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Some Practical Considerations in Developing Effective Compliance Programs: A Framework for Meeting the Requirements of the Sentencing Guidelines

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SOME PRACTICAL CONSIDERATIONS IN DEVELOPING EFFECTIVE COMPLIANCE PROGRAMS: A FRAMEWORK FOR MEETING THE REQUIREMENTS OF THE SENTENCING GUIDELINES

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I. INTRODUCTION

Perhaps the most widely discussed element of the federal organizational Sentencing Guidelines (the "Sentencing Guidelines" or the "Guidelines") is the "requirement" that business organizations establish "effective" compliance programs. Contrary to the belief of many executives, the Guidelines do not impose an affirmative duty on organizations to create compliance programs. However, an effective compliance program provides great advantages to a company; so much so that one scholar has said that "[f]or a general counsel to ignore [the implementation of a compliance program under] these Guidelines is professional malpractice."[1] Thus, since the enactment of the Guidelines on November 1, 1991, many business organizations have either implemented compliance programs for the first time or reviewed and revised existing programs to attempt to meet the Guidelines' requirements for an effective program.

The editors of this symposium asked us, as practicing lawyers, to comment on the practical effect of the Sentencing Guidelines for organizations. Without question, the Guidelines' greatest practical effect thus far is to raise the business community's awareness of the need for effective compliance programs. Unfortunately, the Guidelines are not a model of clarity. Moreover, there has been a dearth of cases applying them thus far. Accordingly, organizations and their lawyers are struggling to im-

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1. Michele Galen, *Keeping the Long Arm of the Law at Arm's Length*, BUS. WK., Apr. 22, 1991, at 104 (quoting Professor John C. Coffee of Columbia University Law School).

plement programs consistent with their business activities yet responsive to the Guidelines' demands.

This Article discusses the advantages and disadvantages of implementing an effective compliance program. It then discusses the specific elements that the Guidelines require for a sentencing court to find a compliance program effective and thus entitled to credit as a mitigating factor in the sentencing process. Finally, the Article sets forth a basic framework for establishing a compliance program that will satisfy the Guidelines' requirements.

II. THE ADVANTAGES TO IMPLEMENTING AN EFFECTIVE COMPLIANCE PROGRAM

Implementing an effective compliance program has four primary advantages. First, an effective compliance program disseminates a positive, law-abiding corporate ethos throughout an organization, and thereby creates an atmosphere that will discourage wrongdoing. Second, an effective compliance program detects misconduct as it occurs so the organization can address problem situations quickly and minimize their adverse consequences. Third, the existence of a comprehensive compliance program serves as a significant mitigating factor to a prosecutor considering whether to indict a company; the organization can point to the program as evidence that it is a good corporate citizen and that the wrongdoing constituted aberrant behavior of rogue employees. Fourth, should a company be prosecuted and convicted, the presence of an effective compliance program at the time of the offense significantly diminishes the organization's exposure at sentencing.

A. Disseminating a Positive Corporate Ethos

Compliance programs can deter corporate crime. A well-structured, widely disseminated, and strongly enforced compliance program encourages employees to think twice before engaging in questionable conduct. A company's constant reminders that it abides by the law and punishes unlawful employee conduct will discourage criminal behavior. As a convicted inside trader explained, "seeing the policy [against insider trading] in black and white . . . might have sensitized me to the issue so that when the offer was made, maybe I would have hesitated just long enough for the temptation to pass."[2]

2. Harvey L. Pitt & Karl A. Groskaufmanis, *Minimizing Corporate Civil and Criminal Liabil-*

Moreover, the dissemination of a positive corporate ethos that deters misconduct ultimately saves a company money. Obviously, misconduct creates a risk of significant "hard costs"—namely, criminal or administrative fines or penalties resulting from enforcement actions; civil damage awards or settlements resulting from private litigation; lost opportunities to compete due to debarment; decreased sales due to damaged reputation; and legal fees. Additionally, misconduct often imposes "soft costs"—namely, lost employee productivity, often at senior levels, due to the expenditure of effort in addressing a legal problem; disruptions to business operations; damage to employee morale; and future heightened scrutiny by, and accountability to, the government. Thus, in addition to being the right thing to do, encouraging adherence to the law and promoting ethical behavior can add to a company's bottom line.

B. Detecting Misconduct

A comprehensive program will likely detect misconduct before it becomes criminal; or if after the misconduct becomes criminal, before the government uncovers it. Early detection of misconduct allows an organization to address problems prospectively rather than reactively. The company might contain a problem detected early and thus minimize its exposure to more severe criminal penalties or civil damages. For example, detection through an effective compliance program might turn what would otherwise be a three-year fraud scheme into a three-month fraud scheme. Early detection may preclude *qui tam* or other whistleblower suits and provide the company with the opportunity to consider whether to disclose misconduct voluntarily before the government learns of it.

