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CORPORATE COMPLIANCE

Two Perkins Coie LLP attorneys discuss the best way for companies that may find themselves in the unenviable position of being under a Justice Department investigation to procure a sentencing reduction for having an effective compliance program. The authors explain that a company's focus should be on prevention first, and offer insight into what such a program should look like.

Understanding 'Corporate Sentencing' . . . Or How to Turn an Ounce of Preventative Compliance Into a Pound of Sentencing Cure

BY T. MARKUS FUNK AND LAURA CRAMER-BABYCZ

Everyone knows that getting ahead of a problem is always a good idea. And this certainly has proven true with respect to company compliance programs. If properly developed, implemented, and maintained, a well-devised, practical compliance program helps companies prevent business-interrupting and morale-crushing problems in the first place. But having one's compliance ducks in a row can also have a dramatic impact on how a company is treated by U.S. authorities if and when problems do arise.

Understanding why this is so requires a brief historical detour. Some seven years ago the U.S. Sentencing Commission changed how the U.S. Sentencing Guidelines (the ''Sentencing Guidelines'' or ''Guidelines'') calculate fines for certain defendant companies. The amendments, made more readily available a long-standing three-level total offense level reduction. The revised Guidelines section simply shifted the inquiry away from (1) the *(mis)conduct* of the company's high-level personnel, and toward (2) the *effectiveness* of the company's overall compliance and ethics program. This move directly benefits prepared businesses.

Of course, and as the title of this piece suggests, the focus now squarely rests on prevention—that is, implementing and maintaining an effective compliance program. After all, prevention is a company's best chance to never have to consider the benefits of the three-point reduction in the first place. Put another way, instituting, (and complying with) the amendments' requirements and the guidance on what the government thinks a sound compliance program ''should look like,'' serves two corollary functions: it both *prevents* liability through deterrence and rapid response and *mitigates* the misconduct's impact should it nevertheless occur.

An (Unsentimental) Goodbye To a 20-Year-Old Categorical Bar on Fine Reduction

Practitioners know that, since the adoption of the Sentencing Guidelines some twenty years ago, Section 8C2.5(f) has permitted corporate defendants to significantly reduce their fines by way of a three-level reduction in their total offense level provided they are able to

demonstrate that they, *at the time of the offense*, had in place an ''effective compliance and ethics program.''

Today's Section 8C2.5(f)(3)(C) permits a company with an ''effective compliance program,'' as defined in Section 8B2.1, to receive the three-level reduction even if high-level personnel participated in, condoned, or were willfully ignorant of the offense.

For a company that finds itself in the unenviable position of having to calculate its guidelines range, a three-level offense reduction has significant real-world results—effectively reducing the applicable fine by at least 50%. Consider that, at the lower end of the range, a three-level decrease drops the fine from $15,000 to $5,000; toward the higher end of the range, a three-level reduction moves the fine from $72.5 million (level 38) down to $36 million (level 35).

For the past two decades, however, companies seeking to benefit from a Section 8C2.5(f) reduction faced a considerable stumbling block in the form of an automatic bar that came down in all cases where ''high-level personnel'' participated in, condoned, or were willfully ignorant of the offense (and it was the latter category of ''willful ignorance'' cases that typically were the death knell to any hopes for receiving the reduction). Today, in contrast, the (bad) actions of high-level corporate personnel no longer foreclose the possibility of receiving a significant compliance credit.

Want Credit for Having a Solid Compliance Program (Despite Misconduct by High-Level Corporate Personnel)? Be Prepared To Qualify Under the Four-Part Eligibility Test

The 2010 amendments to Section 8C2.5(f)(3)(C) were drafted to respond to public concerns that (1) the categorical bar to the reduction operated too broadly; and (2) internal and external reporting of criminal conduct is, in appropriate cases, better encouraged by providing an exception to the general prohibition. The new focus was on the real-world effectiveness of the company's compliance program.

