805 In-house Counsel as Multi-Disciplinarian

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Julie A. Bell

Julie A. Bell is vice president, law and compliance, and associate general counsel of Wireless Facilities, Inc. (WFI), in Reston, Virginia, an independent provider of systems engineering, network services, and technical outsourcing for wireless carriers, enterprise customers, and government agencies. Ms. Bell's responsibilities include developing and implementing an ethics and compliance program for the company's global workforce, in addition to providing general legal counsel to the organization in the areas of mergers and acquisitions, litigation, commercial transactions, and employment law.

Prior to joining WFI, Ms. Bell served as an associate attorney at Washington, DC's Zuckerman Spaeder, LLP and Robins, Kaplan, Miller & Ciresi, LLP, where she provided counsel in corporate and commercial real estate transactions.

She currently serves as pro bono counsel to Glen Echo Pottery, Inc., and is a member of the lawyers' committee for The Shakespeare Theatre in Washington, DC. Ms. Bell's publications include "Representing the Troubled Real Estate Partnership," in The Practical Real Estate Lawyer, "What Licensors and Licensees Want Most from Merchandising Licensing Agreements" in The Licensing Journal, and "EU Data Protection: A Compliance Template for U.S. Companies," the cover story of the June 2002 issue of the ACC Docket.

Ms. Bell received her B.S., summa cum laude, from the University of Denver and is a graduate of the New York University School of Law.

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J. Triplett Mackintosh is a partner at the law firm of Holland & Hart LLP. He defends domestic and foreign corporations, directors, and other personnel facing investigation under a variety of federal laws, including those governing fraud, securities, export controls, embargoes, corruption, and a variety of compliance issues. His clients include small and mid-sized companies that confront the same burdens as large entities when it comes to regulatory compliance. He has designed compliance systems and other remedial measures for these companies facing criminal or civil enforcement actions to terminate investigations and/or mitigate penalties. Mr. Mackintosh has also developed and manages an online compliance training program known as HHCMS, a sophisticated system that administers corporate compliance training via the web while capturing data that helps defend companies in the event of violations.

Mr. Mackintosh has taught courses on white-collar criminal defense, federal regulation of international business, and corporate compliance at the University of Denver College of Law. He speaks and writes regularly on compliance issues, including those confronting in-house counsel.

Mr. Mackintosh received a B.A. from Regis University, an M.A. from the University of Denver, and his J.D. from Georgetown University Law Center.

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Session Number 805:
In-House Counsel as Multi-Disciplinarian

Julie A. Bell

Bradford Weller

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In-House Counsel as Multi-Disciplinarian

- Introduction and Purpose
  - Challenges and conflicts faced by in-house counsel acting as multidisciplinarians, particularly in smaller companies with budgetary concerns, and particularly with regard to establishing compliance programs
  - Individual Introductions
  - Topics:
    - Role of GC/In-House Counsel
    - Conflict and Privilege Issues
    - Ethics & Compliance Program Tips
    - SOX 404 Compliance Tips
    - Hypotheticals

Role of GC - In-House Counsel

- Generalist – Juggling Multiple Responsibilities
  - Business vs. Legal
    - Helping Manage the Business (Vs. Respecting Turf of Business Managers)
    - Negotiation of Transactions
    - Implementation of Policy or Functional Initiatives
    - Investigations -- Privilege
  - What Role does your Client Want You to Play?
    - Disguising Business Advice as Legal Advice
    - Perception of the Lawyer as Risk-Adverse
    - "Don't tell us 'No,' Tell us how."

Role of GC - In-House Counsel (cont.)

- Expanding Rings of Responsibility
  - First Ring – Traditional In-House Role
    - Responsible for all legal affairs of the company
  - Second Ring – Broader Legal Functions
    - Corporate Secretary
    - Compliance Officer
  - Third Ring – Quasi-Legal Functions (Legal affairs overlapping with issues of compliance &/or risk)
  - Fourth Ring – the convergence of management of compliance, risk and legal affairs – the "Chief Risk Officer"

ACC's 2005 Annual Meeting: Legal Underdog to Corporate Superhero—Using Compliance for a Competitive Advantage October 17-19, Marriott Wardman Park Hotel

Role of GC - In-House Counsel (cont.)

- Challenges and Issues Relating to Expanding Your Role
  - Management Ability – Effective Project Management
    - Education – Training – Self-Help
  - Subject Matter Expertise – Do you need it to manage the function?
    - Legal exposure, risk assessment and procedural compliance
  - Internal Politics – Turf Wars
  - Bandwidth
  - Wasting Valuable Time?
    - Just because legal issues or compliance are involved, doesn't mean a lawyer has to do the work (contract negotiation; compliance officers)
  - Role Confusion

Why Expand Your Role?

- Adding Value
  - Will the company be better served with someone having a comprehensive oversight of risk, compliance and legal exposure?
- Being the Super-Hero – Career Issues
  - More interesting
  - More rewarding – Compensation?
  - Job security
  - Resume padding
  - Career pathing

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The New Compliance Dilemma

- The Consequences of Non-Compliance May Now Outweigh Traditional Balancing of Business Risks
  - Demonstration of intent
  - The act of weighing business risks may support a criminal charge
- Pressures to Waive Privilege – Do you have to assume privilege will be waived – How does this change what you do?
  - Internal communications
  - Memoranda/witnesses for interviews
  - Upjohn and civil Miranda
  - Inadvertent waiver and DC Bar Ethics Opinion 269
  - Written report of findings

Compliance Programs in the New Era

- Any program should have in mind:
  - Thompson memorandum (attached)
  - Federal Sentencing Guidelines (Organizations) (attached)
  - Federal Sentencing Guidelines (Effective Corporate Compliance Program standards) (attached)
  - Caremark case – 698 A.2d 959

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Ethics and Compliance Program Tips

- General: A primary goal is to be able to defend the company in the event of non-compliance
- Therefore, use as your prescription the elements of an effective compliance program as described in the Sentencing Guidelines §8B2.1
- The program must speak for itself

Federal Sentencing Guidelines

- Elements of an Effective Ethics & Compliance Program:
  - Standards and Procedures
  - Oversight and Resources
  - Screening
  - Training and Communication
  - Monitoring and Auditing; Hotline
  - Incentives and Discipline
  - Response and Action

Compliance Program Tradeoffs

- Risk assessment will direct these choices
- Hotline – internal or external?
- Training – create internally or purchase?
- Train all employees on Code of Conduct?
- Codes of Conduct – internal, external, vendors and contractors
- Data gathering aspects
- Capture points for delivery and affirmation of Code
- Intranet
- Translations

Compliance Program Success Factors

- Cannot overstate importance of "Tone from the Top" and operations buy-in!
- Tell and Sell:
  - Defensive benefits, if program is "effective" under the Guidelines
  - Dovetails with SOX and SRO requirements
  - Helps BOD meet Caremark responsibility
  - Helps uncover risky conduct before it becomes a liability
  - Employees like being part of a company perceived as ethical, and like to see the company spend time and money on their training and development
  - Your customer contracts may require it (especially if your customer is the government)

Compliance Program Success Factors (cont.)

- Using your internal resources – "Hub and Spoke" concept
  - You are the "hub"; these are the "spokes":
    - HR
    - Division, group, departmental or functional management
    - Accounting and Finance
    - Contract Administration (if you have it)
    - Procurement
    - IT
    - Internal Audit
    - Marketing
  - Spoke leaders form your Ethics Advisory Committee
  - Consult them when doing your risk assessments for training purposes
  - Use them to conduct factual aspects of investigations
  - Communicate!!

SOX Section 404 Compliance Tips

- Planning
  - Project Plan
  - Coordination with Auditor
  - Reporting to Audit Committee
  - Scope
    - Materiality
    - Locations
    - Coverage Problem Management
  - Problem Management

SOX Section 404 Compliance Tips

- Documentation
  - Upper Level Controls
    - Anti-fraud Program
  - Transaction Cycles
  - Matrix of Key Controls
  - Schedule of Aggregated Deficiencies
    - Reporting Tool
  - Evaluation of Deficiencies
    - Annual and Quarterly Basis
    - Aggregation

Helpful Tools

- ACC Virtual Library – valuable resource for sample Codes, policies and forms; useful articles and "Info Paks"
- Detailed work plan
- Streamlined annual plan (use for BOD presentations)
- Screen shot of Ethics & Compliance intranet page
- Screen shot of Ethics & Compliance training homepage (vendor hosted)
- Sample CEO statement
- Sample "welcome" communication to training participants
- Ethics Advisory Committee sample meeting minutes
- Sample hotline message
- Links (OCEG, ERC, DII, Compliance Week, etc.)
- Articles (Mayer, Brown article; DC Bar Ethics Opinion 269; Caremark; Sentencing Guidelines; Thompson Memorandum; WMACCA Focus article from first quarter 2005; "Setting an Example")

Ethics and Compliance Initiative Workplan
February 5, 2005

Item	Responsible	Due Date	Status	Comments
Preliminary meeting re scope of project				
Preliminary meeting with CFO and Controller to present proposed scope and develop budget				
Establish hotline, add greeting in English and Spanish, publicize				
Present Preliminary Program to Audit Committee				
Identify corporate values				
Demo and shortlist compliance training and LMS vendors				
Choose vendor and sign contract				
Revise Code of Conduct – for first review				
Review and approve final version of new Code of Conduct for all employees				
Determine logistics of Code distribution				• Will it be electronic or paper? • Logistics of distribution and acknowledgement?

Ethics and Compliance Initiative Workplan
February 5, 2005

Item	Responsible	Due Date	Status	Comments
Develop streamlined Code of Conduct for Independent Contractors				
Visits to HQ, Executive Off-site, Regional Offices and International Subsidiaries to present the program				
Develop message from the CEO to be placed in employee newsletter, introducing Ethics and Compliance Program				• Basis for message Ethics home page and in Code of Conduct
Translate Codes into other languages				
Insert revamped Code into all New Hire packages and Independent Contractor Agreements with certification – all business units and countries				
Distribute revamped Code to existing employees and get their certification – all business units and countries				
Identify Substantial Authority Personnel for background check purposes				
Identify FCPA and Related Party Transactions disclosure groups				

Ethics and Compliance Initiative Workplan
February 5, 2005

Item	Responsible	Due Date	Status	Comments
Develop and Implement Disclosure and Certification for FCPA, Related Party Transactions and Substantial Authority Personnel				
Develop and Implement Background Check Policy and Process for Substantial Authority Personnel				
Develop Ethics & Compliance Home Page on Intranet				
Perform risk analysis to determine course curricula				
Demo and select off-the-shelf and custom courses for compliance curricula				
Work out mechanics of deployment, assignments and administration; test system				
Inform management groups of compliance training program roll out date				
Roll out full compliance training program				
Report to Audit Committee		Quarterly		
Internal Audit of Ethics and Compliance Program; report to Audit Committee				

CONFIDENTIAL ATTORNEY-CLIENT PRIVILEGED MEMORANDUM

To: Members of Audit Committee of [Company] Board of Directors
From: [Name], VP – Law & Compliance
Date:
Subject: **[Company] Corporate Ethics and Compliance Initiative – 2005 Roll-out Plan**

In late 2004, [Company] established an Office of Legal and Ethical Compliance within the Law Department. The goal of the Office of Legal and Ethical Compliance is to design and implement an effective program to promote a culture of legal and ethical compliance throughout the company's operations. Below is a list of the key measures we plan to take in 2005 in furtherance of this goal.

Description	Targeted Completion Date	Status/Comments
Revise global Code of Legal and Ethical Conduct	[Date]	• Reviewers: General Counsel; VP Marketing/Communications; Cross-Company Review Committee
Insert Code into new hire packages with acknowledgement to be returned	[Date]	• Translate into Spanish and Portuguese
Implement quarterly disclosure of related party transactions and certification regarding FCPA matters	• Begin January 15 • Repeat every 90 days thereafter	• All January 15 disclosures received
Implement background check procedure for selected positions	[Date]	• Required under U.S. Sentencing Guidelines – to avoid hiring those in positions of substantial authority with propensity to engage in illegal conduct • Background investigations to be conducted on higher-level financial and accounting positions
Distribute Code to existing employees and collect acknowledgements	• Distribute by [date] • Receive acknowledgements by [date] • Repeat annually	• Deployment methods under consideration: electronic read-and-acknowledge, electronic version with manual acknowledgement or print and mail booklet
Conduct risk assessment to identify compliance training curriculum for various employees	[Date]	
Roll out on line compliance training for all affected employees	[Date]	• Engaged recognized national vendor for training portal, course content and learning management

Ethics and Compliance Initiative
Annual Plan

Quarter 2 2005:

- Introduce program at Executive off-site
- Develop Audit Committee e-mail box notification procedure
- Roll out Code of Conduct in new hire packages (all countries) and receive employee acknowledgements
- Work with business units to identify high risk groups and develop annual training curriculum for each group
- Quarterly FCPA/Related Party Certifications
- Quarterly Insider Trading Review and Memo
- Draft and adopt policy and begin background checks for financial/cash handling positions
- Introduce program in all-employee newsletter

Quarter 3 2005:

- Develop Ethics & Compliance Intranet Portal
- Assign training for high-risk groups and monitor (ongoing)
- Roll out Code of Conduct for existing employees and contractors and receive employee acknowledgements
- Quarterly FCPA/Related Party Certifications
- Quarterly Insider Trading Memo
- Visit subsidiaries

Quarter 4 2005:

- Continue training and monitoring
- Quarterly FCPA/Related Party Certifications and Insider Trading Memo
- Visit subsidiaries

Quarter 1 2006:

- Continue training and monitoring
- Quarterly FCPA/Related Party Certifications and Insider Trading Memo
- Visit subsidiaries
- Internal Audit Review of program's effectiveness
- Report to Audit Committee
- Revise program as necessary

Logoff

Welcome, Ally Adnan, to WFI's Compliance Training Program

Important Links:

WFI Code of Legal and Ethical Conduct

Other WFI Global Policies

WFI Hotline

WFI Office of Legal & Ethical Compliance

Eric M. DeMarco
President and CEO

1. Important Message:

Click below for an important message.

Read an important message from Eric DeMarco

2. Take This Course:

Click below to start the course.

✓ Course Complete
Financial Integrity

3. Your Additional Courses:

Click below for a list of additional courses assigned to you.

Additional Courses

4. Your Transcript:

Transcript: Click here to see a list of all courses you've completed.

To All [Company] Employees:

[Company] is committed to conducting our business with integrity throughout our global operations. This means that we conduct our business honestly and ethically, comply with applicable law, and represent [Company] responsibly within the communities where we operate.

I am excited to announce the development of a new Company-wide Ethics and Compliance Program, which is aimed at promoting a culture of legal and ethical compliance throughout the Company. As we continue to grow, the various elements of this program will help to ensure that our corporate values govern our decisions and actions wherever we operate. A new Office of Ethics and Compliance within the Law Department will steer this effort. Some of the initiatives you will see this year are a new Code of Conduct applying to all employees worldwide and informative on-line training programs on topics important to the way we do business.

In the long run, our actions and decisions as employees of [Company] determine how the world sees us. I thank you for your support in this important area.

Sincerely,

[Name]
President and Chief Executive Officer

Sample E-Mails to On-Line Training Participants

1. Introductory E-mail

Dear [full name]:

I am writing to announce an exciting new training initiative at [Company].

You will receive an e-mail from me soon that contains a link to our new on-line compliance training. You will be invited to take one or more training courses – but no more than one per quarter – which you can take from any location with an Internet connection, at any time. We've chosen specific training classes for you, based on the risks that you typically face in your job.

Managing compliance risk is an important topic for all of us at [Company] – employees, senior management, directors and shareholders. Please contact me if you have any questions about ethics or compliance.

Thank you and enjoy the training.

[Name], VP – Law and Compliance
Phone

THIS IS A SYSTEM-GENERATED MESSAGE – DO NOT REPLY TO THIS MESSAGE

2. Welcome E-mail

Dear [full name]:

As part of [Company]'s continuing ethics and compliance program, you've been enrolled in an on-line compliance training class in the area of "[course name]."

To begin the training, click the link at the bottom of this e-mail. You will need your User ID/Access Code, shown below, to enter the training. **For technical assistance, send an e-mail to: [e-mail address].**

The course takes 45 minutes or less. It's important that you complete it in the next few weeks. Please contact me at [e-mail address] or [phone] if you have any questions about this or other compliance issues.

Thanks and enjoy the training.

[ID, etc. footer]

Note: If this is for CA Harassment, then change the first sentence of the 3rd paragraph to: "To meet California law requirements, this is a two-hour course."

3. Reminder 1 (2 weeks later)

Dear [full name]:

This e-mail is to remind you to complete your first online training course on "[course name]". Our records indicate that you have not yet done so.

To begin the training, click the link at the bottom of this e-mail. You will need your User ID/Access Code, shown below, to enter the training. **For technical assistance, send an e-mail to: [e-mail address].**

The course takes 45 minutes or less. It's important that you complete it in the next week or two. Please contact me at [e-mail address] or [phone] if you have any questions about this or other compliance issues.

Thanks and enjoy the training.

[ID, etc. footer]

Note: If this is for CA Harassment, then change the first sentence of the 3rd paragraph to: "To meet California law requirements, this is a two-hour course."

4. Reminder 2 (2 weeks after Reminder 1)

Dear [full name]:

This e-mail is to remind you to complete your first online training course on "[course name]". This training course is mandatory and your prompt attention is appreciated.

To begin the training, click the link at the bottom of this e-mail. You will need your User ID/Access Code, shown below, to enter the training. **For technical assistance, send an e-mail to: [e-mail address].**

The course takes 45 minutes or less. It's important that you complete it right away. Thank you.