C. Persuading a Prosecutor Not to Indict

Prosecutors have tremendous discretion in deciding whether to indict a corporation based on the acts of its agents. Any conduct undertaken within the scope of the agent's authority for the benefit of the company can result in the company being bound by the agent's acts for purposes of corporate criminal liability.[3] Thus, whenever a corporate employee com-

ity: A Second Look at Corporate Codes of Conduct, 78 GEO. L.J. 1559, 1644 (1990), quoting R. Foster Winans, Remarks at the National Joint Conference on White-Collar Crime 5 (Aug. 31, 1987).

3. United States v. Automated Medical Labs., 770 F.2d 399, 406-07 (4th Cir. 1985); United States v. Hilton Hotels Corp., 467 F.2d 1000, 1004 (9th Cir. 1972), *cert. denied*, 409 U.S. 1125 (1973); United States v. Twentieth Century-Fox Film Corp., 700 F. Supp. 1246 (S.D.N.Y. 1988), *aff'd in part, vacated in part on other grounds*, 882 F.2d 656 (2d Cir. 1989). See generally, Kathleen

mits a criminal act in the course of performing his job, a court theoretically can hold the company criminally liable. As a practical matter, corporations are not indicted frequently because prosecutors often decide that prosecution of the corporation would not necessarily further the public interest.

A principal factor that prosecutors consider in making indictment decisions is whether a company has acted responsibly to avoid engaging in criminal conduct. Prosecutors often judge this by the quality of the company's compliance program.[4] In fact, the Department of Justice has memorialized this consideration expressly in its July 1991 policy statement regarding indictment decisions in environmental crimes cases in the context of significant voluntary compliance efforts. The policy statement states explicitly that in deciding whether to return an indictment, the prosecutor should consider:

> Was there a strong institutional policy to comply with all environmental requirements? Had safeguards beyond those required by existing law been developed and implemented to prevent noncompliance from occurring? Were there regular procedures, including internal or external compliance and management audits, to evaluate, detect, prevent and remedy circumstances like those that led to the noncompliance? Were there procedures and safeguards to ensure the integrity of any audit conducted? Did the audit evaluate all sources of pollution (i.e., all media), including the possibility of cross-media transfer of pollutants? Were adequate resources committed to the auditing program and to implementing its recommendations? Was environmental compliance a standard by which the employee and corporate departmental performance was judged?[5]

While this policy statement applies to federal prosecutions of environmental crimes only, it reflects the factors considered by prosecutors in all types of cases involving corporations. Good faith, bona fide efforts to avoid criminal liability weigh heavily in the indictment decision.

D. Minimizing the Severity of a Sentence Upon Conviction

The Sentencing Guidelines reduce a convicted organization's "culpa-

F. Brickey, *Corporate Criminal Liability: A Primer for Corporate Counsel*, 40 BUS. LAW. 129, 131 (1984).

4. *See* Dan K. Webb, Steven F. Molo & Robert W. Tarun, CORPORATE INTERNAL INVESTIGATIONS: AVOIDING CRIMINAL LIABILITY § 16.03[2][a] (forthcoming 1993).

5. U.S. Dep't of Justice, *Factors in Decisions on Criminal Prosecutions for Environmental Violations in the Context of Significant Voluntary Compliance or Disclosure Efforts by the Violator*, 21 ENVTL. L. REP. 35,394-99 (July 1, 1991).

bility score" by three points if the offense occurred notwithstanding an effective compliance program.[6] A three-point reduction can decrease a convicted company's fine range as much as eighty percent, which could save the company several million dollars.[7] The Guidelines do not authorize a reduction, however, if a "high level individual" or an "individual responsible for administration or enforcement" of the compliance program participated in or condoned the offense or remained wilfully ignorant of it.[8] The substantial reduction in potential fines alone justifies establishing an effective compliance program. Additionally, the absence of a compliance program may cause a court to impose probation as part of a sentence.

III. THE DISADVANTAGE TO IMPLEMENTING AN EFFECTIVE COMPLIANCE PROGRAM

Although outweighed by the advantages, two primary disadvantages to implementing a compliance program exist.

First, once an organization establishes a compliance program, the company must abide by it. A sentencing court will deem a program "non-effective"—based on lack of enforcement—if the company fails to follow its compliance program.[9] This may force the organization to make difficult choices, such as changing an otherwise effective existing business practice, terminating a long-standing business relationship, or firing a longtime employee. Also, a plaintiff's lawyer or a prosecutor may try to use the company's compliance program as the standard by which employee conduct should be judged in a civil or criminal trial.[10]

Second, by adhering to its compliance program, a company may generate evidence that ultimately may harm the company. As part of its compliance efforts, a company may require that it conduct an internal investigation and prepare a report of the findings. These reports may receive protection under the attorney-client privilege and the work-product doctrine.[11] However, if the corporation discloses the report to regu-

6. UNITED STATES SENTENCING COMMISSION, GUIDELINES MANUAL § 8C2.5(f) (1992) [hereinafter U.S.S.G.].

7. Dan K. Webb, Steven F. Molo & James F. Hurst, *Understanding and Avoiding Corporate and Executive Criminal Liability* (31st Annual Corporate Counsel Institute 1992).

8. U.S.S.G., *supra* note 6, § 8C2.5(f).

9. *Id.* § 8A1.2 (comment. (n.3(k)(5))).

