Corporate Compliance Programs: Protecting the Business from the Rogue Employee

Jeffrey M McFarland, Florida Coastal School of Law

Available at: https://works.bepress.com/jeff_mcfarland/4/
Westlaw Delivery Summary Report for MCFARLAND, JEFFREY

Date/Time of Request: Tuesday, October 27, 2009 13:14 Eastern
Client Identifier: JEFFREY MCFARLAND
Database: FLBJ
Citation Text: 70-JAN FLBJ 34
Lines: 325
Documents: 1
Images: 0

The material accompanying this summary is subject to copyright. Usage is governed by contract with Thomson Reuters, West and their affiliates.
In the past, courts and prosecutors appeared willing to defer to senior management concerning the corporation's handling of employee wrongdoing. As demonstrated by the recent experiences of Daiwa Bank and Archer Daniels Midland Co., those days may be gone.

Congress has shown a renewed interest in prosecuting corporations for criminal conduct. [FN1] This trend is embodied in the Federal Criminal Sentencing Guidelines, which limits the court's discretion in dealing with business organizations when its employees engage in wrongful conduct. The result is increased potential for criminal sanctions. [FN2]

Increased governmental scrutiny of white collar crime [FN3] and the possibility of multi-million dollar judgments in civil cases make an effective corporate compliance program highly desirable for most businesses. The sentencing guidelines provide that an organization can mitigate its criminal punishment if it can show an "effective program to prevent and detect violations of law." [FN4] While the guidelines do not address civil liability directly, the guidelines can serve as the standard for effective programs in all contexts. [FN5]

Primary Advantages of an Effective Compliance Program

• Preventive Maintenance

A compliance program's primary goal is to prevent wrongful conduct. Accordingly, an effective program must first identify the potential legal risks facing a business organization. Even employees with good intentions may be subjecting a company to legal liability. The "empty head, clean heart" defense does not shield a company from civil and criminal sanctions. However, with a corporate compliance program in place, a company hopefully will become aware of such conduct at an earlier stage and will be in a better position to correct the employee's behavior, thereby reducing potential liability.
• **Lower Penalties and Reduced Legal Costs**

Under the Federal Sentencing Guidelines, the existence of an effective compliance program must be considered by the court when determining an appropriate penalty. [FN6] Although the existence of such a program will not absolve the company of responsibility, if a program is in place, the fine may be reduced by as much as 80 percent. [FN7] There are two catches, however. First, although there are benefits to having a corporate compliance program no matter when it is implemented, [FN8] the fine will be reduced only if the program is in place before the offending conduct occurs. [FN9] Second, the compliance program must include the specific elements enumerated in the sentencing guidelines. [FN10] Although aspects of voluntarily adopting a compliance program can be unpleasant, management should recognize that if a company does not have an effective compliance program in place and misconduct occurs, the court may impose a more intrusive and costly program. [FN11]

An effective program also can result in reduced litigation and legal costs. A company with such a program in place will detect problems sooner-possibly in time to correct the offending practices or at least provide relief to the victim before litigation ensues. The government may elect not to prosecute at all if the situation is handled effectively. [FN12]

• **Public Relations and Improved Morale**

Companies with a compliance program can use it as a public relations tool and simultaneously promote a positive attitude among employees. A work environment in which ethical business practices are valued enhances a company's public image. At the same time, employees will feel they are a more integral part of the company's success because they are being trained in specialized aspects of the company's business. [FN13]

**Disadvantages of Corporate Compliance Program**

Implementing a corporate compliance program carries with it certain disadvantages and costs (in terms of both time and money). However, the disadvantages can be minimized in a carefully developed program.

• **Paper Trail**

A corporate compliance program faces a Catch-22 dilemma. On one hand, if the program is confined to a few pages in an employee handbook, it will not be effective. To achieve potential benefits, the program must be proactive in terms of detection and investigation. On the other hand, investigations result in documentation which provides ammunition for civil litigants and government prosecutors. Because a paper trail is unavoidable, the program must be designed to minimize disclosure of the information generated by the program.