[ID, etc. footer]

Note: If this is for CA Harassment, then change the first sentence of the 3rd paragraph to: "To meet California law requirements, this is a two-hour course."

5. Reminder 3 (2 weeks after Reminder 2) **(Copy Manager on this e-mail)**

Dear [full name]:

This e-mail is to remind you to complete your first online training course on "[course name]". This training course is mandatory and your prompt attention is required.

To begin the training, click the link at the bottom of this e-mail. You will need your User ID/Access Code, shown below, to enter the training. **For technical assistance, send an e-mail to: [e-mail address].**

The course takes 45 minutes or less. It's important that you complete it right away. Thank you.

[ID, etc. footer]

Note: If this is for CA Harassment, then change the first sentence of the 3rd paragraph to:

"To meet California law requirements, this is a two-hour course."

6. Course Completion E-mail

Dear [full name]:

Thank you for completing the "[course name]" compliance course. We appreciate your effort in this important area.

Please look for future e-mails from me inviting you to take other courses that we may have assigned to you.

[footer]

[COMPANY] ETHICS ADVISORY COMMITTEE
Quarterly Meeting Minutes
_____ __, 200_

Participants:

[Name] – VP, Law & Compliance
[Name] – President, Division A
[Name] – Director of Internal Audit
[Name] – VP, Human Resources
[Name] – President, Division B
[Name] – VP Marketing & Communications
[Name] – Paralegal and Meeting Secretary
[Name] – Director of Finance, Europe
[Name] – IT Director
[Name] – Corporate Controller
[Name] – Managing Director, South/Latin America
[Name] – COO, Division C

The [Company] Ethics Advisory Committee convened by telephone for its first meeting on _____ __, 200_ at _____ p.m. Eastern Daylight Time.

After taking attendance and calling the meeting to order, [Name] explained the purpose and objectives of the Program and the Committee. She explained that, as [Company]'s Ethics and Compliance Officer, she would be primarily responsible for developing an effective program of ethics and compliance that would apply to [Company]'s operations globally. This would involve evaluating the current legal environment, designing targeted training and certifications for employees based on the legal and ethical risks inherent in their jobs, coordinating internal investigations, responding to reported legal and ethical lapses and communicating related information throughout [Company]. [Name] explained that the purpose of the Committee was to ensure company-wide participation in the Program, and that members were invited to designate other members of their staff to represent them in future quarterly Committee meetings.

[Name] then briefly updated the Committee on the status of the specific aspects of the Ethics and Compliance Program:

New Code of Legal & Ethical Conduct (the "Code")

[Name] reported that the text of the Code had been finalized based on input from various business and support segments of the company. The Code is now being translated into Spanish and Portuguese.

[Name] then proceeded by briefly describing the contents of the Code and the proposed method of implementation. [Name] explained that because of the divisional nature of [Company]'s workforce, workforce turnover, use of independent contractors, and location of the employees in various foreign countries required different methods of delivery with the greatest challenge presented by tracking of the current employees reading and certifying their compliance with the Code's standards.

[Name] then discussed possible approaches to the implementation process targeted to specific groups of employees, from adding a copy of the Code to new hire packages to posting the electronic version of the Code on the [Company] intranet with electronic certification of compliance for existing employees. [Name] stated that the Human Resources Department would play a key role in this implementation.

Employee and Management Training/Compliance Training Vendor

[Name] reported that she had hired [Compliance Training Vendor] to produce on-line training courses, and had assessed the risks intrinsic to the various areas of [Company]'s business and to the functions performed by employees. From this risk assessment, employees required to take training were identified and specific courses assigned. The pilot group is scheduled to start its first assigned course in early July. [Name] also explained that capturing high-risk employees throughout [Company]'s business areas would be an ongoing challenge because of the variety of the functions performed and titles used throughout [Company].

Investigations and Follow-Up Actions

[Name] next discussed the Ethics and Compliance Hotline. [Name] noted that the function of the Hotline had evolved to being a tool for the employees to report their concerns in general. [Name] then described the procedure followed by the Ethics and Compliance Office to retrieve and follow-up on the reports left in the Hotline voice-mail box and, further, updated the participants on an internal investigation into [Name], and that the matter had been reported to the local police.

Questions and Answers

[Name] then opened up the floor for questions. [Division President] asked what was desired from management in support of the Ethics and Compliance initiatives. [Name] explained that assistance sought from the business includes help with collecting employee data, conducting assessments of the business risks, tracking employee turnover, identifying and capturing new and unusual titles for at-risk employees and, most importantly, setting a strong example and creating "the tone from the top" as to the importance of strong ethics and legal compliance. [Director of Internal Audit] corroborated the previous response by emphasizing the importance of the Ethics and Compliance initiatives for the internal controls program as evidence of the good faith and continuous and pro-active efforts of the Company to adhere to the highest standards of business conduct.

Adjournment

The meeting was adjourned at ____ p.m.

Sample Hotline Message

Welcome to the [Company] Ethics & Compliance Hotline. If you have a complaint or concern about the company's ethics, accounting controls, suspected fraud, auditing matters or legal compliance, you are encouraged to bring it to your supervisor. However, if you are uncomfortable raising the issue with your supervisor, then you may leave a detailed message after the tone. If you wish your message to be anonymous, be sure to dial this line for a phone outside the company's telephone network. [Company]'s Ethics Officer and the Audit Committee of [Company]'s Board of Directors will investigate and take appropriate remedial measures in response to your complaint or concern. If you give your name, we will try, but cannot promise, to hold it in confidence in all cases. You will not be retaliated against for having made your report. Thank you.

ACC AMERICA
Association of Corporate Counsel
Washington Metropolitan (WMACCA) Chapter

First Quarter 2005

Focus

Marian Block

President's Message

I am delighted to serve as President of WMACCA in the Chapter's 25th anniversary year. Milestones such as these give us a good opportunity to look back and consider where we have been, as well as to look forward and reach for new goals.

In 1980, 36 attorneys from 33 corporate offices formed WMACCA to allow in-house counsel to share ideas and approaches to common issues of concern. At the time, Philip D. Caraci, then counsel for B.F. Saul Real Estate Investment Trust and a WMACCA founder, explained to the Washington Business Review that: "We're part of management, and managing a corporate law department is different. We need to know how to relate to the balance of the company."

Twenty-five years later, WMACCA has more than 1,150 members from nearly 500 private sector organizations—and our motivation for making WMACCA the premiere professional association for in-house counsel remains, basically, the same.

As WMACCA has grown, we have tried to find ways to provide our members with the resources that help you function as a member of your company's management team. During my term, I want to make sure we are serving your needs by continuing to deliver high quality educational programs on the areas that are meaningful to in-house counsel. When there is a particularly "hot topic," we'll make sure to schedule a program to help you understand and prepare for it. In addition, we will continue to emphasize "nuts and bolts" programs that focus on practical approaches to substantive areas that affect most of us. We also want to find ways to make lawyers who are new to in-house practice comfortable with the challenges that face in-house counsel.

I also think it is important that we educate the community about the significant role corporate counsel play. We are the front-line in identifying issues and counseling our clients. It is time to raise the profile of corporate counsel in the outside legal community to match the role we play inside our organizations.

We will try to accomplish that goal, in part, with our 25th anniversary celebration, which will take place in conjunction with our annual cocktail reception in the fall. As part of our event, we will present awards to honor and celebrate our own: Chief Legal Officer of the Year, Corporate Counsel of the Year, Legal Department of the Year, and Community Service (either by a department or an individual). We hope to have some of the WMACCA founders (several of whom are still in-house here in the DC area and are still WMACCA members) join us. Board member Manik Rath is chairing this event and would welcome your participation in planning it. You can contact him at mrath@lmi.org.

Our WMACCA Corporate Scholars summer internship program is also increasing awareness and interest in corporate practice among students at area law schools. This is the program's second year and we are taking steps to make it a continuing program by setting up a nonprofit foundation to seek contributions and grants to fund the monetary awards we give the participants. We hope that you, our members, will include this program as one of the charities you support. If your company would like to participate in the Corporate Scholars Program by hosting an intern, please see the information on page four of this newsletter.

I want to thank the officers and boards of WMACCA that have preceded me for all their hard work that has made WMACCA the successful organization it is today. In particular, I want to thank our 2004 President, Kathy Barlow, for her energy and enthusiasm. I look forward to another banner year.

The Federal Sentencing Guidelines for Organizations: What's Up?

On November 1, 2004, amendments to the United States Sentencing Commission's federal sentencing guidelines took effect despite urgings by the Association of Corporate Counsel (ACC), the National Association of Criminal Defense Lawyers (NACDL), a number of business lobbies, and others to make what we believe were crucial and necessary changes to the proposed amendments and their commentary. Of special concern are provisions now codified in Chapter 8 (which governs organizational sentencing) that would make waiver of the attorney-client privilege almost a certainty in order for a charged company to be deemed "cooperative" and thus eligible for more lenient treatment in settlement discussions or at sentencing.

Meanwhile, in January of 2005, the U.S. Supreme Court issued its controversial decision in the *Booker* and *Fanfan* cases, which were to shed light on the constitutionality of the application of the Guidelines in the aftermath of the *Blakely* decision, in which a Washington state sentencing guideline system, patterned on the Federal Sentencing Guidelines, was held unconstitutional. The Supreme Court's decision in *Booker/Fanfan* was unexpected, leaving the Guidelines in place, but making their use by judges permissive and advisory—the Guidelines are no longer mandatory in application. A number of constituencies, including the Department of Justice, are seeking to overturn the Court's decision by encouraging Congress to expedite passage of a new Sentencing Guidelines act which will fix the constitutional problems, and perhaps even strengthen prosecutors' powers in the process. And a number of organizations that watch the Guidelines for direction on their compliance and risk management are now confused about whether the Guidelines still apply, and what's on the horizon should they be amended yet again by a new statute.

This whitepaper focuses on why the Federal Sentencing Guidelines are important for companies and their counsel to understand, and how changes to the Guidelines—both through recent amendments and the Supreme Court's findings in the *Booker* and *Fanfan* cases—impact the prosecution of companies found guilty of federal criminal charges, the provision of corporate legal services, and the development of an effective compliance program in corporations, non-profits, unions, and other "entity" clients.

Background

The U.S. Sentencing Commission was established by Congress in 1984 to promulgate mandatory "guidelines" for federal judges to apply when sentencing criminal defendants; the Commission's first Guidelines were established shortly thereafter. Chapter 8, adding sentencing standards for organizational defendants, was added in 1991.

The Guidelines were created to respond to a perception and some evidence (but only in the case of individual, not corporate, defendants) that judges in the federal circuits were want to adopt wildly different sentences for similarly situated defendants found guilty of criminal charges. The Sentencing Guidelines set a baseline range of determinate sentences for different categories of offenses; judges increase or decrease the sentence depending on enumerated circumstances listed in the Guidelines (setting a culpability score from which "upward or downward departures" are made).

[If you'd like to read more about the background of the guidelines (as well as find the actual guidelines themselves), check out the U.S. Sentencing Commission's webpages at http://www.ussc.gov/general.htm (history and overview) and http://www.ussc.gov/GUIDELIN.HTM (guidelines and manuals). Chapter 8's provisions can be found at http://www.ussc.gov/2004guid/tabconchapt8.htm.]

The Guidelines have always been important in the corporate context because they provide really the only "government definition" of the elements of an effective corporate compliance program. The seven elements of an effective program as outlined by the Sentencing Commission in its 1991 rules became the basis for companies seeking guidance and for prosecutors considering charges: the idea was that if a company could show that it had an effective compliance program in place, it might be able to deflect significant penalties or other damages beyond what was necessary for simpler and less putative restitution or remedy on the basis that the corporation had acted in good faith, with reasonable foresight, and had suffered from rogue employee behavior or an unusual and unanticipated failure. The 2004 amendments to Chapter 8 seek to strengthen the importance of these defined characteristics of an effective program.

This "preventive" role of the Guidelines has become overpowering for many corporations caught in the throes of a government investigation of some kind of alleged failure. The DOJ has been very successful in "strongly suggesting" that cooperative behavior, plea bargaining and settlement are much more advantageous courses for companies charged with criminal behavior to pursue (rather than subjecting the organization to additional charges due to uncooperative (and perhaps what can even be construed as "obstructive") behavior by pleading their innocence. Companies that are actually subject to the application of the Sentencing Guidelines after trial statistically do not make out well. The "threat" of the Guidelines actually applied is an extremely effective tool used by the Department of Justice to drive corporate "cooperation" with government investigations and prosecutions and discourage companies from independently investigating allegations and/or fighting the charges.

Also important is new language in the commentary to amended Guideline section 8C2.5 which suggests that the government may demand waiver of the attorney-client privilege in its investigations of an allegation of wrongdoing if the company wishes to receive credit for being cooperative in the investigation. This magnifies the power of the government in coercing cooperation from a corporate defendant, and has significant implications for companies concerned about the "litigation dilemma" they may face when waived communications are then available as fodder to fuel third-party suits against the company, many of which may have greater impact in terms of financial and reputational ruin than the underlying government investigation. Indeed, it is the charging decision that becomes the focal point for the company.

The DOJ issues guidance to prosecutors about the process of charging organizations, and this advice takes the form of a written policy statement sometimes referred to as the "Thompson Memorandum," (2003) ("Principles of Federal Prosecution of Business Organizations" at http://www.usdoj.gov/dag/cftf/corporate_guidelines.htm). This memo relies upon much of what the Sentencing Guidelines suggest as effective corporate compliance behavior which should influence a prosecutor's decisions about how to proceed.

The upshot is that even companies that are never charged with a crime are strongly impacted by the Federal Sentencing Guidelines and its directives: decisions made by compliance managers developing in-house programs and decisions made by prosecutors about whom to pursue and what the charges might be are both strongly influenced by the Sentencing Guidelines.

The Blakely/Booker/Fanfan Cases and the Constitutionality of the Guidelines

Looming large is the question of what role the New Guidelines will have in the future in light of the United States Supreme Court's June 2004 decision in *Blakely v. Washington*. Since the *Blakely* case struck down a Washington State sentencing system based on the Guidelines, commentators immediately began to question the constitutionality of the federal guidelines system upon which the state's system was based. The Supreme Court agreed to accept (and expedite) *cert* in the *U.S. v. Booker* (No. 04-104) and *U.S. v. Fanfan* (No. 04-105) cases, in order to put these questions to rest.

A highly divided Supreme Court held in January of 2005 that the Guidelines will henceforth be advisory for sentencing judges—not mandatory—in order to comply with the Sixth Amendment. Although the Court's holding seems to benefit defendants by permitting greater leeway in sentencing (and returning more discretionary decision-making ability to judges— which discretion was formerly limited in realistic terms to prosecutors in making the decision to charge), its practical effect in the short term is uncertain. Indeed, some in Congress, the DOJ and perhaps the Sentencing Commission will seek to overturn the decision by passing a new set of Guidelines that address the Sixth Amendment concerns, but institute a harsher and more rigid sentencing regime.

So if the Guidelines Aren't Mandatory Anymore, I Can Relax, Right?

Some have suggested that since the Guidelines are now advisory, corporations can relax their focus on developing compliance programs that meet Guidelines standards, and will have more leeway in negotiating with the government in the unfortunate event of a corporate failure. We would suggest that this is advice to be followed at your company's peril.

Why? Well, it is clear from activity emerging on Capitol Hill that there is a strong interest in proposing new mandatory Guidelines, and the starting

point for rebuilding the system will be the current Guidelines already in place: from there, it is likely that they will only get tougher, not more lenient, in today's prosecutorial environment. Also, as noted in the discussion above regarding the Thompson memo and the standards of judicial review already in effect, the existence and adequacy of a corporate compliance program is a factor federal prosecutors will continue to consider in making the threshold determination of whether to criminally charge corporations regardless of the Guidelines' mandatory or advisory nature. And so, while application of the Guidelines is no longer mandatory, substantive provisions in the Guidelines, including those defining minimum criteria for an "effective compliance and ethics program" (ECEP), are not changed from their status as amended in November of 2004 and will likely remain a primary source of guidance on what federal courts and prosecutors consider constitutes minimum requirements for an ECEP.

What is an ECEP in Detail?

The Sentencing Guidelines define seven minimum requirements for an effective ethics and compliance program, or ECEP. Prior to the November 1, 2004 effective date for the amended Sentencing Guidelines, criteria for an "effective program to prevent and detect violations of law" were set forth in commentary to the Guidelines.[1] The amended Sentencing Guidelines now define requirements for an ECEP in the text of newly added provisions set forth at Section 8B2.1. They also describe what is necessary for the program to be effective and require periodic risk assessments of the program (Sections 8B2.1(a), (c)), as well as include new Commentary that provides guidance on application of these guidelines.

More specifically, the Sentencing Guidelines define the following minimum requirements:

1. **Establish Standards and Procedures:** Organization shall establish standards and procedures to prevent and detect criminal conduct (§8B2.1(b)(1)).

2. **Requirements for an organization's governing authority, high-level personnel, and specific individuals:**

(A) Governing Authority shall be *knowledgeable* about the content and operation of the compliance and ethics program (CEP), and shall *exercise reasonable oversight* with respect to the implementation and effectiveness of the program. (§8B2.1(b)(2)(A)(emphasis added).

(B) High-level personnel[2] shall *ensure* that the organization has an effective CEP, and *specific individuals within high-level personnel shall be assigned overall responsibility* for the CEP. (§8B2.1(b)(2)(B))(emphasis added).

(C) Specific individual(s) within the organization shall be delegated *day-to-day operational responsibility* for the program, and shall *periodically report* to high-level personnel (and as appropriate, the governing authority or appropriate subgroup) on the program's effectiveness. Such individuals shall be given *adequate resources, appropriate authority, and direct access* to the governing authority/subgroup. (§8B2.1(b)(2)(C)(emphasis added).

