A white rope is tied in a loop on a textured brown background. The rope is thick and braided, and the loop is large and open. The background has a fine, grainy texture.

Conducting
Business in The
Twenty-First
Century:

**How to
Avoid
Organizational
Suicide**

(Part 1)



“[I]t is organizational suicide not to have a corporate compliance plan.”

This was not true two decades ago. It is today for every business, from large, publicly-owned companies, to small, closely-held family businesses. Among other things, this means that any lawyer who advises a business client without ensuring that the client has an effective, updated, corporate compliance plan risks committing legal malpractice.

This is the first in a series of three articles addressing corporate compliance. This article discusses how and why corporate compliance is important in today’s commercial world. The second article reviews the components of an effective corporate compliance plan.² The third focuses on responding to a problem of non-compliance.³

The combined impact of the following six events over the past 20 years have made effective corporate compliance a necessary part of the duty of due care: (1) promulgation of the *Federal Guidelines for Sentencing Organizations* by the United States Sentencing Commission; (2) the focus on corporate compliance by the United States Department of Justice when deciding whether to charge a business entity with a crime; (3) passage of Sarbanes-Oxley; (4) court decisions holding directors personally liable for failing

to ensure that a business has an effective corporate compliance plan; (5) amendments to, and passage of, civil statutes such as federal and state False Claims acts, which significantly reduce damages and penalties when a defendant exercises “good” corporate citizenship; and (6) market responses to the exercise of “good” and “bad” corporate compliance. Together, these events make an effective corporate compliance program essential for every business.

Recent Events Making Effective Corporate Compliance a Key Part of the Exercise of “Due Care”

In 1986, the United States Sentencing Commission,⁴ an agency within the federal judiciary branch, began drafting guidelines for sentencing businesses which had been convicted of crimes. By 1991, the Commission had promulgated the *Federal Guidelines for Sentencing Organizations*.⁵ These Sentencing Guidelines make a strong statement about corporate compliance. They provide a steep reduction in the sentence (potentially up to 95 percent) for any

**By Pamela H. Bucy and
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organization that had in place at the time of the offense an effective compliance and ethics program.⁶ The Sentencing Guidelines also provide considerable detail about what constitutes an effective compliance plan, including: “standards and procedures to prevent and detect criminal conduct;” ensuring that “[h]igh-level personnel [have] overall responsibility for the compliance and ethics program,” providing “effective training programs,” supplying anonymous and confidential mechanisms for reporting of suspected violations of the law; establishing regular monitoring and evaluation procedures to assess the effectiveness of a compliance program.⁷

At the same time the U.S. Sentencing Commission was developing its sentencing guidelines, the U.S. Department of Justice was drafting guidelines for its prosecutors to determine whether to criminally charge a corporation, partnership or other fictional entity. These guidelines, known as the *Principles of Federal Prosecution of Business Organizations*,⁸ also focus on corporate compliance programs. Revised most recently in 2008, they direct federal prosecutors to consider, before indicting a business, the “existence and effectiveness of the corporation’s pre-existing compliance program.”⁹ Like the Sentencing Guidelines, the *Principles of Prosecution* provide detail about effective corporate compliance, essentially identifying the same components as the Sentencing Guidelines.¹⁰

Because of these developments by prosecutors and the sentencing commission, a

business now may be able to avoid indictment altogether, negotiate lesser charges or receive a lesser sentence if convicted, simply by having an effective corporate compliance program in place at the time a criminal offense may have occurred. This is important because the existing standard for imposing criminal liability on fictional entities is so broad, essentially imposing strict liability on businesses. Under federal law and most state law, fictional entities are subject to criminal liability under an expansive “respondeat superior” standard which provides that entities “may be held criminally liable for the acts of any of its agents [who] (1) commit a crime (2) within the scope of employment (3) with the intent to benefit the corporation.”¹¹

The third key development regarding corporate compliance came from Congress. Following the lead of the Sentencing Commission and the Department of Justice, Congress highlighted the importance of corporate compliance programs by enacting, in 2002, Sarbanes-Oxley (“SOX”).¹² Among other things, SOX imposes civil and criminal liability for failure to ensure that a business has an effective corporate compliance program. Many of SOX’s provisions apply only to publicly-held companies. For example, SOX requires the CEO and CFO of a publicly listed company to certify that the company has effective internal controls for financial reporting in place.¹³ Criminal penalties of up to 20 years in prison attach to false certifications.¹⁴ SOX also requires external auditors of publicly listed companies to issue annual assessments of the effective-

ness of a company’s internal controls over financial reporting.¹⁵ As one might imagine, one response to these SOX provisions has been a greater emphasis by business leaders to the effectiveness of internal controls. Effective internal controls are at the heart of any corporate compliance plan.

