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LITIGATION MANAGEMENT

Compliance programs reduce litigation exposure

Only the rare company faces prosecution, but all must limit liability risks.

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IN 1991, THE U.S. Sentencing Commission promulgated the Sentencing Guidelines for Organizational Defendants. Those guidelines, intended by the commission to lead to more consistent sentences for organizations convicted of federal crimes, introduced the concept of favorable treatment if an organization had an "effective program to prevent and detect violations of law." The commission's commentary provided guidance as to how to determine whether an organization had such a program. Business has much more compelling reasons to create such programs than hoping to realize a reduced sentence if found guilty of violating a federal law.

Since their promulgation, the guidelines have informed the creation and development of compliance programs at myriad companies and other organizations. One commentator even credited them with "hav[ing] produced a new occupation that advises organizations on how to build effective programs that promote ethical behavior." Diana Murphy, "The Federal Sentencing Guidelines for Organizations: A Decade of Promoting Compliance and Ethics," 87 Iowa L. Rev. 697, 699 (2002).

Corporate compliance programs have since multiplied in number and grown in sophistication. The number of companies that have created programs has increased significantly, as measured by the number of corporate officials whose titles include "compliance" or a similar term. In 1992, 12 companies created the Ethics Officer Association (EOA) "to promot[e] ethical business practices and serv[e] as a global forum for the exchange of information and strategies among organizations and individuals responsible for ethics, compliance and business conduct programs." See www.eoa.org/AboutEOA.asp. EOA now has approximately 1,000 members.

Internal education efforts can be crucial.

To deserve labeling as "effective" in the eyes of the commission and, presumably, a court considering what sentence to impose on an organization found guilty of committing a federal crime, a program must satisfy the seven criteria set out in the guidelines. As a result, most commentators measure the value of compliance programs (or, as the commission now refers to them in new § 8B of the guidelines, "ethics and compliance programs") against the guidelines.

The guidelines, however, only set out a very limited view of the purpose of such a program. By focusing too much on the guidelines as providing the raison d'être for such a program, a company might overlook other benefits that the program offers, which might prove more useful on a day-to-day basis than does satisfaction of the guidelines' standards. In addition, because the likelihood of a federal conviction might seem extremely remote to many, such a narrow view of the purpose or benefits of an ethics and compliance program might fail to generate sufficient interest in such a program.

This is not to say that companies should not strive to satisfy the guidelines' standards. To the contrary, an organization should endeavor to implement all of the elements described in the guidelines. Rather, such a program could also, on a continuing basis, provide bottom-line results

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that exceed those realized in a sentencing context.

Why? Only the rare organization will ever find itself in federal court awaiting sentencing after conviction for committing a federal crime and, for that reason, hoping that its ethics and compliance program will earn the label "effective" in the eyes of the judge. Accordingly, the use of the guidelines as the sole touchstone by which to measure a program's benefit is too limited to provide justification for such a program.

Reducing litigation risks

A more immediate, day-to-day benefit of an effective ethics and compliance program flows from reducing a company's exposure to disputes and litigation. That type of exposure is all too real for all companies, rather than little more than hypothetical, as would be needing to take advantage of the guidelines' provisions for a lighter sentence.

How, then, should a company approach compliance? First, its officers should understand that compliance is a process rather than a goal; it constitutes a never-ending quest for conformity with internal and external behavioral norms. Second, the compliance program should support the company's business goals and not create counterproductive incentives. Third, its constituent elements should dovetail with how the organization pursues its business objectives, for the more the elements of the compliance program integrate with the business processes, the more internal clients will support that program. Fourth, the program should effectively address issues of cultural sensitivity. Fifth, its elements should be designed to provide benefits for the business efforts.

The compliance program should be matched to processes that the company undertakes for dispute management and other business goals. By doing so, it will integrate the elements of its compliance program more fully into the organization, enhancing its sustainability and reducing the likelihood of overt or covert opposition (or simply neglect) within the company.

Both total quality management practice (TQM) and good dispute management practice recognize the value of a periodic "look back" at an organization's experience. For TQM, that "look back" attempts to identify means of improving business processes via simplification or streamlining. In a dispute (or litigation) management context, a "look back" (often called a "post mortem," "after action" or "lessons learned") tries to capture lessons from disputes or litigation by which the organization can improve its performance in dispute resolution and avoid repeating activities giving rise to the dispute. In other words, a company should foster an environment of "continuous improvement" as a learning and growing institution.

The commission has added to the guidelines a requirement that an organization periodically assess the performance and efficacy of its compliance program. That process resembles closely the "look backs" that constitute important aspects of TQM and dispute management. A company can easily design a "look back" that serves all three types of objectives—TQM, dispute management and compliance—simultaneously. Indeed, the use of a single process to address multiple objectives has the added benefit of fostering efficiency—again, a continuous-improvement approach.

A critical element of a program must be the means by which any lessons learned are conveyed back to those who can best apply those lessons in their day-to-day activities so as to reduce the company's risk exposure. In other words, training must occupy a central position in both the dispute-management and the compliance programs.