3. **Substantial Authority Personnel**[3]: Organization shall use reasonable efforts *not to include* within substantial authority personnel any individual whom the organization *knew, or should have known* through the exercise of *due diligence*, has engaged in illegal activities or other conduct inconsistent with an ECEP. [4] ((§8B2.1(b)(3)(emphasis added))

4. **Communications; Training:** Organization shall take reasonable steps to *communicate periodically* and in a practical manner to certain individuals[5] its standards and procedures and other aspects of the program *by conducting effective training programs* and otherwise *disseminating information appropriate to the respective roles/responsibilities* of individuals.[6] (§8B2.1(b)(4)(A)(emphasis added))

5. **Monitoring; Evaluation; Reporting/Guidance Mechanism:** Organization shall take reasonable steps to:

(A) ensure the program is followed (including monitoring and auditing to detect criminal conduct)(§8B2.1(b)(5)(A);

(B) evaluate periodically the effectiveness of the program (§8B2.1(b)(5)(B)); and

(C) have and publicize a *system* which may include mechanisms that allow for *anonymity or confidentiality* where employees and agents may report or seek guidance regarding potential or actual criminal activity without fear of retaliation. (§8B2.1(b)(5)(C(emphasis added)).[7]

6. **Enforcement:** The CEP shall be promoted and enforced consistently throughout the organization through *appropriate incentives*, and *appropriate disciplinary measures* for engaging in criminal conduct and for failing to take reasonable steps to prevent or detect criminal conduct. (§8B2.1(b)(6)(emphasis added))

7. **Response following detection of criminal conduct:** After criminal conduct has been detected, the organization shall take reasonable steps to *respond appropriately* to the criminal conduct and to *prevent further similar criminal conduct*, including making any necessary modifications to the CEP. (§8B2.1(b)(7) (emphasis added))

A longer version of this paper is available to ACC members if you haven't had enough! It is provided on ACC's advocacy pages at http://www.acca.com/legres/corpresponsibility/.

Please note that ACC is currently working with a coalition of business and legal interests to encourage the U.S. Sentencing Commission and Congress to amend the guidelines to address concerns raised by members, and most specifically, language that suggests that the attorney-client privilege must be waived (in the discretion of the DOJ) in order for a company to receive credit for cooperation. For more info on these efforts, or if you have questions about the Federal Sentencing Guidelines, please feel free to contact Susan Hackett, ACC's General Counsel, at ACC at hackett@acca.com. While neither we nor this article can offer the definitive word on the Guidelines, we can help refer you to other members who may be able to help, or resources you may wish to consult. This article is not intended to provide legal advice.

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1 These seven criteria were set forth in Application note 3(k) to Section 8A1.2 of Chapter 8 (Sentencing of Organizations) of the Federal Sentencing Guidelines.

2 The Sentencing Guidelines define "high-level personnel of the organization" to mean "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." Application Note 3(b) in Commentary to 8A1.2.

3 "Substantial authority personnel of the organization" is defined in Application Note 3 to the Commentary to Section 8A1.2 to mean "individuals who within the scope of their authority exercise a substantial measure of discretion in acting on behalf of an organization. The term includes high-level personnel of the organization, individuals who exercise substantial supervisory authority (e.g., a plant manager, a sales manager), and any other individuals who, although not a part of an organization's management, nevertheless exercise substantial discretion when acting within the scope of their authority (e.g., an individual with authority in an organization to negotiate or set price levels or an individual authorized to negotiate or approve significant contracts). Whether an individual falls within this category must be determined on a case-by-case basis."

4 The Sentencing Guidelines also include commentary in Application Note 4 to Section 8B2.1 providing additional guidance on implementation for this requirement, and include commentary in the introductory section to the Proposed Amendments stating that this requirements is "meant to ensure that an individual is screened on the basis of his or her culpability and not on the basis of the organization's vicarious liability."

5 These individuals include: members of the governing authority, high-level personnel, substantial authority personnel, the organization's employees, and, as appropriate, the organization's agents. (§8B2.1(b)(4)(B))

6 Note this section makes compliance training a requirement and specifically extends the training requirement to the upper levels of an organization as well as to the organization's employees and agents.

7 Note that auditing and monitoring are now mandated, and periodic evaluation of the ECEP is now also required. In addition, there is now an expanded focus on the reporting mechanism: from reporting criminal conduct to potential or actual criminal conduct.

Board Members and Contacts

WMACCA Corporate Scholars Program

WMACCA is pleased to invite its members' companies to participate in the 2005 WMACCA Corporate Scholars Program by hosting a summer intern.

Our Corporate Scholars summer internship "diversity pipeline" program is aimed at giving students from our local law schools opportunities to experience corporate practice. Our inaugural year, 2004, was very successful, with an impressive number of our member companies stepping up to offer internships. In 2005, we plan to provide seven summer internships. These internships should provide the students with substantive experience and meaningful exposure to in-house practice.

WMACCA has invited applications from students at the laws schools at American, Catholic, George Mason, George Washington, Georgetown, Howard, and the University of the District of Columbia. The program is open to students entering their 2L and 3L years, and both full-time and part-time students. We have asked the law schools to publicize the program to diversity student organizations in order to get applications from populations who may otherwise lack access to these opportunities.

We will work with your company to help you structure a good internship experience. WMACCA will provide a monetary award to the program participants.

If you are interested in participating in the WMACCA Corporate Scholars Program, please contact Ilene Reid, WMACCA executive director, at 301.230.1864, or WMACCA@verizon.net.

WMACCA 25th Anniversary Celebration

As WMACCA celebrates its 25th anniversary, we are looking for members who were there at the beginning and early stages of the organization to give us their perspectives on how in-house practice has evolved over the past 25 years. What is the same, and what is different? Are in-house counsel perceived differently in their organizations? How about in the legal community?

Also, we are looking for people who would like to work on this celebration and on selecting the people and departments we will honor with awards for Chief Legal Officer of the Year, Corporate Counsel of the Year, Legal Department of the Year, and Community Service (either by a department or an individual).

If you would like to help with this event, please contact Ilene Reid, WMACCA executive director, at 301.230.1864, or WMACCA@verizon.net.

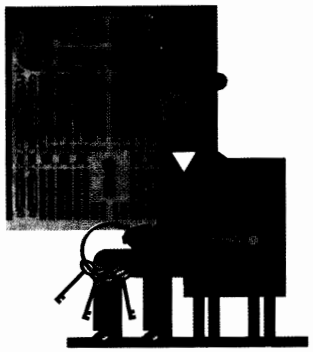
IN THE NEWS

Spotlight

New York state AG Eliot Spitzer defends his Wall Street probes and other investigations.
page 24

INSIDE • FEBRUARY 2005

Setting an Example



GORDON STUDER

THE SECURITIES AND EXchange Commission has a harsh message for in-house lawyers: Fulfill your gatekeeper duties, or suffer the consequences. John Isselmann, Jr., learned this lesson last fall when he became the first GC in the post–SOX era to be penalized for gatekeeper violations. The SEC's civil case against Isselmann, the former general counsel of Electro Scientific Industries, Inc., is a cautionary tale for corporate counsel everywhere.

The SEC accuses a former GC of failing in his gatekeeper role by doing too little, too late.

SEC enforcement chief Stephen Cutler first put in-house lawyers on notice about the agency's emphasis on gatekeepers in a September 20, 2004, speech. Cutler defined gatekeepers as "the sentries of the marketplace"—auditors, directors, and "the lawyers who advise companies on disclosure standards and other securities law requirements." The agency, he added, was "considering actions against lawyers . . . who assisted their companies or clients in covering up evidence of fraud, or prepared, or signed off on, misleading disclosures regarding the company's condition."

Four days after Cutler's speech, the SEC announced that it had settled its allegations against Isselmann. While the agency has gone after a number of lawyers for their alleged role in a financial fraud, Isselmann's case is unique. The SEC doesn't claim that he participated in the scheme to fraudulently boost the quarterly financials at ESI, a semiconductor manufacturer based in Portland, Oregon. The agency doesn't even allege that Isselmann knew about the fraud at the company, which reported revenues of $207 million in fiscal year 2004. The SEC says only that the ex–GC failed to communicate material information to ESI's audit committee and outside auditors—information that would have stopped the accounting fraud.

In his settlement with the SEC, Isselmann neither admitted nor denied the agency's allegations. The 37-year-old lawyer agreed to pay a $50,000 civil penalty, and consented to a cease-and-desist order. He left ESI in 2003—he says that the company asked him to stay on—and currently does consulting work in Portland. (ESI officials did not respond to requests for comment for this article.)

"Mr. Isselmann failed in his gatekeeper role," says Patrick Murphy, an enforcement lawyer in the SEC's San Francisco office, who supervised the ESI probe. "He had information that he should have passed on to the board and the company's external independent auditor. If that information had been provided, it would have prevented the financial fraud."

Isselmann has a different take on the government's case against him: "Cutler was out there putting the fear of God into lawyers, and he needed an exclamation point. I was that exclamation point."

Whether the SEC was looking to make an example of Isselmann or not, his case shows how treacherous the GC job can be these days. The agency alleges that former CFO James Dooley and ex-controller James Lorenz III committed several instances of fraud at ESI. But the SEC doesn't claim that Isselmann was involved in any of the wrongdoing—only that he failed to report a specific incident.

According to the SEC's complaint against Isselmann, Dooley and Lorenz decided late on September 12, 2002, to eliminate $1 million in vested retirement and severance benefits for ESI's employees in Asia. Dooley and Lorenz then fraudulently applied the savings to ESI's bottom line by an accounting move called "reversing the accrual," the SEC claims.

Isselmann was not present or consulted when Dooley and Lorenz made their middle-of-the-night decision, according to the SEC's complaint. But Dooley subsequently asked Isselmann to get a written opinion from the company's outside counsel in Japan on whether Japanese law permitted eliminating the benefits. Dooley didn't tell Isselmann that ESI's books had already been altered, the SEC says.

Morrison & Foerster, ESI's Japanese counsel, e-mailed an opinion to Isselmann, stating that the company could not unilaterally terminate the benefits. According to the SEC's complaint, Isselmann tried to raise this point at a disclosure meeting right before the company filed its financial statement, but Dooley objected and cut him off. After the meeting, Isselmann provided Dooley with a copy of the written legal advice. Nevertheless, ESI went ahead and filed a fraudulent statement overstating its quarterly income by 28 percent, the SEC says.

Five months later, according to the agency's complaint, ESI's new CFO told Isselmann how Dooley and Lorenz had decided to eliminate the benefits and reverse the accrual during their September 12 meeting. (Dooley had since been promoted from CFO to CEO.) Isselmann immediately told ESI's audit committee and outside counsel what had happened, the SEC's complaint says. But that wasn't enough for the agency.

The SEC faulted Isselmann for failing to stand up to then–CFO Dooley at the disclosure meeting, and for failing to provide the audit committee with Morrison & Foerster's advice. These failures allowed Dooley and Lorenz to conceal their fraud, the SEC says.

The agency didn't bring a case against ESI, citing the company's "extraordinary cooperation in the commission's investigation." But Dooley and Lorenz didn't get off so lightly. In September the U.S. attorney's office filed a 17-count indictment against the two men, who were fired from ESI in 2003. Prosecutors allege that Dooley and Lorenz made a series of accounting reversals and reclassifications that falsely boosted ESI's earnings by nearly $7 million, allowing the company to hit its financial targets for the first two quarters of its 2003 fiscal year.

Dooley's lawyer, Steven Ungar of Lane Powell Spears Lubersky in Portland, said in a statement that the government's claims against his client "are false, distorted, and unfairly present only one side of the story . . . When the facts are fairly and accurately presented, we are confident that [Dooley] will be fully exonerated." Lorenz, who has also pled not guilty, could not be reached for comment.

Isselmann says his case was the "exclamation point" to a speech by the SEC's Stephen Cutler.

For his part, Isselmann says he didn't even realize he'd done anything wrong. "I didn't fully understand the accounting issues," says Isselmann. He explains that at the time, he was just eight years out of law school and had no accounting experience and only a limited securities law background. "Like many general counsel, I was a generalist—my job was a mile wide and an inch deep. I relied heavily on accounting people like Dooley and outside auditors to flag those issues for me."

Isselmann says he thought of the Japanese benefits matter as an employment, not an accounting, issue. He adds that as ESI's only in-house lawyer, "I didn't have the luxury of focusing on a single e-mail and thinking about it for weeks and weeks." He says he probably spent an hour and a half in total on the benefits matter.

Isselmann

Ultimately, the SEC charged Isselmann under rule 13b2-2 of the Securities Exchange Act of 1934 with failing to provide a material fact to accountants in connection with an SEC filing. According to Isselmann's lawyer, Melinda Haag, a partner in the San Francisco office of Orrick, Herrington & Sutcliffe, it's essentially a strict liability offense. "No intent or even negligence needs to be shown," she says. "They're saying that [he] should have somehow figured out what was going on." Haag adds, "It's a frightening prospect for anyone who holds that gatekeeper position."

William Baker, a former SEC enforcement chief now in the Washington, D.C., office of Latham & Watkins, agrees: "The SEC is saying, 'Too little, too late.'" Baker adds, "Whatever message they're sending, it's a scary one for in-house lawyers."

—TAMARA LOOMIS

QUOTE

"[Former Disney president Michael Ovitz] was not guilty of gross negligence. He was not guilty of malfeasance. He was guilty of not being able to do the job."

KEVIN HESLIN/NEWSCOM (LITVACK)

—Sanford Litvack,
ex–GC of The Walt Disney Company

In November, Litvack testified in the shareholder suit over the $140 million severance package that Disney paid to Ovitz.

LegalTimes WEEK OF JULY 18, 2005 • VOL. XXVIII, NO. 29
ALM

Quasi-Legal Time Wasters

If anyone can do it, does it make sense to give the work to your law department? Not if the company wants a productive team.

By Rees W. Morrison

IN-HOUSE COUNSEL

Quasi-legal work is the cellulite of law departments. These are the tasks in-house counsel can do but shouldn't—if their legal department wants to reach peak effectiveness.

Quasi-legal tasks include peripheral lawyer activities such as drafting and reviewing routine correspondence for executives, managing projects that involve several departments in the company (such as marketing, a business unit, and the patent group), and responding to routine claims that should be dealt with by the business unit. These kinds of tasks are larded throughout the productive work that lean, efficient law departments should concentrate on instead.

Not that quasi-legal work wears a scarlet Q and is always immediately detectable. Rather, it's a question of separating higher-value legal work from lower-value work that a lawyer can do. These are not water-tight definitions. Nor should paralegals fill in and do these tasks. The improper activity falls outside the boundary of the optimal role of a legal department.

Who makes these demands? For the most part, the managers and executives of the company often trigger quasi-legal work. What is the solution? A department with a clear understanding of how it best contributes to the company's success, along with internal clients with the same understanding, will keep quasi lawyering to a minimum.

What's Valuable?

The most valuable work of in-house counsel is giving legal guidance to business executives; interpreting regulations, statutes, and decisions; reviewing documents and activities for legal risks; and managing outside counsel. Quasi-legal work advances none of these goals.

Instead, quasi-legal work at its rawest has lawyers doing tasks that anyone could do. Tracking the number of company advertisements that need to be reviewed for regulatory compliance, for instance, can and should be done by someone other than a lawyer and, indeed, outside the law department. Preparing run-of-the-mill sublease extensions ought to fall to the real estate group, not to a lawyer.

Although these are a few good examples, it's nearly impossible to catalog the suspect tasks, since many really depend on the particular lawyer and the particular task. The gray area teems with tasks that lawyers might be trained and experienced in, such as writing, fact organization, and analytical thinking, but that do not make the best use of their legal training and experience.

Lower-value work sometimes includes writing documents, when the document is not legal analysis or pleadings; organizing facts, when the facts have more to do with business or administration than law; thinking through a problem, when the problem should be solved by another department; and coordinating a team, when the legal elements of the team's work are small. What the lawyer is asked to do (or takes on) has a legal veneer, but the core of the task should be someone else's responsibility.

I would not be surprised if in most law departments quasi lawyering gobbles up 5 percent to 10 percent or more of lawyers' time. Shed this fat, and your lawyers will be much fitter contributors to the company.

Ask Questions

Companies benefit when they can prevent their lawyers from being sucked into quasi-legal work. But how can a company determine the boundaries if the edges are unclear? Here are some questions to ask:

- Would the company hire an outside firm to do the work? If the client (the company) wouldn't think of paying outside counsel their rates to accomplish the task, the inside lawyer should probably not do it, either.
- Could a person who did not graduate from law school handle the task just as well?
- What happens in other law departments? For example, if no other law department in your industry requires that a lawyer review every contract, you have stumbled upon a quasi-legal waste.
- Are the legal risks infrequent or small in relation to the amount of time lawyers spend sniffing them out? Reviewing plain-vanilla confidentiality agreements falls into this category.

How does a department rout these time wasters? Simply understanding and articulating the concept can help lawyers spot and sidestep less-essential work masquerading as "the law department's responsibility."

Track the Time

Another technique adds more precision. For four weeks, have the in-house lawyers track how they spend their time. They should use five to seven categories of tasks, and make sure they indicate for each task whether—compared with all the tasks done during the period—the particular one is a good, medium, or poor use of their legal talent. Gather the lawyers together and have them discuss which of the activities they are asked to do, or choose to do, fall into the suspect category of quasi-legal work. Once they are aware of these drags on their time, they need to talk with their clients about alternative resources or alternative ways of accomplishing the tasks. Thereafter, much like an exercise regimen, law departments need to periodically sweat off their quasi-legal flab.

