Effective Compliance and Ethics Programs Under
The Amended Sentencing Guidelines

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The Amendments to the United States Sentencing Guidelines Manual ("USSG"), set to take effect on November 1, 2010, further enhance the role of Chief Compliance Officer ("CCO") in business organizations. The 1991 implementation of the Business Organizations section of the USSG formalized the sentencing credit a company could receive if it had in place an effective compliance and ethics program and in doing so encouraged companies to raise the stature of their CCO. The description of the components of the compliance program, however, did not mandate that a program had to follow a specific format to be considered effective. Not surprisingly, companies have continuously wrestled with issues relating to the duties, reporting lines and authority of the CCO to maximize the effectiveness of their compliance and ethics programs in government eyes. Up to now, companies have used a variety of formats to structure their compliance programs. Some house the compliance function in the legal department, others in finance. Some require direct reporting to the Board of Directors, others do not. The recent amendment to the guidelines that carves out a limited exception to the prohibition against issuing compliance program credit to a company that has a high-level employee involved in a criminal offense is likely to change that landscape. In setting forth criteria that must be in place for a company to obtain offense level credit in that situation, the United States Sentencing Commission ("Commission") makes clear that an effective compliance program gives its CCO direct reporting obligations to the Board of Directors or an appropriate sub-committee of the governing authority. That statement solidifies the importance of the role of CCO and will impact corporate structure in the future.

USSG Compliance and Ethics Programs

Since 1991, the United States Sentencing Guidelines Manual (USSG)\(^1\) has provided a road map to Federal Judges on the thorny question of how to sentence business organizations for criminal wrongdoing. The USSG accomplishes its objective by providing a method of calculating what is known as a “culpability” score. That culpability score is the baseline used to determine a sentence. Points are added or subtracted based on factors articulated in the USSG. The USSG adds points for an organization’s involvement in or tolerance of criminal activity, its prior history, violation of an order or obstruction of justice. Points are subtracted for organizations with effective compliance and ethics programs and for organizations that self-report, cooperate with government authorities and accept responsibility for the wrong-doing.\(^2\)

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\(^1\) The Nine-member U.S. Sentencing Commission was created under the Sentencing Reform Act of 1984. “Its principal purpose is to establish sentencing policies and practices for the Federal Criminal Justice System that will ensure the ends of justice by promulgating detailed guidelines prescribing the appropriate sentences for offenders convicted of Federal Crimes” United States Sentencing Commission, Guidelines Manual, Ch.1, Pt. A; intro. Comment (2009). Chapter 8, entitled Business Organizations, came into effect, in 1991 Chapter 8 provides an outline for a compliance and ethics program that, if instituted, could offer companies investigated for or charged with crimes a means to decrease their exposure to criminal sanction.

\(^2\) See USSG §8C2.5.
Although, in the post US v. Booker, 543 U.S. 220 (2005) world, the USSG are simply advisory, Federal judges still look to them for guidance on sentencing business organizations.³ It is also true that the Department of Justice (“DOJ”) looks to the same factors in determining whether to prosecute corporate entities.⁴ Business organizations, consequently, look to the USSG for instruction on how to best protect themselves from the harm that would be caused by a criminal prosecution. Organizations search the guidelines to find ways to minimize the risk presented by the criminal malfeasance of their employees and officers. To date, the best protection a business organization can have to avoid a negative prosecutorial result is to institute a compliance and ethics program consistent with §8B2.1 of the USSG. §8B2.1(b) lists the seven factors that must exist for a compliance and ethics program to be considered “effective”. They are as follows:

“1. The organization shall establish standards and procedures to prevent and detect Criminal conduct.

2. (A) The organization’s governing authority shall be knowledgeable about the content and operation of the compliance and ethics program and shall exercise reasonable oversight with respect to the implementation and effectiveness of the compliance and ethics program.

   (B) High-level personnel of the organization shall ensure that the organization has an effective compliance and ethics program, as described in this guideline. Specific individual(s) within high-level personnel shall be assigned overall responsibility for the compliance and ethics program.

   (C) Specific individual(s) within the organization shall be delegated day-to-day operational responsibility for the compliance and ethics program. Individual(s) with operational responsibility shall report periodically to high-level personnel and, as appropriate, to the governing authority, or an appropriate subgroup of the governing authority, on the effectiveness of the compliance and ethics program. To carry out such operational responsibility, such individual(s) shall be given adequate resources, appropriate authority, and direct access to the governing authority or an appropriate subgroup of the governing authority.

3. The organization shall use reasonable efforts not to include within the substantial authority personnel of the organization any individual whom the organization knew or should have known through the exercise of due diligence, has engaged in illegal activity or other conduct inconsistent with an effective compliance and ethics program.

