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The New Federal Sentencing Guidelines for Organizations: Great for Prosecutors, Tough on Organizations, Deadly for the Privilege

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On November 1, 2004, amendments to the United States Sentencing Commission's federal sentencing guidelines took effect despite urgings by the Association of Corporate Counsel (ACC), the National Association of Criminal Defense Lawyers (NACDL), a number of business lobbies, and others to make what we believe were crucial and necessary changes to the proposed amendments and their commentary. Of special concern are provisions now codified in Chapter 8 (which governs organizational sentencing) that would make waiver of the attorney-client privilege almost a certainty in order for a charged company to be deemed "cooperative," and thus eligible for more lenient treatment in settlement discussions or at sentencing.

Meanwhile, in January of 2005, the U.S. Supreme Court issued its controversial decision in the *Booker* and *Fanfan* cases, which were to shed light on the constitutionality of the application of the Guidelines in the aftermath of the *Blakely* decision, in which a Washington state sentencing guideline system, patterned on the Federal Sentencing Guidelines, was held unconstitutional. The Supreme Court's decision in *Booker/Fanfan* was unexpected, leaving the Guidelines in place, but making their use by judges permissive and advisory – the Guidelines are no longer mandatory in application. A number of constituencies, including the Department of Justice, will likely encourage Congress to expedite passage of a new Sentencing Guidelines act which will fix the Constitutional problems, and perhaps even strengthen prosecutors' powers in the process. And a number of organizations that watch the Guidelines for direction on their compliance and risk management are now confused about whether the Guidelines still apply, and what's on the horizon should they be amended yet again.

This whitepaper focuses on why the Federal Sentencing Guidelines are important for companies and their counsel to understand, and how changes to the Guidelines – both through recent amendments and the Supreme Court's findings in the *Booker* and *Fanfan* cases – impact the prosecution of companies found guilty of federal criminal charges, the provision of corporate

legal services, and the development of an effective compliance program in corporations, non-profits, unions, and other “entity” clients.

Background

The U.S. Sentencing Commission was established by Congress in 1984 to promulgate mandatory “guidelines” for federal judges to apply when sentencing criminal defendants; the Commission’s first Guidelines were established shortly thereafter. Chapter 8, adding sentencing standards for organizational defendants, was added in 1991.

The Guidelines were created to respond to a perception and some evidence (but only in the case of individual, not corporate, defendants) that judges in the federal circuits were want to adopt wildly different sentences for similarly situated defendants found guilty of criminal charges. The Sentencing Guidelines set a baseline range of determinate sentences for different categories of offenses; judges increase or decrease the sentence depending on enumerated circumstances listed in the Guidelines (setting a culpability score from which upward or downward “departures” are made). As noted by the Sentencing Commission, the Guidelines were created to “provide certainty and fairness in meeting the purposes of sentencing by avoiding unwarranted disparity among offenders with similar characteristics convicted of similar criminal conduct, while permitting sufficient judicial flexibility to take into account relevant aggravating and mitigating factors.”¹

[If you’d like to read more about the background of the guidelines (as well as find the actual guidelines themselves), check out the U.S. Sentencing Commission’s webpages at <http://www.ussc.gov/general.htm> (history and overview) and <http://www.ussc.gov/GUIDELIN.HTM> (guidelines and manuals). Chapter 8’s provisions can be found at <http://www.ussc.gov/2004guid/tabconchapt8.htm>.]

The Guidelines have always been important in the corporate context because they provide really the only “government definition” of the elements of an effective corporate compliance program. The seven elements of an effective program as outlined by the Sentencing Commission in its 1991 rules became the basis for companies seeking guidance and for prosecutors considering charges: the idea was that if a company could show that it had an effective compliance program in place, it might be able to deflect significant penalties or other damages beyond what was necessary for simpler and less putative restitution or remedy on the basis that the corporation had acted in good faith, with reasonable foresight, and had suffered from rogue employee behavior or an unusual and unanticipated failure. The 2004 amendments to Chapter 8 seek to strengthen the importance of these defined characteristics of an effective program.

It is worth noting here that the number of companies actually sentenced under the organizational guidelines is really very few, according to research conducted by Gibson Dunn’s sentencing

¹ See “*Overview of the United States Sentencing Commission*” at p.1 (<http://www.ussc.gov/general/USSCoverview.pdf>).

guidelines gurus, Joe Warin and David Debold² (both of whom are former prosecutors who have substantial experience with Guidelines issues), and that those who plead guilty or are subjected to actual sentencing under the Guidelines don't fare very well in asserting that they made good faith efforts to avoid the harm for which they've been found liable. Warin and Debold's research confirms that the Guidelines' largest impact for most corporations comes well before sentencing, and even well before any formal adjudication at all. Their study shows that its strongest effect is twofold: in its presumptive role in defining effective corporate compliance standards, and in its role in both guiding and offering leverage to prosecutors considering what charges they should bring, and against whom they should bring them, when an allegation of wrongdoing surfaces.