Privately-held companies are also affected by SOX. Some of SOX’s broadest provisions, the new obstruction of justice offense,¹⁶ for example, apply to every business, private and public, small and large. Section 802 of SOX makes it a crime, punishable by imprisonment up to 20 years, to alter, destroy, conceal, cover up, falsify, or make a “false entry in any record, document...with the intent to...obstruct or influence the investigation...of any matter within the jurisdiction of any department or agency of the United States...or in relation to or contemplation of any such matter or case....” (emphasis added)¹⁷. Section 1102 of SOX makes it a crime, punishable by imprisonment up to 10 years, for “hinder[ing], delaying[ing] or prevent[ing] the communication to a law enforcement officer...of information relating to the...possible commission of a federal offense.”¹⁸ Both of these provisions are exceptionally broad, applying before there is even an investigation (“in relation to or contemplation of...an investigation”¹⁹ and to “the possible commission of a federal offense”²⁰).

The fourth key development has been by the courts in business litigation matters. Over the past 20 years, various courts have begun emphasizing duties of corporate compliance. For example, the Delaware Chancery Court, one of the most signifi-

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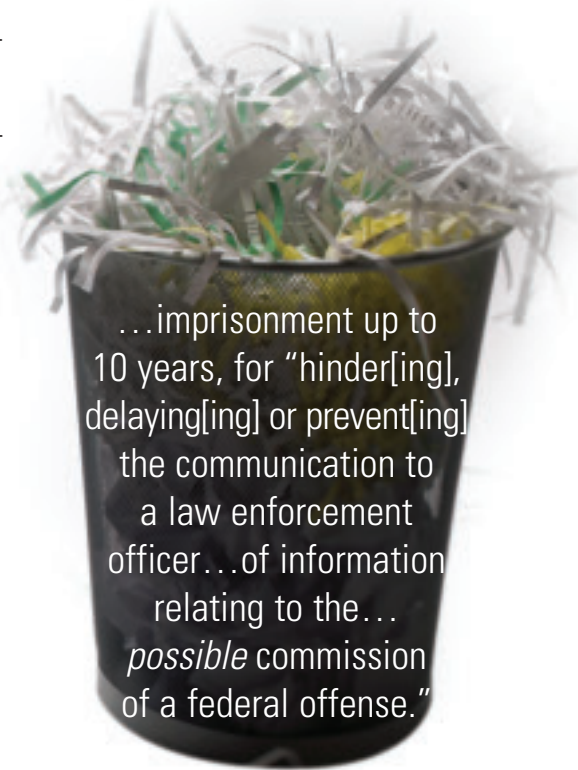
cant courts in corporate matters, held in *In re Caremark International Inc. Derivative Litigation*,²¹ a shareholder derivative action, that “a director’s obligation includes a duty to...assure that a corporate information and reporting system...exists, and that failure to do so...may...render a director liable for losses caused....”²² Thus, officers and directors now face “*Caremark*” liability for failure to ensure that their company has an effective corporate compliance program in place.

The fifth key development affecting corporate compliance has been the passage, or amendment to, “aggressive civil” statutes, such as the federal²³ and state²⁴ False Claims acts (FCAs). These statutes create a cause of action on the part of any person, as well as governmental entities, against anyone who submits false claims for payment to federal or state governments. These statutes also carry significant damages and penalties,¹ with recent cases settling for amounts such as \$900,000,²⁶ \$731,400²⁷ and \$650,000.²⁸

