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Michael Goldsmith

Chad W. King

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Policing Corporate Crime: The Dilemma of Internal Compliance Programs

*Michael Goldsmith**
*Chad W. King***

* B.S., 1972; J.D., 1975, Cornell University; Professor of Law, Brigham Young University; Vice-Chair, United States Sentencing Commission. This article grew out of remarks presented at the Commission's symposium on corporate crime: United States Sentencing Commission, Symposium, *Corporate Crime in America: Strengthening the "Good Citizen" Corporation*, Washington, D.C., Sept. 7-8, 1995 (transcript on file with the Authors). The views expressed herein are those of the Authors and do not necessarily reflect policy of the U.S. Sentencing Commission.

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** B.A., 1993; J.D., 1996, Brigham Young University; Research Assistant for United States Sentencing Commission, 1995-1996; Associate, Robinson, Seiler & Glazier, Provo, Utah. Mr. King acknowledges the assistance of David Thomas, Gary Hill, and Edward Kimball, and the support of his wife, Stephanie, in the preparation of this Article.

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I. INTRODUCTION

No good deed goes unpunished.[1]

In recent years, federal and state laws have sought to promote good corporate citizenship by encouraging business entities to establish internal compliance programs designed to avoid—or at least detect—illicit conduct.[2] The most significant impetus toward effective internal corporate policing occurred in 1991, when the United States Sentencing Guidelines (Sentencing Guidelines) made the existence of an "effective" internal compliance program the *sine qua non* for receiving leniency upon conviction.[3] As a result, corporations na-

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1. Moliere, *The Misanthrope*, in *Plays by Moliere* 177 (Random House, 1983).

2. Several federal agencies encourage companies to establish internal compliance programs. See Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100-704, 102 Stat. 4677, 4680 (stating that broker-dealers and investment advisors must establish, maintain, and enforce internal compliance programs to prevent illegal insider trading); Incentives for Self-Policing: Discovery, Disclosure, Correction and Prevention of Violations, 60 Fed. Reg. 66,706 (1995) (EPA policy statement concerning treatment of internal audit materials); Safety and Health Program Management Guidelines, 54 Fed. Reg. 3904, 3913 (1989) (Department of Labor guidelines addressing compliance audits); *Factors in Decisions on Criminal Prosecutions for Environmental Violations in the Context of Significant Voluntary Compliance or Disclosure Efforts by the Violator* (U.S. Dept. of Justice, 1991) ("Justice Department Factors"); Evelyn E. C. Queen, *Corporate Sentencing Guidelines*, in Margaret P. Spencer and Ronald R. Sims, eds., *Corporate Misconduct: The Legal, Societal, and Management Issues* 57 (Quorum Books, 1995) (reviewing Corporate Sentencing Guidelines).

Furthermore, a growing number of state regulations entice companies to create compliance programs by reducing fines or penalties for violations discovered through an effective program. See, for example, Ill. Ann. Stat. ch. 415, § 5/52.2 (Smith-Hurd, Supp. 1996); Kan. Stat. Ann. § 60-3338(a) (Supp. 1996); Or. Rev. Stat. § 468.963 (Supp. 1996).

3. United States Sentencing Commission, *Guidelines Manual*, ch. 8 (Nov. 1994) ("USSG"). See generally Winthrop M. Swenson and Nolan E. Clark, *The New Federal Sentencing Guidelines: Three Keys to Understanding the Credit for Compliance Programs*, 1 Corp. Conduct Q. 1 (1991) (discussing the purpose of the organizational sentencing guidelines); Richard S. Gruner, *Corporate Crime and Sentencing* §§ 8.3-8.3.3 (Michie, 1994) (discussing the underlying principles, scope, and procedures of the organizational sentencing guidelines); Richard S. Gruner, *Towards an Organizational Jurisprudence: Transforming Corporate Criminal Law Through Federal Sentencing Reform*, 36 Ariz. L. Rev. 407 (1994) (describing the background and policy prompting the organizational sentencing guidelines); Ronald J. Maurer, Comment, *The Federal Sentencing Guidelines for Organizations: How Do They Work and What Are They Supposed to Do?*, 18 U. Dayton L. Rev. 799 (1993) (tracing the history of the organizational sentencing guidelines).

For example, under the Sentencing Guidelines a court may impose significant financial penalties upon a corporation whose employees act unlawfully for the benefit of the corporation. USSG § 8C2.4. The guidelines, however, allow a corporation to mitigate its penalty by conducting an "effective program to prevent and detect violations of law." Id. § 8C2.5(f).

In *United States v. A & P Trucking Co.*, 358 U.S. 121, 126-27 (1958), the Supreme Court made it clear that business entities can be found criminally liable when it ruled that partnerships and other business associations may be prosecuted for violating federal laws. See *United States v. Cincotta*, 689 F.2d 238, 241 (1st Cir. 1982) ("A corporation may be convicted for the criminal acts of its agents . . . ."). See also Ronald L. Dixon, *Corporate Criminal Liability*, in Margaret P. Spencer and Ronald R. Sims, eds., *Corporate Misconduct: The Legal, Societal, and*

tionwide have sought to establish compliance programs that qualify for preferred treatment under federal law.[4] Such programs, however, have produced an unanticipated dilemma for many businesses: when a company responds to regulatory incentives by starting a comprehensive compliance program that promotes lawful conduct, it risks generating incriminating information that may produce criminal or civil liability.[5]

For example, to qualify for mitigation under the Sentencing Guidelines, responsible corporations must institute programs to assess their compliance with applicable laws and to prevent illegal conduct within the workplace.[6] As part of such ongoing compliance

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Management Issues 41, 48-49 (Quorum Books, 1991) (discussing the development of corporate criminal liability).

4. Andrew R. Apel, Remarks at United States Sentencing Commission Symposium, *Corporate Crime in America: Strengthening the "Good Citizen" Corporation*, Washington, D.C., Sept. 7-8, 1995 (transcript on file with the Authors). According to Apel's survey data, nearly 40% of all organizations reported that the Sentencing Guidelines " 'influenced' them to either bolster existing efforts or commence new compliance efforts." Id.

Comparable results have occurred in response to some state legislation. See, for example, 4 Prevention Corp. Liability 1 (May 20, 1996) (reporting that 165 firms have notified the Texas Natural Resource Conservation Commission that they intend to conduct environmental audits in response to a new state privilege and immunity statute and stating that "[t]he first audits . . . have turned up violations that likely would have gone undetected by regulators or not have been discovered by the companies [absent an audit]").

5. See Ronald J. Allen and Cynthia M. Hazelwood, *Preserving the Confidentiality of Internal Corporate Investigations*, 12 J. Corp. L. 355, 357 (1987) (stating that due to the "lack of a generalized corporate right to privacy" a corporation never knows if the results of an internal investigation will be used against it by adverse parties); Nancy C. Crisman and Arthur F. Mathews, *Limited Waiver of Attorney-Client Privilege and Work-Product Doctrine in Internal Corporate Investigations: An Emerging Corporate "Self-Evaluative" Privilege*, 21 Am. Crim. L. Rov. 123, 125 (1983) ("One of the principal risks for management has been the difficulty of clothing such internal corporate investigations with sufficient confidentiality to guarantee that the investigation, on balance, does more good than harm."); Joseph E. Murphy, *Compliance on Ice: How Litigation Chills Compliance Programs*, 2 Corp. Conduct Q. 36, 36-41 (1992) (juxtaposing chilled and interactive compliance program results); Robert J. Bush, Comment, *Stimulating Corporate Self-Regulation—The Corporate Self-Evaluative Privilege: Paradigmatic Preferentialism or Pragmatic Panacea*, 87 Nw. U. L. Rev. 597, 599 (1993) (recognizing the dilemma posed by corporate compliance programs).

In a 1995 survey of 369 United States corporations, 12% of corporations conducting audits stated that audit results they had voluntarily provided to state or federal regulators were subsequently used against them for enforcement purposes. *Companies Would Perform More Audits if Penalties Were Eliminated, Survey Says*, 25 Envir. Rptr. (BNA) 2447 (April 14, 1995) ("*Survey*").

6. See USSG §§ 8A1.2 comment. (3(k)), 8C2.5(f); Winthrop M. Swenson, *An Effective Program to Prevent and Detect Violations of Law*, in Jeffrey M. Kaplan, Joseph E. Murphy, and Winthrop M. Swenson, eds., *Compliance Programs and the Corporate Sentencing Guidelines: Preventing Criminal and Civil Liability* § 4:01 at 1-3 (Clark Boardman Callaghan, 1993-95) (arguing that the credit awarded to companies for effective compliance programs is the philosophical centerpiece of the guidelines).

It should be noted that "[c]ommentary in the [Sentencing] Guidelines Manual that interprets or explains a guideline is authoritative unless it violates the Constitution or a federal

programs, many companies periodically conduct comprehensive audits.[7] These compliance programs and audits inevitably generate a variety of information and materials ranging from objective facts and photographs to subjective evaluations, reports, and opinions.[8] Businesses use these materials to evaluate their compliance efforts[9] and to construct new programs to help prevent future violations.[10]

Under present law, however, compliance program and audit materials are rarely confidential.[11] Consequently, they may be subject to discovery in criminal investigations and civil actions against

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statute, or is inconsistent with, or a plainly erroneous reading of, that guideline." *Stinson v. United States*, 508 U.S. 36, 38 (1993).

7. See Gruner, *Corporate Crime and Sentencing* § 14.1.2 at 818-20 (cited in note 3) (discussing the various forms and uses of compliance programs); Swenson and Clark, 1 Corp. Conduct Q. at 1 (cited in note 3).

8. See Anton R. Valukas, Robert R. Stauffer, and Joseph E. Murphy, *Threshold Considerations*, in Jeffrey M. Kaplan, Joseph E. Murphy, and Winthrop M. Swenson, eds., *Compliance Programs and the Corporate Sentencing Guidelines: Preventing Criminal and Civil Liability* § 5:03 at 2-4 (Clark Boardman Callaghan, 1993-95) (analyzing the scope of many compliance programs); John Calvin Conway, Note, *Self-Evaluative Privilege and Corporate Compliance Audits*, 68 S. Cal. L. Rev. 621, 627-30 (1995) (discussing the role of legal compliance audits).

9. See Gruner, *Corporate Crime and Sentencing* § 14.1.1 at 817 (cited in note 3) (recognizing the various ways corporations can use compliance programs); Bush, 87 Nw. U. L. Rev. at 598 (cited in note 5) (stating that logical corporate managers would conduct internal investigations in order to assess their legal compliance); Conway, 68 S. Cal. L. Rov. at 627-28 (cited in note 8) ("A legal compliance audit is aimed at assuring or achieving compliance with the law."). See generally Louis A. Braiotta, Jr., *Preventing Fraudulent Reporting: Auditing for Honesty*, 78 A.B.A. J. 76, 79 (May 1992) (noting that corporate counsel and audit committees often play a central role in compliance efforts).

10. See Louis M. Brown, *Legal Audit*, 38 S. Cal. L. Rev. 431, 432 (1965) ("[I]f legal problems can be discovered early, then solution is more available and often less expensive than it would be after the problem has matured."); Crisman and Mathews, 21 Am. Crim. L. Rev. at 124-25 (cited in note 5) (stating that internal investigations not only protect against penalties and liability, but also further corporate stewardship); Gruner, *Corporate Crime and Sentencing* § 14.1.2. at 818 (cited in note 3) (stating that compliance efforts can curb illegal conduct in both the present and future). See generally Michael R. Bromwich and Dorann E. Banks, *Today is the Day to Implement Compliance Programs*, N.Y. L. J. at S1 (July 26, 1993) (discussing the importance of a well-designed compliance program).

11. "[T]he corporation must approach compliance matters with the expectation that significant disclosures may result, either because a court finds that the materials are not privileged, because the corporation agrees as part of a settlement or plea agreement to disclose the materials, or because an employee voluntarily discloses tbem." Valukas, Stauffer, and Murphy, *Threshold Considerations*, in Kaplan, Murphy, and Swenson, eds., *Compliance Programs* § 5:10 at 17 (cited in note 8). See James Scott Fargason, *Legal Compliance Auditing and the Federal Sentencing Guidelines* 36 (1993) ("In general, both on the federal and state levels, internal audit documentation is discoverable and is not privileged information."); Karla R. Spaulding, *"An Ounce of Prevention is Worth a Pound of Cure": Federal Sentencing Guidelines for Organizations*, Fed. Law., 35, 39 (Sept. 1995) ("Although the organizational sentencing guidelines encourage voluntary reporting of crimes, they do not ensure that a company will not be prosecuted after it turns itself in.").

the company.[12] Regulatory agencies,[13] corporate shareholders,[14] disgruntled employees,[15] and third parties[16] have all successfully accessed compliance materials in litigation against companies. Unless protected, these materials threaten to become a litigation road map for prosecutors and private plaintiffs.[17] Ultimately, if such disclosures

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12. Louis M. Brown and Anne O. Kandel, *The Legal Audit*, 2-19 to 2-35 (Clark Boardman Callaghan, 1990); Gruner, *Corporate Crime and Sentencing* § 14.5.1 at 883 (cited in note 3). See Queen, *Corporate Sentencing Guidelines*, in Spencer and Sims, eds., *Corporate Misconduct* at 63 (cited in note 2) (observing that corporate counsel will often face difficult decisions of whether to volunteer "ambiguous but arguably criminal activities"); Allen and Hazelwood, 12 J. Corp. L. at 357 (cited in note 5) (stating that some corporate officers do not take aggressive action because the results of internal investigations may be used against the corporation).

Several legal scholars argue that discovery of audit materials adversely impacts corporate behavior. See, for example, Jay A. Sigler and Joseph E. Murphy, *Interactive Corporate Compliance: An Alternative to Regulatory Compulsion* 125 (Quorum Books, 1988) (stating that discovery of internal reviews sends the wrong "message" to companies considering issuing guidelines); James T. O'Reilly, *Environmental Audit Privileges: The Need for Legislative Recognition*, 19 Seton Hall Logis. J. 119, 126 (1994) (describing the adverse impact of disclosure on various aspects of corporate behavior); Jay A. Sigler and Joseph E. Murphy, *Corporate Conduct in the 1990s*, in Jay A. Sigler and Joseph E. Murphy, eds., *Corporate Lawbreaking and Interactive Compliance* 153, 183 (Quorum Books, 1991) (arguing that immunity for good faith audits will promote corporate compliance). For example, when corporations fear that audit materials will be used against them, they examine fewer internal activities, undertake fewer types of investigations, translate fewer findings into corrective plans, distribute criticism less widely and retain analysis for shorter periods. O'Reilly, 19 Seton Hall Legis. J. at 126 (cited in this note).

13. See, for example, *University of Pennsylvania v. EEOC*, 493 U.S. 182, 188-202 (1990) (ruling that academic peer review matorials are not protected by "self-evaluative privilege"); *State ex rel. Celebrezze v. CECOS Int'l., Inc.*, 583 N.E.2d 1118, 1121 (Ohio Ct. App. 1990) (holding that a state agency may discover environmental audit materials); *$1.05 Million Fine Against Coors May Deter Corporate Environmental Audits, Firm Says*, 24 Envir. Rptr. (BNA) 570, 570-71 (July 30, 1993) (finding that a government agency used a brewery's voluntary audit materials te impose fine on the brewery). See also Arthur F. Mathews, Symposium, *Current Issues in Corporate Governance: Internal Corporate Investigations*, 45 Ohio St. L. J. 655 (1984) (describing the SEC's use of corporate audit materials in enforcement proceedings).

14. See, for example, *In re Crazy Eddie Securities Litigation*, 792 F. Supp. 197, 205 (E.D.N.Y. 1992) (noting that the "self-evaluative privilege" held by corporations must be balanced against a plaintiff's need for discovery); *In re Sahlen & Associates, Inc.*, Fed. Secur. L. Rptr. (CCH) ¶ 95,822 (S.D. Fla. 1990) (holding that securities audit materials are discoverable).

15. See, for example, *Stender v. Lucky Stores, Inc.*, 803 F. Supp. 259, 330-31 (N.D. Cal. 1992) (holding that audit materials prepared by company during review of employment practices are discoverable in a subsequent suit for sexual discrimination); *Hardy v. New York News, Inc.*, 114 F.R.D. 633, 641 (S.D.N.Y. 1987) (finding that employment-related audit materials are not privileged); *Robinson v. Magovern*, 83 F.R.D. 79, 82-88 (W.D. Pa. 1979) (holding that materials evaluating a university's tenure process are discoverable).

16. Bush, 87 Nw. U. L. Rev. at 603 (cited in note 5). See, for example, *Adams v. Wecker*, CA No. L-09761-85, slip op. (N.J. Super. Ct. 1987).

