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A Blue-Ribbon Panel Commissioned by the Ethics Resource Center Makes Bold Suggestions to Improve the Federal Sentencing Guidelines for Organizations

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For the past two decades, employers have gradually taken steps to implement compliance and ethics programs. An employer's motivation for taking these steps often varies, but one common motivation is to ensure that those responsible for oversight and executive management are exercising their legal duties to implement programs reasonably designed to prevent criminal misconduct from occurring. Looking ahead, the bar to clear for having an "effective" compliance and ethics program is likely going to rise.

On the 20th anniversary of the Federal Sentencing Guidelines for Organizations (FSGO), the Ethics Resource Center (ERC) issued a discussion draft of a report called: *The Federal Sentencing Guidelines for Organizations at Twenty Years: A Call to Action for More Effective Promotion and Recognition of Effective Compliance and Ethics Programs*. The ERC organized a group of renowned judges, former regulators, professionals and practitioners (the "Advisory Group") to examine the FSGO, "its successes and failures, and to identify possible areas of improvement." The ERC is seeking comments on its draft report, and the comment period is open until November 30, 2011.

The report offers a number of recommendations for revising the FSGO, including several that have the potential for significant impact on employers' compliance programs. With these recommendations, the ERC has sent a clear message to both government and business entities that it is time to raise the bar on ethics and compliance programs.

Background

In 1984, Congress enacted the Sentencing Reform Act, which established the U.S. Sentencing Commission (USSC). The USSC's mandate was to establish standards for sentencing decisions made by federal judges to reduce subjectivity and promote a system that would produce similar sentences for similar crimes. The USSC first issued guidelines for the sentencing of individual offenses in 1987. The USSC also issued standards for organizations subject to the FSGO. On November 1, 1991, the Federal Sentencing Guidelines for Organizations went into effect. The FSGO apply to corporations, partnerships, labor unions, pension funds, trusts, non-profit entities, and governmental units.

The FSGO are built around a "carrot and stick" philosophy. If an organization creates an effective compliance and ethics program (ECEP), then the punishment imposed on that organization if it

is found guilty of criminal misconduct will be lessened. If organizations do not create an ECEP and engage in conduct that encourages the commission of illegal acts, then the FSGO encourage judges to increase the level of the punishment.

In 2004, at the suggestion of an advisory group, the FSGO were revised. Under the revised guidelines, to have an ECEP, the organization's governing body, *i.e.*, the board of directors, was expected to exercise "reasonable oversight" over the organization's compliance and ethics program. In addition, an individual with "day-to-day operational responsibility" was required to make periodic reports directly to the governing body and executive management was instructed to "promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law."

Then, in 2010, the FSGO were revised again. The most notable change promoted the practice of opening a direct line of communication from the chief compliance officer or those with "operational responsibility for the compliance and ethics program" directly to the governing body on any concerns involving actual or potential criminal conduct.

Advisory Group Challenges

In its report, the ERC Advisory Group praised the FSGO for prompting the development of the ethics and compliance profession and being the impetus for a worldwide movement to focus on corporate ethics, though the group also identified several "challenges that persist." The principal problem the Advisory Group identified is that there is very little data or examples to help organizations understand if a particular compliance and ethics program is "effective." With 3,433 organizations sentenced in the last 20 years, only 5 organizations received credit for having an effective compliance and ethics program. And none of those cases involved large corporations.

The Advisory Group believes that the root of the problem lies with the fact that regulators and prosecutors are negotiating plea and deferred prosecutions agreements before a judge has the opportunity to determine whether a program is effective or not. Even though these regulators claim that a factor they consider in their negotiations is whether a program is effective, no public record exists to support that claim. Instead, the most important factors identified in press releases are: (1) whether the entity cooperated with the investigation, and (2) the type of remedial measures the organization will undertake in the future. According to the Advisory Group, the lack of a broader evaluation of the ethics and compliance program, as it existed when the misconduct occurred, leads some to conclude that the prosecutorial process and the lack of emphasis on existing programs is a disincentive for organizations to seriously focus on their compliance and ethics programs. Instead, the prudent approach, if caught, is to negotiate a lesser punishment with promises to make changes prospectively.

The Advisory Group also believes the wording of the FSGO is, in a few areas, too vague to provide organizations with appropriate guidance and that organizations should not use the FSGO as a checklist for literal compliance. In other words, employers should "meet the FSGO in spirit, not just the letter."

Advisory Group Recommendations

The Advisory Group makes a number of recommendations to the Sentencing Commission, Department of Justice, Executive Branch, Congress, and the business community. The majority of the recommendations focus on making internal changes to the Commission or Executive Branch to make the administration of the Guidelines more transparent and consistent. This article focuses on those recommendations that could impact how employers manage and oversee their ethics and compliance programs, as well as how employers should manage and assess employee performance.

