
Pending Amendments to the Organizational Sentencing Guidelines: Changes in the Wind

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ETHICS AND COMPLIANCE SERVICES

On April 8, 2004, the United States Sentencing Commission (the “Commission”) approved changes to the Sentencing Guidelines for Organizational Defendants. Those changes, which the Commission transmitted to Congress on May 1, 2004,¹ will take effect on November 1, 2004, unless Congress acts to change that date or to change the Commission’s proposal.

The Guidelines, which the Commission adopted in 1991, described seven “due diligence” elements by which to measure the effectiveness of a corporate compliance program. The 2004 Changes add considerable detail as to what, in the Commission’s view, organizations must do for their programs to be viewed as effective. Some of those changes derive from the provisions and goals of the Sarbanes-Oxley Act of 2002 (“Sarbanes-Oxley”) while the Commission reviewed information about experiences with corporate compliance programs in order to develop other changes.²

Highlights of the 2004 Changes include new requirements that:

- Boards of directors and executives take an active leadership role with respect to the content and operation of their companies’ corporate ethics and compliance programs.
- Companies promote an organizational culture that encourages a commitment by employees to compliance with the law and ethical conduct.
- Corporate ethics and compliance training for employees – including senior management and the board – is now specifically required and must be “effective.” This training should be appropriate to these employees’ “respective roles and responsibilities.”
- Companies must now periodically evaluate the overall “effectiveness” of their compliance and ethics programs. As part of that process, they must periodically conduct risk assessments to evaluate the likelihood of criminal conduct.
- Companies must have systems in place to allow employees, anonymously if they prefer, to report compliance and ethics violations. Such a system also must provide employees with a means of seeking guidance on ethical and legal compliance issues.
- Companies must give their compliance officers sufficient authority and resources to implement effective corporate ethics and compliance programs.

Background

¹ http://www.usssc.gov/FEDREG/05_04_notice.pdf. We refer to the changes approved on April 8 as the “2004 Changes” and the original Sentencing Guidelines for Organizational Defendants simply as the “Guidelines.” References to the 2004 Changes appear in the form “§8B2.1[],” whereas references to the Guidelines appear as “§8A[]” or “§8C[].”

² The Commission based the 2004 Changes, to a large degree, on recommendations of an Ad Hoc Advisory Group on the Organizational Guidelines (the “Advisory Group”). Those recommendations appear in the Advisory Group’s report dated October 7, 2003. See note 11, *infra*.

Some historical background will place the 2004 Changes in context. By means of the Sentencing Reform Act of 1984,³ Congress sought to introduce into the sentencing process greater certainty and uniformity of sentence by federal judges. By that statute, Congress created the Commission and abolished the United States Parole Commission, empowering the former “to devise guidelines to be used for sentencing.” *Mistretta v. United States*, 488 U.S. 361 (1989).

The Commission first drafted sentencing guidelines in 1987 to apply to the sentencing of (1) individuals and (2) organizations sentenced for violation of the antitrust laws.⁴ The Commission conducted research, collected data and invited submissions by various working groups before submitting to Congress in 1991 a set of sentencing guidelines for organizational defendants.⁵

The Commission determined to write guidelines that would create incentives by which organizations would have reason to prevent crimes by their employees and agents, rather than rely solely on retroactive punishment to deter corporate criminal conduct.⁶ The Commission therefore included with the Guidelines criteria by which a judge could gauge whether he or she should deem an organization’s compliance program effective.⁷

Even though the Guidelines apply, by their terms and by the terms of the statute pursuant to which they were written, only when an organization is being sentenced after having been found guilty of violating a federal criminal law, they’ve impacted corporate structure and behavior more generally. For example, soon after the Guidelines appeared, the Ethics Officers Association (EOA) came into existence, with twelve members. EOA has almost 1,000 members today, including more than one-half of the Fortune 100.⁸ The Guidelines have been credited with the development of the position of ethics and compliance officer.⁹ Surveys by EOA indicate that corporate behavior has changed on account of the Guidelines and the standards that they impose, through the prospect of sentencing, on corporate compliance programs.¹⁰

