

Impact of New Amendments to Sentencing Guidelines on Compliance & Ethics Programs

On April 29, 2010, the U.S. Sentencing Commission submitted to Congress proposed amendments to the Federal Sentencing Guidelines for organizations.¹ Most importantly, the amendments establish conditions that, if met, permit a company's compliance and ethics program to be deemed effective even if high-level personnel were involved in the offense. In addition, the amendments add commentary as to what a company must do to satisfy the requirement to take reasonable steps, once an offense has been detected, to respond appropriately and prevent similar future violations. Finally, the amendments expand and simplify the recommended conditions of probation for organizations, by eliminating the distinction between conditions imposed solely to enforce a monetary penalty and conditions imposed for other reasons.

The current enforcement environment highlights the importance of a robust compliance and ethics program, and companies should consider whether changes to their programs are merited as a result of these amendments. While a detailed discussion of the Federal Sentencing Guidelines is beyond the scope of this memorandum, we highlight below key elements of the amendments for practitioners engaged in designing and executing effective compliance and ethics programs.

Current Guidelines

- Under the Federal Sentencing Guidelines, an effective compliance and ethics program enables the company to qualify for a three-point reduction in its culpability score. Depending on other factors, this often results in a significantly lower Guidelines penalty to be imposed on the corporation.
- Under the current Guidelines, in order to have an effective compliance and ethics program, a company must (a) exercise due diligence to prevent and detect criminal conduct, and (b) otherwise promote an organizational culture that encourages ethical

¹ The amendments will automatically take effect on November 1, 2010, unless Congress adopts legislation rejecting them.

conduct and a commitment to compliance with the law. To meet the latter test, the program must fulfill specified minimum requirements.²

- While criminal convictions of companies are rare, an effective program has benefits beyond possibly qualifying the company for a reduced sentence in a worst-case scenario.
 - o The DOJ and SEC, as well as other regulators, will take a company's compliance program into account in exercising their discretion in deciding what action to take regarding alleged violations.
 - o A robust compliance and ethics program can assist the board in fulfilling its oversight responsibilities.

Amendment to Make Sentence Reduction Credit More Available

- Currently, three-point sentence reduction credit for an effective compliance and ethics program is not available if a member of “high-level personnel”³ participated in, condoned, or was willfully ignorant of the wrongdoing. The proposed amendment would eliminate this automatic disqualification.
- But – in that case, four conditions must be met to qualify for the credit, including that the individual(s) with operational responsibility for the compliance and ethics program must have direct reporting obligations to the board (or a committee of the board).⁴

² These minimum requirements include: (1) standards and procedures to prevent and detect criminal conduct; (2) the company's board is knowledgeable about the content and operation of the compliance and ethics program and exercises reasonable oversight with respect to its implementation and effectiveness; (3) reasonable efforts not to include in the company's substantial authority personnel anyone whom the company knew or should have known has engaged in illegal activities or other conduct inconsistent with an effective compliance and ethics program; (4) reasonable steps to communicate the program's standards, procedures and other aspects throughout the company (including through training); (5) reasonable steps to ensure the program is followed (including monitoring and auditing to detect criminal conduct), to evaluate periodically the program's effectiveness, and to have and publicize a system whereby the company's employees and agents may report potential or actual criminal conduct without fear of retaliation; (6) promoting and enforcing the program consistently throughout the organization through appropriate incentives and disciplinary measures; and (7) after criminal conduct has been detected, reasonable steps to respond appropriately to the criminal conduct and to prevent further similar criminal conduct, including making any necessary modifications to the program.

³ “High-level personnel” include directors, executive officers, individuals in charge of major business or functional units of the organization, and individuals with substantial ownership interests.

⁴ The other three conditions are: (1) the compliance and ethics program detected the offense before discovery outside the organization or before such discovery was reasonably likely; (2) the organization promptly reported the offense to appropriate governmental authorities; and (3) no

- o The requirement of having “direct reporting obligations” means that the responsible person has express authority to communicate personally to the board or an appropriate committee (a) promptly on any matter involving criminal conduct or potential criminal conduct and (b) no less than annually on the implementation and effectiveness of the compliance and ethics program.
- Practical implications
 - o Does the person with operational responsibility for the program currently have the authority to communicate directly with the board of directors? Or does that person instead report to the general counsel (or another member of senior management), who in turn communicates directly with the board?
 - In the latter case, companies should consider whether to give the person with operational responsibility the authority to communicate directly to the board.
 - o To ensure there is “express authority,” the reporting line to the board (or a board committee) should be formalized in writing (e.g., in a board resolution, committee charter or policy).
 - o Direct communication may eliminate a filter (such as the general counsel) on the matters that are raised to the board level and the timing of those communications.
 - If so, the board should be educated about this change.
 - Companies may wish to implement procedures to help evaluate concerns that are raised through this new channel and to ensure they are addressed appropriately.
 - o Companies should consider whether it makes sense to have reporting obligations run to the full board, to the audit committee, or to a different committee.
 - Audit committees often have compliance-related responsibilities, including establishment of whistleblower procedures.
 - However, be aware of potential for audit committee overload, particularly if a new reporting channel will be established; it is important to have the right procedures in place.
 - o The fundamentals of an effective compliance and ethics program have not changed.

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