate assessment and implementation of any modifications.¹¹

Given the importance of an effective compliance program and remediation efforts to the exercise of prosecutorial discretion, corporations are advised to closely consult the Guidelines and this new application note when responding to allegations of misconduct. In particular, although the application note simply suggests potential steps for remediation, their implementation can result in significant benefits. Organizations should therefore seriously consider adopting these steps when responding to criminal conduct.

The Role Of An Effective Compliance And Ethics Program In Government Charging Decisions

Both the DOJ and the Securities and Exchange Commission ("SEC") have long considered the presence of an effective compliance program in making their charging decisions. The DOJ's "Principles of Federal Prosecution of Business Organizations" requires prosecutors to consider, among other things, the following factors in determining whether to charge a corporation for the conduct of an employee: "the corporation's timely and voluntary disclosure of wrongdoing and its willingness to cooperate in the investigation of its agents," "the existence and effectiveness of the corporation's pre-existing compliance program," and "the corporation's remedial actions, including any efforts to implement an effective corporate compliance program or to improve an existing one, to replace responsible management, to discipline or terminate wrongdoers, to pay restitution, and to cooperate with the relevant government agencies."¹²

Similarly, the SEC's *Seaboard* report requires consideration of the following factors, among others, in deciding whether to commence enforcement proceedings against a corporation for the conduct of an employee: the procedures in place to prevent the misconduct, why those procedures failed to stop or inhibit the wrongful conduct, whether the company promptly disclosed the misconduct to its regulators, the company's remedial efforts, and whether the company adopted new and more effective internal controls and procedures.¹³

The new Sentencing Guidelines now provide clearly delineated benefits to corporations with effective compliance programs. While it is not common for a corporation to be charged with and convicted of a crime, it is not uncommon for a corporation to be the subject of a criminal investigation that results in some type of resolution with the government. Under the amended Guidelines, the government will undoubtedly consider the effectiveness of a corporate compliance program when deciding whether to offer a non-prosecution or deferred prosecution agreement, and in determining what the precise terms of such an agreement should be. It is important to note that the DOJ typically relies on the Guidelines to help determine the appropriate fine even when entering into a deferred prosecution or non-prosecution agreement. Thus, corporations

should closely review the Guidelines' description of an "effective compliance and ethics program," including the direct reporting requirement for the corporate compliance department.

Conclusion

The tangible sentencing credit offered by the amended Guidelines for an effective compliance program, while significant, is secondary to the broader impact of such a program on prosecutorial decisions made long before the sentencing phase. The presence of an effective compliance program may be critical to the government's deciding whether to prosecute at all, and, even if no charges are brought, what the appropriate fine should be.

Corporations should review their compliance and ethics programs to ensure that their programs would be considered effective when evaluated according to the criteria set forth in the amended Sentencing Guidelines. If an organization has not already established an effective program, it should take immediate steps to do so.

¹ U.S. DOJ, U.S. Attorney's Manual 9-28.300(A)(5)-(6) available at http://www.justice.gov/usao/eousa/foia_reading_room/usam/ (listing "the existence and effectiveness of the corporation's pre-existing compliance program" and "the corporation's remedial actions, including any efforts to implement an effective corporate compliance program or to improve an existing one" as among the factors the government should consider "[i]n conducting an investigation, determining whether to bring charges, and negotiating plea or other agreements"); Report of Investigation Pursuant to Section 21(a), SEC Exchange Act Release No. 44969 (Oct. 23, 2001), available at <http://www.sec.gov/litigation/investreport/34-44969.htm> (listing the "compliance procedures" "in place" and what "[w]hat steps ... the company [look] upon learning of the misconduct" as factors in determining whether to take no action, bring reduced charges, or seek lighter sanctions).

² U.S. Sentencing Guidelines Manual § 8C2.5(f)(1) (2010).

³ The offense level is used to determine a base fine amount, ranging from \$5,000 to \$72,500,000. U.S. Sentencing Guidelines Manual § 8C2.4 (2010). The culpability score is a 0-10 scale used to create a minimum and maximum "multiplier," with the minimum multiplier ranging from 0.05 to 2 and the maximum multiplier ranging from 2 to 4. U.S. Sentencing Guidelines Manual § 8C2.6 (2010). The base fine amount is multiplied by the minimum multiplier to set the minimum Guidelines fine. U.S. Sentencing Guidelines Manual § 8C2.7 (2010). Similarly, the base fine amount is multiplied by the maximum multiplier to set the maximum Guidelines fine. *Id.* This determines the Guidelines range. *Id.*

⁴ U.S. Sentencing Guidelines Manual §§ 8C2.4, 8C2.6, 8C2.7 (2010).

⁵ *Id.*

⁶ See U.S. Sentencing Guidelines Manual § 8C2.5(f)(3) (2009). Organizations were completely barred from receiving the credit where high-level personnel in larger organizations, high-level personnel of an organizational unit of 200 or more, or personnel responsible for the compliance and ethics program are involved in the offense. U.S. Sentencing Guidelines Manual § 8C2.5(f)(3)(A) (2009). The Guidelines applied a rebuttable presumption that an organization does not have an effective compliance and ethics program where high-level personnel of an organization under 200 people, or personnel with substantial authority that are not high-level personnel, are involved in the offense. *Id.* at § 8C2.5(f)(3)(B); *Id.* at § 8C2.5 app. n.1.

⁷ U.S. Sentencing Guidelines Manual § 8C2.5(f)(3)(C) (2010).

⁸ *Id.*

⁹ U.S. Sentencing Guidelines Manual § 8C2.5 app. n.11 (2010).

¹⁰ U.S. Sentencing Guidelines Manual § 8B2.1(b)(7) (2010).

¹¹ U.S. Sentencing Guidelines Manual § 8B2.1 app. n.6 (2010).

¹² U.S. Attorney's Manual 9-28.300(A)(4)-(6), available at http://www.justice.gov/usao/eousa/foia_reading_room/usam/title9/ltit9e.htm.

¹³ Report of Investigation Pursuant to Section 21(a), SEC Exchange Act Release No. 44969 (Oct. 23, 2001), available at <http://www.sec.gov/litigation/investreport/34-44969.htm>.

Martin B. Klotz, Mei Lin Kwan-Gett and Michael S. Schachter are Partners in the Litigation Department in the firm's New York office.

Please email the authors at mklotz@willkie.com, mkwangett@willkie.com or mschachter@willkie.com with questions about this article.