The 2004 Changes

As the ten-year anniversary of the Guidelines approached, the Commission established the Advisory Group “to review the general effectiveness of [those] guidelines” and to “examin[e] the criteria for an effective program to ensure an

³ 18 U.S.C. §3551 *et seq.*

⁴ Otherwise, the sentencing guidelines promulgated in 1987 did not apply to organizations in respect of violations of other types of laws. Murphy, *The Federal Sentencing Guidelines for Organizations: A Decade of Promoting Compliance and Ethics*, 87 Iowa L. Rev. 697, 699 n. 6 (2002).

⁵ *Id.*, at 700-701.

⁶ Incarceration, one of the primary means of penalizing individuals who violate the law, is ineffective as punishment for organizations, which are not corporeal beings.

⁷ The Guidelines themselves merely provided that “[i]f the offense occurred despite an effective program to prevent and detect violations of law, subtract 3 points” from the organization’s culpability score.

§8C2.5(f). The criteria by which to measure a compliance program’s effectiveness appear in the form of a definition of the term “effective program to prevent and detect violations of law” in application note 3(k) to §8A1.2 of the Guidelines.

⁸ See <http://www.eoa.org/AboutEOA.asp>.

⁹ Murphy, *supra* n. 4, at 710. EOA’s survey of its membership in 2000 revealed that only 15% of the respondents reported that their positions (ethics officer, however titled) were created in or prior to 1991 (when the Guidelines were first written), while 86% were created after the Guidelines appeared. See page 11 of the public version of that survey, which appears at

[http://www.eoa.org/EOA_Resources/Reports/MS2000_\(PublicVersion\).pdf](http://www.eoa.org/EOA_Resources/Reports/MS2000_(PublicVersion).pdf). (We refer to this survey as “EOA’s 2000 Survey.” Rounding of the percentages of responses undoubtedly leads to the total of 101%.)

¹⁰ Of the respondents to EOA’s 2000 Survey, 53% reported that the Guidelines had “a lot of influence” on their organizations’ commitment to ethics. See EOA’s 2000 Survey, p. 14.

organization's compliance with the law."¹¹ The Advisory Group invited participation by various interested parties, analyzed data regarding the operation of the Guidelines and ultimately submitted to the Commission a report containing very specific recommendations as to how the Guidelines should be changed. Ultimately, about six months after receiving the Advisory Group Report, the Commission issued the 2004 Changes. The Commission's action tracks the Advisory Group's recommendations in most, but not all, respects.¹² Much as the Guidelines have animated the designs of many corporate compliance programs, the 2004 Changes likely will lead to substantial differences in how such programs are measured by various audiences in addition to the federal government and in many contexts besides criminal sentencing proceedings.

After reviewing the Commission's proposals, one can identify several themes that should affect further compliance program developments. Those developments will contribute to the continued maturation of such programs. They also present some challenges and opportunities for in-house counsel, compliance professionals and others who deal with corporate compliance and ethics.

We make two general observations about the 2004 Changes and review several specific provisions. First, the Commission has made ethics a more central and more-explicit focus than it had previously. The Guidelines had made the prevention and detection of criminal conduct their goal. Now, "[t]o have an effective compliance and ethics program ... an organization shall – (1) exercise due diligence to prevent and detect criminal conduct; and (2) **otherwise promote an organizational culture that encourages ethical conduct** and a commitment to compliance with the law." §8B2.1(a) (emphasis added).¹³

Second, the 2004 Changes continue the trend of focusing attention on the role, in the context of a corporate compliance program, of a corporation's board of directors. Under Sarbanes-Oxley, the audit committee of the board of directors of a company whose securities are publicly traded must create and manage a process by which a company's employees and others can submit concerns or issues with respect to the company's financial and accounting practices (among other things).¹⁴ The 2004 Changes build on and extend that responsibility more directly into the operation of the company's compliance and ethics program.

