

W Y C H E

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U.S. Sentencing Commission Amends Guidelines for Corporate Compliance and Ethics Plans

TO OUR FRIENDS AND CLIENTS:

The United States Sentencing Commission recently amended its Sentencing Guidelines for Organizational Defendants (the “Sentencing Guidelines”). In doing so the U.S. Sentencing Commission was responding to the mandate in the Sarbanes-Oxley Act that it review and amend the Sentencing Guidelines to ensure that they are sufficient to deter and punish organizational criminal misconduct. The Sentencing Guidelines set forth standards that affect the sentences imposed for criminal conduct.

To what types of entities do the Sentencing Guidelines apply?

The organizational Sentencing Guidelines apply to all “organizations”, including publicly held corporations, privately owned entities, unincorporated organizations and non-profit organizations. The aim of the standards is to motivate entities to implement structural safeguards designed to prevent and detect criminal conduct.

How are the Sentencing Guidelines relevant to an organization that tries in good faith to comply with the law?

An organization can be convicted of a federal crime for the acts of its employees within the apparent scope of their employment, even if the employees acted directly contrary to the organization’s policies and instructions. The Sentencing Guidelines set forth mitigating factors that provide a convicted organization with the opportunity to receive a reduced sentence.

One of these mitigating factors is the existence of an effective Corporate Compliance and Ethics Program. In establishing and implementing ethical rules of conduct, every organization should endeavor to meet the Sentencing Guidelines’ criteria for an effective Compliance and Ethics Program (“Program”).

What is the general effect of the recent Sentencing Guidelines amendments?

The recent amendments to the Sentencing Guidelines place increased emphasis on the criteria for an effective Program and how an organization incorporates the Program into its culture. As stated by the U.S. Sentencing Commission, the amendments “introduc[e] additional rigor generally and impos[e] significantly greater responsibilities on the

organization's governing authority and executive leadership." They strengthen the existing criteria for an effective Program and broaden their scope to deter not only criminal conduct but also non-criminal legal and regulatory violations and unethical conduct in general.

When will the amendments take effect?

The amendments will become effective on November 1, 2004, unless Congress acts to disapprove them.

What is the purpose of a Corporate Compliance and Ethics Program?

A Corporate Compliance and Ethics Program establishes and implements policies and procedures to prevent and detect criminal conduct within the organization.

Do the Sentencing Guidelines distinguish between large organizations and small organizations?

Yes and no. Both large and small organizations must demonstrate the same degree of commitment to ethical conduct and compliance with the law. A large organization, however, generally must devote more formal operations and greater resources in meeting the requirements of the guidelines than must a small organization. In addition, according to the commentary to the Sentencing Guidelines, "[a]s appropriate, a large organization should encourage small organizations (especially those that have, or seek to have, a business relationship with the large organization) to implement effective compliance and ethics programs."

What are the structural components of an effective Program?

To have an effective Program, an organization must:

- (1) exercise due diligence to prevent and detect criminal conduct; and
- (2) otherwise promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law.

In order to satisfy these general criteria, a Program must satisfy seven minimum requirements.

1. The organization must establish standards and procedures to prevent and detect criminal conduct.

What are standards and procedures?

"Standards and procedures" are internal controls and standards of conduct that are reasonably capable of reducing the likelihood of criminal conduct.

2. The organization’s “governing authority” (i.e. Board of Directors) and “high-level personnel” must have significant involvement with the Program.

What are the responsibilities of the organization’s Board of Directors?

The Board of Directors must be knowledgeable about the content and operation of the Program, and must exercise reasonable oversight with respect to the implementation and effectiveness of the Program.

Who are included in the term “high-level personnel”?

Individuals who have substantial control over the organization or who have a substantial role in the making of policy within the organization are part of “high-level personnel”. The term includes directors, executive officers, any individual in charge of a major business or functional unit and any individual with a substantial ownership interest.

What are the responsibilities of “high-level personnel”?

High-level personnel must ensure that the organization has an effective Program. One or more specific individuals within high-level personnel must be assigned overall and ultimate responsibility for the Program.