4. (A) The organization shall take reasonable steps to communicate periodically and in a practical manner its standards and procedures, and other aspects of the compliance and ethics program, to the individuals referred to in subdivision(B) by conducting effective training programs and otherwise disseminating information appropriate to such individuals respective roles and responsibilities.

(B) The individuals referred to in subdivision (a) are the members of the governing authority, high-level personnel, substantial authority personnel, the organization’s employees, and, as appropriate, the organization’s agents.

5. The organization shall take reasonable steps:

(A) to ensure that the organization’s compliance and ethics program is followed, including monitoring and auditing to detect criminal conduct;

(B) to evaluate periodically the effectiveness of the organization’s compliance and ethics program; and

(C) to have and publicize a system, which may include mechanisms that allow for anonymity or confidentiality, whereby the organization’s employees and agents may report or seek guidance regarding potential or actual criminal conduct without fear of retaliation.

6. The organization’s compliance and ethics program shall be promoted and enforced consistently throughout the organization through (A) appropriate incentives to perform in accordance with the compliance and ethics program; and (B) appropriate disciplinary measures for engaging in criminal conduct and for failing to take reasonable steps to prevent or detect criminal conduct.

7. After 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."

The Amendments

As of November 1, 2010, barring congressional action, the United States Sentencing Commission’s (“Commission”) most recent amendments to the USSG will go into effect. The Commission has made three significant changes to the USSG with respect to sentencing business organizations. The amendments (1) clarify that a court has authority to monitor companies as a condition of probation; (2) provide guidance on how a company with an effective compliance and ethics program is to respond upon learning of an offense, and (3) create an exception to the rule that a company with an effective compliance and ethics program cannot get culpability score credit for that program if high-level personnel are involved in the offense. The third amendment reshapes the contours of effective compliance and ethics programs and will likely cause alert organizations to reshape their own compliance and ethics programs as soon as practicable. This article will discuss the changes required to bring existing compliance and ethics programs into compliance with the newly amended USSG.

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5 U.S.S.G. §82.1(b).
The Exception to USSG §8C2.5(f)(3)

§8C2.5(f)(3), as currently written, prohibits a business organization from obtaining a three point reduction in the baseline offense level for having in place an effective compliance program if “an individual within high-level personnel of the organization or a person within high-level personnel of the unit of the organizations within which the offense was committed where the unit had 200 or more employees, participated in, condoned, or was willfully ignorant of the offense.”7 The effect of this provision is to deny compliance program credit to a company that suffered the misfortune of having one of its high-level personnel participate, condone or willfully ignore a criminal offense. The practical result of this prohibition has been a “chill” on voluntary reporting to the government of wrong-doing that involves a high-level employee. The Commission did not intend this result. To address concerns “that the general prohibition in §8(2.5(f)(3) operates too broadly and that internal and external reporting of criminal conduct could be better encouraged by providing an exception to that general prohibition in appropriate cases,” the Commission has carved out an exception to this rule.8 The amended §8C2.5(f)(3) offers a limited opportunity for an organization to benefit from its compliance program if its program meets specified criteria. In the new section §8C2.5(f)(3)(C), the prohibition does not apply if

“(i) the individual or individuals with operational responsibility for the compliance and ethics program (see §8B2.1(b)(2)(C) have direct reporting obligations to the governing authority an appropriate subgroup thereof (e.g., an audit committee for 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.”

At first glance, the criteria set out in the amendment calls for nothing more than a compliance program that meets the objectives already outlined in the USSG. The portion of the amendment that requires a company’s compliance program to have uncovered the offense before it was detected outside of the organization and to promptly disclose the offense to the appropriate government officials does no more than restate compliance program tenets covered elsewhere in the USSG. Sub-sections (ii) and (iii) of the amendment mirror the Commission’s expectations about a properly functioning compliance and ethics program and, therefore, are nothing new.

The changes come in subsections (i) and (iv). Subsection (i) defines the exception and subsection (iv) limits the exception to exclude companies whose compliance personnel

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7 USSG §8C2.5(f)(3)(A)
participated, condoned or ignored the offense.\textsuperscript{10} Amendment 8C2.5(f)(3)(C)(i) requires that a company seeking to take advantage of the point reduction must, as part of its compliance program give, “the individual or individuals with operational responsibility for the compliance and ethics program \[ \text{direct reporting obligations to the organization’s governing authority or appropriate subgroup thereof.}\textsuperscript{11} The amendment also adds an application note that defines ‘direct reporting obligations’ for the purpose of meeting the §8C2.5(f)(3)(c) criterion. According to that note, “an individual has ‘direct reporting obligations’ 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.”\textsuperscript{12}

Interestingly, the direct reporting line to the governing authority expectation echoes a recommendation of the Council for Further Combating Bribery of Foreign Public Officials in International Business Transactions. In November of 2009, the Council issued ‘Good Practice Guidance for Companies’ that included a suggestion that insuring effective internal controls required “oversight of ethics and compliance programs or measures regarding Foreign bribery, including the authority to report matters directly to independent monitoring bodies such as internal audit committees of boards of directors or of supervisory boards.”\textsuperscript{13} It appears that the Commission’s amendment is in line with current approaches to compliance.

