

Preventative Measures against Criminal Conduct Have Wide Ranging Benefits

By Paula J. Desio

EDITOR'S NOTE: The author is deputy general counsel of the United States Sentencing Commission. The views expressed here are solely those of the author and do not represent the official view of the Sentencing Commission.

A host of recent news headlines demonstrate that criminal activity within an organization is a corrosive element that has the potential for damaging, or even destroying an organization. For a number of years, organizational specialists have been developing internal systems to identify and rectify the causes of internal criminal activity. Though no system may provide a panacea, the experience in this field have proven that these systems can significantly improve the chance that an organization will be able to recognize and respond to these very real threats to their viability.

Preventing the losses associated with criminal activity involves at least two general issues. The first is the loss that derives from the criminal activity itself. The second is the loss that may arise from its prosecution. Over the last decade, U.S. federal criminal law has sought to foster preventive measures that are designed to address both concerns. In May of 2004, the United States Sentencing Commission proposed new guidelines addressing organizational penalties, which represent the latest developments in this arena. Organizations intent on limiting losses and promoting sustainable practices will need to respond to these new guidelines, which have an effective date of November 1, 2004.

The Facts of Criminal Liability

Federal criminal liability can attach to an organization whenever an employee commits an act within the apparent scope of his or her employment, even if the employee acted contrary to specific organizational policies and instructions. An entire organization, despite its best efforts to prevent wrongdoing within its ranks, can nonetheless be held criminally liable for any of its employees' illegal actions.

At the federal level, some three hundred organizations annually, including non-profit entities, partnerships, unions, trusts, pension funds, and corporations, are criminally convicted, primarily for fraud, environmental pollution, money laundering, antitrust, and food and drug violations. While many of these are small privately-held companies, a substantial number of large and publicly-held companies are among them. The ensuing penalties under the federal sentencing guidelines may include monetary fines, court-supervised probation of the company's operations for up to five years, restitution, public notices of apology to victims (for example, apologies to communities bordering a polluted river), and exposure to applicable forfeiture statutes.

In addition, the collateral civil and administrative consequences of a criminal conviction may have even greater negative impact on the company. These commonly include loss of regulatory licenses, loss of opportunity to participate in government-sponsored programs and contracts, reputational damage, and productivity decline attributable to lower employee morale.

Because of the strict standard of vicarious liability to which organizations are subjected under criminal law, the federal penalty structure implemented by the United States Sentencing Commission, pursuant to the Sentencing Reform Act of 1984, attempted to alleviate the harshest aspects of institutional

vulnerability by incorporating various opportunities for the mitigation of the severity of the punishment. The centerpiece of mitigation under the federal organizational sentencing guidelines (see <http://www.ussc.gov/orgguide.htm>) addresses the implementation of compliance and ethics programs within the operational structure of any organization, whatever its size or nature. Indeed, this regime of internal crime prevention and self-policing may even persuade the Department of Justice to forgo the pursuit of criminal penalties under its revised 2003 Principles of Federal Prosecution of Business Organizations (http://www.usdoj.gov/dag/cftf/corporate_guidelines.htm).

The culpability level of an organization is generally determined by six factors that the sentencing court must consider. Four factors that increase the ultimate punishment of an organization at the federal level are:

1. The involvement in, or tolerance of, criminal activity;
2. The history of the organization in terms of its prior violations, including civil and administrative dispositions;
3. The violation of an earlier court order during the occurrence of the offense that is being prosecuted; and
4. The obstruction of justice.

Two factors that mitigate the punishment of an organization are:

5. The existence of an effective compliance and ethics program; and
6. The combination of the organization's efforts in self-reporting to, and cooperating with, the authorities, and its acceptance of responsibility.

Mitigation (Reduction) of Liability

The potential fine range for a criminal conviction can be significantly reduced—in some cases up to 95 percent—if an organization can demonstrate that it had put in place an effective compliance and ethics program so that the actual criminal violation in fact represents an aberration within an otherwise law-abiding community of workers. This mitigating credit is contingent upon prompt reporting to the authorities and the lack of involvement of any high-level personnel within the actual offense conduct. Conversely, the absence of an effective compliance and ethics program may be a compelling reason for a sentencing court to place an organization on probation and order the implementation of such a program during a court-supervised term of up to five years.

The federal sentencing guidelines offer strong incentives to reduce and ultimately eliminate criminal conduct by providing a structural foundation from which an organization may police itself. Through the implementation of an effective compliance and ethics program, an organization should be well-situated to prevent criminal conduct from occurring in the first instance. Should that line of defense fail, then such a program should enable an organization to detect the conduct with relative speed, report it promptly to the authorities, and take corrective measures to prevent it from becoming systemic. This approach, while initiated as a deterrent to criminal liability, should nonetheless have the additional benefit of encouraging ethical conduct and full compliance with all applicable laws regardless of their nature.