17. See Allen and Hazelwood, 12 J. Corp. L. at 357 (cited in note 5) (discussing problems created by the lack of a generalized right of corporate privacy); Lawrence B. Pedowitz and Carol Miller, *Confronting the Criminal Investigation*, in Stephen M. Axinn and Jed S. Rakoff, eds., *Corporate Criminal Liability: Representing Corporations, CEOs, Corporate Officers, and the Impact of the Sentencing Guidelines 1991* at 133, 136-37 (Practising Law Institute, 1991) (advising corporations on the proper course of conduct when the government seizes documents generated by an internal investigation); Valukas, Stauffer, and Murphy, *Threshold*

are routinely allowed, they will undermine the law enforcement policies upon which the Sentencing Guidelines and comparable measures are premised: that corporate good citizenship can be induced through incentives that promote self-policing.[18] Notwithstanding this important social policy, the disclosure risks posed by audit materials in litigation have generated only sporadic judicial or legislative attempts to confer protections.

Only a few courts have responded to this dilemma by protecting potentially adverse compliance materials from disclosure.[19] In such instances, compliance materials have been shielded through a variety of methods, including the attorney-client privilege,[20] the work product doctrine,[21] and a self-evaluative privilege.[22] Most courts,

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Considerations, in Kaplan, Murphy, and Swenson, eds., *Compliance Programs* § 5:07 at 9 (cited in note 8) (advising corporations to be selective in their use of internal investigations); Bush, 87 Nw. U. L. Rev. at 599 (cited in note 5) (describing internal investigation results as "smoking gun[s]" to be used against a corporation). See also Gruner, *Corporate Crime and Sentencing* § 14.5.1 at 884 (cited in note 3) ("In addition to highlighting past misconduct, compliance program reports may give plaintiffs a list of disgruntled employees who will be useful deposition targets.").

18. See Winthrop M. Swenson, Remarks at United States Sentencing Commission Symposium, *Corporate Crime in America: Strengthening the "Good Citizen" Corporation*, Washington, D.C., Sept. 7-8, 1995 (Sentencing Guidelines create incentives for companies to take crime-controlling actions) (transcript on file with the authors); William W. Wilkins, Jr., *Sentencing Guidelines for Organizational Defendants*, 3 Fed. Sent. Rptr. (Vera) 118, 119 (1990) (stating that a draft of the Sentencing Guidelines would reduce fines in certain instances to encourage desirable corporate behavior).

19. See, for example, *Bredice v. Doctors Hospital, Inc.*, 50 F.R.D. 249, 251 (D.D.C. 1970) (recognizing an "overwhelming public interest" in keeping hospital staff meetings confidential). See also 1995 Ark. Acts 350 § 8-1-301; Colo. Rev. Stat. § 13-25-126.5(1) (Supp. 1996); 1995 Idaho Sess. Laws 359 § 9-802(a); Va. Code § 10.1-1198(B) (Supp. 1996). But see James F. Flanagan, *Rejecting a General Privilege for Self-Critical Analyses*, 51 Geo. Wash. L. Rev. 551, 574-76 (1983) (arguing that privileges do not promote corporate compliance).

20. See Part III.A.1.

21. See Part III.A.2.

22. See Part III.A.3.

A few commentators would add the ombudsman privilege to this list. See Thomas Furtado, Remarks at United States Sentencing Commission Symposium, *Corporate Crime in America: Strengthening the "Good Citizen" Corporation*, Washington, D.C., Sept. 7-8, 1995 (transcript on file with the authors). No court has yet determined, however, whether this privilege protects compliance materials beyond those directly related to the ombudsman function. Presently, only a few courts protect communications between the ombudsman and the employee, and many of these courts limit their holdings to the specific facts of the case. See *Kientzy v. McDonnell Douglas Corp.*, 133 F.R.D. 570, 571 (E.D. Mo. 1991) (outlining factors considered before granting privileged status to statements made before an ombudsman); *Monoranjan Roy v. United Technologies Corp.*, Civil Case No. H89-680, slip op. (D. Conn.1990); *Garstang v. Superior Court*, 46 Cal. Rptr. 2d 84, 87 (Cal. Ct. App. 1995) ("In our opinion, private institutions have a qualified privilege not to disclose communications made before an ombudsman in an attempt to mediate an employee dispute. That qualified privilege is based on California's constitutional right of privacy."). See generally Brenda V. Thompson, Comment, *Corporate Ombudsmen and Privileged Communications: Should Employee Communications to Corporate Ombudsmen Be Entitled to Privilege?*, 61 U. Cin. L. Rev. 653 (1992) (analyzing the emerging trend of treating discussions with ombudsmen as traditionally privileged communications).

however, have either rejected a privilege for compliance materials[23] or limited the protections to an extent that renders them useless.[24]

Given the judiciary's reluctance to protect compliance materials, several state legislatures have considered proposals that would shield compliance materials generated in the public interest.[25] For example, most state legislatures have enacted statutes designed to limit access to materials derived from medical audits,[26] and several states protect materials generated during environmental audits.[27] Though helpful, these provisions do not provide the comprehensive protection that is required for the potential benefits of incentive-based compliance programs to be achieved.

This Article argues that, in order to eliminate the dilemma posed by the potential disclosure of adverse compliance materials, a limited evidentiary privilege must be established to protect certain compliance materials from disclosure. With this in mind, Part II describes corporate compliance programs in further detail, traces their theoretical underpinnings, and explains the effect of the Sentencing Guidelines. Part III surveys the ad hoc common-law and statutory solutions to the dilemma faced by businesses considering internal compliance programs. Finally, Part IV concludes that statutory protection of compliance materials is vital to promoting compliance programs and proposes legislation shielding certain materials generated under programs that meet Sentencing Guidelines requirements.

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23. *Dowling v. American Hawaii Cruises, Inc.*, 971 F.2d 423, 426 (9th Cir. 1992) (rejecting a self-evaluative privilege for routine safety inspections); *FTC v. TRW, Inc.*, 628 F.2d 207, 210 (D.C. Cir. 1980) (rejecting a self-evaluative privilege); *United States v. Dexter Corp.*, 132 F.R.D. 8 (D. Conn. 1990) (rejecting a self-evaluative privilege for environmental compliance materials).

24. See, for example, *Webb v. Westinghouse Elec. Corp.*, 81 F.R.D. 431, 433-34 (E.D. Pa. 1978) (limiting application of the self-evaluative privilege). See also Bush, 87 Nw. U. L. Rev. at 609-12 (cited in note 5) (stating that the lack of a privilege for objective facts threatens the viability of the corporate self-evaluative privilege).

25. The Arkansas legislature recently adopted an environmental bill declaring that "the public will benefit from incentives to identify and remedy environmental compliance issues." 1995 Ark. Acts 350 § 8-1-301. See also Colo. Rev. Stat. § 13-25-126.5(1) (pointing out that environmental compliance is in the public interest).

26. See David W. Jorstad, Note, *The Legal Liability of Medical Peer Review Participants for Revocation of Hospital Staff Privileges*, 28 Drake L. Rev. 692, 694 n.11 (1979) (listing thirty-four states that have some type of statutory immunity for medical peer review).

27. These states are Arkansas, Colorado, Idaho, Illinois, Indiana, Kansas, Kentucky, Minnesota, Mississippi, Oregon, Texas, Utah, Virginia, and Wyoming. See, for example, 1995 Ark. Acts 350 § 8-1-301; Colo. Rev. Stat. § 13-25-126.5; Ill. Ann. Stat. ch. 415, § 5/52.2; Ind. Code Ann. § 13-28-4-1 (Burns, 1996); Ky. Rev. Stat. Ann. § 224.01-040 (Michie, 1995); Or. Rev. Stat. § 468.963; Wyo. Stat. § 35-11-1105 (Supp. 1996).

See also Thomas E. Lindley and Jerry B. Hodson, *Environmental Audit Privilege: Oregon's Experiment*, 24 Envir. Rptr. (BNA) 1221 (Oct. 29, 1993) (describing Oregon's legislative attempt to protect environmental audit materials).

II. COMPLIANCE PROGRAMS AND COMPLIANCE AUDITS

Compliance programs are organizational systems aimed at comprehensively detecting and preventing corporate criminality.[28] Such programs perform two essential objectives: First, they deter misconduct within a corporation.[29] Second, they provide an internal method of policing and reporting misconduct.[30] To accomplish these goals, businesses employ a variety of methods,[31] including compliance

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28. See USSG § 8A1.2 comment. (3(k)); Gruner, *Corporate Crime and Sentencing* § 14.1.1 at 817 (cited in note 3) (defining an effective compliance program as "systematic measures taken by firms to detect and prevent corporate offenses"); Swenson, *Effective Program*, in Kaplan, Murphy, and Swenson, eds., *Compliance Programs* §§ 4:06-4:07 (cited in note 6) (discussing the general criteria underlying, and precise actions necessary for, an effective compliance program).

Even the Supreme Court concedes that "[i]n light of the vast and complicated array of regulatory legislation confronting the modern corporation, corporations, unlike most individuals, 'constantly go to lawyers to find out how to obey the law,' particularly since compliance with the law in this area is hardly an instinctive matter." *Upjohn Co. v. United States*, 449 U.S. 383, 392 (1981) (citation omitted). As one commentator notes:

> [I]t is virtually impossible for even a well-intentioned company to be in full compliance, at all times, with all of our complex federal, state and local . . . regulations.
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> . . . .
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> . . . . [T]he law is so complex that no sizable company can comply with it at all times in all respects. . . .
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> . . . .
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> The problem is that even responsible companies do not feel free to audit . . . . They are concerned about the risks that arise from [the fact that] . . . [a] thorough audit will probably turn up some instance(s) of non-compliance with some law or regulation.

Barry Goode, Patrick O. Cavanaugh, and Trent Norris, *The Environmental Self-Audit Privilege: A Selected Bibliography*, 14 Preventive L. Rptr. 36, 36 (Summer 1995).

29. Charles J. Walsh and Alissa Pyrich, *Corporate Compliance Programs as a Defense to Criminal Liability: Can a Corporation Save Its Soul?*, 47 Rutgers L. Rev. 605, 645 (1995). See Kenneth K. Marshall, R. Malcolm Schwartz, and Brian J. Kinman, *Auditing and Monitoring Systems*, in Jeffrey M. Kaplan, Joseph E. Murphy, and Winthrop M. Swenson, eds., *Compliance Programs and the Corporate Sentencing Guidelines: Preventing Criminal and Civil Liability* § 11:45 at 47 (Clark Boardman Callaghan, 1993-95) ("[T]he mere existence of an effective auditing and monitoring system may serve as a deterrent to any would-be violators."). This objective is clearly implied in the Guideline requiring that a program "prevent . . . violations of law." USSG §§ 8A1.2 comment. (3(k)), 8C2.5(f).

30. Walsh and Pyrich, 47 Rutgers L. Rev. at 645 (cited in note 29). This objective is also evident in the Guideline requiring that a program "detect violations of law." USSG §§ 8A1.2 comment. (3(k)), 8C2.5(f).

31. Frequently statutes or agency rulings or announcements will outline proper compliance methods for corporations. For example, the Sentencing Guidelines describe factors considered by a court to determine whether a corporation meets the due diligence requirements of an effective compliance program. See note 87 and accompanying text. The Department of Justice has also set forth a list of standards that influence its decision whether to prosecute environmental wrongdoing:

> [I]n 1991 the Department of Justice announced its intention not to prosecute corporations having substantial programs to ensure environmental law compliance if such firms disclose employee offenses and cooperate with subsequent government investigations of the reported offenses. To qualify for this favorable prosecutorial treatment, a firm should have a "regularized, intensive, and comprehensive environmental compliance program" adopted in good faith and in a timely manner. The Department's standards

audits,[32] employee training,[33] reporting mechanisms,[34] and sanctions for illegal actions.[35] When they are properly conducted, compliance programs often provide a good measure of a firm's legal status.[36] Accordingly, because of the benefits associated with compliance investigations,[37] most publicly held corporations now maintain such programs in at least some capacity.[38]

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include a detailed list of criteria that prosecutors are instructed to use in evaluating the substantiality of compliance programs. Prosecutors are to look for the following program features:

(1) A strong institutional policy to comply with all environmental requirements;

(2) Safeguards beyond those required by existing law to prevent noncompliance from occurring;

(3) Regular procedures, including internal or external compliance and management audits, to evaluate, detect, prevent and remedy circumstances like those that led to noncompliance;

(4) Procedures and safeguards to ensure the integrity of any audit conducted;

(5) Evaluations of all sources of pollution (*i.e.*, all media), including the possibility of cross-media transfers of pollutants;

(6) Timely implementation of recommendations for improvement by auditors or evaluators;

(7) Adequate resources committed to audit or evaluation programs and to implementing their recommendations; and

(8) Evaluations of employee and corporate departmental performance regarding environmental compliance.

Gruner, *Corporate Crime and Sentencing* § 14.1.5 at 823-24 (cited in note 3) (citing Justice Department Factors (cited in note 2)).

32. See id. § 14.3.5(f) at 861-65 (recommending compliance audits for large corporations); Marshall, Schwartz, and Kinman, *Auditing and Monitoring Systems*, in Kaplan, Murphy, and Swenson, eds., *Compliance Programs* §§ 11:07, 11:16 (cited in note 29) (discussing compliance and audit programs).

33. See Gruner, *Corporate Crime and Sentencing* § 14.2.2(f) at 848 (cited in note 3) (recommending employee selection, training, and reward systems); Timothy C. Mazur, *Training*, in Jeffrey M. Kaplan, Joseph E. Murphy, and Winthrop M. Swenson, eds., *Compliance Programs and the Corporate Sentencing Guidelines: Preventing Criminal and Civil Liability* § 10:02 at 2-7 (Clark Boardman Callaghan, 1993-95) (discussing the role of training in an effective compliance program). See also USSG § 8A1.2 comment. (3(k)(4)) (stating that due diligence requires that the company communicate compliance standards and procedures to all employees through, for example, training programs).

34. See USSG § 8A1.2 comment. (3(k)(5)) (stating that due diligence requires, for example, that the company utilize a reporting system through which employees can report criminal conduct within the organization without fear of retribution). See note 85 and accompanying text.

35. See Ilene H. Nagel and Winthrop M. Swenson, *The Federal Sentencing Guidelines for Corporations: Their Development, Theoretical Underpinnings, and Some Thoughts About Their Future*, 71 Wash. U. L. Q. 205, 244 (1993) (stating that corporations must take steps to "increase the likelihood that the individuals responsible for the offense [will] be held accountable for their illegal conduct"). See also USSG § 8A1.2 comment. (3(k)(6)) (finding that due diligence requires that the company consistently enforce compliance standards and procedures through disciplinary measures).

36. Brown and Kandel, *Legal Audit* at 1-9 to 1-11 (cited in note 12); Gruner, *Corporate Crime and Sentencing* § 14.3.5 at 855-56 (cited in note 3).

37. See notes 49-62 and accompanying text.

38. Apel, Remarks at United States Sentencing Commission Symposium (cited in note 4).

Rather than maintain an institutionalized compliance program, however, some businesses merely conduct periodic compliance audits. Like the broader compliance program concept, compliance audits[39] are investigations aimed at discovering existing or potential legal problems in a company.[40] Unlike compliance programs, which are usually integrated as part of a business's organizational structure, compliance audits are not institutionalized within the operational structure, and they usually do not provide a long-term assessment of compliance status. Instead, such audits focus on a firm's compliance condition at a specific time. Compliance audits tend to function as subsets of larger compliance programs.[41]

Although audits merely reveal a company's compliance status for a particular period of time,[42] they are key to a company's ability to

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39. Authors often refer to these audits as "compliance audits" or "legal audits." See, for example, Gruner, *Corporate Crime and Sentencing* § 14.3.5 at 861-64 (cited in note 3); Marshall, Schwartz, and Kinman, *Auditing and Monitoring Systems*, in Kaplan, Murphy, and Swenson, eds., *Compliance Programs* § 11:07 at 6 (cited in note 29). In addition to "compliance audits," the EPA also encourages the use of "management audits." Hunt and Wilkins define the difference between the two audits as follows:

> Compliance audits focus on existing and potential environmental hazards, releases, and discharges for the purposes of (1) complying with environmental laws and regulations, (2) identifying nonregulatory risks, including potential liability associated with toxic tort actions, off-site disposal, or citizen suits, (3) evaluating the need to remediate existing environmental conditions and the methods used to do so, and (4) assessing the corporation's or facility's vulnerability to environmental enforcement proceedings.
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> Management audits evaluate a corporation's or facility's management systems or procedures for (1) identifying environmental noncompliance, (2) assessing environmental risks, (3) informing the corporation's decisionmakers of such risks, (4) designing and implementing measures to prevent environmental violations and mitigate nonregulatory environmental risk, and (5) remediating or otherwise responding to potential or actual environmental hazards. A comprehensive management audit will review the organization, structure, and placement of the environmental oversight functions; will evaluato the adequacy of existing statements of the company's environmental mission, goals, and objectives; and will consider the adequacy of current planning and control mechanisms to ensure that environmental criteria are adequately considered in evaluating both individual and organizational performance. It also entails developing operating procedures, training manuals, preventive maintenance programs, proactive planning, and total quality management enhancements to convert high-minded policy statements into a pervasive corporate culture of environmental stewardship.

Terrell E. Hunt and Timothy A. Wilkins, *Environmental Audits and Enforcement Policy*, 16 Harv. Envir. L. Rev. 365, 366 nn. 7-8 (1992).

