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Contacts

Patricia M. Sulzbach

1900 K Street, NW
Washington, DC 20006-1109
(202) 955-1549
psulzbach@hunton.com

Edward J. Fuhr

Riverfront Plaza, East Tower
951 East Byrd Street
Richmond, Virginia 23219-4074
(804) 788-8201
efuhr@hunton.com

Sentencing Changes Under Way for Corporations — Ethics and Compliance Programs Are Key

Corporations will soon see changes to the federal sentencing structure that merit close attention, especially regarding ethics and compliance programs. Compliance personnel and corporate officials should evaluate and modify their ethics and compliance programs in light of proposed amendments to the United States Sentencing Guidelines (“Guidelines”) that set forth new criteria for determining the effectiveness of such programs. Several of the proposed amendments could have significant consequences for corporations facing investigation and/or prosecution and may even be utilized to help avoid such action.

Sentencing Guideline Amendments for Corporations

Specific instruction for the sentencing of organizations, such as corporations, was adopted in 1991 and is found in Chapter Eight of the Guidelines. The United States Sentencing Commission submitted its annual proposed amendments to Congress on April 29, 2010, and, unless Congress intervenes, the proposed amendments will become effective November 1, 2010. Three of the amendments proposed in 2010 significantly alter sentencing under Chapter Eight, and two of those include more rigid

strictures surrounding a corporation's compliance and ethics program.

Increased Significance of the Ethics and Compliance Program

In 2004, the Commission revised Chapter Eight by making the existence of an effective compliance and ethics program a means of mitigating punishment in the wake of criminal conduct. Section 8B2.1(b) identifies seven criteria a corporation must meet in order to be deemed to have an effective compliance and ethics program. The last of the seven criteria pertains to required remediation efforts the corporation must undertake upon discovery of criminal conduct, namely to respond appropriately to the criminal conduct and take reasonable steps to prevent further similar criminal conduct (§8B2.1(b)(7)).

The 2010 proposed amendment to §8B2.1 includes a new Application Note that clarifies in more detail what remediation efforts are required.

Regarding the corporation's appropriate response to the criminal conduct, the new Application Note directs corporations to take reasonable steps to remedy the harm resulting from the criminal conduct, such as by providing restitution to victims (§8B2.1, Application Note 6). More important, the Application

Note suggests that a corporation's appropriate response to the criminal conduct may include self-reporting and cooperation with authorities. Regarding a corporation's reasonable steps to prevent further similar criminal conduct, the new Application Note directs corporations to assess and modify their compliance and ethics programs as necessary. Significantly, the proposed Application Note also explicitly encourages the use of an outside professional advisor "to ensure adequate assessment and implementation of any modifications" (*Id.*).

The other proposed amendment to Chapter Eight that affects a corporation's compliance and ethics program involves Part C, which is a complicated framework for calculating the amount of a fine for a corporation. Much of the complexity revolves around §8C2.5, which assigns a "culpability score" to corporations, based on such factors as the size of the corporation, the management level involved in the offense, and the effectiveness of the corporation's compliance and ethics program. The culpability score is then applied to the corporation's base fine determination and increases that fine according to the corporation's culpability. The existing Guidelines allow a corporation to lower its culpability score by three levels if it has an effective compliance and ethics program, but not if high-level personnel are involved in the offense (§8C2.5(f)(1), §8C2.5(f)(3)(A)).

The proposed amendment carves a new limited exception to this prohibition. Under the proposed amendment, a corporation that maintains an effective compliance and ethics program is still eligible to receive a three-level

sentencing reduction even if high-level personnel are involved in the offense.

However, the proposed amendment establishes four criteria that must be met in order to receive this three-level reduction: 1) the person responsible for the compliance and ethics program must report directly to the board of directors or appropriate subgroup; 2) the compliance and ethics program must have detected the offense before outside discovery or before such discovery was reasonably likely; 3) the corporation promptly reported the offense; and 4) no one with operational responsibility for the compliance and ethics program participated in, condoned, or was willfully ignorant of the offense. The proposed amendment thus eliminates the automatic disqualification based on the offender's organizational rank and focuses instead on the structural independence of compliance personnel and the effectiveness of the program, among other factors.