**Anticipated Changes To Compliance And Ethics Program**

The significance of this amendment cannot be understated. The Commission says, in unequivocal terms, that persons performing the chief compliance officer function must have ‘direct reporting obligations’ to the company’s governing authority or a subgroup of the governing authority. It is well known that up to this point, a compliance program could be considered effective under the guidelines if the CCO reported to the General Counsel or other high-level personnel in the organization or had dotted line access to the Board of Directors or another governing authority. The Society of Corporate Compliance and Ethics conducted a survey that reported that only 41% of publicly traded companies have their CCO report directly to the Board of Directors.\textsuperscript{14} The survey also showed that in other compliance programs, the CCO reported to the General Counsel, the Chief Financial Officer and other senior positions within a company. The variation in lines of reporting obligations suggests that the current USSG contemplates a broader spectrum of acceptable CCO reporting lines than the amended version.

Business organizations must now come to terms with how to address this change. In order to be in a position to take advantage of the three point-reduction for having a compliance program if a high-level employee is implicated in an offense, the compliance program must have its CCO report directly to the Board of Directors or a subgroup such as the audit committee. As

\textsuperscript{10} Id. p. 18.
\textsuperscript{11} Id p18.
\textsuperscript{12} Id.
\textsuperscript{14} “The Relationship between the Board of Directors and the Compliance and Ethics Officer,” Society of Corporate Compliance and Ethics, April, 2010.
pointed out above, this line of reporting is not widespread, suggesting that many organizations will have to determine how to respond to this amendment. Even if a particular company does not believe that it will ever require the three point reduction contemplated by this limited exception there is no doubt that the Commission has determined that a well designed compliance and ethics program will have its CCO report directly to the Board of Directors. Such a direct communication regarding the components of an effective compliance program warrants serious consideration. Business must now weigh the benefits of revamping their compliance and ethics programs to adjust to this guidance against the costs in resources and expense of making the change. While this is an individual company by company decision, there are benefits to be gained by reviewing a compliance program even if, ultimately, the modification is not made.

The act of reviewing the program is a marker of effectiveness. Throughout the USSG, the Commission’s expectation is that companies will periodically review their compliance programs to make certain they are achieving their purpose – preventing and detecting wrong doing --- in an effective manner.15 Moreover, the process of evaluating a compliance and ethics program is likely to lead to function improvements. The criteria set forth in amendments §8C2.5(f)(C)(ii) and (iii) can only be realized through an effectively functioning compliance program. Those amendments require the organization to detect an offense before an outside entity does and to report it to the appropriate governmental authorities. Neither of those criteria can be met with a ‘paper tiger’ compliance program. A comprehensive review of an existing compliance program will unearth any problems that require attention. Making sure that those problems are addressed will enhance the effectiveness of the program.

Other Factors To Consider

Companies that modify their compliance and ethics programs to accommodate the changes to the guidelines should be aware of the affect these modifications might have on their workplace. For example, if a company has its compliance function report to the General Council in its existing program, shifting that function to a stand alone unit with direct reporting obligations to the Board of Directors or Audit Committee is likely to unsettle key personnel. In many organizations, access to the Board of Directors is highly coveted and viewed as a measure of authority within the corporate culture. Key personnel may view the CCO’s enhanced status with a degree of concern. Companies should evaluate the credentials of their CCO and where that individual fits within the firm hierarchy before giving the existing CCO direct reporting lines to the Board of Directors. It may be necessary to create a new title with different job requirements and conduct a CCO search in order to accomplish the desired reporting change with a minimum of workplace disruption.

Measured analysis should also be applied to the resources required to create a separate compliance function if it is currently part of the legal or finance units. Compliance units must be able to conduct investigations, train personnel, monitor conformity with company compliance and ethics standards consistently manage information - some from anonymous sources – on compliance issues and report regularly to the governing authority. Companies need to determine whether their compliance unit can ‘borrow’ personnel from other units to perform these functions or require their own specially designated staff.

15 See USSG §8B2.1(b)(5)(B).
Conclusion

The amendment to §8B2.5(f)(C)(3) of the USSG has undoubtedly narrowed the scope of the types of reporting lines that are acceptable in an ‘effective’ compliance and ethics program. While companies still maintain the ability to chose whether to comply with the amendments, those averse to risk are likely to undertake the task of modifying (or implementing) a compliance program that meets the USSG parameters.