40. See Marshall, Schwartz, and Kinman, *Auditing and Monitoring Systems*, in Kaplan, Murphy, and Swenson, eds., *Compliance Programs* § 11:02 at 2 (citod in note 29) (" 'Auditing' is an independent investigation of a particular activity. It is a systematic process by which someone objectively obtains and evaluates evidence to corroborate a particular assertion.").

41. See Gruner, *Corporate Crime and Sentencing* § 14.3.5(f) at 862 (cited in note 3) ("Legal audits tend to provide a 'snap shot' of the legal status of a firm at a particular time . . . ."). See also note 40 and accompanying text.

42. Compliance audits have also been compared to a "snapshot." Gruner, *Corporate Crime and Sentencing* § 14.3.5(f) at 862 (cited in note 3). Compliance programs, in contrast, are best viewed as an ongoing "movie." Swenson, *Effective Program*, in Kaplan, Murphy, and Swenson,

assess its overall compliance effectiveness.[43] For this reason, companies that follow the Sentencing Guidelines standards conduct periodic compliance audits as part of their ongoing compliance programs.[44] Such audits occur in a wide range of areas, including securities,[45] employment practices,[46] product safety,[47] and environmental regulation.[48]

A. The Benefits of Internal Compliance Programs and Audits

Ultimately, both compliance programs and audits provide several potential benefits for corporations.[49] First, if properly implemented, they allow a business to evaluate its potential criminal or civil liability,[50] assess legal defenses,[51] and make appropriate economic decisions.[52] As such, regardless of whether a program uncovers mis-

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eds., *Compliance Programs* § 4:11 at 26 (cited in note 6). See also Gruner, *Corporate Crime and Sentencing* § 14.3.5(f) at 862 (cited in note 3) (comparing ongoing compliance programs to a " 'flow' analysis").

43. See Brown and Kandel, *Legal Audit* at 1-8 to 1-11 (cited in note 12); Marshall, Schwartz, and Kinman, *Auditing and Monitoring Systems*, in Kaplan, Murphy, and Swenson, eds., *Compliance Programs* § 11.19 at 21 (cited in note 29) (stating that audits are "generally needed to assess whether monitoring controls are functioning as prescribed").

44. See Marshall, Schwartz, and Kinman, *Auditing and Monitoring Systems*, in Kaplan, Murphy, and Swenson, eds., *Compliance Programs* § 11:07 at 5-7 (cited in note 29) (discussing the necessity of periodic compliance audits in the modern business world).

45. See, for example, *Crazy Eddie Securities Litigation*, 792 F. Supp. at 205-06; *In re Salomon Brothers Security Litigation*, Fed. Secur. L. Rptr. (CCH) ¶ 97,254 (S.D.N.Y. 1992).

46. See, for example, *EEOC v. University of Notre Dame Du Lac*, 715 F.2d 331, 333-34 (7th Cir. 1983); *Croker v. Boeing Co. (Vertol Division)*, 437 F. Supp. 1138, 1146 (E.D. Pa. 1977) (stating that the defendant corporation "has been subject te annual audits of its employment practices and employment statistics").

47. See, for example, *Adams*, CA No. L-09761-85, slip op.; *Roberts v. Carrier Corp.*, 107 F.R.D. 678, 684-85 (N.D. Ind. 1985).

48. See, for example, *Reichhold Chemicals, Inc. v. Textron, Inc.*, 157 F.R.D. 522, 527 (N.D. Fla. 1994); *Dexter Corp.*, 132 F.R.D. at 8-10; *CECOS Int'l., Inc.*, 583 N.E.2d at 1119.

49. Brown and Kandel, *Legal Audit* at 1-9 to 1-11 (cited in note 12); Gruner, *Corporate Crime and Sentencing* §§ 14.1.1-14.1.8, 14.3.5(f) (cited in note 3); Sigler and Murphy, *Interactive Corporate Compliance* at 79-89 (cited in note 12).

50. Brown and Kandel, *Legal Audit* at 1-10 (cited in note 12). See generally Thomas B. Heffelfinger, *Compliance Program Checklist*, 13 Preventive L. Rptr. 33 (Spring 1994) (providing a list of issues that may arise through a compliance program).

51. Anton R. Valukas and Robert R. Stauffer, *Investigation and Disclosure of Violations*, in Jeffrey M. Kaplan, Joseph E. Murphy, and Winthrop M. Swenson, eds., *Compliance Programs and the Corporate Sentencing Guidelines: Preventing Criminal and Civil Liability* § 13:04 (Clark Boardman Callaghan, 1993-95).

52. Id. § 13:04 at 5. See Flanagan, 51 Geo. Wash. L. Rev. at 562-72 (cited in note 19) (describing commercial motivations for internal investigations); Mathews, 45 Ohio St. L. J. at 670-71 (cited in note 13) (stating that internal investigations help management decide "whom to hire or fire, whom to promote or demote, what activities to divest or terminate and what modifications in business practice or activity to adopt or promote"); Janet Purdy Levaux, *How to Foster Honesty in Your Company*, Investor's Business Daily A4 (Dec. 5, 1994) (discussing the potential for a quality ethics program to result in reduced penalties for misconduct).

conduct, compliance reviews frequently assist the company economically by exposing inefficient employees or unprofitable departments.[53]

Second, an effective compliance program can help a company avoid indictment.[54] For example, a credible and comprehensive program may demonstrate to prosecutors that the company and its employees lacked the *mens rea* required for criminal liability. The existence of an objectively reasonable program arguably establishes corporate good faith and is thereby inconsistent with criminal intent. Alternatively, a good compliance program may allow a company to discover and address misconduct, thus avoiding an intrusive government investigation.[55] If an investigation does occur, the information gained through the program can also give a firm more control over the direction and scope of the investigation.[56] Furthermore, when the government investigation finds evidence of criminality, an effective compliance program may help the business identify an appropriate defense.[57]

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53. See Kirk S. Jordan, *Designing and Implementing a Corporate Code of Conduct in the Context of an "Effective" Compliance Program*, 12 Preventive L. Rptr. 3, 6 (Winter 1993); Levaux, Investor's Business Daily at A4 (cited in note 52); Marshall, Schwartz, and Kinman, *Auditing and Monitoring Systems*, in Kaplan, Murphy, and Swenson, eds., *Compliance Programs* § 11:03 at 3 (cited in note 29) (stating that "internal audit departments often perform operational and efficiency reviews").

54. See Gruner, *Corporate Crime and Sentencing* § 14.1.5 at 823 (cited in note 3) (discussing the fact that "prosecutors will often refrain from charging firms that have effective compliance programs").

55. Id. § 14.1.7 at 828-29. See also Mathews, 45 Ohio St. L. J. at 671 (cited in note 13) (discussing how compliance programs influence charging decisions); Valukas and Stauffer, *Investigation and Disclosure of Violations*, in Kaplan, Murphy, and Swenson, eds., *Compliance Programs* § 13:04 at 5 (cited in noto 51) ("[A] credible internal investigation can help the corporation avoid being subjected to a wide-ranging, intrusive government investigation into the corporation's affairs and give the corporation more control over the nature and focus of the investigation.").

56. See Gruner, *Corporate Crime and Sentencing* § 14.1.5 at 825 (cited in note 3) (stating that compliance programs may "influence the scope and severity of enforcement responses"); Valukas and Stauffer, *Investigation and Disclosure of Violations*, in Kaplan, Murphy, and Swenson, eds., *Compliance Programs* § 13:04 at 5 (cited in note 51) (stating that an effective program "may assist in persuading the government . . . to reduce the scope of its investigation").

57. Valukas and Stauffer, *Investigation and Disclosure of Violations*, in Kaplan, Murphy, and Swenson, eds., *Compliance Programs* § 13:04 at 5 (cited in note 51). For example, a compliance program may be used by a business to show that illegal conduct occurred outside the scope of employment or tbat the culpable employee did not intend to benefit the company. See *United States v. Beusch*, 596 F.2d 871, 878 (9th Cir. 1979) (finding that the existence of a compliance program discouraging illegal activity may suggest that employee misconduct was outside scope of employment); *United States v. Basic Const. Co.*, 711 F.2d 570, 573 (4th Cir. 1983) (finding compliance efforts relevant to deciding whether an employee committed crime to benefit the company). Under traditional principles of vicarious liability in criminal cases, a principal may not be held liable for actions outside the scope of employment or not intended to benefit the company. See Kathleen F. Brickey, 1 *Corporate Criminal Liability: A Treatise on the Criminal Liability of Corporations, Their Officers and Agents* § 5:01 at 148-49 (Clark Boardman

Third, compliance programs can provide a defense in civil litigation or help persuade potential plaintiffs that their claims are weak.[58] Moreover, even against strong claims, the information generated by compliance programs can help the company to negotiate a settlement based on all the facts, not just those alleged by the plaintiff.[59]

Finally, comprehensive compliance materials may enable the business to respond in a variety of contexts to allegations of wrongdoing.[60] For example, information gained from the compliance program may assist the business in its public relations campaign[61] and in dealing with shareholders.[62]

Callaghan, 2d ed. 1991). Brickey describes circumstances leading to principal liability as follows:

> The principal theories under which courts have held corporate officers liable for criminal violations occurring within the corporation are three in number. First, one who performs an act constituting a criminal offense is personally accountable for the crime, notwithstanding that the agent was acting for the corporation in an official or representative capacity. Corporate agents may not use the corporate entity as a shield against personal liablity for their misdeeds.
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> Second, corporate employees may be accountable, under principles of accomplice liability, for crimes committed by their cohorts and subordinates. Anyone who aids, counsels, commands, encourages, or otherwise assists another to engage in conduct constituting an offense is liable for the crime in the same manner as the actual perpetrator.
>
> And third, criminal responsibility may derive from failure to control corporate misconduct. One who has control over activities that lead to a subordinate's violation may incur liability for failure to fulfill corporate heirarchy, to prevent or correct such violations.

Id.

58. *Landgraf v. USI Film Products*, 968 F.2d 427, 430 (5th Cir. 1992) (finding a company not liable for a sexually hostile work environment because the company bad reporting and disciplinary measures in place); Valukas and Stauffer, *Investigation and Disclosure of Violations*, in Kaplan, Murphy, and Swenson, eds., *Compliance Programs* § 13:04 at 7 (cited in note 51). See also Mathews, 45 Ohio St. L. J. at 672 (cited in note 13) ("[A]n internal self-investigation, if careful, thorough, and independent, may provide the board of directors with a solid basis for terminating or settling favorably derivative suits or class actions respecting the corporate problems investigated.").

59. Valukas and Stauffer, *Investigation and Disclosure of Violations*, in Kaplan, Murphy, and Swenson, eds., *Compliance Programs* § 13:04 at 6-7 (cited in note 51).

60. For example, Valukas and Stauffer state that:

> In instances where a large number of potential plaintiffs exist, the investigation may enable the corporation to identify and settle with principal potential plaintiffs before formal litigation arises. Such a settlement will place the corporation in a much better position to deal with other potential plaintiffs, and the possibility of a class-action lawsuit becomes less significant.

Id. § 13:04 at 7.

61. See Gruner, *Corporate Crime and Sentencing* § 13.5 at 791-94 (cited in note 3) (discussing the impact of corporate misconduct on institutional reputation); Jonathan M. Karpoff and John R. Lott, Jr., *Why the Commission's Corporate Guidelines May Create Disparity*, 3 Fed. Sent. Rptr. (Vera) 140, 140 (1990) (discussing the role that market forces play in policing fraud). See also Gruner, *Corporate Crime and Sentencing* § 14.1.8 at 829 (cited in

Despite these benefits, however, several risks are attendant to comprehensive programs and audits. First, such programs often generate a record of ongoing illegal activity.[63] These materials, if discoverable, may expose the company to criminal or civil liability.[64]

Compliance programs may also uncover evidence of past illegal conduct that can be difficult or expensive to remedy. Failure to report and correct such conduct promptly[65] can also create liability, as federal or state requirements often mandate disclosure.[66]

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note 3) (suggesting that a good compliance program may help a company "maintain [its] good reputation" and "gain a competitive advantage"). For example, information gathered through a compliance audit may help the company regain investor confidence and may quiet talk of potential derivative suits. See id. (discussing evidence that shareholders generally react unfavorably when criminal conduct by a corporation is announced); John A. Meyers, Remarks at United States Sentencing Commission Symposium, *Corporate Crime in America: Strengthening the "Good Citizen" Corporation*, Washington, D.C., Sept. 7-8, 1995 (transcript on file with the Authors) (describing negative shareholder reaction to wrongdoing by National Medical Enterprises).

62. See Michael K. Block, *Optimal Penalties, Criminal Law and the Control of Corporate Behavior*, 71 B.U. L Rev. 395, 411-13 (1991) (discussing the reputational effects and stigma that accompany criminal sanctions for a corporation).

63. See *Montgomery Ward & Co., Inc. v. FTC*, 691 F.2d 1322, 1325 n.4 (9th Cir. 1982) (stating that Ward's "own audits indicated violations of its corporate compliance program"); Gruner, *Corporate Crime and Sentencing* § 14.5.1 at 883 (cited in note 3) ("Managers of firms operating law compliance programs often fear that corporate personnel carrying out the programs will gather information and create records that will be used against the firms in later litigation or other contexts."). See also Valukas, Stauffer, and Murphy, *Threshold Considerations*, in Kaplan, Murphy, and Swenson, eds., *Compliance Programs* §§ 5:03-5:07 (cited in note 8) (discussing corporate document retention). See also notes 11-18 and accompanying text (discussing the problems companies face when illegal conduct is recorded).

64. See Gruner, *Corporate Crime and Sentencing* § 14.5.1 at 883 (cited in note 3) ("Law compliance programs may increase . . . liability through the revelation of offenses that would have otherwise gone undetected and unpunished."); Mathews, 45 Ohio St. L. J. at 672 (cited in note 13) (observing that by conducting an internal investigation a company may build a case for its private or governmental enemies). See also *Survey* at 2447 (cited in note 5) (finding that 12% of corporations conducting audits stated that audit results they had voluntarily provided to state or federal regulators had been used against them for enforcement purposes).

65. In the environmental context, the Department of Justice has stated that it "is more interested in prosecuting the corporate executive who ignores the results of an audit that shows problems. Intentionally ignoring environmental problems is known as willful blindness, which [the] DOJ will prosecute in a criminal case . . . ." *DOJ Plans To Issue Policy Statement on Use of Corporate Environmental Audits*, 22 Envir. Rptr. (BNA) 484 (June 21, 1991). See also Valukas and Stauffer, *Investigation and Disclosure of Violations*, in Kaplan, Murphy, and Swenson, eds., *Compliance Programs* § 13:03 at 3-4 (cited in note 51) ("[D]irectors or officers may face personal liability for failing to investigate under circumstances which raise a reasonable suspicion of wrongdoing."). See generally William E. Knepper and Dan A. Bailey, *Liability of Corporate Officers and Directors* (Michie, 4th ed. 1988).

66. A separate problem arises if the corporation is not required to report the results: When may the company destroy the compliance materials without violating federal criminal statutes, and which materials may it destroy? Fedders and Guttenplan address these questions, stating that:

> Companies which adopt records management programs . . . confront difficult legal and ethical questions regarding, first, continuing *ad hoc* search and destroy operations, and second, the timing of suspensions of routine document destruction programs in the face

Finally, ongoing compliance programs can be expensive.[67] Fees to outside professionals for compliance services can be costly. Businesses often hire an internal team of attorneys, auditors, and other professionals ("ethics officers," for example) whose sole task is to manage the compliance process. Nor are expenses limited to professional fees. Internal investigations associated with compliance programs may increase costs due to lost time, lower productivity, and decreased morale when employee attention is unduly diverted from the ordinary course of business.[68] Given these trade-offs, the profit

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> of "reasonably" or "clearly" foreseeable or pending investigations or proceedings. Beyond doubt, federal criminal statutes and the Code of Professional Responsibility are violated if management and counsel agree to destroy relevant documents after process requiring their production has been served. Furthermore, great risk of violation arises if management and counsel agree to destroy relevant documents in the course of voluntary cooperation with government authorities, or upon learning indirectly of relevant government inquiry. Many other actions by management and counsel, both intentional and inadvertent, give rise to the possibility of criminal and ethical sanctions.
>
> For these reasons, what once was a simple business decision to destroy obsolete or seemingly inconsequential documents has become a senior management concern deserving serious and thoughtful attention. Lawyers must be prepared to assist business clients in responding to the continually enlarging sphere of difficulties surrounding the destruction of documents. The possible legal, practical and ethical consequences of document destruction are vast . . . .

John M. Fedders and Lauryn H. Guttenplan, *Document Retention and Destruction: Practical, Legal and Ethical Considerations*, 56 Notre Dame Law. 5, 64 (1980). See also Lawrence Solum and Stephen Marzen, *Truth and Uncertainty: Legal Control of the Destruction of Evidence*, 36 Emory L. J. 1085, 1087-1106 (1987) (describing the legal doctrines used to control destruction of evidence and the possibility of criminal prosecution for the destruction of evidence in civil litigation).

67. See Valukas and Stauffer, *Investigation and Disclosure of Violations*, in Kaplan, Murphy, and Swenson, eds., *Compliance Programs* § 13:05 at 8-8.1 (cited in note 51) (describing the various costs incurred in conducting an internal investigation); Mathews, 45 Ohio St. L. J. at 672 (cited in note 13) (advising smaller and financially insecure companies to let the SEC assume the cost of developing the facts instead of conducting their own internal investigations).