The 2004 Changes likely will lead to more formal and institutionalized ethics and compliance programs,¹⁵ at least at larger organizations.¹⁶ Reporting relationships for those employees involved in the programs will become clearer and carry greater weight.

¹¹ "Report of the Ad Hoc Advisory Group on the Organizational Sentencing Guidelines" (October 7, 2003), p. 1. That report, which we refer to as "Advisory Group Report," is available at http://www.uscc.gov/corp/advgrprpt/AG_FINAL.pdf.

¹² One significant difference between the Advisory Group's recommendations and the 2004 Changes relates to the scope of a compliance program. Whereas the Advisory Group "emphasize[d] that an effective compliance program should be aimed at preventing not just criminal activities within organizations, but rather all 'violations of law,'" (Advisory Group Report, p. 54), the 2004 Changes only direct that an ethics and compliance program be designed "to prevent and detect criminal conduct." §8B2.1(a)(1). The Commission did not explain why it narrowed the focus of the 2004 Changes from that recommended by the Advisory Group. Perhaps the fact that the Commission's primary role is to introduce greater uniformity to criminal sentences underlies that change.

¹³ "A comprehensive ethics and compliance program [as opposed to a program aimed only at compliance] attempts to challenge the organization continually to embrace true integrity and do what is right, not only what the law requires." Lajoie and Lauer, *Business Ethics and Compliance – Establishing an Effective Program*, *The Lawyer's Brief*, vol. 34, no. 3, p. 2 (Feb. 14, 2004).

¹⁴ This requirement appears in §301 of Sarbanes-Oxley. See pp. 7-8, *infra*.

¹⁵ If this occurs, it would represent a reversal of a possible trend identified by EOA, which reported that 54% of the respondents to its survey in 2000 indicated that they were full-time ethics officers while 61% of respondents to its survey three years earlier were full-time ethics officers. EOA's 2000 survey, p. 5.

Some of the more significant specific provisions of the 2004 Changes¹⁷ and the explanations provided by the Advisory Group of the purpose of each are the following:

- The “governing authority”¹⁸ of an organization “shall be knowledgeable about the content and operation ... and shall exercise reasonable oversight with respect to implementation and effectiveness of the compliance and ethics program.” To enable that group to stay on top of the operation of that program, the Commission added elsewhere the requirement that the “[i]ndividual(s) with operational responsibility [for the program] shall report periodically to high-level personnel and, as appropriate, to the governing authority ..., on the effectiveness of the compliance and ethics program.”¹⁹

According to the Advisory Group, “greater specification of the roles of organizational leadership in the organizational sentencing guidelines [was] essential.” Advisory Group Report p. 57. As the Advisory Group explained,

- The knowledge about program features and operations that members of a governing authority should gain includes: practical management information about the major risks of unlawful conduct facing their organization; the primary compliance program features aimed at counteracting those risks; and, the types of problems with compliance that the organization and other parties with similar operations have encountered in recent activities.

Id., at 60. The Advisory Group also expects that the governing authority will “exercise reasonable oversight of the implementation and effectiveness of an organization’s program to prevent and detect violations of law.” *Id.*, at 61. This certainly suggests that the board of directors of a corporation, which traditionally has merely overseen management’s activities without direct involvement, should be more involved and proactive in the company’s day-to-day activities in respect of ethics and compliance concerns.

- The Commission distinguished the responsibility to “ensure that the organization has an effective program” from “day-to-day operational responsibility” for the program. The former responsibility must be lodged with “high-level personnel” within the organization.²⁰

¹⁶ The Commission explicitly recognized that large and small organizations might be able to accommodate different levels of formality in their compliance efforts. See application note 2(C) to §8B2.1.

¹⁷ This is not a comprehensive list of the changes adopted by the Commission.

¹⁸ The Commission used this term to denote the “Board of Directors; or ... if the organization does not have a Board of Directors, the highest-level governing body of the organization.” §8B2.1, application note 1.