Besides tracking lawyer time, another option is to charge in-house clients, perhaps only for the most egregious examples of quasi-legal work. Although it's a heavy-handed solution, it will make these clients more sensitive to diverting their lawyers to ancillary tasks. On the other hand, the solution raises the possibility that the company will push back. Some might even consider firing some lawyers, which would ultimately force the survivors to eliminate the lowest-value work. Sometimes that approach works, but most would argue that the cure is worse than the disease.

In my consulting experience, consciousness raising and exhortations do well to tame the problem, but for lawyers to push back when asked to take on quasi-legal tasks, or to drop those tasks they are doing, the general counsel must stand up for them and support them in the face of client discontent.

Ironically, sometimes resistance to stopping quasi-legal tasks comes not from clients but from the lawyers themselves. In one insurance company law department that tried to trim some quasi-legal time, the lawyers resisted the change. In fact, the lawyers argued that it was better if they ingratiated themselves with the clients in-house and gave them the services they wanted. They believed that the more the lawyer does, the happier the executive client. Many companies, for instance, use their lawyers as notary publics. If there is no cost of lawyer time to clients, clients will be grateful for the services. But in the end, we're still talking about what amounts to corporate waste.

Lawyers also argue that you can't tell when a legal issue will show up in otherwise nonlegal functions. They feel it's worth the effort to spot the "wheat" of a legal risk mixed in with the "chaff" of low-value quasi-legal activity. But, for the most part, although reading through piles of documents and creating summaries make some use of lawyers' competencies, these tasks mainly divert lawyers from putting their skills to the best use.

There's another reason lawyers sometimes like quasi-legal tasks. Although few might admit this publicly, these duties can be a reprieve from more difficult work. There's nothing like a few minutes of proofreading and initialing standard form leases to let the stressed mind recover. It is said that "No good lawyer is idle," but, unfortunately, busyness is no good if it simply involves lower-value tasks. For lawyers of limited ability or energy, the ideal day is filled with peripheral puttering.

How do quasi-legal burdens arise? These problems arise most commonly in decentralized departments, where lawyers report to a business executive. When lawyers are beholden to a non-lawyer executive, they can find themselves slipping down the slope of handling tasks that don't make good use of their core competencies. Running the crisis management program or business interruption program could be examples of activities outside the sweet spot.

The problem also turns up when companies are forced to lay off employees. Then, business managers are tempted to use lawyers for tasks that can no longer be accomplished within the manager's group. Administering contracts is an example. The lawyer should explain to his or her manager that the task is inappropriate. An uncomfortable discussion? Yes. But rooting out quasi-legal time sappers requires making sometimes-difficult decisions.

Some quasi lawyering survives as an anachronism. Many years ago, it may have been important for lawyers to handle workers' compensation filings because the law was less settled, but now the task has sunk to administrative levels.

Reporting to non-lawyers, headcount shortages outside the law department, misguided notions of client satisfaction, tradition—all of these encrust quasi-legal tasks in a law department. Most crucial to the buildup of these diversions, it should be stressed, is misunderstanding by clients and law departments about the highest and best use of lawyer talent.

Quasi-legal tasks bloat and encumber most law departments. Productivity and focus on the law department's core competencies drift away when there is an infestation of quasi-legal work. The price of fitness is eternal vigilance, a dose of self-discipline, supportive clients, and the conviction that quasi-legal work hobbles a law department.

Rees W. Morrison, co-head of law department consulting for Hildebrandt International, has assisted more than 180 legal departments in his 18 years of consulting. He also hosts the blog LawDepartmentManagement.typepad.com.

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Taking a Chance on More

General counsel who expand the rings of responsibility can benefit their companies and spice up their own careers at the same time.

BY REES W. MORRISON

For an in-house lawyer, doesn't promotion to general counsel mean you have reached the pinnacle? You're the top lawyer, reporting to the CEO. You oversee the law department as it protects the legal well-being of your company. That's been your career goal—but should you consider climbing higher and taking on even more? Shouldn't general counsel break the law barrier?

General counsel should realize there are real advantages to moving beyond the traditional responsibilities. First, though, let's examine the various roles. It's helpful to think of them as a series of rings of increasing responsibility.

1. The inner and most common ring includes reporting to the CEO and having most of the practicing lawyers in the company reporting to you. GCs are comfortable in that familiar zone.

This is the customary work of general counselship: legal adviser to the business and staff units, manager of litigation, mentor of lawyers, guardian of the legal budget.

But not even that simple definition is followed in every situation. We take for granted that general counsel have the normal panoply of responsibilities, but quite a few of them lack one or more. I am still surprised to find, as I did in one manufacturing company, that products liability fell to another corporate executive, or that in a retail products company, human resources had its own set of lawyers, or that in an energy company, the business lawyers reported to the heads of the several business divisions.

Likewise, although more than 80 percent of all general counsel report to the company's (or agency's or partnership's) top executive, many others report to the chief financial officer or a chief administrative officer. The first ring, therefore, has cracks in it. Not every general counsel has full control over the company's legal functions and future.

2. Moving up to the second ring, the general counsel with broader career goals often acts as the corporate secretary and takes on a handful of what I'll call broader legal functions.

The broader legal functions in the second ring often come with the title of general counsel, but nothing can be taken for granted. For instance, being the corporate secretary is not automatic. In my research, I've found that about one-fifth of general counsel do not manage that function.

Although most general counsel oversee the company's patent and trademark lawyers, in many companies they report to the research and development group or even to marketing. Claims functions are also a mixed bag, sometimes reporting to the legal department and sometimes to finance. One government entity requires its labor lawyers to report to the head of human resources. And collections work has the same characteristic of sometimes being part of the legal department and sometimes not.

Perhaps the most common example of a broader legal function that can be the responsibility of the general counsel, but often is not, is compliance. With the onslaught of corporate governance concerns in recent years, compliance has swung between being a stand-alone department—reporting to the chief executive officer and audit committee—and being part of another function, most commonly the legal department. Housed with legal, it enjoys some protections of attorney-client privilege.

3. More ambitiously, general counsel can expand into the third ring by taking on the management of any of several quasi-legal responsibilities, such as security, internal investigations, and government affairs.

Breaking the law barrier means taking charge of jobs that have some relation to the law and that share a fundamental theme: They involve risk to the company and compliance with risk reduction practices. For instance, loss prevention, the function that tries to minimize inventory shrinkage and cash leakage in retail operations, illustrates the overlapping concerns of risk of loss and actions to minimize that risk. Certainly, wrongdoing can lead to legal action or to terminations that trigger lawsuits, and just as certainly it is crucial that the company institute procedures so that employees comply with proper practices. Another example might be overseeing a company's corporate aircraft, which is the responsibility of the general counsel of Pfizer.

Many more quasi-legal functions swirl around law. Procurement, mostly an administrative job but with omnipresent contracts and disputes, shows this Janus-like quality of including both law and risk and compliance.

As interesting are those general counsel charged with responsibility for corporate security, internal audits, government relations, environmental health and safety, or ethics and so on. For instance, the newly appointed general counsel of Medtronics, Terry Carlson, is also responsible for government affairs.

I know an insurance company general counsel who runs human resources and even a general counsel for a retail company in charge of insurance risk management (in other words, buying insurance policies). The general counsel of Pharmacia, before Pfizer acquired it, ran the company's political action committee.

4. The bursting of the law barrier completely pushes general counsel into the fourth ring, the ring of the chief risk officer. I foresee more general counsel serving their company in the realm where management of compliance, risks, and legal exposure come together.

BEYOND THE PALE

Let's consider some challenges to breaking the barrier. In ancient Ireland, a criminal could be banished beyond the town's fortifications. The fortifications were stout sticks called "pales," and it was harsh indeed to be forced "beyond the pale." Many general counsel may contend that handling the traditional portfolio of legal responsibilities—the first ring—is quite challenging enough, thank you, and breaching the law barrier of the third and fourth rings is, well, beyond the pale. While that might be true, let's consider breaking the law barrier.

In truth, not every capable lawyer is a capable manager. Moving through the rings could be putting your head in a career noose if your management skills aren't very good. But some general counsel have the management ability, but simply haven't considered the broader roles they could play.

Even with great management prowess, should a general counsel who is ignorant of the inner workings of a specific area—who, say, has no idea how to create a risk assessment map—back off supervising internal audit? No, because many people manage others who can do functional tasks far beyond the manager. It's the integration of legal exposure, risk management, and procedural compliance that justifies the new role.

Second, companies and colleagues abhor power vacuums, and a general counsel who embarks on an ambitious program to take over neighboring functions will set off political wars. No department wants to be annexed and empire building has a bad name. For example, the chief financial officer will probably resist yielding her tax lawyers. But I would argue that power *should* accumulate for those who are most capable. The company will benefit from adept management of complementary functions.

Third, the rewards of ring-hopping and barrier-breaking may be fame, fortune, and the gratitude of your company and its stockholders, but its dark side may be pressure, long hours, and stomach-churning decisions. Right again. No one said that professional advancement and a wider scope comes free of cost.

If a general counsel explores the possibility of taking charge of more functions, will that cause confusion in the company over the person's "proper" role? Possibly, but keep in mind that there is no ideal definition of the optimal role of a general counsel. The needs of the company and the capabilities of the person set the only limits. Companies ought to be flexible and creative, assigning employees to their highest and best use. Moving a general counsel up a ring or two could be a pivotal, creative, and much-commended decision. Besides, the process of thinking about the relationships between law and other functions as well as who should run those functions beats trundling along in the accustomed ruts.

Why, then, should general counsel move through the rings? Why should a general counsel even give thought to breaking the law barrier?

First, your company will be better served if someone has a comprehensive oversight of risk and compliance responsibilities. An integrated approach to managing them will benefit everyone.

In addition, a broader scope of work is more interesting. True, the law is a jealous mistress, but challenging management problems, new opportunities to learn, and broader perspectives reward the risk-taker. To some, the headaches of management will stop them from ring-hopping. For others, the newfound range brings its own professional rewards.

Also, the senior lawyers in your department, those who report directly to you, have no promotions in prospect while you are in the position they may covet. If you expand your responsibilities, you make room for deputies or other promotions.

Rick Collier, the former general counsel of Pharmacia and now with Morgan Lewis & Bockius, offers another explanation: "CEOs sometimes want to narrow their span of control, so the general counsel ends up being assigned responsibilities in addition to law."

Finally, more responsibility usually means more money, a chair closer to the end of the executive committee table, and a stronger résumé. Little more need be said.

I admire general counsel. They have the brains and ambition to take on broader responsibilities. A larger conception of responsibilities beyond the traditional legal work might propel some general counsel to stretch. In fact, in this world of intertwined law, risk, and compliance monsters, someone holding the sword against them might make all the difference.

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MAYER BROWN ROWE & MAW

Securities Update

Effective Compliance and Ethics Programs under the Amended Sentencing Guidelines

September 27, 2004

Codes of conduct have become the norm for public companies. Stock exchanges mandate them as a corporate governance requirement. Pursuant to the Sarbanes-Oxley Act, public companies must disclose whether or not they have a code of ethics for their principal executive, financial and accounting officers and must disclose amendments and waivers to this code of ethics on a Form 8-K or on their websites. Similarly, the NYSE and Nasdaq listing standards require prompt disclosure of waivers of the code of conduct for any director or executive officer. Organizations that rate corporate governance inquire as to the existence of a code of conduct. Some companies view the code of conduct as an important component of the internal control system. The codes of conduct are readily available for the public to view — they can be found on websites and/or as exhibits to Securities and Exchange Commission filings. So, now everyone has a code of conduct. However, simply having a code of conduct is not enough for the purposes of the Sentencing Guidelines. A code of conduct is an integral part of an effective compliance and ethics program, but it is not the only part of one.

A code of conduct is an integral part of an effective compliance and ethics program, but it is not the only part of one.

Last spring, the United States Sentencing Commission sent to Congress significant changes to the federal Sentencing Guidelines for organizations. The amended Sentencing Guidelines will become effective on November 1, 2004, unless Congress disapproves them. The amended Sentencing Guidelines are available in full at http://www.ussc.gov/FEDREG/05_04_notice.pdf. (The portion of the amended Sentencing Guidelines addressing organizations is Chapter Eight, which begins on page 148 of this document.)

Ideally, a company will never find itself in the position of facing sentencing for corporate wrongdoing, but if it does, an effective compliance and ethics program is a mitigating factor that could reduce the ultimate penalty a company has to pay with respect to specific governmental fines and sanctions. (The absence of an effective program may lead a court to place a company on probation and the implementation of an effective program may be a condition of probation.) Also, an effective compliance program may limit the risk of aiding and abetting liability in private litigation by uncovering, correcting and preventing misconduct. With the effective date for the amended Sentencing Guidelines approaching, companies should consider whether they need to make any changes in their compliance programs.

The amended Sentencing Guidelines strengthen the existing criteria that a company must follow to establish that it has an effective compliance program and introduce new concepts into the definition of an effective compliance program. To emphasize its importance, the criteria for an effective compliance and ethics program has been elevated into its own, separate guideline (as opposed to its prior appearance as commentary). The amended Sentencing Guidelines require high-level responsibility for compliance. The Board must be knowledgeable about the content and operations of the program and members of senior management must administer the program. Training, which had been one way of communicating standards under the existing Sentencing Guidelines, will become a mandatory element of a compliance program once the amended Sentencing Guidelines become effective. And, this training obligation extends to directors and high-level personnel. The amended Sentencing Guidelines focus on incentives for compliance as well as discipline. The amended Sentencing Guidelines also introduce the concept of periodic assessment of potential risk of criminal conduct as a component of an effective compliance program for each company. Companies must provide sufficient resources for their compliance programs. Companies are specifically charged with promoting an organizational culture that encourages ethical conduct and compliance with law.

Under the amended Sentencing Guidelines, a company's culpability is generally determined by six factors. Two of these are factors that mitigate the ultimate sentence:

- the existence of an effective compliance and ethics program; and
- self-reporting, cooperation or acceptance of responsibility.

In addition, the amended Sentencing Guidelines list four factors which increase punishment. These are:

- involvement in or tolerance of criminal activity;
- the company's prior history;
- a violation of an order; and
- obstruction of justice.

An effective compliance program, which by itself serves as a mitigating factor in sentencing decisions, should reduce negative factors that courts are to consider such as tolerance of criminal activity.

Requirements of an Effective Compliance and Ethics Program

The amended Sentencing Guidelines establish two major requirements for an effective compliance and ethics program. First, the organization must exercise due diligence to prevent and detect criminal conduct. Second, the organization must promote an organizational culture that encourages ethical conduct and a commitment to compliance with law. The amended Sentencing Guidelines set forth seven minimum requirements for an effective compliance and ethics program, each of which must be met.

1. **Standards and Procedures.** The first minimum requirement is the establishment of standards and procedures to prevent and detect criminal conduct. This is where a code of conduct addressing compliance with law fits in. In addition, a company may have detailed policies and procedures, not formally part of the code of conduct, that supplement the code of conduct.

2. **Board and Senior Management Oversight.** According to the amended Sentencing Guidelines, for a compliance and ethics program to be effective, the organization's governing authority (i.e., its board of directors, or if the organization does not have a board of directors, its highest-level governing body) must be knowledgeable about both the content and operation of the compliance and ethics program. The governing body must exercise reasonable oversight of the program's implementation. This can be done through a board committee, such as the audit committee (which for a NYSE listed company is specifically charged with responsibility for legal compliance), with the board committee reporting periodically to the board. The amended Sentencing Guidelines also require that high-level personnel of the organization (i.e., persons with substantial control or who have a substantial policy making role, such as directors and executive officers) ensure that the organization has an effective compliance and ethics program. The amended Sentencing Guidelines use the word "ensure" in this requirement, setting a high standard of responsibility for the individuals in the top levels of authority who are charged with compliance responsibility. Specific, high-level individual(s) within each organization must be assigned overall responsibility for the compliance and ethics program. In addition, specific individual(s) must be given day-to-day operational responsibility for the program. These operational individuals must report periodically to high-level personnel and, as appropriate, at least annually, to the board of directors. The individuals who are given operational authority for the compliance program must be given adequate resources, appropriate authority and direct access to the board or a board committee. The individuals with responsibility for the compliance program must perform their duties with due diligence and must promote an organizational culture

that encourages ethical conduct and a commitment to compliance with law.

3. **Screening.** A company must use reasonable efforts so that it does not permit individuals who have engaged in illegal activities or other conduct inconsistent with an effective compliance and ethics program to exercise a substantial measure of discretion in acting on behalf of the organization. The amended Sentencing Guidelines impose a due diligence obligation as part of this requirement. In applying this requirement, a company may consider the relatedness of the misconduct to the specific responsibilities to be performed, the recency of the misconduct and whether the individual in question has engaged in other misconduct.

4. **Training and Dissemination of Information.** The fourth component of an effective compliance and ethics program consists of training programs and the dissemination of information appropriate to an individual's roles and responsibilities. This obligation applies to directors, high-level personnel and personnel who exercise substantial discretion on the part of the company, as well as to employees in general and, in appropriate circumstances, to a company's agents.

It is critical to follow applicable industry practice and standards required by any governmental regulation. The amended Sentencing Guidelines expressly provide that failure to do so will weigh against a finding that an effective compliance and ethics program exists.

5. **Monitoring and Auditing.** The amended Sentencing Guidelines require a company to take reasonable steps to ensure that the program is followed, such as monitoring and auditing to detect criminal conduct. The company must periodically evaluate the effectiveness of its compliance and ethics program. The company must also establish and publicize a system to report or seek guidance regarding potential or actual criminal conduct.

6. **Promotion and Enforcement.** The sixth minimum element of an effective compliance program is the promotion and consistent enforcement of the program throughout the organization. There should be appropriate incentives to perform in accordance with the program and appropriate disciplinary action, both for engaging in criminal conduct and for failing to take reasonable steps to prevent or detect criminal conduct. While adequate discipline is a necessary component of an effective compliance program, the amended Sentencing Guidelines do not mandate the form of discipline other than to require that it be appropriate to the specific case.