68. Valukas and Stauffer, *Investigation and Disclosure of Violations*, in Kaplan, Murphy, and Swenson, eds., *Compliance Programs* § 13:05 at 8-8.1 (cited in note 51). Compliance programs typically do not impose unreasonable demands upon employees—indeed, often employees are not even conscious that their reporting requirement and training meetings are part of a larger compliance program—but a periodic audit of a department may require employees to spend time assembling files, reviewing old data, and interviewing with auditors. See generally Marshall, Schwartz, and Kinman, *Auditing and Monitoring Systems*, in Kaplan, Murphy, and Swenson, eds., *Compliance Programs* § 11:26.5 at 28-29 (cited in note 29) (discussing the use of surveys and random employee interviews in compliance programs). Although this type of comprehensive review is generally a good housekeeping measure for departments, it can affect morale if employees perceive the audit as reflecting lack of confidence or even distrust by management.

Gruner notes that, in spite of these potential negative effects on employees, compliance programs can also promote long-term positive effects on personnel as well:

> In many companies, law compliance systems are part of broader ethics programs. These ethics programs encourage employees to observe stated corporate values in dealings with other employees, customers, suppliers, and members of surrounding communities. Ethics codes are at the core of most corporate ethics programs. These codes invariably require law compliance, but typically go further to mandate adherence to other values

motive alone will not always cause a business to establish a compliance program. Often, therefore, the decision to initiate such a program is induced by regulatory agencies who consider compliance programs to be utilitarian.

From the regulatory perspective, compliance programs carry important benefits for society at large. First, such programs may serve the public interest by identifying potential problems within a company before the matter reaches crisis proportions for the business and its community. For example, a bank might regularly audit its security traders to determine whether they are properly managing the bank's assets.[69] By promptly discovering financial discrepancies or unapproved trading practices, the bank can avoid an institutional financial crisis with broader ramifications.[70] Such compliance programs protect both the bank executives and shareholders, as well as anyone who does business with the bank, including depositors, merchants, investors, and deposit insurers.[71]

Second, effective compliance programs result in lower costs of goods and services for consumers.[72] These savings occur because compliance efforts allow corporations to identify and eliminate inefficient or unprofitable employees, departments, and procedures.[73] As

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and practices selected by top corporate managers. Such codes can promote ethical values in addition to ensuring law compliance.

By defining required conduct in terms of ethical concerns beyond mere law compliance, business ethics codes and related ethics programs often clarify and encourage work behaviors promoting law compliance. Ethical standards and guidance "may serve to improve compliance by removing ambiguity or vagueness with respect to acceptable conduct, by clarifying management's expectations and overriding competing performance incentives, and by encouraging employee 'whistleblowing'."

Gruner, *Corporate Crime and Sentencing* § 14.1.8 at 831-32 (cited in note 3) (citations omitted).

69. For examples of what can happen in the absence of effective compliance programs, see Marc Levinson and Michael Meyer, *Billion-Dollar Bath*, Newsweek 54 (Oct. 9, 1995) (pointing out that an unsupervised trader lost over $1 billion for Daiwa Bank); Bill Powell, *Busted!*, Newsweek 37 (March 13, 1995) (pointing out that an unsupervised trader lost over $1 billion for Barings PLC).

70. See Powell, Newsweek at 37 (cited in note 69) (pointing out that the Barings failure affected bank customers, investers, employees, and creditors).

71. See generally Roy A. Schotland, *Re-examining the Freedom of Information Act's Exception 8: Does It Give an Unduly "Full Service" Exemption for Bank Examination Reports and Related Material?*, 9 Admin. L. J. Am. U. 43 (1995) (discussing the role of audits, examinations, and compliance programs in bank operations).

72. This assumes that the market is working efficiently. But see Frances L. Edwards, *Worker Right-to-Know Laws: Ineffectiveness of Current Policy-Making and a Proposed Legislative Solution*, 15 B.C. Envir. Aff. L. Rev. 1, 17 (1987) ("[I]ndustries will offset additional financial burdens of compliance by passing costs on to the consumers."); John J. Voortman, *Curbing Aftermarket Monopolization*, 19 J. Legis. 155, 167 (1993) ("[I]t is apparent that . . . policing compliance will involve substantial costs. These costs may well increase the price of the repairs to the consumers.").

73. See Jordan, 12 Preventive L. Rptr. at 6 (cited in note 53).

the company becomes more efficient, its operating costs fall, thereby creating an opportunity to lower prices for its customers.[74] Similarly, because compliance programs can prevent wrongful conduct from occurring, businesses pay less in attorney's fees, criminal fines, and civil judgments, thus lowering the overall cost of doing business. These savings ultimately benefit the consumer in the form of lower prices.[75]

B. Compliance Programs, Audits, and the United States Sentencing Guidelines

Because effective compliance programs carry significant social benefits, the United States Sentencing Commission[76] (Commission") incorporated within its Sentencing Guidelines incentives to induce corporations to implement such programs. These incentives operate in two ways: (1) by rewarding the creation of "effective program[s] to prevent and detect violations of law,"[77] and (2) by sanctioning the underlying illegal conduct.[78] In an attempt to induce more companies to create effective compliance programs, the Commission combined specific requirements with general ameliorative principles, thus

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74. Lower costs to the corporation do not automatically mean lower costs to the consumer. Even if consumer costs do not fall, however, society still enjoys indirect benefits from the corporation's extra income. The economic effects of stock dividend increases, corporate pay raises, and corporate work force expansion will eventually benefit consumers indirectly.

75. Jordan, 12 Preventive L. Rptr. at 6 (cited in note 3).

76. Congress described the Sentencing Commission as follows:

> The United States Sentencing Commission ("Commission") is an independent agency in the judicial branch composed of seven voting and two non-voting, *ex officio* members. Its principal purpose is te establish sentencing policies and practices for the federal criminal justice system that will assure the ends of justice by promulgating detailed guidelines prescribing the appropriate sentences for offenders convicted of federal crimes.

USSG ch. 1, part A.1.

77. USSG §§ 8A1.2, comment. (3(k)), 8C2.5(f). This reward is in the form of credit given in the culpability score determination. See id. § 8C2.5(g)(1). Although the Commission has affirmatively set a minimum credit for compliance programs, courts have discretion to credit the culpability score even beyond what the guidelines affirmatively require. See id § 8C4.11; Swenson, *Effective Program*, in Kaplan, Murphy, and Swenson eds., *Compliance Programs* § 4:02 at 5 (cited in note 6) (stating that the Commission "gave courts authority to consider a further reduction *on their own*").

78. Commentators often refer to these incentives as "carrots" and "sticks." See Oversight on the U.S. Sentencing Commission and Guidelines for Organizational Sanctions, Hearings Before the Subcommittee on Criminal Justice of the House Committee on the Judiciary, 101st Cong., 2d Sess. 189 (1990); Wilkins, 3 Fed. Sent. Rptr. at 120 (cited in note 18); Jeffrey M. Kaplan, *Corporate Sentencing Guidelines: Overview*, in Jeffrey M. Kaplan, Joseph E. Murphy, and Winthrop M. Swenson, eds., *Compliance Programs and the Corporate Sentencing Guidelines: Preventing Criminal and Civil Liability* §§ 3:06-3:10 (Clark Boardman Callaghan, 1993-95); Swenson, Remarks at United States Sentencing Commission Symposium (cited in note 18).

allowing sentencing courts the flexibility necessary to promote good corporate citizenship.[79] At the time of sentencing, the Guidelines permit a court to reduce an offender's fine if the illicit conduct occurred, notwithstanding the defendant having established an "*effective* program to prevent and detect violations of law."[80] Four elements determine whether a company's program meets this standard: (1) general effectiveness in preventing and detecting violations of law; (2) due diligence; (3) the compliance context; and (4) compliance with industry practice.[81]

1. Preventing and Detecting Violations of Law

An effective program "means a program that has been reasonably designed, implemented, and enforced so that it generally will be effective in preventing and detecting criminal conduct."[82] By definition, therefore, an effective program should prevent—or at the very least detect—illegal conduct on the part of the business. If a compliance program fails to detect wrongdoing within the company, however, a court may consider the company's "due diligence" and the overall context of its operations to determine whether the program may still be deemed effective.[83]

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79. Swenson, *Effective Program*, in Kaplan, Murphy, and Swenson, eds., *Compliance Programs* § 4:06 at 15-19 (cited in note 6). See Swenson and Clark, 1 Corp. Conduct Q. at 1 (cited in note 3).

80. USSG §§ 8A1.2 comment. (3(k)), 8C2.5(f) (emphasis added); Swenson and Clark, 1 Corp. Conduct Q. at 1 (cited in note 3). Swenson comments that:

> The definition of an effective program to prevent and detect violations of law reflects the same basic approach the United States Sentencing Commission took in devising the organizational guidelines generally: a melding of specific requirements—aimed at ensuring that sentencing discretion will be meaningfully guided and consistently exercised—with general principles, to ensure that courts will have the flexibility necessary to apply reasoned judgment to the sometimes unique issues and frequently complex facts raised by federal organizational offenses.

Swenson, *Effective Program*, in Kaplan, Murphy, and Swenson, eds., *Compliance Programs* § 4:06 at 15 (cited in note 6).

81. Swenson characterizes these elements as a "four-part structure." Swenson, *Effective Program*, in Kaplan, Murphy, and Swenson, eds., *Compliance Programs* § 4.06 at 15 (cited in note 6). For a program to be effective, elements (1), (2), and (4) must be present to some degree. The third element, based on the compliance context, provides the framework within which to consider the existence or operation of the other elements. See notes 88-93 and accompanying text.

82. USSG § 8A1.2 comment. (3(k)).

83. The Guidelines state that "[f]ailure to prevent or detect the instant offense, by itself, does not mean that the program was not effective. The hallmark of an effective program to prevent and detect violations of law is that the organization exercised due diligence in seeking to prevent and detect criminal conduct hy its employees and other agents." Id.

2. Due Diligence

Under the Guidelines, an evaluation of "due diligence" requires a court to consider seven factors:

(1) The organization must have established compliance standards and procedures to be followed by its employees and other agents that are reasonably capable of reducing the prospect of criminal conduct.

(2) Specific individual(s) within high-level personnel of the organization must have been assigned overall responsibility to oversee compliance with such standards and procedures.

(3) The organization must have used due care not to delegate substantial discretionary authority to individuals whom the organization knew, or should have known through the exercise of due diligence, had a propensity to engage in illegal activities.

(4) The organization must have taken steps to communicate effectively its standards and procedures to all employees and other agents.[84]

(5) The organization must have taken reasonable steps to achieve compliance with its standards.[85]

(6) The standards must have been consistently enforced through appropriate disciplinary mechanisms, including, as appropriate, discipline of individuals responsible for the failure to detect an offense. Adequate discipline of individuals responsible for an offense is a necessary component of enforcement; however, the form of discipline that will be appropriate will be case-specific.

(7) After an offense has been detected, the organization must have taken all reasonable steps to respond appropriately to the offense and to prevent further similar offenses—including any necessary modification to its program to prevent and detect violations of law.[86]

A program which meets these requirements is likely to be found "effective."[87]

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84. Some examples of this would be to require participation in training programs or disseminate publications that explain in a practical manner what is required.

85. The organization could utilize monitoring and auditing systems reasonably designed to detect criminal conduct by its employees and other agents or have in place and publicize a reporting system whereby employees and other agents could report criminal conduct by others within the organization without fear of retribution.

86. USSG § 8A1.2 comment. (3(k)(5)).

87. Id. § 8A1.2 comment. (3(k)). To date, no court has interpreted this section of the Sentencing Guidelines.

3. The Compliance Context

In determining whether a program is effective, the Sentencing Guidelines also direct courts to consider the context within which the compliance program operates. Specifically, "[t]he precise actions necessary for an effective program to prevent and detect violations will depend upon a number of factors."[88] These factors include the "size of the organization,"[89] the "[l]ikelihood that certain offenses may occur because of the nature of its business,"[90] and the "[p]rior history of the organization."[91] Taken together, these factors determine how formal the company's program must be, which areas of the business it must cover,[92] and whether the company should be on notice that misconduct is likely to occur.[93]

4. Compliance with Industry Practice

The final element of an effective program concerns the company's compliance with industry practice: "An organization's failure to incorporate and follow applicable industry practice or the standards called for by any applicable governmental regulation weighs against a finding of an effective program to prevent and detect

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88. Id.
89. Id. § 8A1.2 comment. (3(k)(i)).
90. Id. § 8A1.2 comment. (3(k)(ii)).
91. Id. § 8A1.2 comment. (3(k)(iii)).
92. The Commentary states that:
For example, if an organization handles toxic substances, it must have established standards and procedures designed to ensure that those substances are properly handled at all times. If an organization employs sales personnel who have flexibility in setting prices, it must have established standards and procedures designed to prevent 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 designed to prevent fraud.
Id. § 8A1.2 comment. (3(k)(ii)).
93. Swenson notes that:
The relevant portion of the commentary states, "An organization's prior history may indicate types of offenses that it should have taken actions to prevent." The commentary then continues with an admonition: "Recurrence of misconduct similar to that which an organization has previously committed casts doubt on whether it took all reasonable steps to prevent such misconduct." This language not only reinforces the idea that past history helps show *which* violations the compliance program must particularly seek to prevent and detect, it strongly suggests that—because the organization's compliance program will be held accountable for repeat violations—the circumstances surrounding past violations should carefully be examined to see *how* to guard against future violations.
Swenson, *Effective Program*, in Kaplan, Murphy, and Swenson, eds., *Compliance Programs* § 4:06 at 17-18 (cited in note 6).

violations of law."[94] This element requires companies to check the standards governing their industry constantly and to ensure that their compliance efforts conform with other similarly situated programs.[95]

III. PROTECTION FOR COMPLIANCE MATERIALS

Since the promulgation of the Guidelines, more companies have instituted compliance programs to prevent and detect violations of law.[96] Accordingly, more companies now face the dilemma posed by the disclosure risks such programs create. In order to protect materials arising from these programs, businesses can sometimes rely on common-law evidentiary privileges, the work product doctrine, or state privilege statutes. Because these protections are narrowly drawn and lack certainty, however, it is arguable that they exacerbate—rather than resolve—the dilemma posed by compliance programs. The inadequacy of existing protections becomes apparent once their origins and theoretical foundations are better understood.

A. Common Law Evidentiary Privileges

Traditionally, courts have created evidentiary privileges[97] when the potential harm caused by disclosure of information out-

94. USSG § 8A1.2 comment. (3(k)).

95. Swenson comments that "the apparent intent of this final portion of the definition is to encourage companies to look outside the guidelines' general requirements in designing compliance programs. Companies must know what the relevant industry and regulatory standards are and make sure their own programs' features do not fall demonstrably short." Swenson, *Effective Program*, in Kaplan, Murphy, and Swenson, eds., *Compliance Programs* § 4:06 at 18 (cited in noto 6). Furthermore, he states that:

> [W]hile the guideline commentary literally read seems to require adherence to industry practice, it seems obvious that what the Sentencing Commission had in mind was tbat companies' compliance standards and procedures be at *least as good* as prevailing industry practice. It is doubtful the Commission intended to stifle innovation that could foster effective approaches for individual companies or for organizations generally.

Id. § 4:06 at 18 n.8.

96. See Apel, Remarks at United States Sentencing Commission Symposium (cited in note 4). According to Apel's data, 20% of all organizations reported that they added compliance programs because of their awareness of the Sentencing Guidelines. An additional 40% reported that the Guidelines " 'infiuenced' them to either bolster existing efforts or commence new compliance efforts." Id.

97. Privileges tend to fall into two categories: tliose that protect relationsliips and those that protect privacy. Under tlie first category, courts create privileges in order to foster and protect relationships, assuming tliat unfettered communication will not occur unless protected.

weighs the adverse consequences of nondisclosure.[98] Because evidentiary privileges often exclude highly probative evidence, however, courts do not favor such privileges and tend to construe them narrowly.[99]

Within this framework, a few courts have attempted to promote compliance programs[100] by protecting compliance materials from discovery.[101] Judges have achieved this result through a variety of means, including the attorney-client privilege,[102] the work product doctrine,[103] and the self-evaluative privilege.[104] None of these doctrines, however, definitively protects compliance materials from disclosure.

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98. Charles Alan Wright and Kenneth W. Graham, Jr., 23 *Federal Practice and Procedure: Evidence* § 5422 at 668 (West, 1980). This rationale is evident in privileges created to protect relationships: The attorney-client privilege, the priest-penitent privilege, and the privilege protecting marital communications all emphasize the importance of protecting the underlying relationship. Professor Wigmore outlined the factors that a court should look to before granting such a privilege:

> (1) The communications must originate in a *confidence* that they will not be disclosed. (2) This element of *confidentiality must be essential* to the full and satisfactory maintenance of the relation between the parties. (3) The *relation* must be one which in the opinion of the community ought to be sedulously *fostered*. (4) The *injury* that would inure to the relation by the disclosure of the communications must be *greater than the benefit* thereby gained for the correct disposal of litigation.

