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How Effective Will Your Compliance Program Be After November 1, 2010?

A few months ago, the United States Sentencing Commission unanimously passed amendments to Chapter 8 of the Federal Sentencing Guidelines regarding sentencing of organizations.^[1] Those amendments include conditions that a company's compliance and ethics program must meet in order to be deemed "effective" in all circumstances. Having an effective program positions a company to receive appropriate mitigation credit in the event it is found to have committed a criminal violation. The new amendments were submitted to Congress on April 29, 2010, and without action by Congress, the changes will become effective on November 1, 2010. Prior to this effective date, companies may want to consider whether and how to modify their compliance programs to comport with the new standards.

The Sentencing Guidelines provide that an organization convicted of a crime may receive a reduced sentence if it had an effective compliance and ethics program in place at the time of the offense. Under the current guidelines, there is a *per se* disqualification from having an effective program if "high-level personnel"^[2] participated in, condoned, or were willfully ignorant of the offense. The amended guidelines eliminate this automatic disqualification if four conditions are met:

1. The individual with "operational responsibility" for the compliance and ethics program has "direct reporting obligations" to the board of directors or appropriate committee of the board.
2. The program detected the offense before its discovery outside the organization or before such discovery was reasonably likely.
3. The organization promptly reported the offense to the proper governmental authorities.
4. No person with operational responsibility for the compliance and ethics program participated in, condoned, or was willfully ignorant of the offense.^[3]

The first condition, requiring direct access to the board of directors, introduces a significant change. Direct access to the board provides a check against wrongdoing by senior management and encourages compliance officers to act in the company's best interests. A person is considered to have direct reporting obligations if the individual has



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For more information, please contact any of the individuals listed below:

James E. Bowers^{CT, MA, DC}

jebowers@daypitney.com

(860) 275 0339

Michael G. Considine^{CT, NJ, NY}

mgonconsidine@daypitney.com

(212) 297 2479

Edgardo Ramos^{CT, NY}

eramos@daypitney.com

(212) 297 2452

Stanley A. Twardy, Jr.^{CT, DC}

satwardy@daypitney.com

(203) 977 7368

“express authority” to communicate personally to the board or committee (i) promptly on criminal/potentially criminal conduct and (ii) no less than annually on the implementation and effectiveness of the compliance and ethics program.^[4]

In order to meet the express authority requirement, companies should formalize in writing the reporting line to the board or committee. Doing so will afford them the possibility of qualifying for a reduced sentence in the event that high-level personnel are involved. Indeed, it is believed that several companies every year are disqualified from receiving mitigation credit for this reason.

A potential downside of granting compliance officers direct access is that it may eliminate the beneficial role played by senior management in filtering the substance and amount of information provided to the board. Companies who restructure the reporting lines should therefore consider providing guidance concerning the type of conduct that warrants reporting and when the board or committee should be informed. They should also provide guidance concerning the substance of the information that should be provided to the board by the compliance officer.

Ultimately, a change in a company’s compliance structure may be justified in order to preserve the opportunity for a reduction in culpability when high-level personnel are involved. The board should be briefed on the effects of the upcoming changes, and companies will need to determine whether management or the board should decide whether to modify their compliance and ethics programs. Whether or not companies modify their programs, the new amendments highlight the importance of a company’s compliance program in its overall risk management structure.^[5]

Further, the third condition requiring prompt reporting may put pressure on companies to self-report before they fully understand the issues they are facing.

Of course, having an effective compliance program is also viewed favorably by prosecutors in determining whether to prosecute at all, agree to a nonprosecution or deferred prosecution agreement, or mitigate a fine. It also enhances a company’s efforts to avoid civil liability in private litigation and enforcement contexts.

Day Pitney’s Compliance Risk Services group will continue to track any action on these amendments. For information on how to structure your compliance and ethics program to take advantage of the new amendments, please contact our Director, Compliance Risk Services, Jim Bowers, at (860) 275-0339 or jebowers@daypitney.com, or any of the individuals listed above.

^[1] U.S. Sentencing Commission, Amendments to the Sentencing Guidelines 38–39 (May 3, 2010), available at www.ussc.gov/2010guid/20100503_Amendments.pdf.

^[2] “High-level personnel” means 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. U.S. Sentencing Guidelines Manual § 8A1.2, application note 3(b).

[3] U.S. Sentencing Commission, *supra* note 1, at 38–39.

[4] *Id.* at 39–40.

[5] To encourage companies to take reasonable steps upon discovery of criminal conduct, the Commission also added new commentary to the Federal Sentencing Guidelines that lists factors favorably viewed by enforcement agencies in evaluating compliance and ethics programs. With regard to appropriately responding to criminal conduct, the commentary provides that organizations should take reasonable steps to remedy the harm. Such steps may include restitution to identifiable victims, other forms of remediation, and self-reporting and cooperation with authorities. With regard to preventing further similar criminal conduct, the commentary provides that organizations should assess their compliance programs, which may include the use of an outside professional advisor to ensure adequate assessment and implementation of any changes. *Id.* at 34–35.

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