¹⁹ The phrase “as appropriate” seems to make this provision permissive rather than mandatory. At another point in the 2004 Changes, however, the Commission indicates that the individual who has day-to-day operational responsibility for the program “*should*, no less than annually, give the governing authority or an appropriate subgroup thereof information on the implementation and effectiveness of the compliance and ethics program.” §8B2.1, application note 3 (emphasis added). While still not mandatory, such a direct presentation by the employee who is directly involved in the compliance program’s operation seems to be preferred and strongly advised.

²⁰ The term “‘high-level personnel of the organization’ means individuals who have substantial control over the organization or who have a substantial role in the making of policy within the organization.” §8A1.2, application note 3(b). Examples provided by the Commission include directors, executive officers, individuals in charge of major business or functional units and individuals with substantial ownership interests.

The Advisory Group had clarified the need that operational responsibility be lodged in a specific individual so as to achieve greater clarity as to reporting and oversight. That group explained as follows:

The proposed changes to this portion of the definition of an effective compliance program are aimed at clarifying the compliance responsibilities and activities of key organizational officials. The proposal gives separate attention to the roles of three types of organizational officials: members of an organization's governing authority, executives comprising an organization's managerial leadership, and one or more individuals having primary responsibility for the organization's program to prevent and detect violations of law.

Id., at 60. The Commission's action represents a crisper distinction than the Advisory Group's recommendation, however, between the individual to whom the organization delegates overall responsibility for the program and the individual to whom responsibility is given for day-to-day operation of the program. The Commission clarified later in the 2004 Changes that, if the individual who has day-to-day responsibility²¹ is not the same individual who has overall operational responsibility for the program, then the former "should, no less than annually, give the governing authority or an appropriate subgroup thereof information on the implementation and effectiveness of the compliance and ethics program." §8B2.1, application note 3. Bifurcating the overall and day-to-day responsibilities ought not be allowed to hinder a corporation's board of directors from receiving directly the information described in that provision.²²

- The 2004 Changes elevate and formalize the risk assessment in which an organization should engage when designing and operating its compliance and ethics program. The risk assessment should measure "the risk of criminal conduct."²³ The Commission elaborated on the risk assessment process in application note 6.

A "risk assessment to determine the scope and nature of risks of violations of law associated with an organization's activities should be ongoing." Those assessments should be used to create the compliance program and to fine-tune it in light of experience over time. Advisory Group Report, p. 90.

- Whereas the Guidelines could have been read to suggest that employee training was but one means of "tak[ing] steps to communicate effectively [the organization's] standards and procedures to all employees and other agents,"²⁴ the 2004 Changes now make it clear that the organization must "take reasonable steps to communicate periodically and in a practical manner its standards and procedures ... **by conducting effective training programs** and otherwise disseminating information appropriate to such individuals' respective roles and responsibilities." §8B2.1(b)(4)(A) (emphasis added).

This change to the Guidelines had two purposes: to eliminate confusion as to whether or not training is compulsory and to strengthen the dissemination throughout an organization of its commitment to ethical behavior and compliance with law. "[A]ll organizations should engage in some form of active compliance training" and "personnel

²¹ The Commission thereby suggested that divided responsibility – overall versus day-to-day – need not be lodged in separate individuals.

²² In the opinion of the Advisory Group, "[t]he reporting envisioned by this new commentary would periodically supplement, but not replace, reporting by the individual(s) with overall program responsibility." Advisory Group Report, p. 63.

²³ §8B2.1(c).

²⁴ §8A1.2, application note 3(k)(4).

at all levels ... should be made aware of their compliance responsibilities - from the governing authority right down, as appropriate, to organizational agents.” Advisory Group Report, p. 71. The 2004 Changes also highlight that the training should be specific to the needs of the individuals to be trained (*i.e.*, risk-based training).²⁵

- The 2004 Changes suggest that large organizations,²⁶ at least, “should encourage small organizations (especially those that have, or seek to have, a business relationship with the large organization) to implement effective compliance and ethics programs.”²⁷

The Advisory Group made no recommendation to the Commission along these lines.

