

The Metropolitan Corporate Counsel

www.metrocorpcounsel.com

Volume 14, No. 3

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March 2006

Corporate Compliance And Ethics Programs: Don't Sell Them Short

Steven A. Lauer

INTEGRITY INTERACTIVE CORPORATION

Corporate compliance programs have matured considerably since their beginnings several decades ago.¹ A new career ("compliance officer," "ethics officer" and several variations of those terms) has arisen,² a trade association devoted to "[b]eing the leading provider of ethics, compliance, and corporate governance resources to ethics and compliance professionals worldwide" came into being in the early 90s³ and government regulators have adopted compliance and ethics protocols in their regulatory regimes.⁴

Compliance and ethics programs received additional imprimatur from the United States Sentencing Commission in late 2004 when changes to the Sentencing Guidelines for Organizational Defendants (the Guidelines), which it had proposed earlier in the year, took effect.⁵ Those changes provided considerable detail as to what the Commission expects an "effective compliance and ethics program" would include.

Though a company need not limit its program to this, the primary areas of focus for an effective compliance and ethics program, as set out in the Guidelines, are the following:⁶

- 1) Established standards and procedures to prevent and detect criminal conduct
- 2) Appropriate delegation of responsibility for compliance and ethics among the board of directors, senior management and other responsible employees
- 3) Efforts to prevent the appointment

Steven A. Lauer, Director of Integrity Research for Integrity Interactive Corporation, was an in-house counsel for over thirteen years and a consultant to law departments for seven years. For footnotes, see our Website, www.metrocorpcounsel.com.

among a firm's "substantial authority personnel" of individuals who have engaged in illegal activities or other conduct inconsistent with an effective compliance and ethics program

4) Periodic, practical communication of the firm's standards and procedures and other aspects of the compliance and ethics program to all employees and, as appropriate, agents of the firm including, at least, training "appropriate to ... individuals' respective roles"

5) Appropriate monitoring and auditing for criminal conduct, periodic evaluations of the compliance and ethics program's effectiveness, some sort of hotline or other reporting mechanism for employees and agents to ask questions or report potential or actual criminal conduct

6) Consistent promotion and enforcement of the compliance and ethics program by appropriate incentives and discipline

7) Appropriate responses to criminal conduct if detected, so as to correct the impact of such criminal conduct and prevent similar conduct in the future

The Commission also included, as an overview element, the need to assess the risks that an entity confronts in its business.

Even though they've assumed a "top of mind" place in the thinking of several groups, including in-house attorneys, government regulators and prosecutors, investors, courts and observers of the legal "scene, it seems that corporate compliance and ethics programs have yet to penetrate fully the day-to-day life of most organizations. Despite the attention from government officials and the specificity with which those officials have identified the elements of a compliance program that they (the officials) would deem acceptable, many programs fall short of those standards.

Integrity Interactive Corporation and Altman Weil recently surveyed 468 companies about their compliance programs. Of those invited to take part, 64 answered the survey (a 14% response rate). When asked what constituted their compliance programs, they identified the following as the most common

elements in descending order of prevalence:

- a. A code of conduct or business practices (61, or 96.8%)
- b. Training of employees and agents on compliance topics (61, or 96.8%)
- c. A hotline or other reporting mechanism (60, or 95.2%)
- d. Periodic employee certification of compliance with the code of conduct (52, or 82.5%)
- e. An audit committee of the board of directors (51, or 81%)
- f. Chief compliance officer (46, or 73%)
- g. Periodic reports to the audit committee/directors about compliance (46, or 73%)
- h. Periodic risk assessments (40, or 63.5%)
- i. Compliance program audits (37, or 58.7%)
- j. Periodic reviews of the compliance program's effectiveness (36, or 57.1%)
- k. Audits for violations of law (32, or 50.8%)
- l. A compliance committee of senior management (31, or 49.2%)
- m. The appointment of compliance managers (25, or 39.7%)
- n. A code of conduct for senior/financial managers (25, or 39.7%)
- o. Letters to suppliers/vendors regarding compliance (22, or 34.9%)
- p. Compliance-related contractual provisions (21, or 33.3%)
- q. Compliance officers/directors for business units (16, or 25.4%)
- r. A code of conduct for discrete business units (8, or 12.7%)
- s. Compliance reviews with departing employees (7, or 11.1%)
- t. Positive incentives for compliant behavior (6, or 9.5%)