These interesting statistics also show that the companies most likely to receive sentences under the guidelines are smaller and privately-owned companies – those which are less likely to enjoy fuller-scale outside or in-house legal advice: our take is that this may be due, at least in part, to the fact that such companies are less likely to have comprehensive or across the board compliance programs in place (they may only prepare to systematically prevent only the most likely wrongdoing), and are more likely to consider rejecting the government's offer of better treatment in exchange for "cooperation" since no one advised them to sit down and settle in spite of what they believe is their lack of culpability for the crime.

As one federal prosecutor who helped shaped the amendment proposals to the Guidelines in 2004 states: "It is well established that a corporation is vicariously liable under federal law for the criminal conduct of its agents acting with the actual or apparent scope of their employment of authority if the agents intended, at least in part, to benefit the corporation. This is true even though the agents' actions may have been contrary to corporate policy. Criminal intent by one agent of the corporation may be imputed to the corporation Moreover, it is not necessary for a prosecutor to identify the actual agent who committed the crime if the prosecutor can show that some person within the corporation must have done so." [(citations omitted) Mary Beth Buchanan, U.S. Attorney for the West District of Pennsylvania, and Director of the Executive Office of U.S. Attorneys, in an article entitled "Effective Cooperation by Business Organizations and the Impact of Privilege Waivers, from a recent Wake Forest Law Review, available at <http://www.law.wfu.edu/prebuilt/Buchanan-final.pdf>. Ms Buchanan was the DOJ representative on the ad hoc working group that proposed the most recent set of amendments to the guidelines, which became effective in November of 2004.] If it's clear that the company is guilty in the eyes of the prosecutor if there is a documented failure, then arguing innocence is futile: all a company can do is hope to influence the charging decisions and sentencing factors, both of which are hands that the government holds under the guidelines and the Thompson Memorandum (see below).

Thus, it stands to reason that a primary reason why so few companies are actually sentenced under the Guidelines is that the government holds all the cards, and is very successful in "strongly suggesting" that cooperative behavior, plea bargaining and settlement are much more

² For those who want to read more about this research, it is published in part in an article appearing in the Nov./Dec. 2004 (Vol. 12, No. 6) issue of *Corporate Governance Advisor*, published by Aspen Publishers. If you're interested in more about the original research (which has not been published in full in written form), you can contact Joe Warin (202/887-3609) and David Debold (202/955-8551) at Gibson, Dunn & Crutcher LLP, in their Washington, DC offices.

advantageous courses for companies charged with criminal behavior to pursue (rather than subjecting the organization to additional charges due to uncooperative and perhaps what can even be construed as “obstructive” behavior by pleading their innocence).

Companies that are actually subject to the application of the Sentencing Guidelines after trial statistically do not make out well. The Gibson Dunn research evidences this, citing that of all actions in which companies actually plead guilty or were sentenced with the Guidelines in play, only a very small handful of cases have enjoyed the benefits of a downward departure in their sentence in recognition of some positive element of their preventive efforts that they were able to prove (we’re talking something in the order of under five cases in the last 10 years). Thus, if a company actually relies on the power of the application of the Sentencing Guidelines’ downward departure opportunities in the actually adjudicatory process, it’s more than highly likely that the Guidelines won’t support proof of the company’s arguments of good faith compliance to the company’s advantage – the Guidelines in practical application at sentencing will almost always work against the company, increasing, rather than offering an opportunity to decrease, the sentence handed down or the punishment negotiated with the DOJ as a form of plea. Thus, the threat of the Guidelines as they would be actually applied by a court is an extremely effective tool used by the Department of Justice to drive corporate “cooperation” with government investigations and prosecutions, and often acts to discourage companies from independently investigating allegations to remedy the problem or fighting the charges.

Also important is new language in the commentary to amended Guideline section 8C2.5 which suggests that the government may demand waiver of the attorney-client privilege in its investigations of an allegation of wrongdoing if the company wishes to receive credit for being cooperative in the investigation. (See below, the guideline amendments make cooperation with the government’s investigation a lynchpin for any favored treatment.) This magnifies the power of the government in coercing cooperation from a corporate defendant, and has significant implications for companies concerned about the “litigation dilemma” they may face when waived communications are then available as fodder to fuel third-party suits against the company, many of which may have greater impact in terms of financial and reputational ruin than the underlying government investigation and any remedies that are mandated as a result of it. Indeed, it is the charging decision that becomes the focal point for the company: will the company be charged (or will the government focus on rogue employees, if convinced that the company had an ECEP)? what will the charges be? who will be named? how expansive, demoralizing, and disruptive will the resulting investigation be?

The DOJ issues guidance to prosecutors about the process of charging organizations, and this advice takes the form of a written policy statement sometimes referred to as the “Holder Memorandum” (1999) and its successor memo, the “Thompson Memorandum,” (2003) (The Thompson Memo is more formally referred to as the “Principles of Federal Prosecution of Business Organizations,” and can be found at http://www.usdoj.gov/dag/cftf/corporate_guidelines.htm). These memos rely upon much of what the Sentencing Guidelines suggest as effective corporate compliance behavior which should influence a prosecutor’s decisions about how to proceed. (They also support the idea that the government should view the waiver of attorney-client privilege as a necessary step in the

process of convincing the government that the company wishes to cooperate and is holding nothing back.)