Probably the best way to prevent the documentation from rearing its ugly head in a civil or criminal setting is to cloak it with the attorney-client communication and attorney work-product privileges. There are two key requirements a company must keep in mind if it wants to avail itself of the privilege. First, information gained through internal monitoring or investigations should significantly involve a lawyer. If a nonlawyer conducts interviews and issues questionnaires to either maintain compliance or investigate wrongdoing, the information solicited will not be privileged. However, if an attorney conducts those same reviews for the purpose of giving legal advice to a company, the information is privileged. [FN14] Outside counsel arguably is more useful than in-house counsel in this regard because it avoids questions about whether the investigation is truly “legal.” [FN15]
The second key to the privilege is confidentiality. If any of the information gained through monitoring or investigation is revealed to third parties (other than outside counsel), the privilege is considered waived as to that information. [FN16]

To maximize the availability of the attorney-client communication and work-product privileges in connection with a corporate compliance program, the following items should be considered: 1) The compliance reports should contain legal advice and analysis; 2) counsel's professional observations about legal risks should be clearly noted; 3) attorneys, not company executives or employees, should be the note takers during interviews; and 4) all of the resulting paperwork should be kept separate from the people involved in the interview process. Each of these will enhance the viability of the privilege by assuring that the investigation is truly “legal” and is kept confidential. [FN17]

• Poorly Designed Programs Do More Harm Than Good

If a company implements a poorly designed corporate compliance program, it may invite civil or criminal litigation. For example, failure to keep an investigation confidential could result in a defamation lawsuit by the offender against the company. If the program is properly implemented, however, the company may have a qualified privilege. [FN18] In addition, if the policies in the compliance program are not clear and well thought out, employee-wrongdoers may have a defense against the company if the company brings suit for improper behavior.

• Mandatory Response

Once a company learns of a problem through its compliance program, it will have an affirmative duty to remedy the practice and take necessary disciplinary action. The reduced fines under the *36 sentencing guidelines apply only if prompt corrective action is taken. [FN19] In addition, slow or inappropriate responses may increase civil damages and introduce the possibility of punitive damages. Therefore, a company's response must be swift and proper. Legal counsel should be at hand any time the company is forced to take action under its compliance program. After a problem is discovered, the company may need to modify its program to ensure that similar incidents do not recur.

• Adverse Publicity

In the event improper behavior occurs and a company discovers it through the corporate compliance program (as it should), there is always a danger that the information will become publicly known and have a negative effect on the company's business. While this appears to be a significant disadvantage, consider that in the absence of a compliance program, part of the company's punishment for an infraction may consist of publicizing the offense. [FN20] As a result, a company should implement a program and then ensure that its documentation of facts remains confidential. Confidentiality not only avoids potential adverse publicity but, as discussed above, keeps alive the use of attorney-client and work-product privileges.

Sentencing Guidelines' Elements of Program

The advantages of a corporate compliance program under the sentencing guidelines are available only if the
program is an “effective program to prevent and detect violations of law,” as defined in the guidelines. There is no absolute duty to prevent a criminal offense. Instead, the focus is on due diligence in preventing and detecting criminal wrongdoing in the organization. To constitute due diligence, the guidelines require that seven steps be taken in instituting a corporate compliance program: [FN21]

1) Compliance standards and procedures must be followed by employees and must be reasonably capable of reducing the chances of criminal conduct;

2) High-level management must be assigned overall responsibility to oversee compliance with the standards and procedures;

3) The organization must use due care in not delegating authority to persons who the company knew or should have known had a propensity to engage in illegal activities; [FN22]

4) The standards and procedures must be effectively communicated to all employees and other agents;

5) The company must use some form of monitoring and auditing system reasonably designed to achieve compliance with its standards;

6) Standards must be consistently enforced through uniform discipline; and

7) After the discovery of an offense, the company must take all reasonable steps to respond appropriately and prevent future similar offenses.