John Henry Wigmore, 8 *Evidence in Trials at Common Law* § 2285 at 527 (John T. McNaughton, ed., 1961).

The second category of privileges—those created to protect privacy interests—emphasizes an individual's right of privacy over all other rights. Privileges falling within this category assume that an individual has a privacy right that may only be overcome in exceptional circumstances. See Wright and Grabam, 23 *Evidence* § 5422 at 671-73 (cited in note 98) (stating that in such cases "the disclosure is itself thought to be wrong").

99. See *Herbert v. Lando*, 441 U.S. 153, 175 (1979) ("Evidentiary privileges in litigation are not favored, and even those rooted in the Constitution must give way in proper circumstances.").

100. Like compliance programs, audits may yield many potentially problematic materials. Because of tbis, most courts and legislatures treat compliance audit materials in the same way they treat compliance program materials.

101. See *University of Notre Dame Du Lac*, 715 F.2d at 337; *Gray v. Board of Higher Education, City of New York*, 692 F.2d 901, 904-05, 908 (2d Cir. 1982); *Crazy Eddie Securities Litigation*, 792 F. Supp. at 205 (finding that self-improvement through uninhibited self-analysis and evaluation is in the public interest); *Granger v. National R.R. Passenger Corp.*, 116 F.R.D. 507, 510 (E.D. Pa. 1987); *Roberts*, 107 F.R.D. at 685; *Bredice*, 50 F.R.D. at 250-51.

102. See *Upjohn*, 449 U.S. at 383; Wigmore, 8 *Evidence* § 2292 at 554 (cited in note 98); Note, *Attorney-Client and Work Product Protection in a Utilitarian World: An Argument for Recomparison*, 108 Harv. L. Rev. 1697, 1698-1700 (1995).

103. See *Hickman v. Taylor*, 329 U.S. 495, 510 (1947) (stating that a lawyer's work is entitled to freedom from unnecessary intrusion by opposing parties and their counsel). See also FRCP 26(b)(3) (stating that "the court shall protect against disclosure of the mental impressions, conclusions, opinions or legal theories of an attorney or other representations of a party concerning the litigation" when ordering discovery).

104. See Part III.A.3.

1. The Attorney-Client Privilege

The attorney-client privilege is the oldest and most widely applied doctrine protecting confidential communications.[105] Although originally grounded on the belief that an attorney should be permitted to "keep the secrets confided in him by his client and thus preserve his honor,"[106] today most courts justify the privilege on the premise that it encourages clients to make full disclosure to their lawyer, thus enabling counsel to act in an informed and effective manner.[107]

Not all communications between an attorney and client, however, qualify for protection. The privilege is limited to communications made in confidence to an attorney by the client for the purpose of obtaining legal advice.[108] Even when the privilege applies, it is

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105. *Upjohn*, 449 U.S. at 389; Wigmore, 8 *Evidence* § 2290 at 542 (cited in note 98).

106. *In re Colton*, 201 F. Supp. 13, 15 (S.D.N.Y. 1961).

107. The Supreme Court explained the purpose of the attorney-client privilege in *Upjohn*:

> Its purpose is to encourage full and frank communication between attorneys and their clients and thereby promote broader public interests in the observance of law and administration of justice. The privilege recognizes that sound legal advice or advocacy serves public ends and that such advice or advocacy depends upon the lawyer's being fully informed by the client.

Upjohn, 449 U.S. at 389.

108. See id.; *United States v. United Shoe Machinery Corp.*, 89 F. Supp. 357, 358 (D. Mass. 1950). In order for the privilege to apply, the communication must meet several requirements:

> (1) [T]he asserted holder of the privilege is or sought to become a client; (2) the person to whom the communication was made (a) is a member of the bar of a court, or his subordinate and (b) in connection with this communication is acting as a lawyer; (3) the communication relates to a fact of which the attorney was informed (a) by his client (b) without the presence of strangers (c) for the purpose of securing primarily either (i) an opinion on law or (ii) legal services or (iii) assistance in some legal proceeding, and not (d) for the purpose of committing a crime or tort; and (4) the privilege has been (a) claimed and (b) not waived by the client.

United Shoe Machinery Corp., 89 F. Supp. at 358-59. See *United States v. Tedder*, 801 F.2d 1437, 1441-42 (4th Cir. 1986) (citing *United Shoe* with approval); *In re Sealed Case*, 737 F.2d 94, 98-99 (D.C. Cir. 1984) (following *United Shoe*); *United States v. Jones*, 696 F.2d 1069, 1072 (4th Cir. 1982) (referring to *United Shoe* as the "classic test for application of the attorney-client privilege").

Furthermore, the context of the communication is often important in determining whether the communication is protocted:

> It is generally accepted that communications with in-house counsel who also hold a business position within the corporation will be privileged where the attorney is acting in a legal capacity. Where there is the potential for conflict, however, between in-house counsel's desire to see the company prosper and counsel's professional and legal obligations, the Second Circuit has suggested that "[i]n such cases, the wiser course may be to hire counsel with no other connection to the corporation to conduct investigations." *In re John Doe Corp.*, 675 F.2d 482, 491 (2d Cir. 1982). Otherwise, a court may find the [attorney-client] privilege inapplicable because of in-house counsel's handling of the matter.

John R. Wing and Harris J. Yale, *Grand Jury Practice*, in Otto G. Obermaier and Robert G. Morvillo, eds., *White Collar Crime: Business and Regulatory Offense* § 8.04[2] at 8-39 n.64 (Law Journal Seminars-Press, 1990) (citations omitted).

narrowly construed[109] and may be waived by disclosure to a third party,[110] inadvertent testimony at a deposition,[111] or production of privileged documents.[112]

a. Upjohn Co. v. United States

Upjohn Co. v. United States,[113] the Supreme Court's seminal decision interpreting the attorney-client privilege in a corporate context, provides a preliminary framework for analyzing when compliance materials may be protected from disclosure. *Upjohn* involved a company that directed both corporate and outside counsel to investigate allegations that its employees had bribed foreign officials to secure contracts.[114] The attorneys interviewed corporate managers, and circulated a questionnaire asking for details about the alleged transactions.[115] Subsequently, the Internal Revenue Service ("IRS") demanded production of all documents relating to the transactions, including the interview records and questionnaires generated by

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109. See *Spectrum Systems Int'l Corp. v. Chemical Bank*, 581 N.E.2d 1055, 1059 (N.Y. 1991) (stating that the attorney-client privilege "must be narrowly construed and its application must be consistent with the purposes underlying the immunity"); *Smith v. Harmon Group, Inc.*, 1992 U.S. Dist. LEXIS 242 at *4-5 (S.D.N.Y.) ("The attorney-client privilege is narrowly construed because it obstructs the truth-finding process."); Wigmore, 8 *Evidence* § 2291 at 554 (cited in noto 98) (arguing that the privilege "ought to be strictly confined within the narrowest possible limits consistent with the logic of its principle").

110. See *Steen v. First Nat'l Bank of Sarcoxie, Mo.*, 298 F. 36, 41-42 (8th Cir. 1924) (holding that defendants could not invoke the privilege to prevent disclosure of confidential communications after prior voluntary disclosure of the information at a preliminary hearing); *Knaust Brothers v. Goldschlag*, 34 F. Supp. 87, 88 (S.D.N.Y. 1939) (asserting tbat substantial disclosure through oral testimony given in examinations before trial and in bill of particulars furnished to defendant pursuant to court order constituted a waiver of attorney-client privilege).

111. See *In re Sealed Case*, 877 F.2d 976, 980-81 (D.C. Cir. 1989) (holding that inadvertent disclosure due to bureaucratic error waived attorney-client privilege); *White v. Thacker*, 78 F. 862, 865 (5th Cir. 1897) (admitting testimony by attorney where the client in deposition bad offered letters written by attorney). In the corporate context, however, inadvertent production of documents often will not waive the privilege, particularly when the party is required to produce a large number of documents at the same time. See *Transamerica Computer Co., Inc. v. International Business Machines Corp.*, 573 F.2d 646, 647-51 (9th Cir. 1978) (holding that inadvertent disclosure "compelled" by accelerated discovery proceedings did not waive attorney-client privilege); *International Business Machines Corp. v. United States*, 471 F.2d 507, 509-11 (2d Cir. 1972) (stating that disclosure of documents pursuant to a court order did not constitute waiver of attorney-client privilege).

112. See *In rc Grand Jury Subpoena Duces Tecum*, 391 F. Supp. 1029 (S.D.N.Y. 1975) (holding that the corporation waived the attorney-client privilege by producing documents pursuant to grand jury subpoenas). When applied in a corporate setting, the attorney-client privilege attaches to the corporate entity and not to the individual employee who communicates with corporate counsel. The corporation may determine whether to assert the privilege, irrespective of what the employee wishes to do.

113. 449 U.S. 383 (1981).

114. Id. at 386-87.

115. Id.

Upjohn's internal investigation.[116] Upjohn refused to release the documents, arguing that they were protected under the attorney-client privilege and the work product doctrine.[117]

The district court rejected Upjohn's argument and directed disclosure to the IRS.[118] On appeal, the Sixth Circuit summarily disposed of the work product claim[119] and held that the attorney-client privilege only extends to communications made between attorneys and those "control group" employees "who play a substantial role in deciding and directing the corporation's response to the legal advice given."[120] Because the Sixth Circuit's analysis dramatically narrowed the scope of the attorney-client privilege in corporate settings, the Supreme Court granted certiorari to consider this issue.[121] In reversing, the Supreme Court found the "control group" test to be inconsistent with the premise underlying the attorney-client privilege:

> The control group test adopted by the court below . . . frustrates the very purpose of the privilege by discouraging the communication of relevant information by [noncontrol group] employees of the client to attorneys seeking to render legal advice to the client corporation. The attorney's advice will also frequently be more significant to noncontrol group members than to those who officially sanction the advice, and the control group test makes it more difficult to convey full and frank legal advice to the employees who will put into effect the client corporation's policy.[122]

The Court also recognized that, since lower-level employees may "embroil the corporation in serious legal difficulties," such employees must be allowed to give counsel relevant information regarding those difficulties.[123] Thus, the Court concluded that the control group test undermines the judicial system by discouraging knowledgeable employees from speaking with corporate counsel.[124]

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116. Id. at 387-88.
117. Id. at 388.
118. Id.
119. The court found the work product doctrine inapplicable to IRS summonses. Id. at 389.
120. *United States v. Upjohn Co.*, 600 F.2d 1223, 1226 (6th Cir. 1979). In an earlier case, one district court endorsed a similar approach:

> [T]he most satisfactory solution . . . is that if the employee making the communication, of whatever rank he may be, is in a position to control or even to take a substantial part in a decision about any action which the corporation may take upon the advice of the attorney, or if he is an authorized member of a body or group which has that authority, then, in effect, he is (or personifies) the corporation when he makes his disclosure to the lawyer and the privilege would apply.

City of Philadelphia v. Westinghouse Electric Corp., 210 F. Supp. 483, 485 (E.D. Pa. 1962).
121. *Upjohn*, 449 U.S. at 386.
122. Id. at 392.
123. Id. at 391.
124. Id. at 392.

Although the Court rejected the control group test, Justice Rehnquist's majority opinion declined to establish a new standard for operation of the privilege in a corporate setting; instead, *Upjohn* left the lower courts to determine application of the privilege on a case-by-case basis.[125] In its aftermath, some courts[126] have interpreted *Upjohn*'s rejection of the control group test to constitute implicit endorsement of a "subject matter" test for resolving the scope of the attorney-client privilege in corporate settings.[127]

b. The Subject Matter Test

Under the subject matter test,[128] five elements must be present for the attorney-client privilege to apply: (1) the communication must be made for the purpose of securing legal advice;[129] (2) the employee making the communication must do so at the direction of a supervisor;[130] (3) the direction must be given by the supervisor to obtain legal advice for the corporation;[131] (4) the subject matter of the communication must be within the scope of the employee's corporate duties;[132] and (5) the communication may not be disseminated beyond those persons who need to know the information.[133] Although most courts

125. Though *Upjohn* effectively negated the control group test on the federal level, a few state courts still apply that test when faced with attorney-client privilege issues. For example, one year after the *Upjohn* ruling, the Illinois Supreme Court looked to the control group test in finding that reports prepared by general counsel during interviews with employees were not protected by the attorney-client privilege. *Consolidated Coal Co. v. Bucyrus-Erie Co.*, 432 N.E.2d 250, 257-58 (Ill. 1982).

126. See generally Note, *The Attorney-Client Privilege and the Corporate Client: Where Do We Go After* Upjobn?, 81 Mich. L. Rev. 665, 674-83 (1983) (describing the various subject matter tests applied by tbe courts).

127. The Supreme Court has neither rejected the subject matter test nor formally approved it as the standard for applying the attorney-client privilege in a corporate setting. Until the Court affirmatively delineates the circumstances under wbich the subject matter test applies, corporations will ordinarily keep privileged communication at the management level unless circumstances mandate differently.

128. See, for example, *Harper & Row Publishers, Inc., v. Decker*, 423 F. 2d 487, 491-92 (7th Cir. 1970); *Diversified Industries, Inc. v. Meredith*, 572 F.2d 596, 608-10 (8th Cir. 1977); *Sylgab Steel & Wire Corp. v. Imoco-Gateway Corp.*, 62 F.R.D. 454, 456-57 (N.D. Ill. 1974).

129. *Diversified Industries*, 572 F.2d at 609; *Harper & Row*, 423 F.2d at 490.

130. *Diversified Industries*, 572 F.2d at 609; *Harper & Row*, 423 F.2d at 491.

131. *Diversified Industries*, 572 F.2d at 609; *Harper & Row*, 423 F.2d at 491.

132. *Diversified Industries*, 572 F.2d at 609; *Harper & Row*, 423 F.2d at 491-92.

133. *Diversified Industries*, 572 F.2d at 609. See also *Sylgab Steel & Wire Corp.*, 62 F.R.D. at 456 (adopting the *Harper & Row* analysis); *Hasso v. Retail Credit Co.*, 58 F.R.D. 425, 428 (E.D. Pa. 1973) (same); Jack B. Weinstein, Margaret A. Berger, and Joseph M. McLaughlin, 2 *Weinstein's Evidence* ¶ 503(a)[04] at 503-41 (Matthew Bender, 1996) ("If the same statements have been made . . . to third persons on other occasions this is persuasive tbat like communications to the lawyer were not intended as confidential.").

routinely apply the subject matter test,[134] this standard does not afford complete protection to compliance materials. For example, the corporation risks waiving the privilege by disseminating compliance results too broadly among its employees.[135] Broad dissemination, however, may be needed to educate employees and avoid future misconduct.[136] Similarly, the company's own investors are likely to expect reasonable disclosure.[137] Some companies have therefore sought to supplement the attorney-client privilege by looking to the work product doctrine.

2. The Work Product Doctrine

The work product doctrine protects materials that contain the "mental impressions, conclusions, opinions, or legal theories of an attorney."[138] This doctrine is similar to the attorney-client privilege in

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The factors articulated in *Upjohn* are similar to those listed in *Diversified Industries* and *Harper & Row*. *Upjohn*, 449 U.S. at 394. However, the *Upjohn* Court declined to adopt the subject matter test as its own.

134. See Note, 81 Mich. L. Rev. at 674-83 (cited in note 126).

135. Waiver in such case will turn on the fifth factor of the subject matter test—the communication may not be disseminated beyond those who needed to know the information. See note 133 and accompanying text. For example, management risks waiving the privilege if it divulges the results of an internal compliance audit in employee training materials. Compare *James Julian, Inc. v. Raytheon Co.*, 93 F.R.D. 138, 141-42 (D. Del. 1982) (documents were privileged because they were not broadly circulated or used as training materials).

136. Arguably, only those involved in the misconduct need to know the information regarding the misconduct, as required by the subject matter test. In some circumstances, however, a company may wish to publish the confidential information to more than just those involved. For example, if misconduct occurs in one branch of a multinational corporation, management may wish to share confidential information with all of its employees worldwide in order to avoid similar misconduct elsewhere.

137. This situation has led one commentator to remark that the potential protection of the attorney-client privilege has become even more problematic:

> since invocation of that protection would likely void the benefits otherwise available from having the compliance program in the first place. In order to argue that the company does not deserve to be indicted or punished because it had a genuine or "effective" compliance program, it is necessary to put the bona fides of that program in issue. In doing so, the company incurs a high risk of waiving privilege protection for any compliance program activities, even if they were run by legal counsel.

Joseph E. Murphy, *Self-Evaluative Privilege Draft Legislation: The Federal Organizational Compliance Program Improvement Act*, 1 Corp. Conduct Q. 8, 8 (1991). See Reed Abelson, *Offering the Last Word*, N.Y. Times C1 (Sept. 3, 1996) ("Not only is it important to emphasize the investigator's need for independence and an array of skills . . . but companies are also likely to find that investors and other interested parties will expect a fair disclosure of much of the evidence found during the inquiry.").