Who may administer the Program?

One or more individuals, who need not be part of the organization’s high-level personnel, must administer the day-to-day operations of the Program. These administrative individuals must report periodically (at least annually) on the Program to high-level personnel and, as appropriate, to the Board of Directors or an appropriate subgroup of the Board, such as the audit committee. In addition, these administrative individuals must be given adequate resources, appropriate authority and direct access to the Board or the appropriate Board committee.

3. The organization must use reasonable efforts not to include within the “substantial authority personnel” of the organization anyone whom the organization knows, or should have known through the exercise of due diligence, has engaged in illegal activities or other conduct inconsistent with an effective Program.

Who are encompassed within “substantial authority personnel”?

An individual is part of “substantial authority personnel” if he or she exercises a substantial measure of discretion on behalf of the organization. The term includes high-level personnel, individuals with substantial supervisory authority (e.g., a plant manager, a sales manager) and others who exercise substantial discretion, such as with respect to setting prices or negotiating contracts.

What should an organization look for in individuals to be hired or promoted?

The commentary to the Sentencing Guidelines creates an affirmative obligation on the part of an organization to hire and promote individuals to ensure that all “substantial authority personnel” will perform their duties in a manner consistent with the requirements of an effective Program.

A criminal background check for substantial authority personnel is a minimum step to meet this requirement.

4. The organization must periodically and practically communicate its Program by conducting effective training programs and through other appropriate means of information dissemination.

Who must be trained?

The Board, all employees and, as appropriate, the organization’s agents. The nature of the training and information should be tailored to the particular audience’s role and responsibilities.

5. The organization must take reasonable steps to ensure that the Program is followed, including monitoring and auditing to detect criminal conduct. The organization must have and publicize a system (which may include mechanisms that allow for anonymity or confidentiality) whereby the organization’s employees and agents may report or seek guidance regarding potential or actual criminal conduct without fear of retaliation. The organization must periodically evaluate the Program’s effectiveness.

6. The organization’s Program must be promoted and enforced consistently throughout the organization. There should be appropriate incentives to perform in accordance with the Program, and appropriate disciplinary measures for engaging in criminal conduct or for failing to take reasonable steps to prevent or detect criminal conduct.

7. After criminal conduct has been detected, the organization must take reasonable steps to respond appropriately and to prevent further similar criminal conduct, including making any necessary modifications to the organization’s Program.

What must an organization additionally do to reduce the risk of criminal conduct?

The Sentencing Guidelines require each organization to assess periodically the risk of criminal conduct and to take appropriate steps to reduce that risk.

What should an organization do to perform this periodic assessment?

The required periodic assessment should examine the nature and seriousness of the criminal conduct that might occur in the organization, the organization’s prior history and

the likelihood that certain criminal conduct may occur because of the nature of the organization's business.

Should the organization prioritize its actions in response to this assessment?

Yes. The commentary to the Sentencing Guidelines states that the organization should periodically prioritize its actions in order to focus on preventing and detecting the criminal conduct identified in its assessment as most likely to occur.

Will having an effective Program always be a mitigating factor in sentencing?

No. For instance, an organization may have an effective Program but lose the benefit under the Sentencing Guidelines of having such a Program if, after becoming aware of an offense, the organization unreasonably delays reporting the offense to the appropriate governmental authorities.

Conclusion

A primary focus of the Sarbanes-Oxley Act is effective corporate governance. As mandated by the Act, the United States Sentencing Commission has supplemented the reasons for every organization to create and implement a strong set of policies and procedures aimed at an organizational culture of compliance and ethics. We would be pleased to assist your organization in developing a Program appropriate for your organization.

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This memorandum is provided by The Wyche Law Firm for educational and informational purposes only and is not intended and should not be construed as legal advice. This memorandum does not intend to be a complete summary of the U.S. Sentencing Guidelines for Organizational Defendants. We would be pleased to discuss with you in detail any of the amendments. Please contact any of the following attorneys in our firm or your other contact within our firm for more information.

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