It is also worth noting that the leading judicial precedent on the issue of standards for corporate compliance are found in the famous Delaware case, *In re Caremark Int'l Inc. Derivative Litigation*, 698 A.2d 959 (Del. Ch. 1996); in this case, the benchmarks of effective compliance initiatives also refer to the standards set by the Guidelines, and focus special attention on the roles and responsibilities of senior management and the board to ensure that compliance initiatives are meaningful.

The upshot is that even companies that are never subject to prosecution for a crime are strongly impacted by the Federal Sentencing Guidelines and its directives: decisions made by compliance managers developing in-house programs and decisions made by prosecutors about whom to pursue and what the charges might be in the event of an allegation of wrongdoing are both strongly influenced by the guidelines and their commentary.

The Blakely/Booker/Fanfan Cases and the Constitutionality of the Guidelines

Looming large is the question of what role the New Guidelines will have in the future in light of the United States Supreme Court's June 2004 decision in *Blakely v. Washington*, finding that a State court sentence violated a defendant's Sixth Amendment right to trial by jury because the facts supporting the sentence prescribed by the Guidelines (and pursuant to the Sentencing Memo the guidelines authorize prosecutors to submit) were neither admitted by the defendant nor found by the jury. Since the *Blakely* case struck down a Washington State sentencing system based on the Guidelines, commentators immediately began to question the constitutionality of the federal guidelines system upon which the State's system was based. The Supreme Court agreed to accept (and expedite) *cert* in the *U.S. v. Booker* (No. 04-104) and *U.S. v. Fanfan* (No. 04-105) cases, in order to put these questions to rest.

A highly divided Supreme Court held in January of 2005 that the Guidelines will henceforth be advisory for sentencing judges—not mandatory—in order to comply with the Sixth Amendment. Although the Court's holding seems to benefit defendants by permitting greater judicial leeway in sentencing (and returning more discretionary decision-making ability to judges -- which discretion was formerly held in practical terms by the prosecutors who make charging decisions and who write sentencing memos), its effect beyond the short term is uncertain. Indeed, while some suggest that Congress seems well-disposed to a "wait and see" attitude in watching how the guidelines work in an advisory context before jumping in to fix them, others predict that some legislators, the DOJ, and perhaps the Sentencing Commission will focus significant attention on proposing a new set of Guidelines that require judicial sentencing to meet mandatory standards again, addressing the Sixth Amendment concerns, and perhaps instituting an even harsher and more rigid sentencing regime. (It's hard to believe that in today's prosecutorial environment that if new guidelines are proposed, many folks will wish to be seen as pushing for "softer" sentencing for those found guilty.)

But if the Guidelines Aren't Mandatory Anymore, I Can Relax Now, Right?

Some have suggested that since the Guidelines are now advisory and that they may stay that way, corporations can relax their focus on developing compliance programs that meet Guidelines standards, and will have more leeway in negotiating with the government in the unfortunate event of a corporate failure. We would suggest that this is advice to be followed at your company's peril.

Why? Well, it is clear from activity emerging on Capitol Hill that there is a strong interest in proposing new mandatory Guidelines, and the starting point for rebuilding the system will be the current Guidelines already in place: from there, it is likely that they will only get tougher, not more lenient. Second, as noted in the discussion above regarding the Thompson memo and the standards of judicial review already in effect, the existence and adequacy of a corporate compliance program is a factor federal prosecutors will continue to consider in making the threshold determination of whether to criminally charge corporations regardless of the Guidelines' mandatory or advisory nature. Finally, because of their acknowledged role in shaping the standards for effective compliance programs, the Guidelines' definitions, even as amended, of compliance best practices will likely be a continuing font of guidance for courts and prosecutors, especially since the constitutional concerns that prompted the Supreme Court's ruling in *Booker/Fanfan* had nothing to do with Chapter 8's provisions.

So What Do I Need to Understand in Specific and What Compliance Activities Do the Guidelines Mandate?

This White Paper is developed to provide insights only and not to offer legal advice. That said...

Section I of this White Paper provides an overview of the amended federal sentencing guidelines for organizations in effect as of November of 2004, which still guide prosecutorial and sentencing decisions for corporate defendants. It summarizes key provisions in the amended Guidelines to help corporate counsel make decisions involving the development of the company's compliance programs. Of particular importance is our coverage of the new and expanded provisions in the amended Guidelines defining an effective compliance and ethics program ("ECEP"), as well as commentary on when waiver of attorney-client privilege and work product doctrines will be required in order for cooperation with the government's investigation to be sufficiently "timely and thorough" to enable an organization to qualify for cooperation credit under the guidelines.

Section II lists the key requirements for an ECEP and describes the expansion of the notion of a compliance program to one that also promotes an ethical culture and encourages a commitment to compliance with laws. Please note that an attachment to this whitepaper offering further development of these issues is offered for those who want more than the "executive summary."