138. FRCP 26(b)(3). Justice Murphy addressed the rationale of the work product doctrine as follows:

> Historically, a lawyer is an officer of the court and is bound to work for the advancement of justice while faithfully protecting the rightful interests of his clients. In performing his various duties, however, it is essential that a lawyer work with a certain degree of privacy, free from unnecessary intrusion by opposing parties and their counsel. Proper

that it protects some communications between attorney and client. The doctrine differs from the attorney-client privilege, however, in three important respects: First, the work product doctrine requires that the communication be reduced to "tangible form" before the information will be protected.[139] Second, work product doctrine protection is limited to those matters and discussions that relate to pending litigation.[140] Third, the work product doctrine is not an absolute bar to disclosure.

The work product doctrine first won recognition in *Hickman v. Taylor*,[141] when the Supreme Court declared that disclosing an attorney's personal writings about the statements of potential witnesses would contravene public policy.[142] The Court refused to create an absolute privilege, however, ruling instead that a person seeking discovery could obtain an attorney's work product by establishing "adequate reasons to justify production."[143]

Under the work product doctrine courts distinguish between ordinary work product and opinion work product.[144] Ordinary work

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> preparation of a client's case demands that he assemble information, sift what he considers to be the relevant from the irrelevant facts, prepare his legal theories and plan his strategy without undue and needless interference. That is the historical and the necessary way in which lawyers act within the framework of our system of jurisprudence to promote justice and to protect their clients' interests. This work is reflected, of course, in interviews, statements, memorauda, correspondence, briefs, mental impressions, personal beliefs, and countless other tangible and intangible ways .... Were such materials open to opposing counsel on mere demand, much of what is now put down in writing would remain unwritten. An attorney's thoughts, heretofore inviolate, would not be his own. Inefficiency, unfairness and sharp practices would inevitably develop in the giving of legal advice and in the preparation of cases for trial. The effect on the legal profession would be demoralizing. And the interests of the clients and the cause of justice would be poorly served.

Hickman v. Taylor, 329 U.S. 495, 510-11 (1947).

139. The language of the rule states that "a party may obtain discovery of documents and tangible things... only upon a showing that the party seeking discovery has substantial need...." FRCP 26(b)(3).

140. Id. In order for a work product to be considered "in anticipation of litigation," a legal or regulatory proceeding must be "imminent," SEC *v. World-Wide Coin Investments, Ltd.*, 92 F.R.D. 65, 66 (N.D. Ga. 1981), and "fairly foreseeable," *Enforce Administrative Subpoenas of SEC v. Coopers & Lybrand*, 98 F.R.D. 414, 416 (S.D. Fla. 1982). The rule does not require, however, that the action commence before the doctrine may be asserted. See *Sneider v. Kimberly-Clark Corp.*, 91 F.R.D. 1, 6 (N.D. Ill. 1980) (holding that the doctrine protected memoranda prepared up to six years before the commencement of the litigation).

The attorney-client privilege has no such requirement.

141. 329 U.S. 495 (1947). Subsequently, Congress codified the doctrine in Rule 26(b)(3) of the Federal Rules of Civil Procedure.

142. *Hickman*, 329 U.S. at 510.

143. Id. at 512.

144. *Upjohn*, 449 U.S. at 399-402; *Hickman*, 329 U.S. at 511-13; *In re Grand Jury Proceedings*, 473 F.2d 840, 841-42 (8th Cir. 1973); Valukas, Stauffer, and Murphy, *Threshold Considerations*, in Kaplan, Murphy, and Swenson, eds., *Compliance Programs* § 5:23 at 34 (cited in note 8).

product is generally discoverable and includes objective facts of the case and third-party statements.[145] Opinion work product covers materials such as the attorney's mental impressions of the case, strategies for litigation or settlement, and legal conclusions.[146] Opinion work product is only discoverable upon a showing of extraordinary need.[147]

Materials shielded by the work product doctrine may lose their protected status through waiver.[148] Waiver ordinarily occurs in one of three ways: (1) through disclosure of the information to anyone who lacks a common interest;[149] (2) when the work product was prepared to further a crime or fraud;[150] or (3) when the work product is used to refresh a witness's memory under Rule 612 of the Federal Rules of Evidence, either before or during trial.[151]

Given these gaps in both the attorney-client privilege and the work product doctrine, a few courts have begun to rely on a newly established self-evaluative privilege to protect compliance materials from disclosure. As presently construed, however, this privilege also falls short of providing adequate protection for compliance information.

3. The Self-Evaluative Privilege

Several courts have recognized a "self-evaluative privilege"[152] that serves to shield information from discovery when public policy

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145. See *Panter v. Marshall Field & Co.*, 80 F.R.D. 718, 724-26 (N.D. Ill. 1978); Valukas, Stauffer, and Murphy, *Threshold Considerations*, in Kaplan, Murphy, and Swenson, eds., *Compliance Programs* § 5:23 at 34-35 (cited in note 8) (" 'Ordinary work-product,' such as witness statements which do not reveal the attorney's mental processes, receive less protection than does opinion work-product.").

146. Valukas, Stauffer, and Murphy, *Threshold Considerations*, in Kaplan, Murphy, and Swenson, eds., *Compliance Programs* § 5:23 at 34 (cited in note 8). See *Pappas v. Holloway*, 787 P.2d 30, 37-39 (Wash. 1990) (describing various approaches taken by different courts regarding opinion work product).

147. See *Upjohn*, 449 U.S. at 401 (finding that opinion work-product cannot be compelled "simply on a showing of substantial need and inability to obtain the equivalent without undue hardship").

148. See *Westinghouse Electric Corp. v. Republic of Philippines*, 951 F.2d 1414, 1428-30 (3d Cir. 1991) (discussing waiver of the work product privilege).

149. *In re Leslie Fay Companies, Inc. Securities Litigation*, 152 F.R.D. 42, 44-45 (S.D.N.Y. 1993).

150. *In re Murphy*, 560 F.2d 326, 337-39 (8th Cir. 1977).

151. *United States v. Nobles*, 422 U.S. 225, 239 (1975); *Berkey Photo, Inc. v. Eastman Kodak Co.*, 74 F.R.D. 613, 615-17 (S.D.N.Y. 1977). Because of this rule, attorneys should be cautious when preparing witnesses using writings that may contain mental impressions.

152. Courts refer to this privilege by several different names. *Tharp v. Sivyer Steel Corp.*, 149 F.R.D. 177, 179 n.5 (S.D. Iowa 1993). See, for example, *Dowling*, 971 F.2d at 425 (referring to a "privilege of self-critical analysis"); *In re Burlington Northern, Inc.*, 679 F.2d 762, 765 (8th

outweighs the need for disclosure.[153] The self-evaluative privilege is intended to promote confidential self-analysis and self-criticism; it often protects evaluations,[154] recommendations for change,[155] and internal reviews[156] against requests for disclosure.

This privilege arose in *Bredice v. Doctors Hospital, Inc.*,[157] when a federal district judge recognized the need to protect certain peer review findings and reports from civil discovery. In *Bredice*, Doctors Hospital had established a committee to review hospital procedures in selected cases involving patient deaths.[158] In a subsequent malpractice action against the hospital, plaintiff requested access to various documents, including a report, generated by the committee.[159] Although the requested documents almost certainly contained information of great relevance to plaintiff, the district court

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Cir. 1982) (finding a "self-critical subjective analysis privilege"); *Pagano v. Oroville Hospital*, 145 F.R.D. 683, 690 (E.D. Cal. 1993) (calling the privilege a "peer review privilege"); *Hoffman v. United Telecommunications, Inc.*, 117 F.R.D. 440, 442 (D. Kan. 1987) (remarking on the " 'self-evaluation' privilege"); *Witten v. A.H. Smith & Co.*, 100 F.R.D. 446, 449 (D. Md. 1984) (referring to a " 'critical self analysis' privilege"); *Westmoreland v. CBS, Inc.*, 97 F.R.D. 703, 705 (S.D.N.Y. 1983) (finding a "privilege for confidential self-evaluative analysis"); *Rosario v. New York Times Co.*, 84 F.R.D. 626, 631 (S.D.N.Y. 1979) (finding a "qualified privilege of 'self-examination' ").

153. See *Granger*, 116 F.R.D. at 508; *Bredice*, 50 F.R.D. at 250-51 (holding that the public interest prevented discovery of hospital committee meetings); Allen and Hazelwood, 12 J. Corp. L. at 378 (cited in note 5) (finding the self-evaluative privilege much more likely to be applied if an internal investigation clearly furthers an important public interest); David P. Leonard, *Codifying a Privilege for Self-Critical Analysis*, 25 Harv. J. Leg. 113, 116-18 (1988) (noting that courts have recognized a limited privilege in several contexts because businesses may believe that a "full and frank self-evaluation of their operations will be in the public interest"); Bush, 87 Nw. U. L. Rev. at 603 (cited in note 5) ("Many courts and commentators have recognized public policy as a legitimate rationale for restricting broad pretrial discovery.").

154. See, for example, *Nash v. City of Oakwood, Ohio*, 90 F.R.D. 633, 637 (S.D. Ohio 1981) (denying discovery of any "self-criticism" contained in applications, examinations, and written criteria used to evaluato job applicants); *Stevenson v. General Electric Co.*, 18 FEP Cases (CCH) 746 (S.D. Ohio 1978) (denying discovery of investigations into employee complaints on public policy grounds).

155. See, for example, *Sanday v. Carnegie-Mellon Univ.*, 12 FEP Cases (BNA) 101 (W.D. Pa. 1975) (extending the privilege to an employee's affirmative action plans).

156. See, for example, *Flynn v. Goldman, Sachs & Co.*, 1993 U.S. Dist. LEXIS 12801 at *2-5 (S.D.N.Y.) (finding interviews of employees protected by the "self-critical analysis" privilege).

157. 50 F.R.D. 249 (D.D.C. 1970).

158. Id. at 249-50. This committee was formed pursuant to the requirements of the Joint Commission on Accreditation of Hospitals, id. at 250, which sought to standardize hospital practices nationally. Id. Although the Commission lacks the authority to license hospitals, "it is prestigious and can substantially affect the standing of hospitals on a professional basis. Accreditation by the Commission can be gained only by following its recommendations." Id.

The sole purpose of the committee, as specified by the Commission, was to improve the care and treatment of patients in the hospital. Id. This purpose was accomplished by a monthly review of the hospital's clinical work, and included a "consideration of selected deaths, unimproved cases, infections, complications, errors in diagnosis, and results of treatment of patients . . . ." Id. (quoting *Standards for Hospital Accreditation, Bulletin of the Joint Commission on Accreditation of Hospitals, No. 3* (Aug. 1953)).

159. Id. at 249-50.

protected the committee's minutes and reports from discovery by creating a qualified privilege.[160]

The *Bredice* court based its holding on the public's interest in maintaining the confidentiality of the hospital committee's deliberations,[161] concluding that the committee prepared its reports with the understanding that they would remain confidential.[162] The court reasoned that allowing this confidentiality to be compromised would discourage hospital personnel from making full disclosure to future internal investigators; the risk that statements might be admissible in a future malpractice action would stifle cooperation.[163]

The public policy concerns identified by *Bredice* are compelling, but the self-evaluative privilege has not enjoyed widespread application.[164] Consequently, it is of limited value. Because only a few companies can definitively determine at the outset whether the privilege will protect their compliance materials from disclosure, the premise underlying the self-evaluative privilege remains unrealized; to be effective, an evidentiary privilege must operate with certainty.[165]

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160. Id. at 251.

161. Id.

162. Id. at 250.

163. Id. The court stated that:

> Confidentiality is essential to effective functioning of these staff meetings; and these meetings are essential to the continued improvement in the care and treatment of patients. . . . To subject these discussions and deliberations to the discovery process, without a showing of exceptional necessity, would result in terminating such deliberations. Constructive professional criticism cannot occur in an atmosphere of apprehension that one doctor's suggestion will be used as a denunciation of a colleague's conduct in a malpractice suit.

Id.

Several commentators refer to this "atmosphere of apprehension" as a "chilling effect." See, for example, Note, *The Privilege of Self-Critical Analysis*, 96 Harv. L. Rev. 1083, 1091-95 (1983); Comment, *The Attorney-Client Privilege, the Self-Evaluative Report Privilege, and* Diversified Industries, Inc. v. Meredith, 40 Ohio St. L. J. 699, 722-25 (1979). The court left open the possibility that the privilege might be waived if the documents were not intended to be confidential, or if the confidentiality was breached by releasing the documents to a third party. *Bredice*, 50 F.R.D. at 251.

164. See Bush, 87 Nw. U. L. Rev. at 603-614 (cited in note 5) (giving an historical overview of the self-evaluative privilege and discussing limitations on its expansion). See also *University of Pennsylvania v. EEOC*, 493 U.S. 182 (1990) (rejecting a privilege to protect faculty peer review notes in connection with discrimination claim). Murphy points out, however, that this case is of limited scope because the communications were allegedly "part of the violation of law at issue." Joseph E. Murphy, *Supreme Court Recognizes Evaluative Privilege: But Is It Just Personal?* (forthcoming publication).

165. *Upjohn*, 449 U.S. at 393 ("The attorney and client must be able to predict with some degree of certainty whether particular discussions will be protected. An uncertain privilege, or one which purports to be certain but results in widely varying applications by the courts, is little better than no privilege at all."); Note, *Attorney-Client Privilege for Corporate Clients: The Control Group Test*, 84 Harv. L. Rev. 424, 426 (1970).

B. Legislative Protection for Audit Materials: Environmental Audit Statutes

Given the absence of a reliable common-law shield for compliance materials, some members of the business community began to seek legislative relief. For example, during the 1980s, when state and federal governments encouraged greater corporate responsibility and accountability by enacting and enforcing environmental laws, many corporations began to conduct environmental audits to assess their compliance with those laws.[166] The potential liability stemming from ensuing disclosure risks prompted some businesses to lobby for an evidentiary privilege protecting compliance materials from disclosure. Fourteen states responded by codifying an environmental self-evaluative privilege for auditing corporations.[167] These state laws provide a preliminary framework for a legislative solution to the disclosure dilemma posed by internal compliance efforts.

The details of these statutes vary, but their fundamental premise is that every environmentally sensitive business must be encouraged to conduct internal audits,[168] analyze its compliance with environmental regulations,[169] remedy the problem, and report its findings to its employees.[170] Three main policies underlie environmental privilege statutes. First, audits serve an important public interest by reducing state regulatory and enforcement costs: If corporations engage in effective self-policing, states will expend fewer resources on regulatory agencies and related legal action. Second, compliance audits are in the general public interest.[171] By

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166. See Hunt and Wilkins, 16 Harv. Envir. L. Rev. at 365-67 (cited in note 39) ("[M]any corporate managers are using environmental audits to make candid, comprehensive evaluations of their facilities, operations, management procedures, and other internal risk management and liability control functions."); Mary Ellen Kris and Gail L. Vannelli, *Today's Criminal Environmental Enforcement Program: Why You May Be Vulnerable and Why You Should Guard Against Prosecution Through an Environmental Audit*, 16 Colum. J. Envir. L. 227, 229-32 (1991) (discussing the expansion of the federal criminal environmental enforcement program).

167. See *Oregon Passes an Environmental Audit Privilege*, 23 Envir. Rptr. (BNA) 453 (Feb. 12, 1994). See also note 27.

168. Goode, Cavanaugh, and Norris, 14 Preventive L. Rptr. at 36-37 (cited in note 28). See Or. Rev. Stat. § 468.963(1).

169. Goode, Cavanaugh, and Norris, 14 Preventive L. Rptr. at 36-37 (cited in note 28). See Or. Rev. Stat. § 468.963(1).

170. Goode, Cavanaugh, and Norris, 14 Preventive L Rptr. at 36-37 (cited in note 28). See Or. Rev. Stat. § 468.963(1).

171. The Arkansas legislature adopted a statement declaring that "protection of the environment is enhanced by the public's voluntary compliance with environmental laws and . . . the public will benefit from incentives to identify and remedy environmental compliance issues."

encouraging audits, the government fosters a better environment[172] and promotes increased product safety,[173] more conscientious hiring practices,[174] and more candid evaluations of internal activities.[175] Finally, by allowing these investigations to occur unimpeded by liability threats, the government creates an opportunity for companies to engage in "interactive compliance,"[176] a process through which the government and the corporation work together to find solutions to compliance problems.

1. Statutory Requirements

Typically, these statutes protect materials arising from an "environmental audit," which is defined as a "voluntary, internal and comprehensive evaluation" of facilities or activities.[177] The privilege, however, does not apply to any information which must be collected, reported, or "otherwise made available to a regulatory agency" to comply with federal, state, or local laws or regulations.[178] Further, the privilege does not protect information that has been obtained through

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1995 Ark. Acts 350 § 8-1-301. See Colo. Rev. Stat. § 13-25-126.5(1); 1995 Idaho Sess. Laws 359 § 9-802(a); Va. Code § 10.1-1198(B). But see Flanagan, 51 Geo. Wash. L. Rev. at 567-70 (cited in note 19) (concluding that self-critical analysis privilege has little effect on corporate conduct or corporate investigations).

In addition to encouraging more companies starting to conduct audits, a privilege will also influence corporations which presently conduct audits to expand those audits. See *Survey* at 2447 (cited in note 5) (finding that two-thirds of companies which now conduct audits would expand their evaluations if penalties were eliminated).