10. *See* Pitt & Groskaufmanis, *supra* note 2, at 1605-14.

11. Westinghouse Elec. Corp. v. Republic of the Philippines, 951 F.2d 1414 (3d Cir. 1991); In

lators or others outside the organization, it may waive the privilege.[12] Thus, through adherence to its compliance program, the company may collect and ultimately provide access to negative information that prosecutors, plaintiffs' lawyers, competitors, and the media may use against it.[13] Notwithstanding these negative aspects of establishing a program, the implementation of a compliance program is the better course of action.

IV. THE NECESSARY ELEMENTS OF AN EFFECTIVE COMPLIANCE PROGRAM

The Guidelines contain specific requirements for an effective compliance program.[14] Sentencing courts will grant the three-point reduction to the organization's culpability score only if these requirements are met.[15] A sentencing court will examine the following relevant factors in determining whether a compliance program is effective within the meaning of the Guidelines.

A. Timing

The compliance program must be in place *before* the offense was committed. A company that waits to make a serious effort at preventing wrongdoing until after a problem arises will not receive credit.

B. Subject Matter of the Program

The compliance program must address activities most likely to result in misconduct. Whether a program covers the appropriate subject matter depends largely upon the nature of the organization. Effective programs anticipate potential problems at all levels of the organization and specifically address the areas most likely to yield problems in light of the company's business. As the Guidelines explain:

> [i]f an organization employs sales personnel who have flexibility in setting prices, it must have established standards and procedures designed to pre-

re Subpoenas Duces Tecum, 738 F.2d 1367 (D.C. Cir. 1981) (holding that voluntary disclosure of confidential information by corporation to SEC is not protected by work-product doctrine).

12. *See* Pitt & Groskaufmanis, *supra* note 2, at 1605-14.

13. *See* David M. Zornow & Benjamin B. Klubes, *The New Organizational Sentencing Guidelines*, AM. LAW., Mar. 1992, Preventive Law, at 8.

14. A company prosecuted and convicted despite an effective compliance program that meets these requirements can receive as much as an 80% reduction in its fine.

15. U.S.S.G., *supra* note 6, § 8C2.5(f).

vent and detect price-fixing. If an organization employs sales personnel who have flexibility to represent the material characteristics of a product, it must have established standards and procedures to prevent fraud.[16]

C. *Degree of Formality*

The size and nature of an organization generally dictate the appropriate degree of formality of the compliance program. The Guidelines note that "the larger the organization, the more formal the program typically should be."[17] In other words, a court will not hold a family-owned printing company with seventy-five employees and a single facility to the same standard as a publicly traded conglomerate with nineteen facilities in fourteen states and three countries. For the printing company, a written manual, an initial indoctrination session, updates and reminders at monthly safety meetings, an anonymous written reporting system, and oversight by the plant manager may suffice. In contrast, sufficient formality for the conglomerate may include a written manual, additional written policies addressing specific business activities, indoctrination through videos, seminars, or interactive software, periodic refresher seminars for certain classes of employees, periodic briefings via an electronic bulletin board, anonymous toll-free call-in reporting procedures along with anonymous interoffice write-in procedures, an ombudsman, and oversight by a committee comprised of high-level corporate managers.

D. *Industry Practice*

A sentencing court will likely compare a particular compliance program with the programs of other companies within the same industry in determining whether it is effective. A court obviously will consider more favorably a program that is more advanced than those of comparable companies than one that lags behind the industry.[18]

E. *Due Diligence*

The Guidelines state that the "hallmark of an effective program . . . is that the organization exercised due diligence in seeking to prevent and detect criminal conduct by its employees and other agents."[19] The

16. *Id.* § 8A1.2 (comment. (n.3(k)(7)(ii))).
17. *Id.* § 8A1.2 (comment. (n.3(k)(7)(i))).
18. *Id.* § 8A1.2 (comment. (n.3(k)(7))).
19. *Id.* § 8A1.2 (comment. (n.3(k))).

Guidelines then set forth seven criteria for determining whether the program reflects due diligence:

1. *The standards and procedures must be "reasonably capable of reducing the prospect of criminal conduct."*[20] In essence, the organization must display a sincere commitment to prevent and detect criminal conduct.

2. *A specific high-ranking individual or several high-ranking individuals within the organization must oversee compliance with the standards and procedures.*[21] The person or persons monitoring the program must possess substantial control over the organization or the organization's policy making.[22]

3. *The organization must exercise due care not to delegate substantial discretionary authority to individuals who may, based on background or other factors, have "a propensity to engage in illegal activities."*[23] This is the "fox in the chicken coop" provision. It requires that organizations carefully inquire into the background of new hires and review the histories of employees presently in sensitive positions to ensure that no significant prior problems exist.