7. **Responding to Violations.** Finally, if criminal conduct is detected, the amended Sentencing Guidelines require that the organization take reasonable steps to respond appropriately and to prevent further similar criminal conduct. This may require modifying the company's compliance and ethics program.

Satisfying the Compliance Program Guidelines

Each of the above-described minimum requirements must be met in order for a company to have an effective compliance and ethics program for the purposes of the amended Sentencing Guidelines, but the amended Sentencing Guidelines explicitly recognize that the specific actions necessary to satisfy a requirement may vary based on applicable industry practice or government regulation, the size of an organization or similar misconduct. As a result there is no "one size fits all" approach to a compliance program.

Conformance to Industry Practice and Comply with Governmental Regulation. It is critical to follow applicable industry practice and standards required by any governmental regulation. The amended Sentencing Guidelines expressly provide that failure to do so will weigh against a finding that an effective compliance and ethics program exists. Therefore, codes of conduct and company policies should be drafted so that they promote compliance with applicable standards set by the industry as well as governmental regulations.

Size of Organization Considerations. Larger companies will be expected to have more formal compliance operations — and to devote greater resources to compliance activities — than smaller companies. The amended Sentencing Guidelines also suggest that larger companies should be encouraging smaller companies to implement effective compliance and ethics programs, particularly if they seek to do business with the larger company. While smaller companies may meet compliance requirements with less formality and fewer resources than larger companies, they must nevertheless demonstrate the same degree of commitment to ethical conduct and legal compliance as larger companies. Smaller companies may, for example, use available personnel rather than hiring separate compliance staff. Training may occur through informal staff meetings and monitoring may occur through "walk-arounds" or continuous monitoring. The Board may directly monitor the program. Compliance programs may be modeled on well-regarded programs of similarly situated companies.

Similar Misconduct. Recurring misconduct will cast doubt upon the effectiveness of a compliance and ethics program. For this reason it is very important to respond firmly to problems that may arise and to modify the program as necessary to avoid repeated violations by anyone within the organization.

Risk Analysis. The amended Sentencing Guidelines require a risk analysis to be performed in connection with the implementation of the required elements of an effective compliance and ethics program. That is, companies must periodically assess the risk of criminal conduct in their organizations, which may vary depending on the businesses engaged in and the methods of conducting business. This analysis should take into account the nature and the seriousness of the potential criminal conduct. Based on this risk analysis, they must take appropriate steps to design, implement or modify the actions that they are taking to satisfy each requirement of an effective program in order to reduce the risk of criminal conduct that they identify. Companies are expected to prioritize their resources to target potential criminal activities that pose the greatest risk. This is not only an ongoing process, it is one that must be specifically tailored for each company.

Practical Considerations

- **Benefits of an Effective Compliance Program.** Mitigation of penalties after something has gone wrong is not the only benefit of a compliance and ethics program that will satisfy the requirements of the amended Sentencing Guidelines. The principles of an effective compliance and ethics program outlined in the amended Sentencing Guidelines represent a governmentally sanctioned statement of what is expected from a corporate governance perspective. It will be looked upon as a measure of good corporate citizenship. The requirements of the amended Sentencing Guidelines in this area may be used as a measuring stick by institutional investors and organizations that rate corporate governance. Evidence of an effective compliance program may also lessen the threat of a governmental investigation. The minimum requirements of the amended Sentencing Guidelines may have been developed by a review of best practices, but they may now become more than a set of best practice goals. Because the amended Sentencing Guidelines are promulgated by the government, they may actually take on a heightened sensibility. Organizations may find that these standards become viewed as obligatory requirements rather than as a tool to reduce penalties that hopefully will never have the occasion to be imposed.

- **Ongoing Evaluation and Revision.** A code of conduct should be an evolving, rather than a static document. A great deal of attention was focused on codes of conduct during the last year and a half as companies sought to comply with new listing requirements and SEC rules, and to generally respond to the corporate scandals that led to the adoption of Sarbanes-Oxley. This work is not completed, however. Unlike stock exchange listing standards or the SEC's rules on disclosure of codes of ethics, the amended Sentencing Guidelines do not dictate mandatory elements that must be part of an organization's code of conduct. Best practices are evolving. Therefore, there is no set of amendments that needs to be made to bring a code of conduct into compliance with the amended Sentencing Guidelines. What the amended Sentencing Guidelines do require, however, is that the compliance program of which the code of conduct is a part be evaluated on a regular basis, together with procedures for compliance.

- **Identification of Responsible Individuals.** Companies should clearly identify the high-level individuals who have supervisory responsibility for the compliance and ethics program and the individuals who have the day-to-day responsibility for the compliance program. The amended Sentencing Guidelines do not promulgate a single approach, recognizing that a larger organization may have a greater need for formality than a smaller organization. Therefore, it is not necessary for there to be an individual in every organization with the title of compliance officer. That being said, it is important for

all companies to have someone who is charged with compliance responsibilities, even if that person also performs other functions within the organization.

- **Responsibility to Ensure Compliance.** The high-level individuals given responsibility for the compliance and ethics program must recognize that the amended Sentencing Guidelines expect them to "ensure" that the program is effective. Compliance responsibility must be taken seriously so that the tone is set from the top.
- **Board Monitoring.** It is important for reports to be given to the board or a board committee with respect to compliance and ethics issues on a regular basis. The amended Sentencing Guidelines explicitly state that the board must be knowledgeable both about the content and the operation of the compliance and the ethics program. The audit committee may take the lead role in fulfilling this responsibility, but it should report to the full board both as to content and operations. Compliance, of course, should be raised at the board or committee level whenever there is a specific issue that needs to be addressed. In addition, however, companies should consider adding compliance review to the regular schedule of board or committee activities. This requirement of the amended Sentencing Guidelines dovetails with requirements, such as that of the New York Stock Exchange, that the audit committee assist the board with oversight of the company's legal and regulatory requirements.
- **Adequate Reporting Mechanisms.** The Sarbanes-Oxley Act required public companies to implement procedures whereby accounting and auditing concerns could be confidentially and anonymously reported. To get the mitigating benefits of the amended Sentencing Guidelines should a criminal action arise, as well as to generally enhance their corporate governance profile in the eyes of investors, rating agencies and potential investigators, companies should determine that they have adequate systems in place to permit employees to anonymously report other categories of violations of laws without fear of retaliation. One way to accomplish this is through the use of a third-party, toll-free hotline, but that is not a requirement.
- **Importance of Training.** Companies must recognize that under the amended Sentencing Guidelines, training is an integral part of a compliance and ethics program. This includes training at high levels, such as training programs for directors and senior management. It is not sufficient to assign duties to individuals without giving them the tools to understand and effectively implement their legal compliance duties.
- **Compliance by Agents.** Companies should consider how actions of "outsiders," such as agents, suppliers and distributors, reflect upon their own compliance and ethics programs. In some circumstances, it may be appropriate to insist that these other parties adhere to the company's compliance program or demonstrate that they have implemented their own program. The amended Sentencing Guidelines explicitly acknowledge the possibility that training of agents might be appropriate. Therefore, it is important to assess the role agents play for a company. To the extent they play a significant role in a company's business, the company must take steps to clearly communicate its compliance and ethics programs to agents and train them as necessary.
- **Ethical Issues.** The scope of the amended Sentencing Guidelines is not limited to compliance with law. The key phrase used in the amended Sentencing Guidelines is a compliance and *ethics* program. Companies should focus on ethical issues, as well as legal compliance, when designing their programs. This constitutes another aspect of setting the proper compliance tone from the top of the organization.
- **Compliance-Based Incentives.** The amended Sentencing Guidelines explicitly mention incentives, as well as disciplinary actions. Companies should consider how to incorporate this concept in a way that is appropriate for their organizations. Including compliance as a component of employee performance evaluations may be one form of incentive. For some companies, an explicit tying of compliance performance to compensation, at least for individuals who are charged with responsibilities for oversight or operations of the compliance and ethics program, may be appropriate. No specific approach is mandated. However, companies should assess how they address incentives as well as disciplinary action.
- **Follow-Through.** Establishing compliance procedures is not sufficient. There must be follow-through. For example, keep records to demonstrate how employees are made aware of the program. If employees are given hard copies of the code of conduct, be sure all employees get them, including new hires. If employees are expected to access the code of conduct and related policies electronically, be sure they are given adequate information to locate the materials — and access to a computer on which to do so. And, maintain an electronic log to document that employees are accessing those materials. If annual certifications are requested of all or a designated group of employees, be sure that all required certifications are returned.
- **Sufficient Budget.** Companies should assess whether they are providing a sufficient budget for compliance activities.
- **Background Screenings.** Companies should review their procedures for screening the background of senior management to be sure that they can demonstrate that they are not giving substantial authority to persons with a history of illegal or unethical conduct.

If you have any questions regarding the release, we would be pleased to provide additional details or advice about specific situations. For more information, please contact any of the attorneys listed below or any other member of our corporate and securities group. If you would prefer to receive distributions electronically and are not receiving them that way now, please send your e-mail address to cblackmond@mayerbrownrowe.com.

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U.S. Department of Justice

Office of the Deputy Attorney General

The Deputy Attorney General

Washington, D.C. 20530

January 20, 2003

MEMORANDUM

TO: Heads of Department Components
United States Attorneys

FROM: Larry D. Thompson
Deputy Attorney General

SUBJECT: Principles of Federal Prosecution of Business Organizations

As the Corporate Fraud Task Force has advanced in its mission, we have confronted certain issues in the principles for the federal prosecution of business organizations that require revision in order to enhance our efforts against corporate fraud. While it will be a minority of cases in which a corporation or partnership is itself subjected to criminal charges, prosecutors and investigators in every matter involving business crimes must assess the merits of seeking the conviction of the business entity itself.

Attached to this memorandum are a revised set of principles to guide Department prosecutors as they make the decision whether to seek charges against a business organization. These revisions draw heavily on the combined efforts of the Corporate Fraud Task Force and the Attorney General's Advisory Committee to put the results of more than three years of experience with the principles into practice.

The main focus of the revisions is increased emphasis on and scrutiny of the authenticity of a corporation's cooperation. Too often business organizations, while purporting to cooperate with a Department investigation, in fact take steps to impede the quick and effective exposure of the complete scope of wrongdoing under investigation. The revisions make clear that such conduct should weigh in favor of a corporate prosecution. The revisions also address the efficacy of the corporate governance mechanisms in place within a corporation, to ensure that these measures are truly effective rather than mere paper programs.

Further experience with these principles may lead to additional adjustments. I look forward to hearing comments about their operation in practice. Please forward any comments to Christopher Wray, the Principal Associate Deputy Attorney General, or to Andrew Hruska, my Senior Counsel.

Federal Prosecution of Business Organizations[1]

I. Charging a Corporation: General

A. General Principle: Corporations should not be treated leniently because of their artificial nature nor should they be subject to harsher treatment. Vigorous enforcement of the criminal laws against corporate wrongdoers, where appropriate results in great benefits for law enforcement and the public, particularly in the area of white collar crime. Indicting corporations for wrongdoing enables the government to address and be a force for positive change of corporate culture, alter corporate behavior, and prevent, discover, and punish white collar crime.

B. Comment: In all cases involving corporate wrongdoing, prosecutors should consider the factors discussed herein. First and foremost, prosecutors should be aware of the important public benefits that may flow from indicting a corporation in appropriate cases. For instance, corporations are likely to take immediate remedial steps when one is indicted for criminal conduct that is pervasive throughout a particular industry, and thus an indictment often provides a unique opportunity for deterrence on a massive scale. In addition, a corporate indictment may result in specific deterrence by changing the culture of the indicted corporation and the behavior of its employees. Finally, certain crimes that carry with them a substantial risk of great public harm, e.g., environmental crimes or financial frauds, are by their nature most likely to be committed by businesses, and there may, therefore, be a substantial federal interest in indicting the corporation.

Charging a corporation, however, does not mean that individual directors, officers, employees, or shareholders should not also be charged. Prosecution of a corporation is not a substitute for the prosecution of criminally culpable individuals within or without the corporation. Because a corporation can act only through individuals, imposition of individual criminal liability may provide the strongest deterrent against future corporate wrongdoing. Only rarely should provable individual culpability not be pursued, even in the face of offers of corporate guilty pleas.

Corporations are "legal persons," capable of suing and being sued, and capable of committing crimes. Under the doctrine of *respondeat superior*, a corporation may be held criminally liable for the illegal acts of its directors, officers, employees, and agents. To hold a corporation liable for these actions, the government must establish that the corporate agent's actions (i) were within the scope of his duties and (ii) were intended, at least in part, to benefit the corporation. In all cases involving wrongdoing by corporate agents, prosecutors should consider the corporation, as well as the responsible individuals, as potential criminal targets.

Agents, however, may act for mixed reasons -- both for self-aggrandizement (both direct and indirect) and for the benefit of the corporation, and a corporation may be held liable as long as one motivation of its agent is to benefit the corporation. In *United States v. Automated Medical Laboratories*, 770 F.2d 399 (4th Cir. 1985), the court affirmed the corporation's conviction for the actions of a subsidiary's employee despite its claim that the employee was acting for his own benefit, namely his "ambitious nature and his desire to ascend the corporate ladder." The court stated, "*Partucci* was clearly acting in part to benefit AML since his advancement within the corporation depended on AML's well-being and its lack of difficulties with the FDA." Similarly, in *United States v. Cincotta*, 689 F.2d 238, 241-42 (1st Cir. 1982), the court held, "criminal liability may be imposed on the corporation only where the agent is acting within the scope of his employment. That, in turn, requires that the agent be performing acts of the kind which he is authorized to perform, and those acts must be motivated -- at least in part -- by an intent to benefit the corporation." Applying this test, the court upheld the corporation's conviction, notwithstanding the substantial personal benefit reaped by its miscreant agents, because the fraudulent scheme required money to pass through the corporation's treasury and the fraudulently obtained goods were resold to the corporation's customers in the corporation's name. As the court concluded, "Mystic–not the individual defendants–was making money by selling oil that it had not paid for."

Moreover, the corporation need not even necessarily profit from its agent's actions for it to be held liable. In *Automated Medical Laboratories*, the Fourth Circuit stated:

> [B]enefit is not a "touchstone of criminal corporate liability; benefit at best is an evidential, not an operative, fact." Thus, whether the agent's actions ultimately redounded to the benefit of the corporation is less significant than whether the agent acted with the intent to benefit the corporation. The basic purpose of requiring that an agent have acted with the intent to benefit the corporation, however, is to insulate the corporation from criminal liability for actions of its agents which be inimical to the interests of the corporation or which may have been undertaken solely to advance the interests of that agent or of a party other than the corporation.

770 F.2d at 407 (emphasis added; quoting *Old Monastery Co. v. United States*, 147 F.2d 905, 908 (4th Cir.), cert. denied, 326 U.S. 734 (1945)).

II. Charging a Corporation: Factors to Be Considered

A. General Principle: Generally, prosecutors should apply the same factors in determining whether to charge a corporation as they do with respect to individuals. *See* USAM § 9-27.220, *et seq.* Thus, the prosecutor should weigh all of the factors normally considered in the sound exercise of prosecutorial judgment: the sufficiency of the evidence; the likelihood of success at trial,; the probable deterrent, rehabilitative, and other consequences of conviction; and the adequacy of noncriminal approaches. *See* id. However, due to the nature of the corporate "person," some additional factors are present. In conducting an investigation, determining whether to bring

charges, and negotiating plea agreements, prosecutors should consider the following factors in reaching a decision as to the proper treatment of a corporate target:

1. the nature and seriousness of the offense, including the risk of harm to the public, and applicable policies and priorities, if any, governing the prosecution of corporations for particular categories of crime (*see* section III, *infra*);

2. the pervasiveness of wrongdoing within the corporation, including the complicity in, or condonation of, the wrongdoing by corporate management (*see* section IV, *infra*);

3. the corporation's history of similar conduct, including prior criminal, civil, and regulatory enforcement actions against it (*see* section V, *infra*);

4. the corporation's timely and voluntary disclosure of wrongdoing and its willingness to cooperate in the investigation of its agents, including, if necessary, the waiver of corporate attorney-client and work product protection (*see* section VI, *infra*);

5. the existence and adequacy of the corporation's compliance program (*see* section VII, *infra*);

6. the corporation's remedial actions, including any efforts to implement an effective corporate compliance program or to improve an existing one, to replace responsible management, to discipline or terminate wrongdoers, to pay restitution, and to cooperate with the relevant government agencies (*see* section VIII, *infra*);

7. collateral consequences, including disproportionate harm to shareholders, pension holders and employees not proven personally culpable and impact on the public arising from the prosecution (*see* section IX, *infra*); and

8. the adequacy of the prosecution of individuals responsible for the corporation's malfeasance;

9. the adequacy of remedies such as civil or regulatory enforcement actions (*see section X, infra*).

B. Comment: As with the factors relevant to charging natural persons, the foregoing factors are intended to provide guidance rather than to mandate a particular result. The factors listed in this section are intended to be illustrative of those that should be considered and not a complete or exhaustive list. Some or all of these factors may or may not apply to specific cases, and in some cases one factor may override all others. The nature and seriousness of the offense may be such as to warrant prosecution regardless of the other factors. Further, national law enforcement policies in various enforcement areas may require that more or less weight be given to certain of these factors than to others.

In making a decision to charge a corporation, the prosecutor generally has wide latitude in determining when, whom, how, and even whether to prosecute for violations of Federal criminal law. In exercising that discretion, prosecutors should consider the following general statements of principles that summarize appropriate considerations to be weighed and desirable practices to be followed in discharging their prosecutorial responsibilities. In doing so, prosecutors should ensure that the general purposes of the criminal law -- assurance of warranted punishment, deterrence of further criminal conduct, protection of the public from dangerous and fraudulent conduct, rehabilitation of offenders, and restitution for victims and affected communities -- are adequately met, taking into account the special nature of the corporate "person."