Section III summarizes changes to the New Guidelines requested by ACC and a coalition of organizations which are concerned that Guidelines' provisions regarding waiver of the attorney-client privilege as the quid pro quo to "cooperative" behavior are inappropriate and ill-advised.

Section IV offers a short conclusion.

I. NAVIGATING THE NEW GUIDELINES

OVERVIEW

As noted, Chapter 8 of the Guidelines addresses Sentencing of Organizations. "Organization" is broadly defined to include "corporations, partnerships, associations, joint-stock companies, unions, trusts, pension funds, unincorporated organizations, governments and political subdivisions thereof, and non-profit organizations."³ The amended text for Chapter 8 of the federal sentencing guidelines may be found at <http://www.ussc.gov/2004guid/tabconchapt8.htm>. In addition, a stand-alone version of the recently effective amendments, including introductory commentary describing key amendment provisions, may be found at the Sentencing Commission's website at http://www.ussc.gov/2004guid/RFMay04_Corp.pdf.

The Guidelines provide that the culpability score for organizations is generally determined by six factors that the sentencing court must consider: four factors which may increase the ultimate punishment, and two factors that may mitigate the ultimate punishment.⁴

Increasing factors include:

- Involvement or tolerance of criminal activity
- Prior history of the organization
- Violation of an order
- Obstruction of Justice

Decreasing factors:

- Existence of an ECEP
- Either self-reporting, cooperation, or acceptance of responsibility

It is important to note that just having an ECEP and/or simply self-reporting will not be good enough to result in a reduction of the culpability score. More specifically, the New Guidelines expressly state that an organization will not be eligible to receive a downward adjustment for having an ECEP if the organization delays reporting an offense and/or if individuals within certain levels of the organization "participated in, condoned or were willfully ignorant of the offense." The New Guidelines also establish rebuttable presumptions that no ECEP exists if

³ Federal Sentencing Guideline Manual, Section 8A1.1, Application Note 1.

⁴ See the Introductory commentary at p. 5 of the Proposed Amendments to Chapter 8 at http://www.ussc.gov/2004guid/RFMay04_Corp.pdf.

individuals within certain positions at an organization or a small organization “participated in, condoned or [were] willfully ignorant of the offense.”⁵

NAVIGATING THE NEW GUIDELINES

Below is an outline of some of the key amendments in effect as of November 2004:

- **Section 8B2.1: Defines Effective Compliance and Ethics Program (ECEP)**
Defines an ECEP and enumerates the minimum requirements for an ECEP. Commentary and Application notes following Section 8B2.1 provide useful information, including definitions for key terms, factors to consider in meeting the requirements of 8B2.1, and commentary on size of the organization.

- **Section 8C2.5: Describes ECEP Impacts on Culpability Score**
Subsection 8C2.5(f) describes culpability score adjustments for having an ECEP, including exclusions and rebuttable presumptions regarding the effectiveness of an ECEP. Commentary in Application Note 1 to 8C2.5 defines a small organization as one with fewer than 200 employees at the time of the instant offense.

- **Commentary-Application Note 12 to Section 8C2.5: Waiver of Privilege**
This commentary addresses requirements to qualify for a reduction for cooperation. Significantly, it includes a new sentence on waiver of attorney-client privilege and work product protections, and provides the government’s view on when waiver is required for cooperation to be “timely and thorough.”

- **Section 8C2.8: ECEP as Factor in Determining the Fine**
Subsection 8C2.8(a)(11) identifies an ECEP as a factor to consider in determining the amount of the fine within the applicable guideline range.

- **Section 8C4.10: Policy Statement on Mandatory Programs to Prevent and Detect Violations of Law**
This section describes possible upward departures to offset mandated ECEPs (or lack thereof).

⁵ Sections 8C2.5(f)(2) and (f)(3)(A) describe circumstances where no reduction in culpability score will be available despite having a bona fide ECEP (e.g., if, after becoming aware of an offense, the organization unreasonably delays reporting to the appropriate governmental authorities; OR if an individual within high-level personnel of the organization (or unit if the unit has more than 200 employees) participated, condoned, or was willfully ignorant of the offense). Section 8C2.5(f)(3)(B) creates a rebuttable presumption that an organization did not have an ECEP if an individual within high-level personnel of a small organization (e.g., less than 200 employees) or within substantial authority personnel but not high-level personnel, participated in, condoned, or was willfully ignorant of the offense. See *infra* notes 8 & 9 for definitions of “high-level personnel” and “substantial authority personnel.”

- **Section 8D1.1: Probation-Organizations**

Subsection 8D1.1(a)(3) describes requirements for ordering probation in certain circumstances for not having an ECEP at the time of sentencing.

- **Section 8D1.4: ECEP as Possible Condition of Probation**

Subsection 8D1.4(c)(1) describes developing and submitting to the court an ECEP as a possible condition of probation.