Possible impact of the 2004 changes and recommendations

One should attempt to predict the possible impact of the 2004 Changes only in light of the environment in which businesses operate. In other words, the 2004 Changes will not work in isolation.

As important as the 2004 Changes may be in the context in which they apply directly (*i.e.*, when an organization has been convicted of a federal crime and awaits its sentence), the reality is that relatively few businesses are likely to find themselves in that situation. Nonetheless, businesses clearly have recognized that the standards contained in the Guidelines, as to what constitutes an effective compliance program, provide value in a broader range of contexts.²⁸

There are two areas in which the 2004 Changes likely will present some particularly noteworthy opportunities and challenges. Both areas relate to civil litigation. Several other trends might accelerate on account of the 2004 Changes.

Director liability

Directors of a corporation might face a claim of liability for their decisions and for their inaction when action was called for. Courts will not second-guess decisions of a corporation’s board of directors if those decisions qualify for the “business judgment rule.” Under that standard, courts generally review the process by which the directors made the decision in question and “where a director in fact exercises a good faith effort to be informed and to exercise appropriate judgment, he or she should be deemed to satisfy fully the duty of attention.” *In re Caremark International Inc. Derivative Litigation*, 698 A. 2d 959, ___ (1996). With respect to the second type of claim (*i.e.*, inaction when action was called for), “absent grounds to suspect deception, neither corporate boards nor senior officers can be charged with wrongdoing simply for assuming the integrity of employees and the honesty of their dealings on the company’s behalf.” *Id.*, at ___.

²⁵ The training that is prescribed for various individual employees or groups of employees should be determined on the basis of the risk assessments conducted by the organization. Moreover, the larger an organization is, the more formal the training program might be, with appropriate documentation and dedicated resources and tools. Advisory Group Report, p. 71.

²⁶ A large organization is one with at least 200 employees (the definition of a small organization is one “that, at the time of the instant offense, had fewer than 200 employees.” §8C2.5, application note 1.

²⁷ §8B2.1, application note 2(C)(ii).

²⁸ One important benefit of an effective compliance program that does not relate to the Guidelines is that an organization that is more compliant with the law and with its own processes and policies is much less vulnerable to successful litigation claims. See Weise, “Representing the Corporation: Strategies for Legal Counsel” (Aspen Law & Business 1997), vol. 2, p. 22-5: “a compliance plan may enable your company to handle compliance issues internally without the costs of litigation by demonstrating to employees that wrongful conduct will not be tolerated.”

Section 301 of Sarbanes-Oxley²⁹ requires that the audit committee of the board of directors of a publicly traded corporation “establish procedures for – (A) the receipt, retention, and treatment of complaints received by the [company] regarding accounting, internal accounting controls, or auditing matters; and (B) the confidential, anonymous submission by employees of the [company] regarding questionable accounting or auditing matters.” In the 2004 Changes, the Commission added some further detail to that type of process through its prescription that an organization “have and publicize a system, which may include mechanisms that allow for anonymity or confidentiality, whereby the organization’s employees and agents may report or seek guidance regarding potential or actual criminal conduct without fear of retaliation.” §8B2.1(b)(5)(C).

The combination of Sarbanes-Oxley’s requirement that the audit committee of the board of directors set up an issues-submission procedure and the 2004 Changes’ mandate that the “governing authority” of an organization (*i.e.*, the board of directors, in the case of a corporation) “be knowledgeable about the content and operation of the compliance and ethics program” (which will include the “system ... whereby ... employees and agents may report or seek guidance regarding potential or actual criminal conduct”) may make it increasingly difficult for a board of directors to invoke the business judgment rule successfully. Many courts, when invoking the business judgment rule to insulate a board’s decision from review, predicate that rule’s applicability on the absence of “grounds to suspect deception” (see *Caremark*³⁰). See, for example, *Dellastatious v. Williams*, 242 F. 3d 191 (CA4 2001) (“as long as directors have no knowledge that makes reliance unwarranted, they may rely on financial statements prepared by corporate officers, legal counsel, or public accountants.... [W]here shareholders allege that directors have insufficiently supervised the corporation’s affairs, directors can avoid liability by showing that they attempted in good faith to ensure that an adequate corporate information-gathering and reporting system was in place.”), and *McCall v. Scott*, 239 F. 3d 808 (CA6 2001) (“when director liability is predicated upon ignorance of liability creating activities ‘only a sustained or systematic failure of the board to exercise oversight – such as an utter failure to attempt to assure a reasonable information and reporting system exists – will establish the lack of good faith that is a necessary condition to liability’”). If a board has received information through the mechanism required by Sarbanes-Oxley and augmented by the 2004 Changes, that board may be less able to plead ignorance.