Employee and Program Performance Must Be Measured and Evaluated

The Advisory Group contends that most employers are not satisfying the FSGO's standard that the "organization's compliance and ethics program shall be promoted and enforced consistently throughout the organization through . . . appropriate incentives to perform in accordance with the compliance and ethics program." In other words, there is often no clear and meaningful connection between "an employee's commitment to compliance/ethics" and "his/her advancement and compensation." The Advisory Group is critical of an approach using "vague language in a performance evaluation about being 'ethical' – the kind of criterion that is quickly passed over before the evaluation process turns to the 'real' criteria such as whether the employee has met his/her financial goals." Instead, the Advisory Group contends that, for an

employer to have an effective program, it must incorporate meaningful measures tied to ethical values into compensation and performance decisions.

Likewise, the employer should adopt “outcome metrics for periodic evaluation.” While the current guidelines encourage organizations to “evaluate periodically the effectiveness of the organization’s compliance and ethics standards,” organizations are provided little guidance on how to conduct these evaluations. The Advisory Group specifically mentions that organizations should track and measure whether “employee perceptions and conduct” have improved over time.

Employers Must Focus on the Role of Managers in Promoting an Ethical Culture

While the existing FSGO discuss the importance of the “tone at the top,” the Advisory Group suggests the Commission also stress that employers should focus on “mid-level managers” or “the mood-in-the-middle.” While the current FSGO have some language emphasizing the importance of middle-management setting the right tone and responding to reports of misconduct, the Advisory Group believes the language is “buried in Guideline commentary.” In other words, the Advisory Group wants the Commission to take away any ambiguity and direct employers to train managers to understand the importance of creating an ethical environment and to train managers how to handle complaints and to avoid the appearance of retaliatory behavior.

Employers Should Insist on the Implementation of Programs that Go Beyond Minimum Standards

The Advisory Group contends that “a company that merely checks the box when it comes to satisfying regulation relies on false hope.” It contends that “corporate executives who don’t push for stronger compliance/ethics programs will soon fall behind in their own markets.” The Advisory Group wants to see executives and organizations conduct “regular assessments of corporate cultures” connected to established performance standards. And it wants executives to include compliance and ethics professionals into regular business discussions. For larger organizations, the Advisory Group recommends having at least one board member who is familiar with the FSGO and has some expertise overseeing compliance programs.

What Should Employers Do

Now is an excellent time for employers to re-examine their compliance and ethics programs. With the bounty incentives of Dodd-Frank now in effect and the Advisory Group’s admonitions to regulators to improve transparency surrounding how compliance and ethics programs should be evaluated, employers have a much better line of sight into how they can enhance their ethics and compliance programs in a manner consistent with their business needs and priorities. The following are some suggestions on how to accomplish these objectives.

Make “Culture” a Strategic Priority

Because of the bounty incentives of Dodd-Frank, employers should strive to make a “culture” of compliance a strategic priority. The Advisory Group suggests something similar but provides little guidance on what that really means for a business. Slight exception is taken with the Advisory Group’s recommendation that all employers must insist on exceeding minimum standards because, in theory, this could impose a duty on a business that is inconsistent with its investment thesis and impose a duty that does not legally exist. A business can lawfully and ethically choose to have a short-term investment strategy. As an example, suppose that Business A, which might be regulated in the future under a carbon cap and trade regulation, decides that it will – in the short run – comply with existing regulation instead of installing an expensive system and process to track and report carbon emissions. That decision is not “unethical” or illegal. Likewise, Business B, which has taken a long term view, decides that it is worth the investment now to develop a carbon accounting system in order to prepare for the future. Business B is not more “ethical” than Business A. Employers should work on adopting values that are connected to strategic plans and then develop and implement an employee engagement strategy and measurement system to track employee and business performance and to build the “culture” that fits the business.

Adopt a Continuous Improvement Model for Incident/Complaint Management

The Advisory Group highlighted the fact that most reports of misconduct are made to mid-level management. How those managers respond

to and investigate those reports will establish the culture that the employees working underneath them will see and believe. Consequently, it is vital for employers to make sure that executives through line management are trained and understand their obligation to take reports of misconduct seriously and professionally and to promote a culture where employees believe their concerns will be taken seriously and will not result in retaliation. Employers are advised to adopt a continuous improvement management approach to handle incidents and complaints. Having a continuous improvement approach will help ensure that reports do not fall through the cracks, managers learn from mistakes and implement corrective measures, the right people conduct effective investigations, and reports are made to those who need to know.

Continually Assess Compliance and Ethics Programs Against the FSGO

The work of the ERC and the Advisory Group does an excellent job of pointing out that the government and the judicial branch have missed the opportunity to show the business world how the “carrot and stick” approach should really work. For the past 20 years, the government has not shown it will stand behind the promises in the FSGO. The Advisory Group’s recommendations – especially to regulators negotiating deferred prosecution agreements – that judges, prosecutors, and regulators offer more transparency into the rationale used to assess punishment will be noticed and may lead to significant change. With no other real competing framework, the FSGO’s prominence will be enhanced because of the Advisory Group’s suggestions.

As a result, employers should re-examine their compliance and ethics programs against both the current FSGO and the Advisory Group’s proposals. Before conducting that assessment, however, employers should decide whether to keep that assessment privileged and confidential before starting the process. Finally, training is always an essential part of an effective compliance program. If training in the ethics areas has not occurred recently, employers should consider undertaking that type of training, including at the highest levels.

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