II. MINIMUM REQUIREMENTS FOR AN ECEP UNDER THE NEW GUIDELINES

The New Guidelines enumerate a set of minimum requirements for an “effective compliance and ethics program” or ECEP. By definition, the ECEP under the New Guidelines is an expanded concept – moving beyond the traditional notion of a compliance program that prevents and detects criminal conduct to one that must also promote an organizational culture that encourages ethical conduct and a commitment to compliance with law generally (not just laws with criminal consequences).⁶ Please see the Attachment to this whitepaper that details the requirements of an ECEP in general. Under the New Guidelines, an organization’s ECEP must meet the following minimum requirements:⁷

- **Include Standards & Procedures:** Organization must establish standards of conduct and internal controls reasonably capable of reducing the likelihood of criminal conduct. (Section 8B2.1(b)(1))
- **Governing Authority Must be Knowledgeable & Exercise Reasonable Oversight:** Governing Authority (e.g., Board of Directors or highest level governing body of the organization) must be knowledgeable about the content and operation of the ECEP and exercise reasonable oversight with respect to implementation & effectiveness. *Note this is a more specific requirement extending to an organization’s governing authority.* (Section 8B2.1(b)(2)(A))
- **High-level Personnel Must Ensure ECEP Effectiveness:** High-level Personnel⁸ must ensure that the organization has an effective ECEP. Overall responsibility for the ECEP

⁶ See Section 8B2.1(a)(2) of the New Guidelines.

⁷ Application Note 2 in the Commentary to Section 8B2.1 provides additional information on factors to consider in determining what specific actions are necessary to meet the requirements of the New Guidelines, including considering: “(i) applicable industry practice or the standards called for by any applicable governmental regulation, (ii) size of the organization, and (iii) similar misconduct.”

⁸ The New Guidelines define “high-level personnel of the organization” to mean “individuals who have substantial control over the organization or who have a substantial role in the making of policy within the organization. The term includes: a director; an executive officer; an individual in charge of a major business or functional unit of the organization, such as sales, administration, or finance; and an individual with a substantial ownership interest.” Application Note 3(b) in Commentary to 8A1.2.

must be assigned to specific individual(s) within high-level personnel. *Note this is a more specific requirement stating that high-level personnel must take overall responsibility for the ECEP.* (Section 8B2.1(b)(2)(B))

- **Day-to-Day Operational Responsibility & Reporting:** If day-to-day operational responsibility rests with an individual other than a high-level personnel, responsibility must be delegated to specific individual(s) who must report periodically (e.g., no less than annually) on the effectiveness of the ECEP to high-level personnel and to the governing authority (or a subgroup). (Section 8B2.1(b)(2)(C))
- **Resources, Authority & Access for Individual's with Day-to-Day Responsibility:** Individual(s) with day-to-day operational responsibility for the ECEP must be given adequate resources, appropriate authority, and direct access to the governing authority (or subgroup). *Note that resources, authority, and direct access must be provided no matter the level of the individual with day-to-day responsibility.* (Section 8B2.1(b)(2)(C))
- **Qualifications of Substantial Authority Personnel:** Organization must use reasonable efforts not to include within substantial authority personnel⁹ any individual who the organization knew/should have known has engaged in illegal activities or other conduct inconsistent with an ECEP. With respect to hiring or promotion of such individuals, the organization shall consider the relatedness of individual's prior illegal activities/misconduct to the responsibilities anticipated to be assigned. (Section 8B2.1(b)(3))¹⁰
- **Conduct Effective Training and Communicate:** Organization must communicate in a practical manner its standards and procedures and ECEP by conducting effective training programs and disseminating information on roles and responsibilities to all of the following: members of the governing authority, high-level personnel, substantial authority personnel, employees, and agents (as appropriate). *Note this section makes*

⁹ "Substantial authority personnel of the organization" is defined in Application Note 3 to the Commentary to Section 8A1.2 to mean "individuals who within the scope of their authority exercise a substantial measure of discretion in acting on behalf of an organization. The term includes high-level personnel of the organization, individuals who exercise substantial supervisory authority (e.g., a plant manager, a sales manager), and any other individuals who, although not a part of an organization's management, nevertheless exercise substantial discretion when acting within the scope of their authority (e.g., an individual with authority in an organization to negotiate or set price levels or an individual authorized to negotiate or approve significant contracts). Whether an individual falls within this category must be determined on a case-by-case basis."