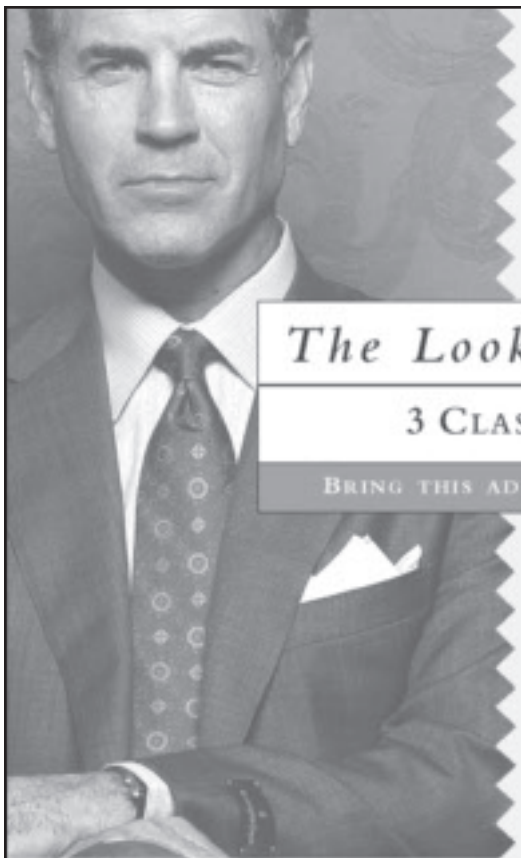
There are two provisions in the federal and state FCAs that encourage businesses to implement and maintain effective corporate compliance plans. The first and most

significant incentive is possible prevention of an FCA lawsuit altogether. The federal, and virtually all state, FCAs include a *qui tam* provision that permits any person, known as a “*qui tam* relator,” to file a complaint under the statute. Because historically most relators are current or former employees,²⁹ an effective corporate compliance plan is one of the best ways to preempt these individuals from filing cases as relators. Here’s why: a corporate compliance plan should require employees to report internally their suspicions of false claims or fraud.³⁰ The company then has notice of the fraud, can conduct an internal investigation and make necessary disclosure of the problem to authorities. It is this disclosure that preempts the false claim lawsuit by individuals because once the government knows of the fraud, private individuals are “jurisdictionally barred” from filing suit under the FCAs.³¹

The second incentive in FCAs for businesses to implement effective corporate compliance plans is reduction in the otherwise mandatory damages and penalties for companies that exercise “good” corporate compliance. The FCAs provide that treble damages shall be reduced to double dam-



...imprisonment up to 10 years, for “hinder[ing], delaying[ing] or prevent[ing] the communication to a law enforcement officer...of information relating to the... possible commission of a federal offense.”



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ages and that all penalties can be avoided if a defendant discloses to authorities, prior to official discovery of any false or fraudulent claims, that the statute may have been violated.³² Again, since internal investigations and disclosure to authorities are key components of any effective corporate compliance plan, FCAs encourage businesses to implement and maintain plans and make disclosures pursuant to them.

The reaction of the market is the final event that solidifies the need for every business to implement an effective corporate compliance plan. The market rewards “good” corporate citizenship and punishes “bad” corporate behavior. The New York Stock Exchange and NASDAQ, for example, require that companies have effective corporate compliance plans.³³ Directors’ and officers’ insurance policies assess the effectiveness of a company’s corporate compliance plan as part of their underwriting process.³⁴ Merger and acquisition due diligence now includes an assessment of a target company’s corporate compliance plan. Stock prices react to exercises of good, or bad, corporate behavior. To take one example, beginning in 2004, Marsh & McLennan, one of the largest financial brokerage companies³⁵ was investigated (and ultimately settled a civil suit) for accounting fraud.³⁶ On October 14, 2005, the day New York Attorney General Eliot Spitzer announced that his office was investigating Marsh Inc. and that the company was not cooperating with investigators, the price of Marsh’s stock dropped 24 percent. Over the next two days, as Marsh leadership stonewalled (announcing it had confidence in the current leadership and cancelling a scheduled investor conference call), the company stock sank another 18 percent. Two days later, the company did an about-face. Its independent directors announced that the company had fired the presumptively culpable executives, was conducting an internal investigation and would cooperate with the attorney general’s investigation. Immediately, the company’s stock jumped 20.4 percent. As this example shows, for better or worse, candor about possible compliance problems and cooperation with authorities is viewed by the investing public as “good” corporate citizenship while stonewalling is viewed as “bad” corporate behavior.³⁷ Such candor and cooperation are facilitated by an effective corporate compliance plan.


What These Events Mean for Businesses Today

There are four notable features about this activity regarding corporate compliance by the Sentencing Commission, the Department of Justice, Congress, the states, private industry, and the market. First, the emphasis on effective corporate compliance has been increasing for more than 20 years. It is not a temporary trend that will ebb and flow. Good corporate compliance is now entrenched as good business basics.

Second, the emphasis on good corporate compliance has become mainstreamed. What started as a factor relevant in the fairly narrow world of white collar crime and criminal sentencing and charging decisions, has permeated every aspect of business, including insurance rates, stock prices, company value and personal liability of directors and officers.