When you examine the identified elements of the compliance programs of the respondents to the Integrity/Altman survey,⁷ you note that each of the elements included in at least 70% of programs of responding organizations respond to only four of the seven main structural components of an "effective compliance

Please email the author at slauer@i2c.com with questions about this article.

and ethics program” under the Guidelines: established standards and practices; appropriate delegation of responsibility for compliance and ethics; periodic, practical communication regarding those standards and practices; and appropriate monitoring and auditing. Many fewer programs of the responding firms seemed to include elements that would respond to the other three main components described in the Guidelines – procedures to prevent the inclusion among substantial authority personnel of those whose past conduct was demonstrably inconsistent with compliance, the use of incentives as well as discipline to promote and enforce compliance and ethical behavior, and appropriate responses to detected criminal conduct. Other surveys have revealed less conformity with the guidelines, than the Integrity Interactive Survey. In light of the time that has passed since the Sentencing Commission first issued the Guidelines in 1991 and the considerable attention that the Guidelines and the 2004 revisions have received,⁸ the absence of complete mapping between the programs represented in the survey and all the expectations expressed in the Guidelines seems surprising.⁹

What might explain this disconnect? Perhaps the answer lies in some common misperceptions about compliance and compliance programs. Let’s examine a few.

The likelihood of my company being convicted of a federal crime is minuscule so the Guidelines don’t mean much practically speaking. Few organizations face sentencing in federal court. The United States Sentencing Commission reported that in fiscal year 2003, only 90 organizations were sentenced using the culpability factors of the Guidelines to increase or decrease the organization’s punishment.¹⁰ While those numbers seem to support this perception, it represents too narrow a view.”

A compliance program serves many goals in addition to constituting a basis for a lesser sentence from a federal court upon conviction. For example, when federal prosecutors review the possible culpability of an organization while they are considering whether to file charges and, if they determine to do so, which charges to file, the existence of an effective compliance and ethics programs plays a large role in their calculation. The “existence and adequacy of the corporation’s compliance program” is one of nine factors listed by Deputy Attorney General Thompson in his memo to United States Attorneys titled “Principles of Federal Prosecution of Business Organizations” dated January 20, 2003.¹¹ Since prosecutors review the behavior of many more organizations than they indict or than ultimately endure a criminal trial and suffer conviction, adequate compliance programs play a larger role in this area than the statistics of the Sentencing Commission suggest.

In addition, a corporate compliance and

ethics program should improve a firm’s defenses to civil litigation. The facts that comprise a compliance failure also provide an opportunity and a rationale for litigation by another party.¹² To the extent a firm can argue that the lapse represents an unusual event, as demonstrated by the existence of an effective program of training, auditing, etc., such a firm should better withstand such litigation attacks.¹³ The absence of an effective program, on the other hand, enables a plaintiff to argue, as has happened on several occasions, that a defendant should be liable for punitive damages because its conduct demonstrated a disregard for prudent commercial behavior.

In short, the limited applicability of the Guidelines does not detract from the benefits of applying their elements. Satisfying the standards for a compliance program contained in the Guidelines should provide benefits far beyond, and much more certain and immediate than, those available exclusively from the application of the Guidelines in a sentencing context.

The Guidelines constitute only advisory materials for a federal judge during sentencing. Slightly more than one year ago, the Supreme Court issued a pair of rulings in which it determined that the Sentencing Guidelines must be advisory only in order to render the Sentencing Reform Act of 1984 constitutional.¹⁴ If the Guidelines are advisory only, can we consider their terms for assessing the effectiveness of a compliance and ethics program useful?