Some sort of duty to investigate likely flows from the existence of the information-gathering system and the notice so conveyed to the board. For that reason, simply setting up a system that permits the submission of such complaints or notices, without a

²⁹ Congress did not impose that requirement directly through the statute but, rather, by mandating that the Securities and Exchange Commission “direct the national securities exchanges and national securities associations to prohibit the listing of any security of an issuer that is not in compliance with the requirements” of certain provisions in the law, including the one quoted in the text. For all intents and purposes, we treat the requirement as if imposed directly by the statute.

³⁰ Interestingly, elsewhere in his opinion in that case, Chancellor Allen of the Delaware Court of Chancery stated that the question of “the board’s responsibility with respect to the organization and monitoring of the enterprise to assure that the corporation functions within the law to achieve its purposes” has acquired “special importance by the increasing tendency, especially under federal law, to employ the criminal law to assure corporate compliance with external legal requirements, including environmental, financial, employee and product safety as well as assorted other health and safety regulations. In 1991, ... the United States Sentencing Commission adopted [the Guidelines] which impact importantly on the prospective effect these criminal sanctions might have on business corporations. The Guidelines set forth a uniform sentencing structure for organizations to be sentenced for violation of federal criminal statutes and provide for penalties that equal or often massively exceed those previously imposed on corporations.” The Guidelines and the 2004 Changes will continue to loom large in Corporate America as did the Guidelines in the *Caremark* decision.

reliable means of confirming or refuting the accuracy of those complaints or notices and then taking appropriate action, might create more liability than it satisfies.

Employee training

The 2004 Changes make employee training a mandatory, rather than optional, element of a compliance program (assuming that an organization wants to have an “effective compliance program”). The Commission was quite explicit about its goal in that regard.³¹ This is consistent with the views of other government officials. The Office of the Inspector General of the federal Department of Health and Human Services, for example, has indicated in guidance documents that “[a] critical element of an effective compliance program is a system of effective organization-wide training on compliance standards and procedures. In addition, there should be specific training on identified risk areas, such as claims development and submission, and marketing practices.” See page 8 of Corporate Responsibility and Corporate Compliance: A Resource for Health Care Boards of Directors, which is posted at <http://oig.hhs.gov/fraud/docs/complianceguidance/040203CorpRespRscGuide.pdf>.³²

Employee training can serve other important corporate interests. Particularly in defending against a claim for punitive damages related to a claim of harassment, for example, a company’s ability to demonstrate that it trained its employees with respect to its policies against such behavior might keep that claim from a jury. See, for example, *Equal Employment Opportunity Commission v. Wal-Mart Stores, Inc.*, 187 F. 3d 1241, 1248 (CA10 1999); *Woodward v. Ameritech Mobile Communications, Inc.*, Civ. No. IP 98-07744-CH/G (March 20, 2000) (“the extent to which an employer has adopted antidiscrimination policies and educated its employees about the requirements of the [applicable statute] is important in deciding whether it is insulated from vicarious punitive liability.’ ... Despite the employer’s adoption of such a policy, the court found in Wal-Mart that the employer had failed to educate employees about its antidiscrimination policy.”).