4. *The company must effectively disseminate the standards and procedures to all employees.*[24] The Guidelines clearly state what effective communication means, "e.g., by requiring participation in training programs or by disseminating publications that explain in a practical manner what is required."[25]

5. *The organization must take reasonable steps to achieve compliance with its standards.*[26] The Guidelines identify reasonable steps, "e.g., by utilizing monitoring and detecting criminal conduct by its employees and other agents and by having in place and publicizing a reporting system whereby employees and other agents could report criminal conduct by others within the organization without fear of retribution."[27]

6. *The organization must discipline employees who violate the standard through established mechanisms.* As appropriate, discipline should ex-

20. *Id.* § 8A1.2 (comment. (n.3(k)(1))).
21. *Id.* § 8A1.2 (comment. (n.3(k)(2))).
22. *Id.* § 8A1.2 (comment. (n.3(b))).
23. *Id.* § 8A1.2 (comment. (n.3(k)(3))).
24. *Id.* § 8A1.2 (comment. (n.3(k)(4))).
25. *Id.*
26. *Id.* § 8A1.2 (comment. (n.3(k)(5))).
27. *Id.*

tend to individuals responsible for failing to detect an offense.[28] However, the Guidelines do not mandate a specific form of discipline and recognize that it will be "case specific."[29]

7. *Finally, the organization must make appropriate modifications to the program after it detects offenses to prevent future offenses.*[30]

A well-crafted compliance program takes into account each of these factors. An organization should review them when developing a program and reexamine them each time it considers modifications to its program.

V. A PRACTICAL FRAMEWORK FOR DEVELOPING A COMPLIANCE PROGRAM

While the Guidelines mandate what an effective compliance program must include, they provide no insight into how a company undertakes the task of structuring a program. To be truly effective, each compliance program will be structured uniquely to account for the company's corporate culture, business activities, and work force. Avoiding *criminal* misconduct and satisfying the Guidelines' requirements for designation as an effective program should be goals of the program; however, they should not be its only goals. The company should consider ways to use the compliance program to further other business goals and foster improved communication within the organization.

While the end result will differ in each case, companies can follow a common process to develop a program best suited for the organization.[31] The process entails six basic steps. Step I is gaining the commitment and involvement of the board of directors and chief executive officer ("CEO"). Step II is conducting a survey of the organization's business activities to identify potential problem areas and assess current compliance efforts. Step III is surveying the compliance efforts within the organization's industry. Step IV is synthesizing the information gained through the internal survey and the industry survey and then establishing a workable compliance structure. Step V is implementing the structure

28. *Id.* §§ 8A1.2 (comment. (n.3(k)(5))), 8A1.2 (comment. (n.3(k)(7))).

29. *Id.* § 8A1.2 (comment. (n.3(k)(6))).

30. *Id.* § 8A1.2 (comment. (n.3(k)(7))).

31. This is merely one method of establishing a program. We do not suggest that a company that fails to follow each and every step as set forth below will or should have its program deemed "non-effective" under the Guidelines. We believe this methodology is most likely to result in a program that meets the Guidelines' requirements.

through training, continuous monitoring, and enforcement. Finally, Step VI is updating the program to adapt to changes in the company's business activities and the law.

A. Step I - Enlisting the Support of the Board and Chief Executive Officer

To succeed, a compliance program must be truly a company effort. While the impetus for creating a compliance program may emanate from the general counsel's office, it must have complete support at the highest levels of the organization. Senior management and the board of directors must be involved, in part, based on their duty of care.[32] Moreover, for employees to appreciate the importance of the compliance effort, it is essential that the program carry the imprimatur of the board of directors and senior management—specifically, the CEO. Thus, from the outset, the board and senior management must support the program visibly.

Usually the board will delegate oversight for the compliance program to the audit committee. Some boards, however, have formed separate compliance committees with oversight responsibility for implementation and enforcement of the compliance program. The advantage to oversight by a compliance committee, separate and apart from the audit committee, is that compliance issues often arise in the audit area. Thus, an independent compliance committee or the board as a whole may oversee the company's compliance efforts more effectively. If the board as a whole monitors compliance, it should require regular reporting from the program administrator and should consider significant compliance policy matters as agenda items when appropriate. After committing to a compliance program and accepting responsibility for ultimate oversight, the board must not risk having compliance efforts deemed non-effective or rendered ineffective due to its lack of involvement.

The CEO's involvement sets the tone for the program and demonstrates that the company considers its compliance efforts a serious matter. While a sentencing court might not expect the CEO to examine regular monthly reports on environmental audits, his commitment to a compliance effort—by actions such as disseminating the code of conduct under his signature, regularly emphasizing the importance of the compli-

32. *See* WILLIAM E. KNEPPER & DAN A. BAILEY, LIABILITY OF CORPORATE OFFICERS AND DIRECTORS § 1.05, chs. 2, 3, 4 (4th ed. 1988); Lanza v. Drexel & Co., 479 F.2d 1277, 1306 (2d Cir. 1973) (en banc).

ance efforts to employees during meetings, and conducting periodic discussions with persons responsible for administering the compliance program—will send a strong message to the rest of the organization.