Yes, the specifications in the Guidelines for an effective program can and will continue to serve as helpful guidance on how to organize a corporate compliance and ethics program. First, federal prosecutors still refer to the Guidelines during their pre-indictment calculations. Second, federal judges likely must continue to consult the Guidelines during their sentencing deliberations even if the Guidelines are only advisory. Third, many regulators view the Guidelines as helpful touchstones for consideration when reviewing corporate behavior.

The amount that we spend on compliance training and other program efforts would be wasted. Funds spent for a corporate compliance and ethics program serve multiple purposes. To the degree that they increase the likelihood that the firm’s actions will comport with the expectations of government and private regulators of corporate behavior, those expenditures will avoid costs related to non-compliance, such as responding to regulators.

In addition, an effective, well-designed compliance program dovetails with other corporate programs and serves other objectives. For example, effective litigation management includes a step that one might label a “post mortem,” an “after action” or “lessons learned” when a particular litigation matter ends. Such a protocol closely resembles the periodic assessment of risk expected by the Sentencing Com-

mission to appear in an effective compliance and ethics program.¹⁵ That process also serves the purpose of a total quality management program by helping to identify defects in the business process that might call for improvements.¹⁶ Compliance programs also help to prevent and detect misconduct where the company is itself the victim, such as vendor fraud and employee theft; savings in this arena alone can exceed the program’s cost.

You should consider the cost of an effective compliance and ethics program in a broader context than simply assuring compliance or creating the proper environment for ethical action. Rather, efforts to inculcate ethical behavior and compliant actions within the corporate politic will make the organization more efficient and more effective. To the degree that employees better understand the expectations of regulators, investors, corporate management and other relevant audiences, they’re better able to avoid compliance failures and dispute-causing actions.¹⁷

Compliance training and compliance would merely add a layer of bureaucracy.

As noted, at least some of the steps called for by the Sentencing Commission can fill multiple roles within a business organization. To that extent, then, they do not represent totally new bureaucracy. Moreover, by taking care when designing the program, one can minimize the additional burden that results from the compliance and ethics program. Indeed, the design of the program should include consideration for adding as little burden as possible.¹⁸ Finally, one should also take note of research on the value of an effective compliance and ethics program. As reported by Standard & Poor’s Managing Director and Global Practice Leader for Governance Services, one study “found that a significant majority of institutional investors were willing to pay a premium for well-governed companies.”¹⁹ Well-governed includes effective compliance and ethics programs.

Conclusion

While corporate compliance and ethics programs have gained considerable stature within the ranks of American business, they still appear less frequently than one would expect in light of their significance and the prominence they receive from government and other regulators of corporate behavior. If that shortfall results from the concerns described above, perhaps corporate managers should re-examine the basis for those concerns. They might very well find that an effective corporate compliance and ethics program will assist the organization to move to a higher plane of action – one that includes less litigation-related skirmishing as well as fewer disputes with government officials and other corporate audiences. Corporate compliance and ethics programs offer many benefits that companies may have overlooked in their analysis of whether and how to implement them. Don’t make that mistake.