What additional steps should an employer take, if any, in conjunction with its employee training in order to maximize the benefit that it receives from that training in terms of its compliance with law and its compliance program? An important consideration that courts examine is how well the employer assures itself that the training leads to behavioral change and that the lessons imparted by that training result in attitudes that conform to the policy, at least in their manifestation. For example, in *Lowery v. Circuit City Stores, Incorporated*, 206 F. 3d 431 (2000), a panel of the United States Court of Appeals for the Fourth Circuit stated as follows:

A reasonable juror could infer that [the manager of the company’s Management Recruiting Department] had knowledge of the existence of federal antidiscrimination laws from Circuit City’s evidence that it required every person in management to attend a week-long training seminar that included education on the federal anti-discrimination laws.

* * * * *

While an employer’s institution of a written policy against race discrimination may go a long way toward dispelling any claim about the employer’s reckless or malicious state of mind with respect to racial

³¹ “The organization shall take reasonable steps to communicate periodically and in a practical manner its standards and procedures, and other aspects of the compliance and ethics program, to the [organization’s employees and, as appropriate, agents] by conducting effective training programs and otherwise disseminating information appropriate to such individuals’ respective roles and responsibilities.” §8B2.1(b)(4)(A).

³² “Training is an important element of any ethics and compliance program.” Lajoie and Lauer, *supra*, n. 13, at 4.

minorities, such a policy is not automatically a bar to the imposition of punitive damages.... Here, the sincerity of Circuit City's commitment to a company-wide policy against racial discrimination in the workplace is called into question when one considers the racially discriminatory attitudes of two top Circuit City executives and the implementation of a promotional system by one of those executives having the capacity to mask race discrimination in promotional decisions.

Merely adopting a policy against discrimination will not avoid liability, even for punitive damages, if that policy does not prevent the actions that it supposedly prohibits. In fact, such a policy, if actions by managers contravene that policy, might render those actions knowingly reckless or malicious and thereby strengthen the case for punitive damages. Instead, an employer must take additional steps to assure that its employees (especially those who are managers) take that policy to heart in their day-to-day actions.

This conforms to the lessons of a line of cases involving claims of harassment and/or discrimination. *Faragher v. City of Boca Raton*, 118 U.S. 2275, ____ (1998), established that an employer would be liable for the existence of a hostile working environment based on actions of an employee's immediate or distant supervisor, even when the complaining employee suffered no tangible, adverse employment action, unless the employer can establish "(a) that the employer exercised reasonable care to prevent and correct promptly any sexually harassing behavior, and (b) that the plaintiff employee unreasonably failed to take advantage of any preventive or corrective opportunities provided by the employer or to avoid harm otherwise. While proof that an employer had promulgated an antiharassment policy with complaint procedure is not necessary in every instance as a matter of law, the need for a stated policy suitable to the employment circumstances may appropriately be addressed in any case when litigating the first element of the defense." In that case, "[t]he District Court found that the City had entirely failed to disseminate its policy against sexual harassment among the beach employees and that its officials made no attempt to keep track of the conduct of supervisors.... The record also makes clear that the City's policy did not include any assurance that the harassing supervisors could be bypassed in registering complaints.... Under such circumstances, we hold as a matter of law that the City could not be found to have exercised reasonable care to prevent the supervisors' harassing conduct." *Id.*, at ____.

A later decision by the Supreme Court gave further guidance as to what an employer can do to distance itself successfully from the actions of its managerial agents. "[A]n employer may not be vicariously liable for the discriminatory employment decisions of managerial agents where these decisions are contrary to the employer's 'good-faith efforts to comply'" with the antidiscrimination law in question. *Kolstad v. American Dental Association*, 119 Sup. Ct. 2118, ____ (1999). Lower courts have applied that formulation. See Ford, "Discrimination and Harassment Training Can Help Protect Employers," *The Metropolitan Corporate Counsel*, vol. 12, no. 4 (Northeast ed., April 2004), p. 33.