¹⁰ The New Guidelines also add new commentary in Application Note 4 to Section 8B2.1 providing additional guidance on implementation for this requirement, and include commentary in the introductory section to the Proposed Amendments stating that this requirements is "meant to ensure that an individual is screened on the basis of his or her culpability and not on the basis of the organization's vicarious liability."

compliance training a requirement and specifically extends the training requirement to the upper levels of an organization as well as to the organization's employees and agents. (Sections 8B2.1(b)(4)(A) and (B))

- **Monitoring and Auditing:** Organization must take reasonable steps to ensure that the ECEP is followed, including: (1) monitoring and auditing to detect criminal conduct, (2) evaluating periodically the effectiveness of the ECEP, and (3) having and publicizing a system (that may allow for anonymity or confidentiality) whereby the organization's employees and agents may report or seek guidance regarding potential or actual criminal conduct without fear of retaliation. *Note that auditing and monitoring are now mandated, and periodic evaluation of the ECEP is now also required. In addition, there is now an expanded focus on the reporting mechanism: from reporting criminal conduct to potential or actual criminal conduct. (Sections 8B2.1(b)(5)(A), (B) and (C))*

- **Consistent Promotion & Enforcement Through Incentives and Disciplinary Measures:** ECEP must be promoted and enforced consistently through appropriate incentives to perform accordingly, and disciplinary measures for engaging in criminal conduct or failing to take reasonable steps to prevent or detect such conduct. *Note that this requirement also now requires appropriate incentives to perform in accordance with the ECEP. (Section 8B2.1(b)(6))*

- **Action to Respond Appropriately to Detected Conduct and Prevent Further Conduct:** Organization must take reasonable steps to respond to detected criminal conduct and to prevent similar conduct from occurring, including making any necessary modifications to the ECEP. (Section 8B2.1(b)(7))

- **Periodic Risk Assessment & Action to Design, Implement, or Modify ECEP Requirements to Reduce Risks:** Organization must periodically assess the risk that criminal conduct will occur, including evaluating: (1) nature and seriousness of such criminal conduct, (2) likelihood that certain criminal conduct may occur because of the nature of the organization's business, and (3) prior history of the organization. In addition, the organization must periodically prioritize actions taken to implement an ECEP and modify them to reduce the risk of criminal conduct identified through this analysis as most likely to occur. (Section 8B2.1(c))¹¹

III. KEY COMMENTS OF ALLIED ORGANIZATIONS URGING MODIFICATIONS TO THE NEW GUIDELINES

¹¹ Application Note 6 in the Commentary to Section 8B2.1 provides additional information on how to meet the requirements of this subsection.

The Association of Corporate Counsel was one of the few organizations commenting on the proposed amendments to the Guidelines, and urging their revision prior to their proposal to Congress of the Spring of 2004 and their enactment date in November of the same year. ACC is now joined by a number of other interested groups, including the American Bar Association, (the ABA), the National Association of Criminal Defense Lawyers (NACDL), The U.S. Chamber of Commerce, the Business Roundtable, The National Association of Manufacturers, the American Civil Liberties Union (ACLU), and several other distinguished organizations, to work to have the Guidelines amended, focusing our strongest attention on the removal of language in the commentary to 8C2.5 suggesting that waiver of the attorney-client privilege is in the government's discretion to demand.¹²

Working as a coalition, these groups have met with a number of key staff leaders supporting the Judiciary Committees of both the U.S. House and Senate. As of this writing (February, 2004), The House Judiciary Committee has opened hearings on the Sentencing Guidelines post-*Booker*, and our coalitions have submitted comments to the U.S. Sentencing Commission and Congress urging reconsideration and modification of some of the provisions contained in the Guidelines if new Guidelines are to be considered and adopted. If new Guidelines are not adopted, we are requesting a "surgical" deletion of the offensive commentary in Chapter 8 which gives the DOJ authority to determine whether it wants to demand waiver of the attorney-client privilege in order for a corporation to get "cooperation" points.

Key concerns and recommendations communicated by ACC and its coalition partners are summarized below.

- **Waiver Should Not be a Factor in Determining Whether Sentencing Reduction is Warranted**

- The New Guidelines add a sentence in Application Note 12 to Section 8C2.5 stating that "Waiver of attorney client privilege and or work product protections is not a prerequisite to a reduction in culpability score under subdivisions (1) and (2) of subsection (g) *unless such waiver is necessary in order to provide timely and thorough disclosure of all pertinent information known to the organization.*" (emphasis added). We assert that the exception will essentially "swallow the rule," and have requested an affirmative statement amending Application Note 12 that such waiver should not be a factor in determining whether a sentencing reduction is warranted for cooperation with the government, or alternatively, the deletion of the clause which is emphasized as reproduced above.

- **Organizations Should Not be Required to Report Offense But Should Take Internal Action**

- Coalition partners requested an amendment to Section 8C2.5(f)(2). That section provides that an organization shall not receive a reduction in culpability score even if an

¹² ACC and our coalition partners' formal letters to Congress and the Commission are available on our website at <http://www.acca.com>.

organization has an ECEP if, after becoming aware of an offense, the organization unreasonably delayed reporting the offense to the appropriate governmental authorities. The requested amended language would eliminate the requirement to report and instead emphasize the need to take internal action to address any discovered offenses. More specifically, the requested amendment changes that language to read: "...if, after becoming aware of the offense, the organization unreasonably delayed (a) in taking appropriate steps to terminate any continuing unlawful conduct, or (b) in assessing whether the organization's compliance program should be modified in light of the discovery of the offense, and thereafter implementing any appropriate modifications." Our comments also note that there is already powerful incentive under the New Guidelines for an organization to self-report: Section 8C2.5(g) provides for a five point culpability score reduction.