- ¹ General Electric inaugurated its compliance program after several companies were convicted in the early 60s for antitrust violations in the electrical equipment industry. Environmental enforcement in the 70s and then enactment of the Foreign Corrupt Practices Act in 1977, following disclosure of instances of bribes paid by American corporations to foreign government officials to secure business and congressional hearings into the prevalence of such payments, led more and more companies to institute compliance programs. Several companies in the defense and aerospace industries came together to create the Defense Industry Initiative to promote ethical behavior among members of the defense and aerospace industries, including companies' "obligation to self-govern by implementing controls to monitor compliance with federal procurement laws and by adopting procedures for voluntary disclosure of violations of federal procurement laws to appropriate authorities." See the fourth of "The DII Principles" contained at <http://www.dii.org/Statement.htm>. The defense and aerospace industries have, as a result, among the most mature compliance programs in American business.
- ² See Murphy & Leet, "Working for Integrity" (Society of Corporate Compliance and Ethics, June 2006).
- ³ <http://www.theecoa.org/AboutEOA.asp>.
- ⁴ <http://oig.hhs.gov/fraud/complianceguidance.html>.
- ⁵ <http://www.uscc.gov/2004guid/TABCON04.htm>.
- ⁶ The Sentencing Commission itemized seven main areas of focus for a program, though the precise number of elements might vary depending on how one classifies or breaks them down. For example, another organization identified "nine elements necessary for achieving an effective compliance program to detect and prevent criminal conduct and promote ethical behavior," including among those nine elements the "[a]bility to [q]uery and [g]enerate [r]eports." See page 7 of "Framework for Corporate Culture and Integrity" <http://www.globalcompliance.com/pdf/GCSFrameworkforCorporateCultureandIntegrity.pdf>.
- ⁷ Other surveys yielded different results: e.g., see <http://www.protiviti.com/downloads/PRO/prosus/publications/RiskBasedCompSurvey.pdf>, p. 14 (less than 30% of respondents already had whistleblower programs, rather than the 95.2% of respondents to the Integrity/Altman survey that had a hotline or reporting mechanism in place. This may be explainable, at least in part, because Integrity's clients, which comprised approximately half of those invited to participate in the Integrity/Altman survey, were pre-disposed to having more comprehensive compliance programs as demonstrated by their use of online compliance training from Integrity for their programs. The survey by Protiviti and Operational Risk magazine "focused on financial institutions" and may have been weighted more toward companies based outside the United States, since survey responses originating in the United States comprised only 12% of the total. *Id.*, at 3.
- ⁸ A former chair of the Sentencing Commission (and federal circuit judge) reviewed the first ten years of experience under the Guidelines in Murphy, *The Federal Sentencing Guidelines for Organizations: A Decade of Promoting Compliance and Ethics*, 87 *Iowa L. Rev.* 697 (2002).
- ⁹ Since the Integrity/Altman survey invitations went to firms with which Integrity Interactive and Altman Weil had had some contact, those invitees probably were among the more proactive organizations in terms of their compliance programs. Integrity's business centers on compliance- and ethics-related training and Altman Weil often works with companies that have in-house law departments. A survey population truly representative of all businesses in this country likely would include a greater proportion of firms that have devoted less attention to this subject.
- ¹⁰ <http://www.uscc.gov/ANNRPT/2003/table54.pdf>. Those 90 organizations constitute a subset of the 200 organizations sentenced in federal court (as to which the Guidelines would have been legally applicable). Of those 200, 101 "had fine guidelines application data missing or inapplicable due to [G]uideline provisions such as a 'preliminary determination of inability to pay fine.'" *Ibid.* (note 1). See table 52 at <http://www.uscc.gov/ANNRPT/2003/table52.pdf>.
- ¹¹ http://www.usdoj.gov/dag/ctff/corporate_guidelines.htm.
- ¹² That other party could be an employee, employment applicant, transaction counterparty, partner, government regulator, consumer or any of the innumerable groups with which an organization deals on a daily basis.
- ¹³ See Carr & Lauer, "Compliance Programs Reduce Litigation Exposure," *The National Law Journal*, vol. 27, no. 33 (April 25, 2005), p. S3.
- ¹⁴ See *United States v. Booker*, 543 U.S. 220 (2005).
- ¹⁵ See Carr & Lauer, *supra*, n. 12, and Chema & Lauer, "A Holistic Approach to Corporate Compliance and Dispute Management," *The Lawyer's Brief*, vol. 34, no. 24 (Dec. 31, 2004), p. 2.
- ¹⁶ Carr & Lauer, *supra*, n. 13.
- ¹⁷ Spinnato & Lauer, "The Big Picture: Compliance and Knowledge Management in Today's Law Department," *GC New York* (ALM Publications, May 9, 2005), p. 2.
- ¹⁸ Lajoie & Lauer, "Business Ethics and Compliance – Establishing an Effective Program," *The Lawyer's Brief*, vol. 34, no. 3 (Feb. 15, 2004), p. 2.
- ¹⁹ Dallas, "Governance and Risk: An Analytical Handbook for Investors, Managers, Directors & Stakeholders" (McGraw-Hill 2004), p. 11.