The guidelines also mention as relevant factors the size of the organization relative to the degree of the program's formality and whether the program addresses risks normally associated with the company and the company's industry.

Developing the Program

Although the guidelines apply strictly to criminal behavior, they lend guidance to the development of corporate compliance programs regardless of whether a company is protecting against criminal or civil risks. [FN23] The program must be tailored to an organization's size, industry, business problems, and history. So where does a company begin?

First, a company must determine which problems and risks it needs to address. This can be done by interviewing management and employees about their concerns. In addition, a company should examine the practices and standards in its own industry and should involve legal counsel to evaluate the legal risks. [FN24] As discussed earlier, this information should be kept strictly confidential to avoid discovery in later litigation.

Second, a company should prioritize its efforts so that its program first addresses those areas with the most legal risk. Other areas can be added as time and money permit. For instance, a small company in an industry where worker safety is of particular concern might initially focus on compliance with the Occupational Safety and Health Act. It might then move on to sexual harassment or other forms of discrimination, if necessary, when the company has the resources available.

Third, the company must clearly articulate its policies to all employees and agents. The type of communica-
tion used will depend on the company and the subject being addressed. Generally, ethical codes of conduct and policy statements are a starting point. Such devices should establish not only the standards adopted by the company, but also the procedures for reporting violations and evaluating conduct. [FN25] A thorough program will also make handbooks available to employees and may offer orientation courses on legal aspects of their particular job.

Fourth, the company must be able to change its program when new potential risks arise. This means the company must monitor its program on a regular basis and have the flexibility to implement new policies, especially after an incident of improper conduct. The ability to adapt the program is crucial to show employees, the public, and the courts that the company is making a sincere effort to comply with the law.

Fifth, the company must maintain records of its compliance program activities. Because one of the main advantages of a program is to negate culpability, the company must be able to prove that it took appropriate steps to prevent improper conduct. All aspects of the program should be documented, including policy statements, training programs and educational materials, investigations, and disciplinary action. As discussed above, this leaves a potentially dangerous paper trial. However, the company can minimize the disadvantages of these records through attorney-client privilege. In addition, a document retention program might be introduced. This would allow the company*37 to destroy documents after a certain period of time without incurring charges that documents were selectively destroyed. Of course, if litigation commences, all destruction of documents that may relate to that case must cease.

Finally, if something does go wrong, under certain circumstances a company's best strategy may be to report it to the appropriate authorities. If the company does so prior to a government investigation and accepts responsibility for the wrongdoing, it will receive a significant reduction in penalties under the guidelines. [FN26] In the event a company does not discover or cannot report the conduct before the investigation, full cooperation in the investigation and affirmative acceptance of responsibility will also mitigate the severity of the company's sentence under the guidelines.

FNNote 1. Gardner F. Davis is a partner with Foley & Lardner in Jacksonville, where he practices in the areas of corporate law, finance, and bankruptcy. He received his A.B. in 1981 from Dartmouth College and his J.D. from Duke University in 1984. He clerked for Judge Gerald Bard Tjoflat, U.S. Court of Appeals for the 11th Circuit.

FNNote 2. Jeffrey M. McFarland is a corporate attorney in the Jacksonville office of Foley & Lardner. He received his B.A. from University of North Florida and his J.D. with honors in 1995 from the University of Florida, where he was managing editor of the law review.

This column is submitted on behalf of the Business Law Section, Paul S. Singerman, chair, and Diane Noller Wells, editor.


[FN10]. See *id.*; U.S.S.G. §8A1.2, comment n. 3(k).


[FN16]. See *Southern Bell Tel. & Tel. Co. v. Deason*, 632 So. 2d 1377, 1385-86 (Fla. 1984).


[FN21]. U.S.S.G. §8A1.2, comment n. 3(k).

[FN22]. See also U.S.S.G. §8C2.5(f).


[FN26]. U.S.S.G. §8C2.5(g)(1).

END OF DOCUMENT