- **Culpability Score Reduction Should Be Available if High-level Personnel Involved if Organization Can Overcome Rebuttable Presumption re: ECEP**
 - Coalition partners requested an amendment to Section 8C2.5(f)(3) to eliminate any absolute unavailability of culpability score reduction if high-level personnel participated in, condoned, or were willfully ignorant of the violation. In addition, coalition partners proposed adding a three-tier rebuttable presumption approach defining different levels of required showings depending upon the level of personnel involved in the misconduct.

- **Annual Assessments and Prompt Assessments following Discovery of Criminal Offense Should Satisfy Requirement to Conduct Periodic Assessments**
 - Coalition partners requested an Application Note be added following 8B2.1 stating that the periodic assessment requirements of 8B2.1(c) will be met if assessments are conducted annually and promptly following discovery of any criminal offense committed by a member of the organization.

- **Eliminate the 'all-or-nothing' Approach of the amended ECEP Provisions**
 - Coalition partners requested that the Sentencing Commission retain the approach of the 1991 Guidelines, or create a sliding scale for reductions in culpability score based on the degree to which an organization satisfies the ECEP criteria in Section 8B2.1. The new guidelines otherwise require that all ECEP provisions must be met 100% before any credit can be given for any of them.

- **Request Not to Expand the Scope of the Guidelines to Cover All Violations of Law**
 - ACC stated concerns in its written comments and testimony about the changes in Application Notes 1 and 4(A) to Section 8B2.1 regarding an expansion from the focus on developing compliance programs to prevent criminal violations to a new requirement for the ECEP to detect and prevent violations of any law. It is highly improbable and impractical that a company can develop compliance initiatives that anticipate and prevent violations of every kind of law given the thousands of laws in effect between local, state and federal governments.

- **Suggestion that Self-Evaluative Privilege be Considered by Congress to Allow Privileged Investigations to be Shared with the Government Only**
 - ACC noted rising concerns about third-party plaintiff actions resulting from the government's investigation and charges, and the litigation dilemma faced by organizations asked to surrender confidential/privileged information to the government as part of the organization's cooperation in the investigation. ACC suggested that while limited waiver solutions still pose difficult and unresolved problems for corporate employees and clients and are not the course we prefer to pursue, they were at least a point of discussion that should be raised if wholesale waivers were the only alternative left on the table. The Commission may wish to consider proposal of a self-evaluative privilege to be recognized by Congress which would allow privileged investigations to be shared with the government and the government only, and then only under specified terms.

IV. CONCLUSION

For now, the New Guidelines continue to impact corporate compliance behavior and prosecutorial charging decisions, even if they are not considered mandatory in application. While they do not helpfully address many issues of importance to corporate counsel, they are the most current 'state-of-the-law' on what the government expects to see in deciding whether an organization has an ECEP. Consequently, we believe that close attention to the Guidelines and their prescriptions is a prudent course of action for any organization operating in today's business environment.

ATTACHMENT: The Seven Elements of an Effective Compliance and Ethics Program (ECEP), as defined in the Amended Sentencing Guidelines.

If you have questions about the Federal Sentencing Guidelines, please feel free to contact Susan Hackett, ACC's General Counsel, at ACC at hackett@acca.com. While neither we nor this article can offer the definitive word on how to prepare your company's compliance initiatives, we can help refer you to additional resources or other experts you may wish to consult. See, e.g., ACC's Virtual Library for material on developing effective compliance initiatives: <http://www.acca.com/vl/>, enter the keyword "compliance."

ATTACHMENT

CRITERIA FOR AN EFFECTIVE COMPLIANCE AND ETHICS PROGRAM (ECEP): MINIMUM REQUIREMENTS DEFINED IN THE FEDERAL SENTENCING GUIDELINES FOR ORGANIZATIONS

The recent decision by the United States Supreme Court in the *Booker* and *Fanfan* cases preserves the validity of the Federal Sentencing Guidelines for Organizations (Sentencing Guidelines) as a permissive reference to help guide federal judges in making reasonable sentencing decisions. While application of the Guidelines is no longer mandatory, substantive provisions in the Guidelines, including those defining minimum criteria for an “effective compliance and ethics program” (ECEP), were not changed from their status as amended in November of 2004. Accordingly, the Sentencing Guidelines remain a primary source of guidance on what federal courts and prosecutors consider constitutes minimum requirements for an ECEP, and consequently are viewed by many as *de facto* standards that serve as a touchstone for creating and measuring corporate compliance programs.

The Sentencing Guidelines define seven minimum requirements for an ECEP. Prior to the November 1, 2004 effective date for the amended Sentencing Guidelines, criteria for an “effective program to prevent and detect violations of law” were set forth in commentary to the Guidelines.¹³ The amended Sentencing Guidelines now define requirements for an ECEP in the text in newly added provisions set forth at Section 8B2.1. They also describe what is necessary for the program to be effective and require periodic risk assessments of the program (Sections 8B2.1(a), (c)), as well as include new Commentary that provides guidance on application of these guidelines.