III. Charging a Corporation: Special Policy Concerns

A. General Principle: The nature and seriousness of the crime, including the risk of harm to the public from the criminal conduct, are obviously primary factors in determining whether to charge a corporation. In addition, corporate conduct, particularly that of national and multi-national corporations, necessarily intersects with federal economic, taxation, and criminal law enforcement policies. In applying these principles, prosecutors must consider the practices and policies of the appropriate Division of the Department, and must comply with those policies to the extent required.

B. Comment: In determining whether to charge a corporation, prosecutors should take into account federal law enforcement priorities as discussed above. *See* USAM § 9-27-230. In addition, however, prosecutors must be aware of the specific policy goals and incentive programs established by the respective Divisions and regulatory agencies. Thus, whereas natural persons may be given incremental degrees of credit (ranging from immunity to lesser charges to sentencing considerations) for turning themselves in, making statements against their penal interest, and cooperating in the government's investigation of their own and others' wrongdoing, the same approach may not be appropriate in all circumstances with respect to corporations. As an example, it is entirely proper in many investigations for a prosecutor to consider the corporation's pre-indictment conduct, *e.g.*,voluntary disclosure, cooperation, remediation or restitution, in determining whether to seek an indictment. However, this would not necessarily be appropriate in an antitrust investigation, in which antitrust violations, by definition, go to the heart of the corporation's business and for which the Antitrust Division has therefore established a firm policy, understood in the business community, that credit should not be given at the charging stage for a compliance program and that amnesty is available only to the first corporation to make full disclosure to the government. As another example, the Tax Division has a strong preference for prosecuting responsible individuals, rather than entities, for corporate tax offenses. Thus, in determining whether or not to charge a corporation, prosecutors should consult with the Criminal, Antitrust, Tax, and Environmental and Natural Resources Divisions, if appropriate or required.

IV. Charging a Corporation: Pervasiveness of Wrongdoing Within the Corporation

A. General Principle: A corporation can only act through natural persons, and it is therefore held responsible for the acts of such persons fairly attributable to it. Charging a corporation for even minor misconduct may be appropriate where the wrongdoing was pervasive and was undertaken by a large number of employees or by all the employees in a particular role within the corporation, *e.g.*, salesmen or procurement officers, or was condoned by upper management. On the other hand, in certain limited circumstances, it may not be appropriate to impose liability upon a corporation, particularly one with a compliance program in place, under a strict *respondeat superior* theory for the single isolated act of a rogue employee. There is, of course, a wide spectrum between these two extremes, and a prosecutor should exercise sound discretion in evaluating the pervasiveness of wrongdoing within a corporation.

B. Comment: Of these factors, the most important is the role of management. Although acts of even low-level employees may result in criminal liability, a corporation is directed by its management and management is responsible for a corporate culture in which criminal conduct is either discouraged or tacitly encouraged. As stated in commentary to the Sentencing Guidelines:

> Pervasiveness [is] case specific and [will] depend on the number, and degree of responsibility, of individuals [with] substantial authority ... who participated in, condoned, or were willfully ignorant of the offense. Fewer individuals need to be involved for a finding of pervasiveness if those individuals exercised a relatively high degree of authority. Pervasiveness can occur either within an organization as a whole or within a unit of an organization.

USSG §8C2.5, comment. (n. 4).

V. Charging a Corporation: The Corporation's Past History

A. General Principle: Prosecutors may consider a corporation's history of similar conduct, including prior criminal, civil, and regulatory enforcement actions against it, in determining whether to bring criminal charges.

B. Comment: A corporation, like a natural person, is expected to learn from its mistakes. A history of similar conduct may be probative of a corporate culture that encouraged, or at least condoned, such conduct, regardless of any compliance programs. Criminal prosecution of a corporation may be particularly appropriate where the corporation previously had been subject to non-criminal guidance, warnings, or sanctions, or previous criminal charges, and yet it either had not taken adequate action to prevent future unlawful conduct or had continued to engage in the conduct in spite of the warnings or enforcement actions taken against it. In making this determination, the corporate structure itself, *e.g.*, subsidiaries or operating divisions, should be ignored, and enforcement actions taken against the corporation or any of its divisions, subsidiaries, and affiliates should be considered. *See* USSG § 8C2.5(c) & comment. (n. 6).

VI. Charging a Corporation: Cooperation and Voluntary Disclosure

A. General Principle: In determining whether to charge a corporation, that corporation's timely and voluntary disclosure of wrongdoing and its willingness to cooperate with the government's investigation may be relevant factors. In gauging the extent of the corporation's cooperation, the prosecutor may consider the corporation's willingness to identify the culprits within the corporation, including senior executives; to make witnesses available; to disclose the complete results of its internal investigation; and to waive attorney-client and work product protection.

B. Comment: In investigating wrongdoing by or within a corporation, a prosecutor is likely to encounter several obstacles resulting from the nature of the corporation itself. It will often be difficult to determine which individual took which action on behalf of the corporation. Lines of authority and responsibility may be shared among operating divisions or departments, and records and personnel may be spread throughout the United States or even among several countries. Where the criminal conduct continued over an extended period of time, the culpable or knowledgeable personnel may have been promoted, transferred, or fired, or they may have quit or retired. Accordingly, a corporation's cooperation may be critical in identifying the culprits and locating relevant evidence.

In some circumstances, therefore, granting a corporation immunity or amnesty or pretrial diversion may be considered in the course of the government's investigation. In such circumstances, prosecutors should refer to the principles governing non-prosecution agreements generally. *See* USAM § 9-27.600-650. These principles permit a non prosecution agreement in exchange for cooperation when a corporation's "timely cooperation appears to be necessary to the public interest and other means of obtaining the desired cooperation are unavailable or would not be effective." Prosecutors should note that in the case of national or multi-national corporations, multi-district or global agreements may be necessary. Such agreements may only be entered into with the approval of each affected district or the appropriate Department official. *See* USAM §9-27.641.

In addition, the Department, in conjunction with regulatory agencies and other executive branch departments, encourages corporations, as part of their compliance programs, to conduct internal investigations and to disclose their findings to the appropriate authorities. Some agencies, such as the SEC and the EPA, as well as the Department's Environmental and Natural Resources Division, have formal voluntary disclosure programs in which self-reporting, coupled with remediation and additional criteria, may qualify the corporation for amnesty or reduced sanctions.[2] Even in the absence of a formal program, prosecutors may consider a corporation's timely and voluntary disclosure in evaluating the adequacy of the corporation's compliance program and its management's commitment to the compliance program. However, prosecution and economic policies specific to the industry or statute may require prosecution notwithstanding a corporation's willingness to cooperate. For example, the Antitrust Division offers amnesty only to the first corporation to agree to cooperate. This creates a strong incentive for corporations participating in anti-competitive conduct to be the first to cooperate. In addition, amnesty, immunity, or reduced sanctions may not be appropriate where the corporation's business is permeated with fraud or other crimes.

One factor the prosecutor may weigh in assessing the adequacy of a corporation's cooperation is the completeness of its disclosure including, if necessary, a waiver of the attorney-client and work product protections, both with respect to its internal investigation and with respect to communications between specific officers, directors and employees and counsel. Such waivers permit the government to obtain statements of possible witnesses, subjects, and targets, without having to negotiate individual cooperation or immunity agreements. In addition, they are often critical in enabling the government to evaluate the completeness of a corporation's voluntary disclosure and cooperation. Prosecutors may, therefore, request a waiver in appropriate circumstances.[3] The Department does not, however, consider waiver of a corporation's attorney-client and work product protection an absolute requirement, and prosecutors should consider the willingness of a corporation to waive such protection when necessary to provide timely and complete information as one factor in evaluating the corporation's cooperation.

Another factor to be weighed by the prosecutor is whether the corporation appears to be protecting its culpable employees and agents. Thus, while cases will differ depending on the circumstances, a corporation's promise of support to culpable employees and agents, either through the advancing of attorneys fees,[4] through retaining the employees without sanction for their misconduct, or through providing information to the employees about the government's investigation pursuant to a joint defense agreement, may be considered by the prosecutor in weighing the extent and value of a corporation's cooperation. By the same token, the prosecutor should be wary of attempts to shield corporate officers and employees from liability by a willingness of the corporation to plead guilty.

Another factor to be weighed by the prosecutor is whether the corporation, while purporting to cooperate, has engaged in conduct that impedes the investigation (whether or not rising to the level of criminal obstruction). Examples of such conduct include: overly broad assertions of corporate representation of employees or former employees; inappropriate directions to employees or their counsel, such as directions not to cooperate openly and fully with the investigation including, for example, the direction to decline to be interviewed; making presentations or submissions that contain misleading assertions or omissions; incomplete or delayed production of records; and failure to promptly disclose illegal conduct known to the corporation.

Finally, a corporation's offer of cooperation does not automatically entitle it to immunity from prosecution. A corporation should not be able to escape liability merely by offering up its directors, officers, employees, or agents as in lieu of its own prosecution. Thus, a corporation's willingness to cooperate is merely one relevant factor, that needs to be considered in conjunction with the other factors, particularly those relating to the corporation's past history and the role of management in the wrongdoing.

VII. Charging a Corporation: Corporate Compliance Programs

A. General Principle: Compliance programs are established by corporate management to prevent and to detect misconduct and to ensure that corporate activities are conducted in accordance with all applicable criminal and civil laws, regulations, and rules. The Department encourages such corporate self-policing, including voluntary disclosures to the government of any problems that a corporation discovers on its own. However, the existence of a compliance program is not sufficient, in and of itself, to justify not charging a corporation for criminal conduct undertaken by its officers, directors, employees, or agents. Indeed, the commission of such crimes in the face of a compliance program may suggest that the corporate management is not adequately enforcing its program. In addition, the nature of some crimes, *e.g.*, antitrust violations, may be such that national law enforcement policies mandate prosecutions of corporations notwithstanding the existence of a compliance program.

B. Comment: A corporate compliance program, even one specifically prohibiting the very conduct in question, does not absolve the corporation from criminal liability under the doctrine of *respondeat superior. See United States v. Basic Construction Co.*, 711 F.2d 570 (4th Cir. 1983) ("a corporation may be held criminally responsible for antitrust violations committed by its employees if they were acting within the scope of their authority, or apparent authority, and for the benefit of the corporation, even if... such acts were against corporate policy or express instructions."). In *United States v. Hilton Hotels Corp.*, 467 F.2d 1000 (9th Cir. 1972), *cert. denied,* 409 U.S. 1125 (1973), the Ninth Circuit affirmed antitrust liability based upon a purchasing agent for a single hotel threatening a single supplier with a boycott unless it paid dues to a local marketing association, even though the agent's actions were contrary to corporate policy and directly against express instructions from his superiors. The court reasoned that Congress, in enacting the Sherman Antitrust Act, "intended to impose liability upon business entities for the acts of those to whom they choose to delegate the conduct of their affairs, thus stimulating a maximum effort by owners and managers to assure adherence by such agents to the requirements of the Act."[5] It concluded that "general policy statements" and even direct instructions from the agent's superiors were not sufficient; "Appellant could not gain exculpation by issuing general instructions without undertaking to enforce those instructions by means commensurate with the obvious risks." *See also United States v. Beusch,* 596 F.2d 871, 878 (9th Cir. 1979) ("[A] corporation may be liable for the acts of its employees done contrary to express instructions and policies, but ... the existence of such instructions and policies may be considered in determining whether the employee in fact acted to benefit the corporation."); *United States v. American Radiator & Standard Sanitary Corp.,* 433 F.2d 174 (3rd Cir. 1970) (affirming conviction of corporation based upon its officer's participation in price-fixing scheme, despite corporation's defense that officer's conduct violated its "rigid anti-fraternization policy" against any socialization (and exchange of price information) with its competitors; "When the act of the agent is within the scope of his employment or his apparent authority, the corporation is held legally responsible for it, although what he did may be contrary to his actual instructions and may be unlawful.").

While the Department recognizes that no compliance program can ever prevent all criminal activity by a corporation's employees, the critical factors in evaluating any program are whether the program is adequately designed for maximum effectiveness in preventing and detecting wrongdoing by employees and whether corporate management is enforcing the program or is tacitly encouraging or pressuring employees to engage in

misconduct to achieve business objectives. The Department has no formal guidelines for corporate compliance programs. The fundamental questions any prosecutor should ask are: "Is the corporation's compliance program well designed?" and "Does the corporation's compliance program work?" In answering these questions, the prosecutor should consider the comprehensiveness of the compliance program; the extent and pervasiveness of the criminal conduct; the number and level of the corporate employees involved; the seriousness, duration, and frequency of the misconduct; and any remedial actions taken by the corporation, including restitution, disciplinary action, and revisions to corporate compliance programs.[6] Prosecutors should also consider the promptness of any disclosure of wrongdoing to the government and the corporation's cooperation in the government's investigation. In evaluating compliance programs, prosecutors may consider whether the corporation has established corporate governance mechanisms that can effectively detect and prevent misconduct. For example, do the corporation's directors exercise independent review over proposed corporate actions rather than unquestioningly ratifying officers' recommendations; are the directors provided with information sufficient to enable the exercise of independent judgment, are internal audit functions conducted at a level sufficient to ensure their independence and accuracy and have the directors established an information and reporting system in the organization reasonable designed to provide management and the board of directors with timely and accurate information sufficient to allow them to reach an informed decision regarding the organization's compliance with the law. *In re: Caremark*, 698 A.2d 959 (Del. Ct. Chan. 1996).

Prosecutors should therefore attempt to determine whether a corporation's compliance program is merely a "paper program" or whether it was designed and implemented in an effective manner. In addition, prosecutors should determine whether the corporation has provided for a staff sufficient to audit, document, analyze, and utilize the results of the corporation's compliance efforts. In addition, prosecutors should determine whether the corporation's employees are adequately informed about the compliance program and are convinced of the corporation's commitment to it. This will enable the prosecutor to make an informed decision as to whether the corporation has adopted and implemented a truly effective compliance program that, when consistent with other federal law enforcement policies, may result in a decision to charge only the corporation's employees and agents.

Compliance programs should be designed to detect the particular types of misconduct most likely to occur in a particular corporation's line of business. Many corporations operate in complex regulatory environments outside the normal experience of criminal prosecutors. Accordingly, prosecutors should consult with relevant federal and state agencies with the expertise to evaluate the adequacy of a program's design and implementation. For instance, state and federal banking, insurance, and medical boards, the Department of Defense, the Department of Health and Human Services, the Environmental Protection Agency, and the Securities and Exchange Commission have considerable experience with compliance programs and can be very helpful to a prosecutor in evaluating such programs. In addition, the Fraud Section of the Criminal Division, the Commercial Litigation Branch of the Civil Division, and the Environmental Crimes Section of the Environment and Natural Resources Division can assist U.S. Attorneys' Offices in finding the appropriate agency office and in providing copies of compliance programs that were developed in previous cases.

VIII. Charging a Corporation: Restitution and Remediation

A. General Principle: Although neither a corporation nor an individual target may avoid prosecution merely by paying a sum of money, a prosecutor may consider the corporation's willingness to make restitution and steps already taken to do so. A prosecutor may also consider other remedial actions, such as implementing an effective corporate compliance program, improving an existing compliance program, and disciplining wrongdoers, in determining whether to charge the corporation.

B. Comment: In determining whether or not a corporation should be prosecuted, a prosecutor may consider whether meaningful remedial measures have been taken, including employee discipline and full restitution.[7] A corporation's response to misconduct says much about its willingness to ensure that such misconduct does not recur. Thus, corporations that fully recognize the seriousness of their misconduct and accept responsibility for it should be taking steps to implement the personnel, operational, and organizational changes necessary to establish an awareness among employees that criminal conduct will not be tolerated. Among the factors prosecutors should consider and weigh are whether the corporation appropriately disciplined the wrongdoers and disclosed information concerning their illegal conduct to the government.

Employee discipline is a difficult task for many corporations because of the human element involved and sometimes because of the seniority of the employees concerned. While corporations need to be fair to their employees, they must also be unequivocally committed, at all levels of the corporation, to the highest standards of legal and ethical behavior. Effective internal discipline can be a powerful deterrent against improper behavior by a corporation's employees. In evaluating a corporation's response to wrongdoing, prosecutors may evaluate the willingness of the corporation to discipline culpable employees of all ranks and the adequacy of the discipline imposed. The prosecutor should be satisfied that the corporation's focus is on the integrity and credibility of its remedial and disciplinary measures rather than on the protection of the wrongdoers.

In addition to employee discipline, two other factors used in evaluating a corporation's remedial efforts are restitution and reform. As with natural persons, the decision whether or not to prosecute should not depend upon the target's ability to pay restitution. A corporation's efforts to pay restitution even in advance of any court order is, however, evidence of its "acceptance of responsibility" and, consistent with the practices and policies of the appropriate Division of the Department entrusted with enforcing specific criminal laws, may be considered in determining whether to bring criminal charges. Similarly, although the inadequacy of a corporate compliance program is a factor to consider when deciding whether to charge a corporation, that corporation's quick recognition of the flaws in the program and its efforts to improve the program are also factors to consider.

IX. Charging a Corporation: Collateral Consequences

A. General Principle: Prosecutors may consider the collateral consequences of a corporate criminal conviction in determining whether to charge the corporation with a criminal offense.