Today's Section 8C2.5(f)(3)(C) permits a company with an ''effective compliance program,'' as defined in Section 8B2.1, to receive the three-level reduction even if high-level personnel participated in, condoned, or were willfully ignorant of the offense. But in order to do so, the company must persuade the Court that it satisfies four distinct (and potentially tricky) criteria:

1. The individual or individuals with operational responsibility for the compliance and ethics program have *direct reporting obligations* to the company's governing authority or appropriate subgroup thereof;
2. The compliance and ethics program detected the offense *before* discovery outside the company - or before such discovery was *reasonably likely*;
3. The company promptly *reported* the offense to the appropriate government authorities; and
4. No individual with *operational responsibility* for the compliance and ethics program participated in, condoned, or was willfully ignorant of the offense.

OK, We Get It—Having a Sound Compliance Policy Is Important . . . But What Should Such a Program Look Like?

While issues such as when and how misconduct was detected, and whether the self-reporting obligation was satisfied, are frequently hotly contested, having in place an ''effective compliance and ethics program'' typically begins the discussion of whether the three-level reduction is available in the first place. The question then becomes: What does such a program look like?

Back to Basics: Understanding the Sentencing Guidelines' (High-Level) Description of an Effective Compliance Program

The Guidelines state broadly that in order to have an ''effective'' compliance and ethics program, a company must:

1. ''exercise due diligence to prevent and detect criminal conduct''; and
2. ''otherwise promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law.'' (*See* USSG § 8B2.1(a)).

These are certainly sensible sentiments—but what they in practice require of a company's compliance program is less than clear. The Guidelines set forth the following minimum requirements for compliance programs, but they, too, lack the type of detail that helps a company design, implement, and assess an effective compliance program:

- **Policies and Procedures**: The company must establish ''standards and procedures to prevent and detect criminal conduct'' that are communicated to members of the governing authority, high-level personnel, substantial authority personnel, employees, and, as appropriate, the company's agents.

- **Commitment from Governing Authority and High-Level Personnel**: The company's governing authority must be knowledgeable and exercise oversight over the compliance program, and certain high-level personnel must be assigned overall responsibility for the program.

- **Compliance Function**: Day-to-day operational responsibility for the compliance and ethics program must be delegated to specific individuals who periodically report to high-level personnel and, as appropriate, the governing authority. These compliance individuals must be given ''adequate resources, appropriate authority, and direct access to the governing authority or an appropriate subgroup of the governing authority.''

- **Monitoring and Auditing**: The company must ensure that the compliance program is followed by monitoring, auditing, and periodically evaluate the program.

- **Reasonable Response to Criminal Conduct**: The company must also ''take reasonable steps to respond appropriately'' once criminal conduct is detected. Application note 6 helpfully explains what constitutes (1) an appropriate response to criminal conduct, as well

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as (2) proactive steps designed to avert similar conduct in the future. Specifically, the application note provides that such steps ''may include the use of an *outside professional advisor* to ensure adequate assessment and implementation of any modifications.'' (emphasis added).

Adding Some Meat to the Compliance Bones: Justice Department Guidance on Compliance Programs

Moving from the general to the specific, guidance from the DOJ, including the *Resource Guide to the U.S. Foreign Corrupt Practices Act* (''FCPA Guide''), provides additional background on what a solid compliance program might look like. In addition, and more recently, the DOJ's Criminal Fraud Section issued guidance for corporate compliance programs in a document titled *Evaluation of Corporate Compliance Programs* (''Fraud Section Guidance''), which reflects a number of notable differences from prior guidance on similar issues. Specifically, the Fraud Section Guidance contains a list of criteria used by the Fraud Section in evaluating corporate compliance programs. As several commentators have noted—and the Fraud Section acknowledges—many of the topics contained in this recent guidance are consistent with, among other things, the FCPA Guide and the current Sentencing Guidelines. But it is the less-frequently-explored differences—areas where the DOJ has expanded on prior commentary—that provide companies with additional detail about how to design, implement, and evaluate their compliance programs:

A. Greater Focus on Compliance Function. As with prior public commentary, including the Guidelines, the Fraud Section Guidance reiterates that the compliance function should:

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- Be **delegated** to specific individuals within the organization who have day-to-day responsibility for the compliance and ethics program;
- Be **autonomous**, *i.e.*, have direct reporting lines to the board of directors; and
- Have **adequate resources**.