Third, criminal and “aggressive civil” prosecutions of businesses are almost certainly to increase. The glut of fraud in the financial services industry, the attention such fraud is getting from law enforcement and the plaintiffs’ bar, and the existing prosecutorial infrastructure, all make criminal corporate prosecutions and plaintiffs’ fraud suits more, not less, likely. Thus, it is all the more crucial for businesses to protect themselves from such liability. Maintaining an effective corporate compliance plan is a viable way to do so.

Fourth, because the emphasis on corporate compliance has permeated every aspect of the business world, developing an effective corporate compliance plan is a multi-faceted endeavor, requiring a variety of legal expertise: employment law, corporate financing, corporate governance and criminal law and procedure.

For all of these reasons, effective corporate compliance plans are now a necessity for every business. 

Endnotes

1. Pamela H. Bucy, HEALTH CARE FRAUD: ENFORCEMENT AND COMPLIANCE § 9.01 (Law Journal Seminars Press, with authors Robert Fabrikant, Paul E. Kalb, M.D. and Mark D. Hopson) quoting Karen Morrisette, deputy chief, Fraud Section Criminal Division, United States Department of Justice.

2. Pamela H. Bucy and Anthony A. Joseph, *Creating an Effective Corporate Compliance Plan*, ___ ALA. LAW. ___ (___).
3. Pamela H. Bucy and Anthony A. Joseph, *Corporate Compliance: When A Problem Occurs*, ___ ALA. LAW. ___ (___).
4. The United States Sentencing Commission (U.S.S.G.) was created under the Sentencing Reform Act of 1984, 28 U.S.C. §§ 991-998.
5. U.S.S.C., United States Sentencing Guidelines (U.S.S.G.), Chapter 8
6. U.S.S.C., Chapter Eight, Introductory Commentary.
7. U.S.S.G. §8B2.1.
8. UNITED STATES DEPARTMENT OF JUSTICE, UNITED STATES ATTORNEYS’ MANUAL, § 9.28.000 *et seq.* [hereinafter *Principles of Federal Prosecution*]
9. *Id.* at § 9.28.300.
10. *Id.* at § 9.28.800.
11. *Developments in the Law—Corporate Crime: Regulation Corporate Behavior Through Criminal Sanctions*, 82 HARV. L. REV. 1127, 1247 (1979), discussed in Pamela H. Bucy, *Corporate Ethos: A Standard for Imposing Corporate Criminal Liability*, 75 MINN. L. REV. 1095 (1991).
12. Public Company Accounting Reform and Investor Protection Act of 2002, known as Sarbanes-Oxley (SOX), Pub. L. 107-204, 116 Stat. 745 (July 30, 2002).
13. SOX § 302 codified at 15 U.S.C. § 7241(a)(4) and SOX § 906 codified at 18 U.S.C. § 1350; SEC Final Rule 33-8124.
14. 18 U.S.C. § 1350.
15. SOX § 404 codified at 15 U.S.C. § 7262; Public Company Accounting Oversight Board (PCAOB) Auditing Standard No. 5; SEC Interpretative Guidance.
16. 18 U.S.C. §§ 1512 (a)(1)(C); 1519.
17. 18 U.S.C. § 1519.
18. 18 U.S.C. § 1512(a)(2)(C).
19. 18 U.S.C. § 1519.
20. 18 U.S.C. § 1512(a)(2)(C).
21. 698 A.2d 959 (De. Ch. 1996).
22. *Id.* at 970.
23. 31 U.S.C. §§ 3729-3733.
24. *See, e.g.* CAL. GOV’T CODE §§ 12650-12655 (1992); FLA. STAT. § 68.081 (2007) *et seq.*; TENN. CODE ANN. § 4-18-101 (2001). The Deficit Reduction Act of 2005, Pub. L. 109-171, 120 Stat 4 *amending* the Social Security Act, 42 U.S.C. § 1396(h)(b) (enacted Feb. 8, 2006).
25. *See, e.g.* 31 U.S.C. §§ 3730.
26. Tenet Healthcare, 2006, TAXPAYERS AGAINST FRAUD, [HTTP://WWW.TAF.ORG](http://www.taf.org).
27. HCA (The Healthcare Company, formerly known as Columbia/HCA), TAXPAYERS AGAINST FRAUD, [HTTP://WWW.TAF.ORG](http://www.taf.org).
28. Merck, 2008, TAXPAYERS AGAINST FRAUD, [HTTP://WWW.TAF.ORG](http://www.taf.org).
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