B. Comment: One of the factors in determining whether to charge a natural person or a corporation is whether the likely punishment is appropriate given the nature and seriousness of the crime. In the corporate context, prosecutors may take into account the possibly substantial consequences to a corporation's officers, directors, employees, and shareholders, many of whom may, depending on the size and nature (e.g., publicly vs. closely held) of the corporation and their role in its operations, have played no role in the criminal conduct, have been completely unaware of it, or have been wholly unable to prevent it. Prosecutors should also be aware of non-penal sanctions that may accompany a criminal charge, such as potential suspension or debarment from eligibility for government contracts or federal funded programs such as health care. Whether or not such non-penal sanctions are appropriate or required in a particular case is the responsibility of the relevant agency, a decision that will be made based on the applicable statutes, regulations, and policies.

Virtually every conviction of a corporation, like virtually every conviction of an individual, will have an impact on innocent third parties, and the mere existence of such an effect is not sufficient to preclude prosecution of the corporation. Therefore, in evaluating the severity of collateral consequences, various factors already discussed, such as the pervasiveness of the criminal conduct and the adequacy of the corporation's compliance programs, should be considered in determining the weight to be given to this factor. For instance, the balance may tip in favor of prosecuting corporations in situations where the scope of the misconduct in a case is widespread and sustained within a corporate division (or spread throughout pockets of the corporate organization). In such cases, the possible unfairness of visiting punishment for the corporation's crimes upon shareholders may be of much less concern where those shareholders have substantially profited, even unknowingly, from widespread or pervasive criminal activity. Similarly, where the top layers of the corporation's management or the shareholders of a closely-held corporation were engaged in or aware of the wrongdoing and the conduct at issue was accepted as a way of doing business for an extended period, debarment may be deemed not collateral, but a direct and entirely appropriate consequence of the corporation's wrongdoing.

The appropriateness of considering such collateral consequences and the weight to be given them may depend on the special policy concerns discussed in section III, *supra*.

X. Charging a Corporation: Non-Criminal Alternatives

A. General Principle: Although non-criminal alternatives to prosecution often exist, prosecutors may consider whether such sanctions would adequately deter, punish, and rehabilitate a corporation that has engaged in wrongful conduct. In evaluating the adequacy of non-criminal alternatives to prosecution, *e.g.*, civil or regulatory enforcement actions, the prosecutor may consider all relevant factors, including:

1. the sanctions available under the alternative means of disposition;

2. the likelihood that an effective sanction will be imposed; and

3. the effect of non-criminal disposition on Federal law enforcement interests.

B. Comment: The primary goals of criminal law are deterrence, punishment, and rehabilitation. Non-criminal sanctions may not be an appropriate response to an egregious violation, a pattern of wrongdoing, or a history of non-criminal sanctions without proper remediation. In other cases, however, these goals may be satisfied without the necessity of instituting criminal proceedings. In determining whether federal criminal charges are appropriate, the prosecutor should consider the same factors (modified appropriately for the regulatory context) considered when determining whether to leave prosecution of a natural person to another jurisdiction or to seek non-criminal alternatives to prosecution. These factors include: the strength of the regulatory authority's interest; the regulatory authority's ability and willingness to take effective enforcement action; the probable sanction if the regulatory authority's enforcement action is upheld; and the effect of a non-criminal disposition on Federal law enforcement interests. *See* USAM §§ 9-27.240, 9-27.250.

XI. Charging a Corporation: Selecting Charges

A. General Principle: Once a prosecutor has decided to charge a corporation, the prosecutor should charge, or should recommend that the grand jury charge, the most serious offense that is consistent with the nature of the defendant's conduct and that is likely to result in a sustainable conviction.

B. Comment: Once the decision to charge is made, the same rules as govern charging natural persons apply. These rules require "a faithful and honest application of the Sentencing Guidelines" and an "individualized assessment of the extent to which particular charges fit the specific circumstances of the case, are consistent with the purposes of the Federal criminal code, and maximize the impact of Federal resources on crime." *See* USAM § 9-27.300. In making this determination, "it is appropriate that the attorney for the government consider, *inter alia*, such factors as the sentencing guideline range yielded by the charge, whether the penalty yielded by such sentencing range ... is proportional to the seriousness of the defendant's conduct, and whether the charge achieves such purposes of the criminal law as punishment, protection of the public, specific and general deterrence, and rehabilitation." *See* Attorney General's Memorandum, dated October 12, 1993.

XII. Plea Agreements with Corporations

A. General Principle: In negotiating plea agreements with corporations, prosecutors should seek a plea to the most serious, readily provable offense charged. In addition, the terms of the plea agreement should contain appropriate provisions to ensure punishment, deterrence, rehabilitation, and compliance with the plea agreement in the corporate context. Although special circumstances may mandate a different conclusion, prosecutors generally should not agree to accept a corporate guilty plea in exchange for non-prosecution or dismissal of charges against individual officers and employees.

B. Comment: Prosecutors may enter into plea agreements with corporations for the same reasons and under the same constraints as apply to plea agreements with natural persons. *See* USAM §§ 9-27.400-500. This means, *inter alia*, that the corporation should be required to plead guilty to the most serious, readily provable offense charged. As is the case with individuals, the attorney making this determination should do so "on the basis of an individualized assessment of the extent to which particular charges fit the specific circumstances of the case, are consistent with the purposes of the federal criminal code, and maximize the impact of federal resources on crime. In making this determination, the attorney for the government considers, inter alia, such factors as the sentencing guideline range yielded by the charge, whether the penalty yielded by such sentencing range ... is proportional to the seriousness of the defendant's conduct, and whether the charge achieves such purposes of the criminal law as punishment, protection of the public, specific and general deterrence, and rehabilitation." *See* Attorney General's Memorandum, dated October 12, 1993. In addition, any negotiated departures from the Sentencing Guidelines must be justifiable under the Guidelines and must be disclosed to the sentencing court. A corporation should be made to realize that pleading guilty to criminal charges constitutes an admission of guilt and not merely a resolution of an inconvenient distraction from its business. As with natural persons, pleas should be structured so that the corporation may not later "proclaim lack of culpability or even complete innocence." *See* USAM §§ 9-27.420(b)(4), 9-27.440, 9-27.500. Thus, for instance, there should be placed upon the record a sufficient factual basis for the plea to prevent later corporate assertions of innocence.

A corporate plea agreement should also contain provisions that recognize the nature of the corporate "person" and ensure that the principles of punishment, deterrence, and rehabilitation are met. In the corporate context, punishment and deterrence are generally accomplished by substantial fines, mandatory restitution, and institution of appropriate compliance measures, including, if necessary, continued judicial oversight or the use of special masters. *See* USSG §§ 8B1.1, 8C2.1, *et seq.* In addition, where the corporation is a government contractor, permanent or temporary debarment may be appropriate. Where the corporation was engaged in government contracting fraud, a prosecutor may not negotiate away an agency's right to debar or to list the corporate defendant.

In negotiating a plea agreement, prosecutors should also consider the deterrent value of prosecutions of individuals within the corporation. Therefore, one factor that a prosecutor may consider in determining whether to enter into a plea agreement is whether the corporation is seeking immunity for its employees and officers or whether the corporation is willing to cooperate in the investigation of culpable individuals. Prosecutors should rarely negotiate away individual criminal liability in a corporate plea.

Rehabilitation, of course, requires that the corporation undertake to be law-abiding in the future. It is, therefore, appropriate to require the corporation, as a condition of probation, to implement a compliance program or to reform an existing one. As discussed above, prosecutors may consult with the appropriate state and federal agencies and components of the Justice Department to ensure that a proposed compliance program is adequate and meets industry standards and best practices. *See* section VII, *supra*.

In plea agreements in which the corporation agrees to cooperate, the prosecutor should ensure that the cooperation is complete and truthful. To do so, the prosecutor may request that the corporation waive attorney-client and work product protection, make employees and agents available for debriefing, disclose the results of its internal investigation, file appropriate certified financial statements, agree to governmental or third-party audits, and take whatever other steps are necessary to ensure that the full scope of the corporate wrongdoing is disclosed and that the responsible culprits are identified and, if appropriate, prosecuted. *See* generally section VIII, *supra*.

Footnotes:

1. While these guidelines refer to corporations, they apply to the consideration of the prosecution of all types of business organizations, including partnerships, sole proprietorships, government entities, and unincorporated associations.

2. In addition, the Sentencing Guidelines reward voluntary disclosure and cooperation with a reduction in the corporation's offense level. *See* USSG §8C2.5)g).

3. This waiver should ordinarily be limited to the factual internal investigation and any contemporaneous advice given to the corporation concerning the conduct at issue. Except in unusual circumstances, prosecutors should not seek a waiver with respect to communications and work product related to advice concerning the government's criminal investigation.

4. Some states require corporations to pay the legal fees of officers under investigation prior to a formal determination of their guilt. Obviously, a corporation's compliance with governing law should not be considered a failure to cooperate.

5. Although this case and *Basic Construction* are both antitrust cases, their reasoning applies to other criminal violations. In the Hilton case, for instance, the Ninth Circuit noted that Sherman Act violations are commercial offenses "usually motivated by a desire to enhance profits," thus, bringing the case within the normal rule that a "purpose to benefit the corporation is necessary to bring the agent's acts within the scope of his employment." 467 F.2d at 1006 & n4. In addition, in *United States v. Automated Medical Laboratories*, 770 F.2d 399, 406 n.5 (4th Cir. 1985), the Fourth Circuit stated "that Basic Construction states a generally applicable rule on corporate criminal liability despite the fact that it addresses violations of the antitrust laws."

6. For a detailed review of these and other factors concerning corporate compliance programs, see United States Sentencing Commission, GUIDELINES MANUAL, §8A1.2, comment. (n.3(k)) (Nov. 1997). *See* also USSG §8C2.5(f)

7. For example, the Antitrust Division's amnesty policy requires that "[w]here possible, the corporation [make] restitution to injured parties...."

TO: All Federal Prosecutors

FROM: John Ashcroft
Attorney General

SUBJECT: Department Policy Concerning Charging Criminal Offenses, Disposition of Charges, and Sentencing

INTRODUCTION

The passage of the Sentencing Reform Act of 1984 was a watershed event in the pursuit of fairness and consistency in the federal criminal justice system. With the Sentencing Reform Act's creation of the United States Sentencing Commission and the subsequent promulgation of the Sentencing Guidelines, Congress sought to "provide certainty and fairness in meeting the purposes of sentencing." 28 U.S.C. § 991(b)(1)(B). In contrast to the prior sentencing system – which was characterized by largely unfettered discretion, and by seemingly severe sentences that were often sharply reduced by parole – the Sentencing Reform Act and the Sentencing Guidelines sought to accomplish several important objectives: (1) to ensure honesty and transparency in federal sentencing; (2) to guide sentencing discretion, so as to narrow the disparity between sentences for similar offenses committed by similar offenders; and (3) to provide for the imposition of appropriately different punishments for offenses of differing severity.

With the passage of the PROTECT Act earlier this year, Congress has reaffirmed its commitment to the principles of consistency and effective deterrence that are embodied in the Sentencing Guidelines. The important sentencing reforms made by this legislation will help to ensure greater fairness and to eliminate unwarranted disparities. These vital goals, however, cannot be fully achieved without consistency on the part of federal prosecutors in the Department of Justice. Accordingly, it is essential to set forth clear policies designed to ensure that all federal prosecutors adhere to the principles and objectives of the Sentencing Reform Act, the PROTECT Act, and the Sentencing Guidelines in their charging, case disposition, and sentencing practices.

The Department has previously issued various memoranda addressing Department policies with respect to charging, case disposition, and sentencing. Shortly after the constitutionality of the Sentencing Reform Act was sustained by the Supreme Court in 1989, Attorney General Thornburgh issued a directive to federal prosecutors to ensure that their practices were consistent with the principles of equity, fairness, and uniformity. Several years later, Attorney General Reno issued additional guidance to address the extent to which a prosecutor's individualized assessment of the proportionality of particular sentences could be considered.

The recent passage of the PROTECT Act emphatically reaffirms Congress' intention that the Sentencing Reform Act and the Sentencing Guidelines be faithfully and consistently enforced. It is therefore appropriate at this time to re-examine the subject thoroughly and to state with greater clarity Department policy with respect to charging, disposition of charges, and sentencing. One part of this comprehensive review of Department policy has already been completed: on July 28, 2003, in accordance with section 401(*l*)(1) of the PROTECT Act, I issued a Memorandum that specifically and clearly sets forth the Department's policies with respect to sentencing recommendations and sentencing appeals. The determination of an appropriate sentence for a convicted defendant is, however, only half of the equation. The fairness Congress sought to achieve by the Sentencing Reform Act and the PROTECT Act can be attained only if there are fair and reasonably consistent policies with respect to the Department's decisions concerning what charges to bring and how cases should be disposed. Just as the sentence a defendant receives should not depend upon which particular judge presides over the case, so too the charges a defendant faces should not depend upon the particular prosecutor assigned to handle the case.

Accordingly, the purpose of this Memorandum is to set forth basic policies that all federal prosecutors must follow in order to ensure that the Department fulfills its legal obligation to enforce faithfully and honestly the Sentencing Reform Act, the PROTECT Act, and the Sentencing Guidelines. This memorandum supersedes all previous guidance on this subject.

I. Department Policy Concerning Charging and Prosecution of Criminal Offenses

A. General Duty to Charge and to Pursue the Most Serious, Readily Provable Offense in All Federal Prosecutions

It is the policy of the Department of Justice that, in all federal criminal cases, federal prosecutors must charge and pursue the most serious, readily provable offense or offenses that are supported by the facts of the case, except as authorized by an Assistant Attorney General, United States Attorney, or designated supervisory attorney in the limited circumstances described below. The most serious offense or offenses are those that generate the most substantial sentence under the Sentencing Guidelines, unless a mandatory minimum sentence or count requiring a consecutive sentence would generate a longer sentence. A charge is not "readily provable" if the prosecutor has a good faith doubt, for legal or evidentiary reasons, as to the Government's ability readily to prove a charge at trial. Thus, charges should not be filed simply to exert leverage to induce a plea. Once filed, the most serious readily provable charges may not be dismissed except to the extent permitted in Section B.

B. Limited Exceptions

The basic policy set forth above requires federal prosecutors to charge and to pursue all charges that are determined to be readily provable and that, under the applicable statutes and

Sentencing Guidelines, would yield the most substantial sentence. There are, however, certain limited exceptions to this requirement:

1. ***Sentence would not be affected.*** First, if the applicable guideline range from which a sentence may be imposed would be unaffected, prosecutors may decline to charge or to pursue readily provable charges. However, if the most serious readily provable charge involves a mandatory minimum sentence that exceeds the applicable guideline range, counts essential to establish a mandatory minimum sentence must be charged and may not be dismissed, except to the extent provided elsewhere below.

2. ***"Fast-track" programs.*** With the passage of the PROTECT Act, Congress recognized the importance of early disposition or "fast-track" programs. Section 401(m)(2)(B) of the Act instructs the Sentencing Commission to promulgate, by October 27, 2003, a policy statement authorizing a downward departure of not more than 4 levels "pursuant to an early disposition program *authorized by the Attorney General* and the United States Attorney." Pub. L. No. 108-21, § 401(m)(2)(B), 117 Stat. 650, 675 (2003) (emphasis added). Although the PROTECT Act requirement of Attorney General authorization only applies by its terms to fast-track programs that rely on downward departures, the same requirement will also apply, as a matter of Department policy, to any fast-track program that relies on "charge bargaining" — *i.e.*, an expedited disposition program whereby the Government agrees to charge less than the most serious, readily provable offense. Such programs are intended to be exceptional and will be authorized only when clearly warranted by local conditions within a district. The specific requirements for establishing and implementing a fast-track program are set forth at length in the Department's "Principles for Implementing An Expedited or Fast-Track Prosecution Program." In those districts where an approved "fast-track" program has been established, charging decisions and disposition of charges must comply with those Principles and with the other requirements of the approved fast-track program.

3. ***Post-indictment reassessment.*** In cases where post-indictment circumstances cause a prosecutor to determine in good faith that the most serious offense is not readily provable, because of a change in the evidence or some other justifiable reason (*e.g.*, the unavailability of a witness or the need to protect the identity of a witness until he testifies against a more significant defendant), the prosecutor may dismiss the charge(s) with the written or otherwise documented approval of an Assistant Attorney General, United States Attorney, or designated supervisory attorney.

4. ***Substantial assistance.*** The preferred means to recognize a defendant's substantial assistance in the investigation or prosecution of another person is to charge the most serious readily provable offense and then to file an appropriate motion or motions under U.S.S.G. § 5K1.1, 18 U.S.C. § 3553(e), or Federal Rule of Criminal Rule of Procedure 35(b). However, in rare circumstances, where necessary to obtain substantial assistance in an important investigation or prosecution, and with the written or otherwise documented approval of an Assistant Attorney General, United States Attorney, or designated supervisory attorney, a federal prosecutor may decline to charge or to pursue a readily provable charge as part of plea agreement that properly reflects the substantial assistance provided by the defendant in the investigation or prosecution of another person.