The Vision of the Sentencing Commission

The United States Sentencing Commission, the independent judicial agency responsible for implementing and updating the federal sentencing guidelines, has recently revised and strengthened the criteria for an effective compliance and ethics program. After two years of expert advice and public

hearings and testimony, it took this step in order to synchronize the guidelines with best practices as reflected by over a decade of guideline application within companies of all sizes and natures, the Sarbanes-Oxley Act mandates of 2002, and other relevant regulatory and administrative initiatives (see <http://www.ussc.gov/corp/advgrp.htm>).

Under the changes that took effect on November 1, 2004, barring any restrictions by Congress, the Commission has elevated the criteria for an effective compliance and ethics program into a separate new guideline to emphasize the preeminent place that such programs can play within the corporate and business communities (see http://www.ussc.gov/2004guid/RFMay04_corp.pdf). The Commission also elaborated upon these criteria, introducing additional rigor generally and imposing significantly greater responsibilities upon an organization's governing authority (such as the board of directors) and its executive leadership.

In order to have an effective compliance and ethics program as defined by the federal sentencing guidelines, an organization must demonstrate that it exercised due diligence in fulfilling the enumerated requirements and also that it promoted in other ways "an organizational culture that encourages ethical conduct and a commitment to compliance with the law." The requirements for an effective program as defined by the federal sentencing guidelines are functional ones. It does not fundamentally matter whether a program is called a "compliance" or "ethics" program or some other designation appropriate to the organization, as long as the organization can demonstrate that it incorporated the following requirements into its operational structure.

1. Standards and procedures to prevent and detect criminal conduct;
2. Responsibility at all levels for aspects of the program, together with adequate resources for the program and adequate authority for its managers;
3. Personnel screening related to the goals of compliance and ethics programs;
4. Training in the standards and procedures at all levels;
5. Non-retaliatory internal reporting systems together with auditing, monitoring, and evaluation of the program's overall effectiveness;
6. Incentives and discipline to promote compliance and ethical conduct; and
7. Reasonable, responsive and preventive steps upon detection of a violation.

Requirement One—Standards and Procedures to Prevent and Detect Criminal Conduct

Fundamental to the structure of the organizational sentencing guidelines is the establishment of standards and procedures to prevent and detect criminal conduct. The sentencing guidelines do not prescribe particular standards and procedures because these are necessarily unique to each organization. The sentencing guidelines reject a "cookie cutter" approach, or "one-size fits all" programmatic response. The size of an organization is an important factor in determining the formality of its approach, and examples of less rigorous application standards for small organizations are provided to illustrate that flexibility in design and implementation is paramount in meeting the ultimate objective.

While an organization is expected to have "standards of conduct and internal controls that are reasonably capable of reducing the likelihood of criminal conduct," its leadership must determine the content of such standards and controls based upon its assessment of leadership and the risk of criminal conduct. For example, if a company has business ventures in countries where the corruption index is high, the company's standards and procedures should address ways of preventing bribery and similar

activities. Similarly, if a company must dispose of toxic waste due to its manufacturing processes, its standards and procedures must logically include methods for the proper handling of such materials.

Applicable government regulations and industry practice are also essential components of an organization's formulation of its standards and procedures. The failure to incorporate applicable government regulations and industry practice into its standards and procedures will weigh heavily against a finding that an organization merits mitigation of its punishment. Serious consideration of past infractions by the organization must also inform its establishment of standards, procedures, and internal controls.

The concept underlying this requirement is clear: if an organization has been sanctioned by the administrative authorities in any jurisdiction for particular violations, it is considered to be on notice that there have been deficiencies in its procedures and standards. Prudence and diligence dictate greater attention to preventing and detecting incipient problems in the wake of such notice.

Requirement Two—Program Responsibility, Authority, and Resources

The second requirement contains the most detailed set of changes, reflecting adjustments to the deficiencies identified in the recent wave of corporate scandals. In contrast to its initial, generalized requirement that there be "high-level oversight" of an organization's efforts to prevent and detect criminal conduct, the Sentencing Commission developed this standard to give much more explicit guidance about the roles and responsibilities of the executive leadership.

In particular, the guidelines require the governing authority of an organization, either its board of directors or equivalent, to be knowledgeable about the content and operation of the compliance and ethics program and also to exercise reasonable oversight of the program's implementation and effectiveness. Senior management collectively must ensure that the organization has an effective compliance and ethics program, and specific individuals within senior management must be assigned overall responsibility for the program. Consistent with best practices observed in the Commission's research, this function may be handled by a committee of the board.

The individuals responsible for the program may delegate operational, day-to-day responsibility for the program, as necessary. When this occurs, however, such individuals are to be given access to the governing authority, as appropriate, and to report to them at least annually, reflecting the Commission's intention to strengthen the link between the governing authority and its oversight responsibility. Regardless of where the operational responsibility for the compliance and ethics program resides within an organization, the sentencing guidelines now explicitly require that the person(s) in charge be given appropriate authority and adequate resources to carry out their responsibilities. Failure to do so is an institutional shortcoming.