Suggested measures

At FMC Technologies Inc., the legal team participates in internal educational efforts. Because stakeholders learn in different ways and through many processes, the company established several elements of the corporate training program to provide its employees with as many options as possible. Some of the suggestions detailed below are drawn from the company's program.

Companies can deliver training in a variety of ways, including live, in-person presentations and monthly "webinars" that employees can attend (or replay from an intranet as schedules permit) without charge to their business units. Members of the legal team can present these presentations and webinars consistent with the team members' substantive specialties. In-person training alone, while effective, personal and flexible, simply cannot reach all of a company's employees and suffers from the "happenstand" method of training (if you "happen" to be "standing" in the room with the trainer, you get trained). A company should therefore consider developing online courses on a range of substantive topics covered by its compliance program. These courses will be delivered by a vendor with expertise in that field.

Other important elements to a compliance program are a publicly available written code of ethics and policy statement; detailed guidelines, available on a company's intranet, containing additional guidance for its employees; an employee certification program; management compliance letters; financial representation letters; an ethics hotline; internal audits and investigations; and training. Several

components serve multiple purposes. They not only reinforce the company's commitment to ethical practices (conveying the "tone from the top" that represents one of the core goals of the Sarbanes-Oxley Act), but they also help it avoid public relations nightmares and criminal exposure for the company. They also satisfy the listing rules of the New York Stock Exchange.

Compliance may well constitute the most cost-effective means of reducing expenses. Rather than doing so exclusively by monitoring and policing the cost of the legal services the company needs, though, a legal team should consider devoting more time to compliance-related training as a component of preventative law that in-house lawyers intuitively favor. In other words, a company should focus on proactive, not reactive, compliance.

A company should devote such efforts to training because, in the final analysis, a compliance program consists of nothing more than the company's employees. The ultimate test of a program's effectiveness is whether the employees' day-to-day behavior meets the standards represented by government rules, industry norms, the company's own expectations expressed in its policies and the views of other relevant constituencies. No matter how well drafted its policies or well designed its procedures, a company achieves little if employees don't understand its policies or the standards that govern the firm's actions and act accordingly.

Employees who are better trained can better avoid mistakes (errors of both commission and omission) that lead to disputes and litigation. Remember, companies are in the business of making and selling products and services—not in the business of winning lawsuits or answering interesting questions of law. As such, companies' dispute-resolution goals are quite simple: first, avoidance; second, if involved, as quick and cost-effective a resolution as possible; and, third, learning from the process to prevent repetition. Thus, more training usually results in fewer disputes and litigation—which translates directly into less spending for dispute resolution.

The General Counsel Roundtable has reported that its research on compliance supports that belief, concluding that "companies can substantially reduce legal liability by increasing their investment in compliance; this finding is even more compelling once the indirect ramifications of compliance failures (such as reputational harm and lost productivity) are included in [return on investment] calculations." "Seizing the Opportunity—Part One: Benchmarking Compliance Programs" (General Counsel Roundtable, Washington 2003), at 26. The Roundtable quantified that impact as a $1.37 reduction in legal liability for each $1.00 spent on compliance-related efforts.

A particularly troubling aspect of litigation for many in-house attorneys is the possibility of punitive damages. Since punitive damages awards are designed to punish "bad" actors, compliance-related errors could very well prompt a jury to consider punitive damages after finding liability. Indeed, plaintiffs might use the absence of an effective program (or argue that a program was not effective, as happened in a case in Arizona superior court several years ago) as justifying punitive damages. Similarly, while some in-house and defense counsel might instinctively shy away from after-action processes based on a fear that an ineffective program is worse than no program, the key is to conduct the process and ensure implementation and execution.

Among the most problematic issues that in-house counsel face when managing litigation are claims that a company treated the plaintiff in that case differently than it treated similarly situated people in other situations. Juries dislike dissimilar treatment, even if the treatment at issue was not criminal. An effective compliance program should lead to more consistent behavior by a company's employees, both over time and among the entire employee population. That behavior should conform to a greater degree than it otherwise would to both internal and external mandates. The training that constitutes such a critical part of such a program should reduce the likelihood of disparate treatment of customers, clients, partners and others. A company with an effective compliance program, including an effective training regimen, should therefore find itself less subject to litigation. Furthermore, when it faces claims in court, such a company should have an effective argument against the imposition of punitive damages.

In sum, corporate compliance programs have matured considerably since their first appearance. That maturation, however, has occurred in the shadow of the guidelines, for good reasons. The time has arrived for corporate ethics and compliance programs to emerge from that shadow, for they deserve recognition for many other benefits that they offer. Some of those benefits may even outweigh, in terms of their day-to-day impact on corporate activities and stature, the benefits created in the guidelines. After all, the real objective is to avoid situations where the guidelines even come into play—by creating and maintaining a culturally embedded and appropriately aligned ethical compass. NLJ