172. See *Illinois Bill Creating Privilege For Environmental Audits Wins Passage*, Prevention Corp. Liab. (BNA) 1 (Jan. 16, 1995). But see Jennifer Arlen, *Shielding Audits Will Aggravate Pollution Problems*, Nat'l. L. J. at A23 (Oct. 3, 1994).

173. See *Roberts*, 107 F.R.D. at 683.

174. See *University of Notre Dame Du Lac*, 715 F.2d at 336-37 ("[C]onfidentiality is equally critical in the faculty tenure selection process, in order that only the best qualified educators become the 'lifeblood' of our institutions of higher learning.").

175. *Granger*, 116 F.R.D. at 508; *Bredice*, 50 F.R.D. at 250-51.

176. See Sigler and Murphy, *Interactive Corporate Compliance* at 143 (cited in note 12) (stating that "specific legislation to permit compliance plans and programs to be used in defense of private suits" helps to "enhance the cooperative atmosphere that leads to interactive compliance").

177. 1995 Ark. Acts 350 § 8-1-302(3); Ill. Rev. Stat. ch. 415, § 5/52.2(i); Kan. Stat. Ann. § 60-3332(a); Ky. Rev. Stat. Ann. § 224.01-040(1)(a); Or. Rev. Stat. § 468.963(6)(a); Tex. Rev. Civ. Stat. Ann. art. 4447cc § 3(a)(3) (Vernon, Supp. 1996); Utah R. Evid. 508(a)(5); Wyo. Stat. § 35-11-1105(a)(i). See Colo. Rev. Stat. § 13-25-126.5(2)(e) (" 'Voluntary self-evaluation' means a self-initiated assessment, audit, or review, not otherwise expressly required by environmental law . . . .").

178. 1995 Ark. Acts 350 § 8-1-305(a). See also Colo. Rev. Stat. § 13-25-126.5(4)(a)-(b); Ill. Ann. Stat. ch. 415, § 5/52.2(h)(1); Kan. Stat. Ann. § 60-3336(a); Ky. Rev. Stat. Ann. § 224.01-040(6)(a); Or. Rev. Stat. § 468.963(5)(a); Tex. Rev. Civ. Stat. Ann. art 4447cc, § 8(a)(1); Utah R. Evid. 508(d)(6); Wyo. Stat. § 35-11-1105(d)(i).

independent monitoring[179] or otherwise through an independent source.[180] The statutes ordinarily protect materials included in an "environmental audit report."[181] This report may include objective material, such as photographs, maps, charts, surveys, and electronically recorded information, as well as subjective material, including opinions and conclusions.[182]

Most privilege statutes suggest, rather than mandate, the types of materials that may be included in an audit report.[183] Companies are thereby allowed some latitude in determining the content of their environmental audits. A business assumes a risk by disregarding these suggestions, however, as courts are likely to look to the statutory criteria in deciding whether the business conducted the audit "with reasonable diligence."[184]

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179. 1995 Ark. Acts 350 § 8-1-305(b); Or. Rev. Stat. § 468.963(5)(b); Tex. Rev. Civ. Stat. Ann. art. 4447cc, § 8(a)(2).

180. 1995 Ark. Acts 350 § 8-1-305(c); Or. Rev. Stat. §468.963(5)(c); Tex. Rev. Civ. Stat. Ann. art. 4447cc, § 8(a)(3); Utah R. Evid. 508(d)(8). This limitation on the privilege is similar to the "independent source" doctrine in criminal procedure. See *Murray v. United States*, 487 U.S. 533, 537 (1988) (doctrine permits introduction of "evidence initially discovered during, or as a consequence of, an unlawful search, but later obtained independently from activities tainted by the initial illegality").

181. 1995 Ark. Acts 350 § 8-1-303(b); Colo. Rev. Stat. § 13-25-126.5(3); Ill. Ann. Stat. ch. 415, § 5/52.2(b); Ind. Code Ann. § 13-28-4-1; Kan. Stat. Ann. § 60-3333(a) ("audit report"); Ky. Rev. Stat. Ann. § 224.01-040(3); Miss. Code § 49-2-71(1) (1990 & Supp. 1996) ("environmental self-evaluation report"); Or. Rev. Stat. § 468.963(2); Tex. Rev. Civ. Stat. Ann. art. 4447cc, § 5(a); Utah R. Evid. 508(a)(3); Wyo. Stat. § 35-11-1105(c).

182. For example, the Kansas statute states, "[a]n audit report may include the following supporting information, if collected or developed for the primary purpose and in the course of an audit: field notes and records of observations, opinions, suggestions, conclusions, drafts, memoranda, drawings, photographs, computer-generated or electronically recorded information, maps, charts, graphs and surveys." Kan. Stat. Ann. § 60-3332(b). See 1995 Ark. Acts 350 § 8-1-302(4)(A); Colo. Rev. Stat. § 13-25-126.5(2)(b); Ill. Ann. Stat. ch. 415, § 5/52.2(i); Or. Rev. Stat. § 468.963(6)(b); Tex. Rev. Civ. Stat. Ann. art. 4447cc, § 4(c); Utah R. Evid. 508(a)(3); Wyo. Stat. § 35-11-1105(a)(ii).

It may also include any materials prepared by the auditor as a result of the audit. For example, the Illinois statute provides that "[a]n environmental audit report, when completed, may have . . . [a]n audit report prepared by the auditor, which may include the scope of the audit, the information gained in the audit, conclusions, and recommendations, together with exhibits and appendices." Ill. Ann. Stat. ch. 415, § 5/52.1(i)(1). See 1995 Ark. Acts 350 § 8-1-302(4)(B)(1)-(4); Kan. Stat. Ann. § 60-3332(b)(1).

183. The Arkansas statute declares that an audit report "*may include*: (A) field notes, records of observations, findings, opinions, suggestions, conclusions, drafts, memoranda, drawings, photographs, computer generated or electronically recorded information, maps, charts, graphs, and surveys collected or developed for the primary purpose of preparing an environmental audit; and (B) [a]n audit report prepared by the auditor . . . ." 1995 Ark. Acts 350 § 8-1-302(4)(A)-(B) (emphasis added).

184. Id. § 8-1-307(a)(3)(D). Several of the statutes also require the corporation to label the audit materials "Environmental Audit Report: Privileged Document" before the privilege will apply. See, for example, id. at § 8-1-302(4); Idaho Code § 9-803(4) (Supp. 1996); Ill. Ann. Stat. ch. 415, § 5/52.2(i); Ind. Code Ann. § 13-11-2-69; Ky. Rev. Stat. Ann. § 224.040(1)(b); 1996 Mich. Legis. Serv. 132(b) (West); 1996 N.H. Laws ch. 4(V); Or. Rev. Stat. § 468.963(6)(b); Wyo. Stat. §

2. Scope of the Privilege

The privilege statutes generally protect environmental audit reports from discovery in "any civil, criminal, or administrative proceeding."[185] This language, however, is somewhat misleading. Because federal courts are not always bound to honor state evidentiary privileges,[186] the environmental privilege statutes only preclude discovery in actions before state courts.[187] Accordingly, the statutes should be treated as if they protect audits from discovery only in state civil, criminal, or administrative proceedings, and in federal actions when the state law provides the rule of decision.[188]

At least one statute makes the audit reports subject to discovery but declares that they shall not be admissible in any civil, criminal, or administrative legal action.[189] In many situations, this standard effectively eliminates an important benefit of the privilege: even without admissibility, disclosure of the report may prompt a criminal prosecution, regulatory action, or civil suit. For example, a corporate audit may reveal that an employee illegally deposited toxic waste in a landfill. If an audit report is discoverable but not admissible, a government agency may use the information gained from the report to gather evidence which falls outside of the privilege and then charge

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35-11-1105(a)(ii). Further, as a practical matter, if non-document materials such as videotapes or computer disks are included as part of the audit report, those items should also be individually labeled to protect the company if they are separated from the rest of the report.

185. Ky. Rev. Stat. Ann. § 224.01-040(3). See also Or. Rev. Stat. § 468.963(2); Colo. Rev. Stat. § 13-25-126.5(3); Ind. Code Ann. § 13-28-4-1(3); Ill. Ann. Stat. ch. 415, § 5/52.2(b); Wyo. Stat. § 35-11-1105(c); Tex. Rev. Civ. Stat. Ann. art. 4447cc, § 5(b)(1)-(3); 1995 Ark. Acts 350 § 8-1-303(b); Kan. Stat. Ann. § 60-3333(a).

186. Federal courts evaluate privileges "in the light of reason and experience." FRE 501. Within this context, state privileges enjoy limited application: "[I]n civil actions and proceedings, with respect to an element of a claim or defense as to which State law supplies the rule of decision, the privilege of a witness, person, government, State, or political subdivision thereof shall be determined in accordance with State law." Id. While a federal court might consider state statutory privileges in a request for document production, it is not bound by them. See *Memorial Hospital v. Shadur*, 664 F.2d 1058, 1061 (7th Cir. 1981) ("Because state law does not supply the rule of decision as to this claim, the district court was not required to apply state law in determining whether the material . . . is privileged."); *In re Grand Jury Subpoena*, 596 F.2d 630, 632 (4th Cir. 1979) (refusing to follow New York state statute regarding release of tax information).

187. Though federal courts often recognize state evidentiary privileges, see, for example, *In re Doe*, 964 F.2d 1325, 1328 (2d Cir. 1992); *Memorial Hospital*, 664 F.2d at 1061; *Lora v. Board of Education*, 74 F.R.D. 565, 569 (E.D.N.Y. 1977); *States v. King*, 73 F.R.D. 103, 105 (E.D.N.Y. 1976), state privilege statutes should be treated as if they only affect state regulatory agencies, state attorney generals' offices, and civil litigants bringing suit in state courts.

188. See note 187.

189. "An audit report shall be subject to discovery procedures but shall be privileged and shall not be admissible as evidence in any legal action in any civil, criminal or administrative proceeding . . . ." Kan. Stat. Ann. § 60-3333(a).

the corporation with illegal dumping. Consequently, unless a statutory privilege provides protections commensurate with the risk of prosecution, its safeguard will be illusory.

3. Other Requirements

a. The Business Must Attempt to Remedy the Problem

Most of the statutes explicitly require the company to correct expeditiously any problems discovered during the audit.[190] Indeed, this requirement is probably implicit in all the statutes, as the privilege is primarily designed to encourage compliance with environmental laws. Thus, if a business conducts the audit without attempting to remedy the violations that are identified, a court will likely find bad faith or fraudulent purpose.

b. The Corporation Must Have a Program to Prevent and Detect Environmental Violations

Presently, Kansas is the only state that makes the privilege contingent upon whether the corporation has established a program to prevent and detect violations of law.[191] Because of the prevention and detection requirements in the United States Sentencing Guidelines for Organizations[192] and the anticipated United States Sentencing Guidelines for Environmental Violations,[193] however, this contingency may become a more common requirement in other statutes.

4. Limitations on the Privilege

To protect against abuse, evaluative-privilege statutes often qualify the privilege and allow the audit report to be discovered in certain situations. In theory, these limitations help dissuade corporations from asserting the privilege in bad faith or for illegal purposes. Because of these limitations, however, fewer corporations are likely to

190. 1995 Ark. Acts 350 §§ 8-1-307(a)(3)(D), 8-1-308(a)(3)(D); Colo. Rev. Stat. § 13-25-126.5(3)(b)(I)(B); Kan. Stat. Ann. § 60-3334(d)(4); Ky. Rev. Stat. Ann. § 224.01-040(4)(c)(3); Or. Rev. Stat. § 468.963(3)(d); Tex. Rev. Civ. Stat. Ann. art. 4447cc, § 7(a)(3); Utah R. Evid. 508(d)(5); Wyo. Stat. § 35-11-1105(c)(iv).

191. Kan. Stat. Ann. § 60-3334(d)(2).

192. See USSG § 8C2.5(f).

193. These guidelines are still being considered by the Commission.

assume the disclosure risk inherent to a compliance audit.[194] The limitations can be divided into five basic categories: waiver, continued non-compliance, danger to public health, fraud, and compelling circumstances.

a. Waiver

A company may affirmatively waive the privilege and allow discovery of the audit materials.[195] Further, because a corporation has a duty to take reasonable measures to keep privileged documents confidential, waiver might also occur unintentionally if a corporation responds to discovery by inadvertently sending an unlabeled copy of the report.[196]

b. Continued Non-Compliance

The statutes provide that, if the company discovers environmental violations and fails to begin remedying them, the audit materials will not be privileged.[197] This limitation reflects the policy that corporations should conduct audits with the intention of correcting problems.[198] Consequently, the business must begin to rectify environmental violations before they have been independently discovered by others outside the company.

c. Present or Impending Danger to Public Health

If a judge determines that the information in the audit report "demonstrates a clear, present, and impending danger to the public health or the environment in areas outside of the facility property," the report will not be privileged.[199] This limitation reflects the theory underlying the environmental audit statutes: Corporations may protect compliance information from third parties as long as a problem is

194. While their numbers are likely small, a few corporations prefer to assume optimistically that no illegal conduct occurs in their organization rather than uncover small violations that might be subject to discovery because of these privilege limitations.

195. See, for example, Colo. Rev. Stat. § 13-25-126.5(3)(a); Tex. Rev. Civ. Stat. Ann. art. 4447cc, § 6(a).

196. See *United States v. Ryans*, 903 F.2d 731, 741 n.13 (10th Cir. 1990) (reviewing cases where inadvertent disclosure led to waiver of the privilege); *In re Sealed Case*, 877 F.2d at 980 (finding that inadvertent disclosure of attorney-client communications will waive privilege). See also note 184.

197. See, for example, Colo. Rev. Stat. § 13-25-126.5(3)(b); Or. Rev. Stat. § 468.963(3)(d).

198. See note 86 and accompanying text.

199. Colo. Rev. Stat. § 13-25-126.5(3)(e). See Utah R. Evid. 508.

discovered and addressed before rising to crisis level. When the problem becomes a threat to public health and safety, however, the court will allow the information to be discovered.

d. Fraud

Not surprisingly, the privilege may not be asserted for fraudulent or criminal purposes.[200] In this regard, courts will likely consider an audit conducted in bad faith to be evidence of fraud.

e. Compelling Circumstances

The most ambiguous and potentially troublesome limitation on the environmental audit privilege is the "compelling circumstances" exception. Under this exception, a judge may suspend the privilege if "compelling circumstances exist that make it necessary to admit the environmental audit report into evidence or that make it necessary to subject the environmental audit report to discovery procedures."[201] The statutes, however, do not define what constitutes "compelling" circumstances. Thus, if a judge reads this exception too broadly, the statutory privilege may offer no more protection than the common law self-evaluative privilege.[202]

IV. A NEW APPROACH TO PROTECTING COMPLIANCE MATERIALS

Given these sporadic judicial and legislative attempts to protect compliance materials, companies remain in the difficult position of having to decide whether to risk establishing a compliance program

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200. See, for example, Colo. Rev. Stat. § 13-25-126.5(3)(d); Ky. Rev. Stat. Ann. § 224.01-040(4)(c)(1), (d)(1); Or. Rev. Stat. §§ 468.963(3)(b)(A), 468.963(3)(c)(A). See Alan Stone, Note, *Attorney-Client Privilege and the Crime-Fraud Exception: Rejection of a Specific Intent Requirement in* In re Sealed Case, 60 Tul. L. Rev. 1061 (1986) (discussing application of the crime-fraud exception upon prima facie evidence of fraud).

201. Colo. Rev. Stat. § 13-25-126.5(3)(c).

202. See note 165 and accompanying text. Ordinarily, the term "compelling circumstances" should limit such judicial inroads.

Because some jurisdictions have not defined what circumstances are "compelling," the decision whether to apply the privilege to a particular situation may be left to the judge's discretion. See *In the Matter of Asbestos II Consolidated Pretrial*, 1989 U.S. Dist. LEXIS 2917, *2 (N.D. Ill.) ("It will be in the court's discretion to determine whether compelling circumstances exist . . . ."); *People v. Downey*, 454 N.W.2d 235, 239 (Mich. 1990) (listing various factors that have been found to constitute compelling circumstances); *State v. Brown*, 785 P.2d 790, 796 (Or. 1990) (Riggs, J.; concurring) ("It may be that the test of 'compelling circumstances' is as slippery a concept and as difficult to define in a given case as any of the other tests that have been proffered from time to time . . . .").

that may generate evidence resulting in criminal or civil liability. As long as this dilemma remains in effect, the Commission's objective of promoting internal compliance programs will be frustrated. Notwithstanding Sentencing Guideline inducements, few companies will establish comprehensive compliance programs without adequate assurance of protection for confidential materials.[203] To remedy this situation, some proponents of effective compliance programs have suggested that immunity ought to be conferred upon companies that establish such programs.[204]

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203. Because of the Sentencing Guidelines, the number of companies that maintain compliance programs may not decrease. Without further protection for compliance materials, however, the quality of these programs is likely to suffer. Businesses will commit fewer resources to compliance programs and their efforts will become superficial and inconsistent. When companies lack a shield for compliance materials, they examine fewer internal activities, undertake fewer types of investigations, translate fewer findings into corrective plans, and retain analysis for a shorter period. See O'Reilly, 19 Seton Hall Legis. J. at 119 (cited in note 12).