B. Step II - Surveying Existing Business Activities

Surveying existing business activities is perhaps the most important step in establishing an effective program. Unless a company completely understands where problem areas might lie, it cannot develop a program to address potential problems. Without a thorough internal survey, the organization cannot meet the threshold requirement of implementing standards and procedures "reasonably capable of reducing the prospect of criminal conduct."[33]

To ensure that an organization examines all aspects of the business, a team of individuals with broad exposure to the company's operations should conduct the survey. For most organizations, team members should include representatives from the legal department, human resources, and significant operational areas in which the company will likely have the greatest exposure to liability—such as, environmental compliance, workplace safety guidelines, and product safety. Although the direction and leadership must come from within the organization, the team should also include outside counsel to provide credibility to the process. Moreover, outside counsel—experienced in corporate criminal liability issues, internal investigations, and compliance programs—will expedite the process, provide the company with valuable expertise, and increase the likelihood that the company's program meets industry standards. Most importantly, having outside counsel involved heightens the likelihood that the survey team's work will be protected under the attorney-client privilege and the work-product doctrine.[34]

The survey team should begin by reviewing past problems that resulted in criminal, administrative, or serious civil exposure. It should then examine other problem areas including conflicts of interest, political contributions, insider trading, and pricing and antitrust matters. Finally, the survey team should consider prospective business activities that may pose risks that the compliance program should address.

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33. U.S.S.G., *supra* note 6, § 8A1.2 (comment. (n.3(k)(1))).

34. *See* Pitt & Groskaufmanis, *supra* note 2, at 1605-14; Joseph E. Murphy, *Protections, Incentives for Self-Policing Lacking*, NAT'L L.J., Mar. 8, 1993, at S12. Counsel should assume that negative information will be developed in the process. Thus, it is important to attempt to cloak sensitive communications with the protections of the attorney-client privilege and work product doctrine.

The team should elicit information from the legal department, managers, and, to an extent, hourly workers. A broad survey will not only yield more information about potential problem areas, but it will give the team a better understanding of the types of policies, procedures, and training most likely to succeed. The survey is likely to uncover information that could be damaging. Thus, the team should take care to structure its inquiries to reflect that they are for the purpose of supplying information to legal counsel in connection with rendering legal advice to the company.

While the survey team gathers information on the nature of the business, outside counsel should prepare legal memoranda that address the elements of criminal offenses most likely implicated by the company's business activities. These memoranda should explain the relevant statutes in sufficient detail without becoming mired in minutiae. If certain elements are particularly relevant in light of the organization's activities, the memoranda should explore them in greater detail. Because these memoranda explain the legal parameters of conduct they must be comprehensible to those designing the compliance program, including nonlawyers. They should include both the relevant federal statutes and the applicable state statutes in key areas in which the company does business.[35] For example, a corporation manufacturing or selling products in California would be foolish to ignore the California Corporate Criminal Liability Act, which imposes criminal liability upon corporations and their managers for knowingly concealing serious dangers from their employees or covering up harmful consumer product defects from regulatory authorities.[36]

The goal of outside counsel's memoranda should be to provide a comprehensive overview of the law governing the company's conduct. The extent to which a company may wish to engage outside counsel will largely be a function of its nature, size, and individual circumstances. For example, a smaller company that has not fully implemented compliance programs to address the Americans with Disabilities Act[37] or sexual harassment matters might use this as an opportunity to assure compli-

35. Only in rare situations can state criminal law impact sentences under the Guidelines. RICO offenses, for example, can include certain state crimes as predicate acts. *See* 18 U.S.C. §§ 1961-1968 (1970). Nonetheless, while undertaking the effort to perform such a thorough review, the company should seize the opportunity to incorporate compliance measures to minimize the chance of violating state laws as well.

36. CAL. PENAL CODE § 387 (West 1988 & Supp. 1993).

37. Americans with Disabilities Act, Pub. L. No. 101-336, 104 Stat. 327 (1990).

ance in those areas as well as areas relating to possible criminal violations.

The internal survey team should next review the organization's existing compliance efforts. Many companies have only piecemeal policies or ethics statements that relate to specific aspects of the business. For example, companies that operate in industries that were subjected to serious antitrust scrutiny in the 1960s and 1970s often have policy statements or codes relating to pricing, market division, marketing arrangements, boycotts, and other antitrust concerns. Similarly, most publicly traded companies have some form of policy relating to insider trading. The survey team should compile and review these policies to determine whether they meet the current legal requirements and cover the relevant aspects of the company's current business practices.

C. Step III - Surveying Compliance Efforts Within the Industry

The survey team should try to learn how other organizations in the industry implement compliance programs. The Guidelines explicitly refer to industry practice as one barometer of determining the effectiveness of a compliance program.[38] While some companies have taken a proprietary view toward their compliance programs, others take pride in sharing their work.[39] As a practical matter, the Guidelines' industry practice standard encourages companies to share, at least in part, their compliance program with competitors so that it can gain reciprocal information.

Resources for learning what efforts others within the industry are taking can include industry publications and organized programs or informal conversations at trade association meetings or other business gatherings. However, the most productive effort is likely a telephone call from the general counsel to his counterpart with a competitor.