The Fraud Section Guidance, however, places greater emphasis on role of the compliance function within a company. For example, the recent guidance indicates that the Fraud Section may consider (and companies should therefore evaluate):

1. **The compliance function's stature within the company**, including whether:
   - The compliance function's compensation levels and rank/title are comparable to other strategic functions;
   - There has been a high turnover rate for compliance personnel; and
   - The compliance function is involved in strategic and operational decisions.
2. **The experience and qualifications of compliance personnel**, and, in particular, whether their experience and qualifications are commensurate with their roles and responsibilities.
3. **''Empowerment'' of the compliance function**, in other words, whether the company takes the compliance function seriously. Among other things, in evaluating the compliance function's role, a company should consider whether:
   - Compliance previously raised concerns with respect to wrongdoing and, if so, how the company responded to such concerns; and
   - Specific transactions or deals have been stopped or modified as a result of compliance concerns.

B. Enhanced Training—Should Not be ''One Size Fits All.'' The recent guidance again emphasizes the importance of compliance training for employees, but appears to place significant emphasis on ''risk-based'' trainings. By way of example, the Fraud Section Guidance highlights questions regarding whether companies:

- **Analyze training needs**, *i.e.*, determine (1) who should be trained and, in particular, whether there are high-risk employees who should receive additional training; and (2) whether different employees should be trained on different compliance topics.
- **Provide additional training for ''key gatekeepers,''** such as employees who issue payments or review approvals, to ensure they are familiar with the company's control processes.

C. Higher Expectations for Testing and Updating Compliance Programs. The recent guidance builds on what companies already know from the FCPA Guide and the Sentencing Guidelines: responsible companies should periodically review and update their compliance programs to ensure that they are effective. The Fraud Section Guidance, however, goes a few steps further by providing more detail about what the DOJ Fraud Section thinks that review-and-improvement process should look like. In particular, that companies should conduct regular, holistic reviews of compliance pro-

grams that include (1) testing controls; (2) collecting and analyzing compliance data; (3) interviewing employees and relevant third parties to assess the implementation of, and familiarity with, policies and procedures; and (4) reporting the results of such review and tracking action items.

Avoid Liability—and the Financial (And Reputational) Consequences Thereof—in Four Easy Steps

Although the Fraud Section Guidance is largely consistent with prior compliance-program guidance, it provides companies an ideal occasion to re-evaluate their compliance programs to ensure that they are in line with both the Sentencing Guidelines' minimum requirements and the DOJ's view of best practices. This re-evaluation can take place in four steps:

1. Review compliance and ethics program to ensure the compliance and ethics officers have *direct* responsibility, set forth in writing, to the board of directors audit committee or similar subgroup to immediately inform them of suspected noncompliance or criminal conduct.

2. Revise existing compliance policies and procedures to identify and promptly remedy potential internal control and compliance weaknesses.

3. Hire outside counsel to investigate cases of suspected noncompliance and to suggest appropriate amendments to the company's compliance and ethics program to help stave off questions concerning whether the company took ''reasonable steps'' upon learning of the suspected criminal conduct.

4. Submit an annual report assessing the implementation and effectiveness of the company's compliance and ethics program.

These four simple steps offer companies low-cost ''insurance'' against criminal conduct, as well as a means to mitigate—if not entirely avoid—the ''parade of horribles'' that unchecked conduct can have on a company's long-term future.

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