204. See Joseph E. Murphy, *Moving Towards Immunity*, 4 Corp. Conduct Q. 18 (1994). Two of the most eloquent advocates of immunity legislation, Jay A. Sigler and Joseph E. Murphy, have argued that "[i]n order to protect [and promote] self-evaluation the necessary tool is an . . . absolute self-evaluative privilege." Sigler and Murphy, *Interactive Corporate Compliance* at 158 (cited in note 12). Sigler and Murphy attempted te break from the regulation/deregulation paradigm by proposing a third alternative, an approach they call interactive corporate compliance. Under this approach, a corporation may protect its compliance materials if it conducts a program which has been "certified" by the administrative agency responsible for that area of the law. Id. at 149.

Whether a program qualifies for certification depends on minimum standards designed by corporate personnel and government officials from the relevant federal agencies. Those corporations not meeting the certification requirements "would be subject to the provisions and penalties of the law as they currently exist." Id. If a program meets the requirements and is "certified," however, the corporation could be rewarded for its diligence. For example, the corporation might be relieved of some of its reporting or consent decree requirements. Id. at 151. In addition, the certified corporation might receive a preference when bidding for government contracts or could qualify for tax advantages. Id. These suggestions merit careful consideration. At first glance, the most problematic aspect of this approach stems from the fact that not all businesses are regulated by federal agencies. Consequently, in many instances, interactive compliance will not be realistic. Furthermore, few businesses would welcome the creation of an ongoing relationship with the federal government that may produce a constant federal presence on the premises.

Sigler and Murphy's most troubling proposal, however, arises from their discussion of criminal and civil liability for certified corporations. They propose that a certified company be free from criminal prosecution and liability unless the government can show that "the corporation had subverted the compliance process." Id. at 152. In that case the company would be liable not only for the criminal violation but also for the new crime of subverting the compliance process, a crime treated much like obstruction of justice. Id. Sigler and Murphy furtber state that, if Congress insists upon making companies strictly liable for some crimes, penalties for those crimes would be mitigated by evidence of a certified program. Id. at 153.

Sigler and Murphy also suggest that certified companies should be immune from suits brought by "private attorney[s]- general" Id. at 153-54. Civil damages against a certified corporation would be limited to actual damages; treble damages, attorneys fees, and punitive damages would not be allowed.

Though Sigler and Murphy's ideas are innovative, several problems arise from tbeir approach. For example, by requiring that federal agencies certify the program, businesses may be

Compliance immunity would certainly grant corporate citizens the necessary protection to promote comprehensive and effective compliance efforts. In the criminal justice system, immunity grants are often conferred to compel testimony from recalcitrant witnesses who might otherwise rely upon their fifth amendment privilege against self-incrimination to remain silent. The immunity grant displaces the fifth amendment privilege by providing the witness with comparable protections.[205] Depending upon the type of immunity employed, the witness receives either complete protection from prosecution (transactional immunity) or a guarantee that neither his testimony nor anything derived therefrom will be used against him at trial (use immunity).[206]

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placed in the awkward position of trying to meet the conflicting demands of multiple agencies. Assuming that these demands could be met, the regulatory overkill may result in a bloated—and expensive—compliance program. In addition, this approach assumes that a regulatory agency exists for every area of business that faces compliance issues. This is not always the case. Some businesses, for example, are self regulating and do not have a federal agency from which to seek certification for compliance programs.

Furthermore, in many cases this approach removes a plaintiff's incentive to bring an action for injury caused by a certified corporation. By limiting damages to actual damages, many plaintiffs will never be fully compensated for their injury as a substantial portion of their damage award will go towards their attorney fees, court costs, and related expenses. Michael Goldsmith, *Civil RICO Reform: The Basis for Compromise*, 71 Minn. L. Rev. 827, 835 (1987) (arguing that damages do little to deter illegal conduct).

In addition, the Sigler and Murphy proposal fails to indicate who will receive the immunity. Will the company alone be protected, or will the protection extend to employees? If only the company is immune from prosecution, the employees are unlikely to support the program, perhaps even withholding information at times for their own protection.

Finally, compliance programs may be encouraged with a narrower approach to immunity. The Sigler and Murpby proposal allows transactional immunity from criminal prosecution for a "reasonable" program; however, the existence of a "reasonable" compliance program, standing alone, will not always negate the existence of *mens rea* under traditional principles of vicarious liability in criminal cases. See generally Brickey, 1 *Corporate Criminal Liability* § 4:02 (cited in note 57) (stating that the corporation may be vicariously liable for the acts of employees done within the scope of their employment and with intent to benefit the corporation); Wayne R. LaFave and Austin W. Scott, Jr., *Criminal Law* § 3.10(c) (West, 2d ed. 1986) (same). Therefore, reasonableness, standing alone, is not a defense to vicarious liability. See generally Richard S. Gruner and Louis M. Brown, *Organizational Justice: Recognizing and Rewarding the Good Citizen Corporation*, 21 J. Corp. L. (1996) (forthcoming publication). By providing for transactional immunity, Sigler and Murphy potentially allow every compliance-certified company to commit at least one free crime (upon which, presumably, the program might be decertified). This approach is contrary to traditional immunity principles, which never absolve crimes *before* they are committed. Compare *United States v. Apfelbaum*, 445 U.S. 115, 121-27 (1980) (ruling that immunized testimony may be admissible in a subsequent perjury prosecution).

205. See *Kastigar v. United States*, 406 U.S. 441, 449-54 (1972) (holding that use immunity "is coextensive with the scope of the privilege against self-incrimination"); *Goldberg v. United States*, 472 F.2d 513, 516 (2d Cir. 1973) ("[W]e must accept the Court's confidence that use and derivative use immunity will in fact prove to be coextensive with the privilege against self-incrimination.").

206. See Wayne R. LaFave and Jerold H. Israel, *Criminal Procedure* § 8.11(b) at 394-97 (West, 2d ed. 1996). Under federal law, immunized witnesses receive use immunity. 18 U.S.C.

Although immunity grants often allow criminals to escape prosecution, Congress and most state legislatures have enacted immunity provisions because of the need to compel crucial witnesses to cooperate with government prosecutors. Absent such protections, recalcitrant witnesses often lack any incentive to testify.[207] Because statutory immunity procedures allow testimony to be induced,[208] they have often been instrumental in complex white-collar investigations and successful organized crime prosecutions.[209]

Notwithstanding these successes, the potential application of use immunity to compliance program materials has raised some concerns. For example, critics contend that immunity legislation offers corporations a privilege against self-incrimination similar to the Fifth Amendment. Under traditional legal doctrine, however, corporations are not protected by the Fifth Amendment's privilege against self-incrimination.[210] Opponents of immunity also assert that protection for evaluative materials often precludes actions against an outlaw corporation. They contend that, because the corporation is privy to information not available to others, prosecutors and plaintiffs will be disadvantaged when they are unable to obtain such evidence.[211] Finally, some argue that the added cost and burden of obtaining

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§ 6001 et seq. (1994 ed.). By comparison, some states confer transactional immunity. See Kenneth J. Melilli, *Exclusion of Evidence in Federal Prosecutions on the Basis of State Law*, 22 Ga. L. Rev. 667, 684 n.96 (1988) (noting that some state constitutions may be "more demanding" than the federal privilege against self-incrimination); Jerold H. Israel, *On Recognizing Variations in State Criminal Procedure*, 15 U. Mich. J. L. Ref. 465, 477 (1982) (noting that Michigan retained transactional immunity after *Kastigar*).

207. See *Kastigar*, 406 U.S. at 447 (finding immunity statutes "essential to the effective enforcement of various criminal statutes"); Ronald Goldstock and Dan T. Coenen, *Controlling the Contemporary Loanshark: The Law of Illicit Lending and the Problem of Witness Fear*, 65 Cornell L. Rev. 127 (1980) (providing historical overview emphasizing importance of immunity in organized crime cases). In a fifth amendment context, once a witness has been immunized, his testimony may be compelled through the threat of contempt sanctions.

208. See *Pillsbury Co. v. Conboy*, 459 U.S. 248, 290 n.11 (1983) (Stevens, J., dissenting) (discussing the practice of using immunity to induce testimony); *United States v. Brookins*, 614 F.2d 1037, 1043 (5th Cir. 1980) (finding that testimony was partially induced by a grant of immunity).

209. See James Hamilton, *The Power to Probe* 78 (Random House, 1976); Kristine Strachan, *Self-Incrimination, Immunity, and Watergate*, 56 Tex. L. Rev. 791 (1978); John Van Loben Sels, Note, *From Watergate to Whitewater: Congressional Use Immunity and Its Impact on the Independent Counsel*, 83 Geo. L. J. 2385 (1995).

210. See, for example, *Bellis v. United States*, 417 U.S. 85, 89-90 (1974) (finding that "privilege . . . should be 'limited to its historic function of protecting only the natural individual from compulsory incrimination' "); *United States v. White*, 322 U.S. 694, 698-700 (1944) (finding that privilege is purely personal and does not apply to corporations or other organizations).

211. See Arlen, Nat'l L. J. at A23 (cited in note 172). See also *Banks v. Lockheed-Georgia Co.*, 53 F.R.D. 283, 285 (N.D. Ga. 1971) (allowing plaintiff access to "factual or statistical information that was available" to the defendant during defendant's evaluation); *Mergentime Corp. v. Washington Metropolitan Area Transportation Authority*, 1991 U.S. Dist. LEXIS 11080 at *10 (D.D.C.) (adopting a "very narrow definition" of the self-evaluative privilege).

closely held information undermines the efficiency of our justice system.[212]

Such arguments are misplaced and myopic. Although business entities are not protected by the Fifth Amendment's privilege against self incrimination,[213] they ought not be *required* to maintain compliance programs that build a prosecutor's or plaintiff's case. Few businesses could survive the litigation-consciousness that such a requirement would foster.

Further, an intermediate mechanism exists that strikes an appropriate balance between the desire for effective law enforcement and the need to protect confidential compliance materials: providing limited use immunity for qualified materials generated by an effective compliance program. In contrast to transactional immunity, use immunity does not confer complete protection from prosecution. Rather, such immunity merely precludes the declarant's evidence—or anything derived therefrom—from being used against the declarant in a subsequent prosecution.[214] The premise for use immunity under the Fifth Amendment is that the witness is placed in the same position that he would have occupied had he not made an incriminating statement.[215] Therefore, the privilege against self-incrimination remains intact. Because the witness is still subject to possible prosecution, however, he receives no windfall benefits under such an immunity grant.[216]

This theory also makes sense in the corporate compliance context. Use immunity operates effectively in the federal criminal justice system to induce recalcitrant witnesses to testify. Equivalent protection for compliance materials can be expected to induce businesses to establish internal compliance programs. Transactional immunity might provide a better incentive for businesses to establish compliance programs, but transactional immunity goes too far by producing windfall protections.[217] Further, the incentives provided by

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212. Bush, 87 Nw. U. L. Rev. at 634-37 (cited in note 5).

213. See note 210.

214. *Kastigar*, 406 U.S. at 448-53.

215. Id. at 452-53, 458-59.

216. See id. at 453 (stating that the privilege "has never been construed to mean that one who invokes it cannot subsequently be prosecuted").

217. In *Kastigar*, the Supreme Court observed:

> While a grant of immunity must afford protection commensurate with that afforded by the privilege, it need not be broader. Transactional immunity, which affords full immunity from prosecution for the offense to which the compelled testimony relates, affords the witness *considerably broader protection* than does the Fifth Amendment privilege.

Id. (emphasis added).

use immunity should be sufficient, especially since they would be complemented by the Sentencing Guidelines "carrot and stick" approach to internal compliance.[218]

The Sentencing Guidelines also provide an excellent foundational context for this approach: to be eligible for use immunity, the company would need to demonstrate that it has established an "effective" compliance program as defined by the Guidelines.[219] Absent this threshold, the immunity would not apply.

Finally, under a use immunity approach, neither the government nor private plaintiffs would be prejudiced by the grant of such immunity. This is because use immunity merely places the company in the same position it would have occupied had no internal investigation been conducted.[220] Accordingly, the company may still be prosecuted or civilly sued, but no compliance materials—or anything derived therefrom—would be admissible in such actions. As with the federal use immunity statute, the profferring party would need to establish by a preponderance of the evidence that proffered materials are independent of an immunized source.[221]

V. CONCLUSION

Internal compliance programs have become a central component of good corporate citizenship. Good corporate citizens, however, ought not be placed in the dilemma of choosing between effective internal compliance and the liability risks attendant to full disclosure. Thus far, judicial and legislative efforts to eliminate this dilemma have proven inadequate. Fortunately, the dilemma may be resolved by enacting federal legislation that confers use immunity upon compliance materials produced by programs that meet the due diligence

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218. See note 78 and accompanying text.

219. See notes 80-95 and accompanying text.

220. As the Supreme Court noted in *Jaffee v. Redmond*:

> Without a privilege, much of the desirable evidence to which litigants . . . seek access—for example, admissions against interest by a party—is unlikely te come into being. This unspoken "evidence" will therefore serve no greater truth-seeking function than if it had been spoken and privileged.

Jaffee v. Redmond, 116 S. Ct. 1923, 1929 (1996).

221. In other words, the evidence must show that they do not stem from protected compliance materials. Compare *United States v. North*, 910 F.2d 843, 866-868 (D.C. Cir. 1990) (remanding conviction of Oliver North for district court determination of whether prosecution improperly used immunized testimony). Although such immunity may increase investigative and litigation costs to opposing parties, these costs would be offset by the social and economic benefits stemming from effective internal compliance programs. Similar utilitarian considerations apply under the federal use immunity statute in criminal cases.

requirements of the Sentencing Guidelines. A model immunity statute reflecting this approach is set forth in the Appendix to this Article. Until such an immunity procedure is established, the dilemma posed by internal compliance programs will remain, and some good deeds will continue to be punished.[222]

222. See note 1 and accompanying text.

APPENDIX

PROPOSED LEGISLATION

Section I: Definitions

(a) "Eligible compliance program" means an institutionalized internal review program that meets the requirements contained in Chapter Eight of the United States Sentencing Guidelines.[223]

(b) "Compliance program materials" means a set of documents or other materials prepared during the course of an eligible compliance program. Compliance program materials include the following: compliance audit results, field notes and records of observations, training materials, opinions, suggestions, conclusions, drafts, memoranda, drawings, photographs, computer-generated or electronically recorded information, maps, charts, graphs, and surveys.

(c) "Compliance report" means a document that is prepared pursuant to an eligible compliance program and that sets forth partial or complete results of a compliance investigation.

Section II: Immunity for Compliance Program Materials

(a) Pursuant to authorization by the principals of any business entity, any individual within high-level management of a business organization[224] may petition a federal district court for use immunity as defined in subsection (d) of this Section.

(b) In deciding whether to grant the requested immunity, the court may appoint a private inspector general[225] to help determine

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223. See Part II.B.

224. See USSG § 8A1.2 comment. (3(k)(2)) (stating that individuals within high-level personnel of organizations must he assigned to oversee compliance).

225. See generally Ronald M. Goldstock, Remarks at United States Sentencing Commission Symposium, *Corporate Crime in America; Strengthening the "Good Citizen" Corporation*, Washington, D.C., Sept. 7-8 (1995) (transcript on file with the Authors) (describing the use of Independent Private Sector Inspector Generals); Thomas D. Thatcher II, *Combatting Corruption and Racketeering: A New Strategy for Reforming Public Contracting in New York City's Construction Industry*, 40 N.Y. L. Sch. L. Rev. 113, 134-35 (1995) (discussing corporate use of an Independent Private Sector Inspector General). See also Margaret J. Gates and Marjorie Fine Knowles, *The Inspector General Act in the Federal Government: A New Approach to Accountability*, 36 Ala. L. Rev. 413 (1985) (discussing the federal Inspector General Act of 1978).

whether the company has established an eligible compliance program. The company shall bear all costs associated with this private inspector general.

(c) Upon finding that a company has established an eligible compliance program, the court shall issue an immunity order protecting specified compliance materials from use in subsequent litigation.

(d) No information arising from protected compliance materials (nor any evidence derived from such materials) may be used against the petitioner in a civil or criminal case, except in a prosecution for perjury or giving a false statement.

(e) Nothing in this section should be construed to limit use of information contained in the protected materials if the proponent establishes by a preponderance of the evidence that the information was obtained from an independent source.[226]

(f) Upon finding that a company has not established an eligible compliance program, the court shall return the materials to the company with an order declaring the materials unprotected. Absent a compelling public interest, the court shall not release the unprotected materials to any other individual or entity.

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226. See *United States v. Williams*, 809 F.2d 1072, 1082 (5th Cir. 1987) (finding that the government must prove that the evidence was "derived from a legitimate source wholly independent of the compelled testimony") (quoting *Kastigar*, 406 U.S. at 460); *United States v. Frumento*, 552 F.2d 534, 542 (3d Cir. 1977) (finding that the government must meet a heavy burden by showing that evidence was derived from sources other than the immunized defendant's testimony)).