D. Step IV - Structuring the Formal Program

The results of the survey team's work should be digested and synthesized by counsel, who should then make a formal recommendation to the senior management, and perhaps the board, regarding the nature and elements of the program. This recommendation should come from counsel rather than non-lawyers because it will truly be legal advice concern-

38. U.S.S.G., *supra* note 6, § 8A1.2 (comment. (n.3.(k)(7))).

39. *See infra* note 43.

ing action needed to meet the legal requirements of the Guidelines. As such it will be privileged. Once the company identifies the specific concerns that it must address, it can structure a formal program to meet those concerns.

The formal program should have, at a minimum, the following elements: (1) an administrator to oversee its implementation and enforcement; (2) a written set of policies distributed to employees at all levels; (3) a violation reporting process; and (4) a process for disciplining employees who violate company policies.

1. Selecting the Program Administrator

The Guidelines mandate that a person or persons of significant authority administer and enforce the compliance program. They use the term "high-level personnel," defined as "individuals who have substantial control over the organization or who have a substantial role in the making of policy within the organization."[40] This may include "a director; an executive officer; an individual in charge of major business or functional units of the organization such as sales, administrative, or finance; or an individual with a substantial ownership interest."[41]

Companies have struggled with the question of whether the general counsel or someone within the legal department should serve as administrator of the compliance program. Some organizations have declined to install a lawyer as the administrator due to concern that they might jeopardize the confidentiality of communications otherwise protected under the attorney-client privilege or work-product doctrine. A court is more likely to view an attorney serving as a compliance program administrator as a businessman rather than an attorney. Thus, a court may not view communications between the lawyer/administrator and employees in the course of investigating a compliance program violation as confidential communications between a client and its lawyer for purposes of obtaining legal advice.[42] Rather, they may be viewed as communications between one business person and another business person in the course of following business procedures.

The better practice probably is to have a non-lawyer serve as the pro-

40. U.S.S.G., *supra* note 6, § 8A1.2 (comment. (n.3(k)(2))).

41. *Id.*

42. Herbert v. Lando, 73 F.R.D. 387, 398-99 (S.D.N.Y. 1977); United States v. Am. Tel. & Tel., 86 F.R.D. 603, 618 (D.D.C. 1979); United Coal Cos. v. Powell Constr. Co., 839 F.2d 958 (3d Cir. 1988).

gram administrator but to have in-house counsel investigate the more serious situations. That way, the attorney-client privilege and work-product doctrine will more likely protect in-house counsel's communications with employees in the course of the investigation. As needed, in-house counsel can seek outside counsel to assist in the investigation.

A number of companies favor the committee approach with several high-level personnel sharing the role of administrator. Often, these people have oversight responsibility for key areas likely implicated by the compliance program—for example, the senior executive in charge of auditing, environmental compliance, or product safety. The committee approach ensures that decisions on major compliance questions are made only after the consideration of multiple points of view. It also ensures that someone exercising the administrator function will likely be available at any time. Further, a committee reflecting multiple aspects of the company's business will more likely enact a balanced program and make decisions which do not neglect or favor any particular segment of the organization. The need for balance and an overall perspective may cause a company to appoint either the CEO or the chief operating officer as the administrator.

The precise duties of the administrator will vary based on the nature and size of the organization. The Guidelines provide no insight into the administrator's duties other than to state that the administrator "must have been assigned overall responsibility to oversee compliance with [the] standards and procedures."[43] Logically, this means that the administrator should have ultimate responsibility for: (1) implementing the compliance program, which includes disseminating the standards and procedures to personnel as well as training, monitoring, and disciplining employees; (2) assuring that the organization responds appropriately when faced with an allegation; and (3) updating and revising the program when necessary.

2. *Written Policies*

Written policies generally fall into two categories: (1) general company codes of conduct that an organization disseminates to all employees; and (2) detailed supplemental policies and procedures addressing specific areas of concern that an organization disseminates only to em-

43. U.S.S.G., *supra* note 6, § 8A1.2 (comment. (n.3(k)(2))).

ployees whose activities are affected by the supplemental policies and procedures.

a. Codes of Conduct

Most codes of business conduct range from ten to thirty pages in length. They usually begin with a general statement of ethical principles, indicating the company's commitment to integrity and honesty in the conduct of its affairs and its intent to operate within the law. One commentator has suggested that organizations should include two additional statements in the preamble: (1) a statement that conduct in violation of the code is considered activity beyond the scope of an employee's authority; and (2) a statement that the code represents an effort to not only meet, but also to exceed, the requirements of the law and industry practice.[44] The first statement might allow the company to later argue that employee activities that violate the code fall outside the scope of the employee's authority and thus, cannot be imputed to the company for purposes of imposing corporate criminal liability.[45] The second statement arguably diminishes the chance that a plaintiff's lawyer could use it as a standard for the imposition of civil liability.

Following the statement of principles, the code of conduct should identify the manager or managers within the organization who administer the program. The organization should reassure employees that when potential violations of the code arise, they can readily make these violations known by approaching the administrator or others through the available reporting mechanisms.

Next, the company should clearly state its intent to enforce the code against all employees. The code should indicate that all employees—from the mailroom clerk to the chief executive officer—are accountable for their actions.