These two amendments to Chapter Eight highlight the critical importance of a corporation's compliance and ethics program and remind corporations that such programs are not static and should be assessed and updated periodically, perhaps with the assistance of an outside advisor. The potential applicability of the three-level reduction under §8C2.5(f)(1) is particularly significant, since, depending on the loss, there could be a reduction of 30%-50% of the fine range.

The proposed amendment to §8C2.5 also includes a new Application Note that defines what is meant by direct reporting, namely that the individual has express authority to communicate

personally with the board promptly on matters involving potential criminal conduct and at least annually on the implementation and effectiveness of the compliance and ethics program (§8C2.5, Application Note 11).

More Options for Corporate Probation

The third and final proposed amendment to Chapter Eight simplifies and expands the recommended conditions of probation for corporations. Section 8D1.1 describes the circumstances in which a court should order probation for a corporation, and §8D1.4 contains recommended probation terms. The proposed amendment removes the distinction between conditions of probation imposed solely to enforce a monetary penalty and conditions of probation imposed for any other reason. All conditional probation terms, therefore, are consolidated under this amendment and are available for consideration by the court in determining an appropriate sentence. This consolidation could result in more onerous conditions of probation for corporations than would have been previously assigned, since the court now has more options to choose from and is not limited by the prior distinction regarding the purpose of the probationary sentence.

Mixed Bag for Corporations

Although the amendments propose changes for corporations that appear to be beneficial, they also pose stricter requirements, particularly regarding a corporation's ethics and compliance program. The ultimate benefit to corporations is equivocal and somewhat of a mixed bag. While it is true that the amendments remove

previous restrictions on a corporation's eligibility for a reduction due to an effective compliance and ethics program, such a reduction is only possible inside of a more detailed and, arguably, more rigorous framework of what constitutes an effective program, including what requirements must be met upon discovery of criminal conduct. Similarly, consolidation of probationary terms for corporations could open the door to more probationary sentences but could also result in more onerous terms of probation than were previously proscribed.

On balance, the proposed amendments ultimately seem designed to encourage earlier and more frequent detection and reporting of suspected criminal conduct. The amendments reflect the importance of independent and autonomous compliance officers and clearly emphasize the vital importance of a corporation's compliance and ethics program, in both how it is structured and how it is utilized. In the words of the Guidelines, an effective compliance and ethics program must "exercise due diligence to prevent and detect criminal conduct" and "otherwise promote an organizational culture that encourages

ethical conduct and a commitment to compliance with the law" (§2B2.1(a)).

Recommended Action

Understanding the new Guidelines is critical for not only corporations facing criminal prosecution, but also those seeking to avoid it. The Justice Department's charging policies require prosecutors to consider Chapter Eight of the Guidelines, including the corporation's ethics and compliance program, when deciding whether to charge a corporation. To reduce the risk of prosecution, civil exposure, and maximum penalties, corporations should consider taking the following actions:

- Reassess and modify, as necessary, the ethics and compliance program to meet the new requirements of the proposed amendments.
- Ensure that the ethics and compliance program will effect early and efficient detection of suspected criminal conduct.
- Review ethics and compliance training materials and mandate routine training for all employees.

- Provide for regular review of the ethics and compliance program.
- Consider the use of an outside consultant to assess and evaluate the ethics and compliance program.
- Re-examine and redefine, if necessary, the role of the compliance officer with respect to reporting relationships and access to the corporation's governing authority.
- Reassess compliance reporting procedures.
- Require, at a minimum, annual reporting to the corporation's governing authority regarding the implementation and effectiveness of the ethics and compliance program.

Hunton & Williams has experience helping corporations assess their ethics and compliance programs. We would welcome the opportunity to help ensure that your company's programs are consistent with the 2010 amendments.