More specifically, the Sentencing Guidelines define the following minimum requirements:

1. **Establish Standards and Procedures:** Organization shall establish standards and procedures to prevent and detect criminal conduct (§8B2.1(b)(1)).

¹³ These seven criteria were set forth in Application note 3(k) to Section 8A1.2 of Chapter 8 (Sentencing of Organizations) of the Federal Sentencing Guidelines.

2. **Requirements for an organization’s governing authority, high-level personnel, and specific individuals:**

- (A) Governing Authority shall be knowledgeable about the content and operation of the compliance and ethics program (CEP), and shall exercise reasonable oversight with respect to the implementation and effectiveness of the program. (§8B2.1(b)(2)(A)(emphasis added).
- (B) High-level personnel¹⁴ shall ensure that the organization has an effective CEP, and specific individuals within high-level personnel shall be assigned overall responsibility for the CEP. (§8B2.1(b)(2)(B))(emphasis added).
- (C) Specific individual(s) within the organization shall be delegated day-to-day operational responsibility for the program, and shall periodically report to high-level personnel (and as appropriate, the governing authority or appropriate subgroup) on the program’s effectiveness. Such individuals shall be given adequate resources, appropriate authority, and direct access to the governing authority/subgroup. (§8B2.1(b)(2)(C)(emphasis added).

3. **Substantial Authority Personnel**¹⁵: Organization shall use reasonable efforts not to include within substantial authority personnel any individual whom the organization knew, or should have known through the exercise of due diligence, has engaged in illegal activities or other conduct inconsistent with an ECEP. ¹⁶ (§8B2.1(b)(3)(emphasis added))

¹⁴ The Sentencing Guidelines define “high-level personnel of the organization” to mean “individuals who have substantial control over the organization or who have a substantial role in the making of policy within the organization. The term includes: a director; an executive officer; an individual in charge of a major business or functional unit of the organization, such as sales, administration, or finance; and an individual with a substantial ownership interest.” Application Note 3(b) in Commentary to 8A1.2.

¹⁵ “Substantial authority personnel of the organization” is defined in Application Note 3 to the Commentary to Section 8A1.2 to mean “individuals who within the scope of their authority exercise a substantial measure of discretion in acting on behalf of an organization. The term includes high-level personnel of the organization, individuals who exercise substantial supervisory authority (e.g., a plant manager, a sales manager), and any other individuals who, although not a part of an organization’s management, nevertheless exercise substantial discretion when acting within the scope of their authority (e.g., an individual with authority in an organization to negotiate or set price levels or an individual authorized to negotiate or approve significant contracts). Whether an individual falls within this category must be determined on a case-by-case basis.”

¹⁶ The Sentencing Guidelines also include commentary in Application Note 4 to Section 8B2.1 providing additional guidance on implementation for this requirement, and include commentary in the introductory section to the Proposed Amendments stating that this requirements is “meant to ensure that an individual is screened on the basis of his or her culpability and not on the basis of the organization’s vicarious liability.”

4. **Communications; Training:** Organization shall take reasonable steps to communicate periodically and in a practical manner to certain individuals¹⁷ its standards and procedures and other aspects of the program by conducting effective training programs and otherwise disseminating information appropriate to the respective roles/responsibilities of individuals.¹⁸ (§8B2.1(b)(4)(A)(emphasis added))

5. **Monitoring; Evaluation; Reporting/Guidance Mechanism:** Organization shall take reasonable steps to:

- (A) ensure the program is followed (including monitoring and auditing to detect criminal conduct)(§8B2.1(b)(5)(A);
- (B) evaluate periodically the effectiveness of the program (§8B2.1(b)(5)(B)); and
- (C) have and publicize a system which may include mechanisms that allow for anonymity or confidentiality where employees and agents may report or seek guidance regarding potential or actual criminal activity without fear of retaliation. (§8B2.1(b)(5)(C)(emphasis added)).¹⁹

6. **Enforcement:** The CEP shall be promoted and enforced consistently throughout the organization through appropriate incentives, and appropriate disciplinary measures for engaging in criminal conduct and for failing to take reasonable steps to prevent or detect criminal conduct. (§8B2.1(b)(6)(emphasis added))

7. **Response following detection of criminal conduct:** After criminal conduct has been detected, the organization shall take reasonable steps to respond appropriately to the criminal conduct and to prevent further similar criminal conduct, including making any necessary modifications to the CEP. (§8B2.1(b)(7)(emphasis added))

¹⁷ These individuals include: members of the governing authority, high-level personnel, substantial authority personnel, the organization's employees, and, as appropriate, the organization's agents. (§8B2.1(b)(4)(B))

¹⁸ Note this section makes compliance training a requirement and specifically extends the training requirement to the upper levels of an organization as well as to the organization's employees and agents.

¹⁹ Note that auditing and monitoring are now mandated, and periodic evaluation of the ECEP is now also required. In addition, there is now an expanded focus on the reporting mechanism: from reporting criminal conduct to potential or actual criminal conduct.