Following these three initial elements, corporate codes of conduct generally address specific company policies regarding employee conduct. Subjects frequently covered include: antitrust; accountability for company property; conflicts of interest; confidential and proprietary informa-

44. Karl A. Groskaufmanis, *Corporate Compliance Programs as a Mitigating Factor*, *in* ORGANIZATIONAL SENTENCING GUIDELINES § 5.08[11] (Jed S. Rakoff ed., 1993).

45. *But see* United States v. Basic Constr., 711 F.2d 570 (5th Cir.) (stating that the fact that an employee's acts may have been contrary to a corporate program is irrelevant to the question of the corporation's accountability), *cert. denied*, 464 U.S. 956 (1983); United States v. Automated Medical Labs., Inc., 770 F.2d 399 (4th Cir. 1985) (same).

tion; bribery, gratuities, and kickbacks; accuracy in accounting and recordkeeping practices; insider trading; political contributions; and discrimination and harassment. The precise elements of a code will vary depending upon the nature of the organization's specific business practices and the extent to which the company may have effective programs in areas not likely to result in criminal exposure.[46]

The code of corporate conduct should be comprehensive yet comprehensible. It should inform employees of the legal parameters governing their conduct and promote positive ethical values in an understandable fashion. As one corporate counsel involved in implementing his company's compliance program put it, "[w]rite policies and procedures in the style of the *USA Today*, not the *Harvard Law Review*."[47]

Finally, the code should reflect the company's culture and, to the extent it is appropriate, be integrated with existing company procedures and programs. Most organizations have adopted some form of Total Quality Management program ("TQM"). Devising the code so that it complements the company's TQM efforts may be one way of integrating it into the company's business practices. For example, IBM's Business Conduct Guidelines integrate its code of conduct and business practices. They begin with a letter from the company's chairman stating:

> Through the years, we have built our business on trust and confidence, because you and your colleagues have earned for IBM an outstanding reputation for ethical conduct and fair dealing. Those values are at the very center of our drive for market-driven quality. We intend to be a world class leader in every aspect of our business—including our business conduct.[48]

Combining the code of conduct with existing procedures and programs emphasizes that the compliance program forms part of the fabric of the organization. Through integration, employees will view the code as an ongoing daily activity, not just an attractive brochure containing high-

46. There are several excellent resources for model codes of business conduct. *See* Groskaufmanis, *supra* note 44. Also, the American Corporate Counsel Association ("ACCA") has prepared a work entitled "Establishing a Code of Business Conduct" ("ACCA 1992") which includes a model code of business conduct prepared by John Sciamanda, former General Counsel of Control Data Corporation. The ACCA work also contains codes of business conduct used by several major corporations including General Dynamics Corporation, IBM Corporation, Sun Company, NYNEX, and Martin Marietta Corporation.

47. David S. Machlowitz, *Making a Compliance Program Work: A Practical Guide*, AM. LAW., Mar. 1992, Preventive Law, at 16.

48. AMERICAN CORP. COUNSEL ASSOC., ESTABLISHING A CODE OF BUSINESS CONDUCT 99 (1992).

minded statements of ideals that merely sits on a bookshelf or at the back of a filing cabinet.

b. Supplemental Policies and Procedures

Since the enactment of the Guidelines, much of the discussion on policies and procedures has focused on corporate codes of conduct. Little mention has been made of the necessity for more detailed policies and procedures relating to areas most likely to pose the greatest problems for the organization. The general code of conduct, while useful in disseminating a positive corporate ethos and setting forth basic rules for employees, is not "reasonably capable of reducing the prospect of criminal conduct"[49] in matters which are necessarily complex given the governing law and the company's business activities. For example, the complexity of antitrust, environmental, or anti-boycott regulations may require detailed explanations. Yet, such areas may not be relevant for the entire work force. The hourly worker operating a punch press need not concern himself with the nuances of the Robinson-Patman Act. Accordingly, the organization must develop supplemental written policies and procedures, targeted at specific groups of employees, to ensure specific, yet understandable guidance in more complex and technical matters.

3. A Process for Reporting Violations

Employees at all levels must be able to report suspected violations without fear of retribution. The organization's ability to enforce its compliance program necessarily will depend upon discovering wrongdoing. Thus, a corporation must establish a system that employees know how to use and feel comfortable using.

The exact nature of the reporting system will depend upon the nature of the organization. In a small company, it may suffice if employees can communicate anonymously with the administrator or another high-level manager through interoffice mail or a company suggestion box. A larger organization may need to establish those same means of reporting as well as toll-free telephone numbers so employees can call to report violations. These toll-free numbers may allow an employee direct access to the administrator or someone within the administrator's office. Alternatively, some organizations employ a service that channels such calls, generates a basic report, and forwards it to the administrator.

49. U.S.S.G., *supra* note 6, § 8A1.2 (comment. (n.3(k))).

Reporting services generally record only basic information from the employee—the nature of the wrongdoing, the time and place of the wrongdoing, and the participants involved in the wrongdoing, if the reporting service can provide that information without revealing the identity of the reporting employee. In structuring a reporting format, companies should ensure that the report provides sufficient information to determine the seriousness of the allegation and the need for further investigation. This report, however, will not, in most instances, be protected against outside disclosure by the attorney-client privilege or work-product doctrine. Thus, the ideal reporting system should elicit enough information to determine whether an attorney needs to inquire further. This way, more detailed communications will remain confidential while the company obtains legal advice regarding an appropriate course of action.