Requirement Three—Personnel Screening Related to Program Goals

The organizational sentencing guidelines further provide that organizations must pay special attention to the backgrounds of its executive leadership as well as other employees to whom are entrusted substantial discretionary authority. Screening out those who have engaged in illegal activities or other conduct inconsistent with a program aimed at promoting ethical conduct and preventing illegal activities is an essential hallmark of an organization's commitment to sound governance.

The organization must also consider whether potential employees and candidates for advancement will promote ethical conduct and otherwise enhance the organization's commitment to preventing violations of law. Potential employees and candidates for promotion who have a history of

prior misconduct are not automatically precluded from advancement, however, but the organization is well advised to consider whether the prior misconduct is related to the responsibilities of the job, how recently it occurred, and its frequency.

Requirement Four—Communication and Training

The fourth requirement, communication of the standards and procedures to prevent and detect criminal conduct throughout the organization, now includes training in these standards, as appropriate to each employee's role and responsibility. The organizational guidelines make it explicit that training must extend up the chain to the executive leadership of an organization, to the board of directors and senior management, as well as down the chain to line employees and agents.

Requirement Five—Audit, Monitor, and Evaluate Program Effectiveness and Institute Non-retaliatory Internal Reporting Systems

The fifth requirement of the revised organizational sentencing guidelines is comprised of three complementary parts. The first part requires that organizations periodically audit and monitor all aspects of their compliance and ethics programs, as well as for the specific purpose of detecting criminal conduct. The second part requires periodic evaluation of all components of the program. The third part requires that organizations institute systems that not only permit, but encourage, employees to seek guidance regarding potential or actual criminal conduct and to report such activity if it has occurred.

Again, the organizational sentencing guidelines do not prescribe a particular set of systems, recognizing that organizations must design and select methods that they consider most effective in the context of the organization's particular culture. The recent changes also stress the importance of having internal consultative mechanisms for employees to obtain advice and guidance prior to taking actions, consistent with the overarching principle of prevention and deterrence of criminal conduct that frames the organizational sentencing guidelines.

Requirement Six—Incentives and Discipline

Organizations are now required, under the organizational sentencing guidelines, to promote and consistently enforce their compliance and ethics programs through both positive incentives and appropriate discipline. Again, organizations are free to select and implement methods consistent with their culture and operational environment by which to accomplish this objective. Significantly, however, the organizational sentencing guidelines indicate that the failure to take reasonable steps to prevent or detect criminal conduct is a factor to be considered in evaluating an employee's or officer's performance. This component underscores that an organization's commitment to this undertaking crosses functional and hierarchical boundaries.

Requirement Seven—Reasonable, Responsive, and Preventive Steps upon Detection of a Violation

While an organization must use "due diligence" to prevent and detect criminal conduct, it is not to be penalized for failing to detect every violation or infraction that may rise to the level of criminal conduct. If an organization can demonstrate that the criminal conduct that occurred was aberrational and not systemic, the organization is on solid ground in its efforts to persuade the court that it nonetheless deserves the mitigating credit offered by the sentencing guidelines.

The seventh and final requirement reinforces this fundamental principle by stating that once criminal conduct has been detected, an organization shall take reasonable steps to respond appropriately. This response often includes prompt self-reporting to the appropriate authorities and making necessary adjustments in the program and its oversight to prevent recurrences.

Assessing Risk Is Axiomatic

The Sentencing Commission also made explicit in its recent revisions that the implementation and successful maintenance of an effective compliance and ethics program, sufficient to earn mitigating credit, requires that organizations periodically assess the risk of criminal conduct within their ranks. The Commission has provided guidance on the implementation of these requirements, as well as suggested particular ways in which they may be adapted to the constraints of small organizations.

For example, the revised organizational sentencing guidelines provide that, while periodically assessing the risk of criminal conduct, an organization must take into consideration the nature of its various businesses and its prior history. An organization that has had administrative sanctions at the local level for environmental violations clearly is on notice of its increased vulnerability and should reasonably be expected to focus on such a high-risk area.

The requirement for “periodic” assessment further suggests that this exercise of identifying and prioritizing areas with potential for criminal violations is to be on-going, in order to accommodate changes in the nature of the company’s business activities. For example, a U.S. organization that expanded and developed an international component, but did nothing for several years to prepare and train its employees about the constraints of the Foreign Corrupt Practices Act, would likely fail to meet the “due diligence” standard in this regard.

Concluding Observations

The organizational sentencing guidelines were developed against the backdrop of a major reform of the criminal justice penalty structure in the mid-eighties, and the Commission’s innovative approach of encouraging proper corporate governance and organizational self-responsibility has had profound and far-reaching effects. Although there was already increased attention within the business sector in this time period upon self-audit and internal policing, the incorporation of these concepts into the criminal law in 1991 undoubtedly fostered greater dialogue and bolstered momentum for this effort. The 2004 revisions reflect the Commission’s timely decision, after careful analysis and review, to synchronize the guidelines with important trends in legislation and corporate governance during the past decade and maintain their commitment to innovation.