Risk assessments

In the 2004 Changes, the Commission emphasized that "[i]n implementing subsection (b) [of the 2004 Changes that defines an "effective compliance and ethics program"], the organization shall periodically assess the risk of criminal conduct and shall take appropriate steps to design, implement or modify each requirement [in that guideline] to reduce the risk of criminal conduct identified through this process." §8B2.1(c). The Commission elaborated on its concept of a risk assessment. The organization should analyze: (i) "the nature and seriousness of ... criminal conduct"; (ii) the "likelihood that certain criminal conduct may occur because of the nature of the

organization's business"; and (iii) the "history of the organization." Application note 6. The Advisory Group recommended that the Guidelines explicitly incorporate the risk-assessment concept because "[a] detailed risk assessment is required to appropriately tailor a compliance program to a company's business circumstances." Advisory Group Report, p. 88.

The risk assessment will also serve another important purpose under the 2004 Changes very well. As indicated, employee training constitutes a required part of an effective ethics and compliance program (*supra*, p. 6). The training must be "appropriate to [the employee's] respective roles and responsibilities." §8B2.1(B)(4)(a). As the Advisory Group noted, "risk assessments that identify likely means of violating legal standards in an organization's operating context can help the organization develop training programs for preventing and detecting its most probable forms of unlawful conduct." Advisory Group Report, p. 91.

What would a risk assessment entail? Unfortunately, the 2004 Changes provide only general guidance.³³ To understand how the behavior of its employees and agents might run afoul of the law and of its own policies and procedures, an organization must analyze what laws and regulations apply to its business and how those requirements can impact its day-to-day operations, whether by creating standards that it must meet or prohibiting actions that it otherwise might take. With that understanding in hand, the firm can review its procedures and determine the points in its operations where those regulatory and other requirements are most directly implicated.

Others' compliance programs

In the 2004 Changes, the Commission also introduced, almost as an aside, a comment that could easily be overlooked. In its application note on the relative burdens that the 2004 Changes might impose on small and large organizations, the Commission indicated that, "[a]s appropriate, a large organization should encourage small organizations (especially those that have, or seek to have, a business relationship with the large organization) to implement effective compliance and ethics programs." Application note 2(C)(ii). In essence, the Commission sought to enlist larger organizations in its efforts to introduce ethics and compliance programs to smaller organizations even while it (the Commission) tries to provide more latitude to the latter through its comment that "[t]he formality and scope of actions that an organization shall take to meet the requirements of [the 2004 Changes], including the necessary features of the organization's standards and procedures, depend on the size of the organization." Application note 2(C)(i).

Interestingly, this suggestion seems to conform somewhat to a growing practice. In its 2000 member survey, the EOA asked if the respondents' companies formally evaluate their suppliers' commitment to ethical practices. While 17% of all respondents answered in the affirmative, 32% of those who worked for large organizations answered that they do.³⁴

In a related vein, many companies have adopted corporate social responsibility policies. The Commission's decision to make ethical conduct more specifically and prominently a focus of the Guidelines through the 2004 Changes likely will accelerate that trend also. McDonald's, for example, has accepted, as an integral element of its position in the business world, "a responsibility to be a good neighbor, employer, and

³³ "[T]he proposed guideline and commentary provisions do not mandate how risk assessment studies need to be performed.... Each organization will need to scrutinize its operating circumstances, legal surroundings, and industry history to gain a practical understanding of the types of unlawful practices that may arise in future organizational activities." Advisory Group Report, p. 91.

³⁴ See EOA 2000 Survey, p. 22.

steward of the environment, and a unique opportunity to be a leader and a catalyst for positive change.” McDonald’s Social Responsibility Report, p. 4 (April 2002). That company “is committed to high standards of behavior and performance on issues of social responsibility. [It] hold[s its] suppliers to these same high standards.” *Id.*, at 37.

Predicting how the Commission’s suggestion will affect the ethics and compliance programs of businesses represents a considerable gamble, but to the extent that large businesses follow that approach, they will extend the impact of the 2004 Changes far beyond what those changes likely can achieve alone. Much as the standards of Sarbanes-Oxley have migrated beyond the ranks of corporations whose securities are traded publicly due to the views of the investment community and other audiences, the effect of the 2004 Changes will be felt by many organizations that might otherwise give little thought to the possibility of facing sentencing in federal court.

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