While organizations should make anonymous reporting available, they should not *require* it. Organizations should encourage employees to feel comfortable reporting a violation directly to their supervisors or during face-to-face meetings with the administrator. Direct reporting can facilitate communication within the organization and potentially save time and effort in addressing the allegation.

4. A Process for Disciplining Violators

The Sentencing Guidelines recognize that employee discipline is not a matter easily addressed within the Guidelines' framework. Accordingly, they do not attempt to do so; instead, they vest discretion within the organization to administer a system of discipline consistent with the circumstances of the wrongdoing. Nonetheless, the organization should draft basic guidelines for employee discipline that allow the company sufficient flexibility, yet have a deterrent and punitive effect. Many companies already have such disciplinary guidelines in place apart from their compliance programs. It may suffice to incorporate these systems into a compliance program either directly or by reference. The key is the existence of a "disciplinary mechanism"[50] for the company to enforce.

E. Step V - Implementing the Structure

The implementation of the structure has essentially three components: training employees, monitoring the program, and disciplining employees.

50. *Id.* § 8A1.2 (comment. (n.3(k))).

1. Training Employees

The best way to communicate a compliance program's standards and procedures to employees depends upon the nature of the procedures, the type of organization, and the composition of the work force. For example, a foundry with a work force consisting of 150 poorly educated hourly employees, fifteen supervisors, eight clerical staff, and four sales representatives will face different challenges in disseminating its standards than a multinational software manufacturer with a work force of 900 highly educated, white collar employees.

Rarely will a single training program suffice for an organization's entire work force. Rather, a corporation should train different groups of employees in different manners based upon job duties, educational backgrounds, and the impact of the compliance program on them. Written materials, seminars, videos, software programs, and vignettes are all possible means of explaining the compliance program's standards and procedures. The "right" method is that which best communicates the appropriate message to the particular audience.

Organizations may find it useful to integrate compliance program training into existing training programs, thus reinforcing the message that compliance is an ongoing aspect of the organization. For example, a company that sells its products through a dealer network supervised by district managers may hold periodic seminars to discuss dealer termination, price fixing, and other antitrust issues. The organization could introduce its compliance program to this group of employees at such a meeting. The training session would include not only a review of the general code of business conduct but also the specific legal limitations relating to the antitrust issues affecting their job duties. Similarly, a company that holds monthly quality sessions with its hourly workers might find that such meetings provide a convenient setting for introducing those employees to the company's compliance program. However, if a company chooses to use existing training programs as a vehicle for introducing its compliance program, it should ensure that the association with non-compliance matters does not diminish the importance of the compliance program.

The organization should make compliance program training an ongoing process. A company does not have to expend the same effort annually on training as it did when it established the program. However, the company should give employees periodic refreshers and regularly bring

relevant new information to their attention. A company may require employees to sign annual statements attesting to the fact that they have reviewed the code of conduct and any other relevant supplemental policies and procedures. Organizations also can make compliance program training part of the indoctrination process for new employees.

2. Monitoring and Auditing Compliance

Once an organization establishes a compliance program and trains its employees, it must have sufficient monitoring and auditing systems to ensure that the program is working. This entails more than counting the number of calls on the company's toll-free compliance telephone number. The organization should periodically review various aspects of the program to determine whether they are achieving their intended effect. A company should pay close attention to specific problems that the company faced before establishing the compliance program.

The nature of the compliance program and the organization will significantly affect monitoring and auditing efforts. These efforts may involve periodic confidential interviews of select employees, questionnaires, "tests" of procedures through contrived situations, and analysis of the types and frequency of reported violations.

3. Disciplining Employees

As mentioned above, the Guidelines provide organizations with significant discretion in selecting appropriate disciplinary measures. When a company takes disciplinary action against an employee for violating the compliance program, it should consider disclosure to other similarly situated employees to the extent possible without violating other legal limitations. The "publication" of disciplinary actions within the organization should create a deterrent effect and motivate other employees to engage in proper conduct.

F. Step VI - Updating and Revising the Program

An effective compliance program must be up-to-date. The organization must continually refine the program to ensure that it serves its purpose. Required modifications may result from changes in the law, changes in the organization's business practices, changes in industry practices, and the occurrence of violations despite the compliance program. The ongoing refinement of a compliance program carries the

message that compliance is relevant and important to the day-to-day operations of the company.

VI. CONCLUSION

Many organizations doubt courts and prosecutors will deliver on the Guidelines' promise to reward organizations that expend the effort to implement comprehensive compliance programs. They fear that the response to the introduction of a compliance program as a mitigating factor will be: "if the program was truly 'effective,' the problem that brought the company to court would not have occurred." This skepticism should not deter companies from devising and implementing aggressive, comprehensive compliance programs. If a program has its most productive effect, the company will never face the question whether its compliance program will ultimately impact its sentencing level.