5. ***Statutory enhancements.*** The use of statutory enhancements is strongly encouraged, and federal prosecutors must therefore take affirmative steps to ensure that the increased penalties resulting from specific statutory enhancements, such as the filing of an information pursuant to 21 U.S.C. § 851 or the filing of a charge under 18 U.S.C. § 924(c), are sought in all appropriate cases. As soon as reasonably practicable, prosecutors should ascertain whether the defendant is eligible for any such statutory enhancement. In many cases, however, the filing of such enhancements will mean that the statutory sentence exceeds the applicable Sentencing Guidelines range, thereby ensuring that the defendant will not receive any credit for acceptance of responsibility and will have no incentive to plead guilty. Requiring the pursuit of such enhancements to trial in every case could therefore have a significant effect on the allocation of prosecutorial resources within a given district. Accordingly, an Assistant Attorney General, United States Attorney, or designated supervisory attorney may authorize a prosecutor to forego the filing of a statutory enhancement, but *only* in the context of a negotiated plea agreement, and subject to the following additional requirements:

   a. Such authorization must be written or otherwise documented and may be granted only after careful consideration of the factors set forth in Section 9-27.420 of the United States Attorneys' Manual. In the context of a statutory enhancement that is based on prior criminal convictions, such as an enhancement under 21 U.S.C. § 851, such authorization may be granted only after giving particular consideration to the nature, dates, and circumstances of the prior convictions, and the extent to which they are probative of criminal propensity.

   b. A prosecutor may forego or dismiss a charge of a violation of 18 U.S.C. § 924(c) only with the written or otherwise documented approval of an Assistant Attorney General, United States Attorney, or designated supervisory attorney, and subject to the following limitations:

      (i) In all but exceptional cases or where the total sentence would not be affected, the first readily provable violation of 18 U.S.C. § 924(c) shall be charged and pursued.

      (ii) In cases involving three or more readily provable violations of 18 U.S.C. § 924(c) in which the predicate offenses are crimes of violence, federal prosecutors shall, in all but exceptional cases, charge and pursue the first two such violations.

6. ***Other Exceptional Circumstances.*** Prosecutors may decline to pursue or may dismiss readily provable charges in other exceptional circumstances with the written or otherwise documented approval of an Assistant Attorney General, United States Attorney, or designated supervisory attorney. This exception recognizes that the aims of the Sentencing Reform Act must be sought without ignoring the practical limitations of the federal criminal justice system. For example, a case-specific approval to dismiss charges in a particular case might be given because the United States Attorney's Office is particularly over-burdened, the duration of the trial would be exceptionally long, and proceeding to trial would significantly reduce the total

number of cases disposed of by the office. However, such case-by-case exceptions should be rare; otherwise the goals of fairness and equity will be jeopardized.

II. Department Policy Concerning Plea Agreements

A. Written Plea Agreements

In felony cases, plea agreements should be in writing. If the plea agreement is not in writing, the agreement should be formally stated on the record. Written plea agreements will facilitate efforts by the Department of Justice and the Sentencing Commission to monitor compliance by federal prosecutors with Department policies and the Sentencing Guidelines. The PROTECT Act specifically requires the court, after sentencing, to provide a copy of the plea agreement to the Sentencing Commission. 28 U.S.C. § 994(w). Written plea agreements also avoid misunderstandings with regard to the terms that the parties have accepted.

B. Honesty in Sentencing

As set forth in my July 28, 2003 Memorandum on "Department Policies and Procedures Concerning Sentencing Recommendations and Sentencing Appeals," Department of Justice policy requires honesty in sentencing, both with respect to the facts and the law:

> Any sentencing recommendation made by the United States in a particular case must honestly reflect the totality and seriousness of the defendant's conduct and must be fully consistent with the Guidelines and applicable statutes and with the readily provable facts about the defendant's history and conduct.

This policy applies fully to sentencing recommendations that are contained in plea agreements. The July 28 Memorandum further explains that this basic policy has several important implications. In particular, if readily provable facts are relevant to calculations under the Sentencing Guidelines, the prosecutor must disclose them to the court, including the Probation Office. Likewise, federal prosecutors may not "fact bargain," or be party to any plea agreement that results in the sentencing court having less than a full understanding of all readily provable facts relevant to sentencing.

The current provision of the United States Attorneys' Manual that addresses charging policy and that describes the circumstances in which a less serious charge may be appropriate includes the admonition that "[a] negotiated plea which uses any of the options described in this section must be made known to the sentencing court." *See* U.S.A.M. § 9-27.300(B); *see also* U.S.A.M. § 9-27.400(B) ("it would be improper for a prosecutor to agree that a departure is in order, but to conceal the agreement in a charge bargain that is presented to a court as a fait accompli so that there is neither a record of nor judicial review of the departure"). Although this Memorandum by its terms supersedes prior Department guidance on this subject, it remains Department policy that the sentencing court should be informed if a plea agreement involves a "charge bargain." Accordingly, a negotiated plea that uses any of the options described in Section I(B)(2), (4), (5), or (6) must be made known to the court at the time of the plea hearing and at the time of sentencing, *i.e.*, the court must be informed that a more serious, readily provable offense was not charged or that an applicable statutory enhancement was not filed.

C. Charge Bargaining

Charges may be declined or dismissed pursuant to a plea agreement only to the extent consistent with the principles set forth in Section I of this Memorandum.

D. Sentence Bargaining

There are only two types of permissible sentence bargains.

1. ***Sentences within the Sentencing Guidelines range.*** Federal prosecutors may enter into a plea agreement for a sentence that is within the specified guideline range. For example, when the Sentencing Guidelines range is 18-24 months, a prosecutor may agree to recommend a sentence of 18 or 20 months rather than to argue for a sentence at the top of the range. Similarly, a prosecutor may agree to recommend a downward adjustment for acceptance of responsibility under U.S.S.G. § 3E1.1 if the prosecutor concludes in good faith that the defendant is entitled to the adjustment.

2. ***Departures.*** In passing the PROTECT Act, Congress has made clear its view that there have been too many downward departures from the Sentencing Guidelines, and it has instructed the Commission to take measures "to ensure that the incidence of downward departures [is] substantially reduced." Pub. L. No. 108-21, § 401(m)(2)(A), 117 Stat. 650, 675 (2003). The Department has a duty to ensure that the circumstances in which it will request or accede to downward departures in the future are properly circumscribed.

Accordingly, federal prosecutors must not request or accede to a downward departure except in the limited circumstances specified in this memorandum and with authorization from an Assistant Attorney General, United States Attorney, or designated supervisory attorney. Likewise, except in such circumstances and with such authorization, prosecutors may not simply stand silent when a downward departure motion is made by the defendant.

An Assistant Attorney General, United States Attorney, or designated supervisory attorney may authorize a prosecutor to request or accede to a downward departure at sentencing only in the following circumstances:

a. ***Substantial assistance.*** Section 5K1.1 of the Sentencing Guidelines provides that, upon motion by the Government, a court may depart from the guideline range. A substantial assistance motion must be based on assistance that is *substantial* to the Government's case. It is not appropriate to utilize substantial assistance motions as a case management tool to secure plea agreements and avoid trials.

b. ***"Fast-track" programs.*** Federal prosecutors may support a downward departure to the extent consistent with the Sentencing Guidelines and the Attorney General's "Principles for Implementing An Expedited or Fast-Track Prosecution Program." The PROTECT Act

specifically recognizes the importance of such programs by requiring the Sentencing Commission to promulgate a policy statement specifically authorizing such departures.

c. ***Other downward departures.*** As set forth in my July 28 Memorandum, "[o]ther than these two situations, however, Government acquiescence in a downward departure should be, as the Sentencing Guidelines Manual itself suggests, a "rare occurenc[e]." *See* U.S.S.G., Ch. 1, Pt. A, ¶ (4)(b). Prosecutors must affirmatively oppose downward departures that are not supported by the facts and the law, and must not agree to "stand silent" with respect to such departures. In particular, downward departures that would violate the specific restrictions of the PROTECT Act should be vigorously opposed.

Moreover, as stated above, Department of Justice policy requires honesty in sentencing. In those cases where federal prosecutors agree to support departures, they are expected to identify departures for the courts. For example, it would be improper for a prosecutor to agree that a departure is warranted, without disclosing such agreement, so that there is neither a record of nor judicial review of the departure.

In sum, plea bargaining must honestly reflect the totality and seriousness of the defendant's conduct, and any departure must be accomplished through the application of appropriate Sentencing Guideline provisions.

CONCLUSION

Federal criminal law and procedure apply equally throughout the United States. As the sole federal prosecuting entity, the Department of Justice has a unique obligation to ensure that all federal criminal cases are prosecuted according to the same standards. Fundamental fairness requires that all defendants prosecuted in the federal criminal justice system be subject to the same standards and treated in a consistent manner.

cc: The Acting Deputy Attorney General
The Associate Attorney General
The Solicitor General
The Assistant Attorney General, Criminal Division
The Assistant Attorney General, Antitrust Division
The Assistant Attorney General, Civil Rights Division
The Assistant Attorney General, Environment and Natural Resources Division
The Assistant Attorney General, Tax Division
The Assistant Attorney General, Civil Division
The Director, Executive Office of United States Attorneys

DISTRICT OF COLUMBIA BAR
LEGAL ETHICS COMMITTEE
Opinion No. 269

Obligation of Lawyer for Corporation to Clarify Role in Internal Corporate Investigation

A lawyer retained by a corporation to conduct an internal investigation represents the corporation only, and not any of its constituents, such as officers or employees. Corporate constituents have no right of confidentiality as regards communications with the lawyer, but the lawyer must advise them of his position as counsel to the corporation in the event of any ambiguity as to his role.

A corporation may hire and pay the fees of a lawyer to represent corporate constituents, so long as there is no interference with, or diminution of, the lawyer's obligations to his constituent client. Where the lawyer proposes to represent the corporation and a constituent, or two or more constituents, the general conflict provisions of Rule 1.7 must be applied to determine the propriety of the dual representation, and appropriate client disclosures must be made and consents received.

Applicable Rules

Rule 1.7 (Conflict of Interest: General Rule)

Rule 1.8(e) (Conflict of Interest: Prohibited Transactions)

Rule 1.13 (Organization as Client)

Rule 4.3 (Dealing with Unrepresented Person)

Inquiry

This inquiry presents several questions concerning the obligations of a lawyer conducting an investigation of possible wrong-doing by a corporate client or its employees. Such investigations are not uncommon today. A corporation may, for example, investigate itself as part of a routine regulatory compliance program, it may do so in response to information received from some source suggesting that a violation of law may have occurred, or it may do so in the

course of, or in anticipation of, a government proceeding. During such an investigation, counsel for the corporation will likely review records and files maintained by various corporate officials and employees, and may interview such persons at various levels of seniority within the corporation.

The inquirer asks whether an attorney-client relationship is created between the corporate counsel performing the investigation and corporate employee-interviewees; what professional obligations, if any, are owed by the lawyer to the employees in such a circumstance; and what is the nature and extent of confidentiality which applies to information acquired by the lawyer from the employees. The inquiry also raises, inferentially, a question about the general obligations of counsel retained by the corporation to represent the interests of its employees.

Although the inquiry poses its questions in the context of outside counsel performing the legal work, in-house counsel may perform similar activities. Our opinion extends to both types of counsel.

Discussion
Attorney-Client Relationship

Under the former Code of Professional Responsibility, the relationship of a lawyer for a corporation to corporate officials was addressed in Ethical Consideration (EC) 5-18, but not in the Code itself. EC 5-18 read, in relevant part, that:

> A lawyer employed or retained by a corporation or similar entity owes his allegiance to the entity and not to a stockholder, director, officer, representative or other person connected with the entity.

That ethical principle was elevated in stature in the Rules of Professional Conduct, where it (and related principles) were incorporated in Rule 1.13. 1

Subpart (a) of Rule 1.13 makes clear that, when a lawyer is retained to represent a corporation, the lawyer's client is the corporation only, acting through its duly authorized constituents (such as its officers and employees).2 The situation was no different under the Code of Professional Responsibility. *See* Opinion No. 159. In this circumstance, then, the lawyer does not have, by reason of the lawyer's representation of the corporation, attorney-client responsibilities to the corporate constituents with whom he may be dealing in the course of his investigation.

Nevertheless, in some settings, a lawyer for the corporation may have an incentive, grounded in the lawyer's desire to further his client's interests, to minimize any perception by the corporate constituent that the corporation and the constituent may have differing interests in the subject matter of the representation, lest such perception affect the willingness of the constituent to be candid and forthcoming with the lawyer. While a lawyer's obligation to represent a client zealously (Rule 1.3(a)) might suggest that the client's need for information from the constituent is the lawyer's only concern, the Rules specifically require that the lawyer be mindful of the interests of the constituent.

Subpart (b) of Rule 1.13 makes clear the obligation of the lawyer to inform corporate constituents of the identity of the lawyer's client when there is a potential for conflict between the position of the corporation and that of the constituent. Such a potential for conflict is a possibility where, for example, the person being interviewed was more than a passive observer of some act or omission which may be attributable to the corporation, but was instead a person who may have been directly or indirectly responsible for the questioned conduct. Such person's interests may be in conflict with those of the corporation, which may want to discipline or terminate him/her or which may, *vis-a-vis* a third-party (such as a government agency or a civil litigant), endeavor to distance itself from the person's conduct, such as by acknowledging the conduct but denying responsibility for it, or by characterizing the conduct as that of an employee acting contrary to company policy or direction.

The corporate constituent being interviewed by a lawyer for the corporation, however, may consider the lawyer as also representing the employee's personal interests, absent a warning to the contrary. The employee could understandably conclude that, since he is employed by the corporation and the lawyer has been retained to serve the interest of the corporation, the lawyer would not be pursuing interests adverse to those of the employee. Rule 1.13(b) specifically addressed this potential for misunderstanding by the corporate constituent by requiring the lawyer to explain the identity of the lawyer's client "when it is apparent that the organizations' interests may be adverse to those of the constituents with whom the lawyer is dealing. 3 Comment 8 to Rule 1.13 advises the lawyer in such a situation to

> advise any constituent. . .of the conflict or potential conflict of interest, that the lawyer cannot represent such constituent, and that such person may with to obtain separate representation. Care must be taken to assure that the individual understands that , when there is such adversity of interest, the lawyer for the organization cannot provide representation for that constituent individual, and that the discussions between the lawyer for the organization and the individual may not be privileged.

Disclosure is required not just when an actual conflict exists between the interests of the corporation and those of the employee (for example, when the corporation has already confided to the lawyer that it will concede wrong-doing by the employee but will attempt to avoid corporate responsibility for any illegality). Disclosure is also required when there "may be" an adversity between the interests of corporation and employee. There "may be" an adversity when the corporation has not yet irretrievably committed itself to a position in the matter, but where one such position might be adverse to the employee. Such a possible adversity would almost always arise, then, when the corporation is able to take a position adverse to the employee.

On the other hand, Rule 1.13(b) applies only when the possible conflict is "apparent," which we interpret to mean actually apparent to the lawyer or apparent to a reasonable lawyer under the circumstances.4 As so interpreted, the obligation of disclosure would not arise in those situations where the lawyer had no reason to believe that there was any possibility of adversity between corporation and employee when the interview was conducted. 5

Confidentiality

As Comment [3] to Rule 1.13 notes, communications between the lawyer and the person being interviewed are protected by Rule 1.6 (Confidentiality of Information), but the protection accorded is for the benefit of the client corporation, not the interviewee. *See also Upjohn Co. v. United States*, 449 U.S. 383 (1981). Thus, the interviewee has no right to expect that disclosure or use of the information provided by him or her to the lawyer will be subject to his/her control under Rule 1.6, as the corporation will have the right to use the information to serve its purposes. In this regard, it makes no difference whether the interviewee is an employee performing routine services, or corporate director or officer entrusted with more significant responsibilities. Both are persons with interests potentially separate from those of the corporation.

Notwithstanding the law on this subject, a corporate interviewee might reasonably conclude that the information she provides to the investigating lawyer will be treated as confidential by the lawyer, perhaps because she mistakenly believes that the lawyer is representing her also. This, then, is another situation in which Rules 4.3(b) and 1.13(b) may require the lawyer to clarify his role and the status of the information to be provided by the interviewee. 6

Representation of Constituents

A further question presented in the inquiry concerns the obligations of a lawyer who is retained by a corporation to represent one of its constituents, such as a corporate officer, director or employee. Such retentions, under which the corporation is typically responsible for the lawyer's fees, are not unusual when the representation concerns a matter arising from the constituent's work for the corporation. One aspect of the ethical concerns in such an arrangement is addressed in Rule 1.8(e), which permits a lawyer to accept compensation from someone other than the client (which, in this case, is the corporate employer of his client), but only where the client consents to the arrangement, where the arrangement does not interfere either with the exercise of the lawyer's professional judgment on behalf of his client or with the attorney-client relationship, and where client confidences are protected.

Where such representation is one of the constituent alone, that person is the lawyer's sole client, just as the lawyer representing the corporation has that entity as his sole client. The lawyer has no attorney-client relationship with the person paying the lawyer's fees, and the lawyer must take care that his activities on behalf of his client are not influenced by that person. *Id.* And as regards attorney-client confidentiality, that obligation is owed to the constituent-client only, and not to the person paying the lawyer's fees. *Id.*

The lawyer retained by the corporation to represent the employee also may have a conflict of interest concern under Rule 1.7(b)(4), which applies when the lawyer's work on behalf of a client will or reasonably may be affected, not by obligation to another client, but by the lawyer's financial or personal interests.

Such interests could include continuing referral or unrelated other work for the corporation, which could be influenced by the manner in which the lawyer represents the employee. For example, it is not unthinkable that a lawyer who is regularly paid by a stock brokerage to represent its brokers individually may have a financial disincentive to represent a broker in a manner which implicates the brokerage in wrong-doing. Where a situation like that will or may arise, the lawyer could represent the individual client only with the client's informed consent to this potential conflict of interest. 7

Multiple Representation

Finally, where the lawyer is asked to represent in the same matter a constituent and the corporation, or two constituents, the same types of conflicts may arise as in any other situation where a lawyer (or law firm) represents more than one party in the same matter.8 Where the potential clients are directly adverse (or become directly adverse after commencement of the dual representation), the dual representation is absolutely prohibited under Rule 1.7(a). But even where the parties are nominally aligned together, there may be a risk that the representation of one will adversely affect the representation of the other. For example, one client may wish to settle a matter in litigation, while the other may not and might perceive his/her litigation position to be prejudiced by a settlement by the other client. In such a situation, the clients represented by the same lawyer are not advancing interests adverse to one another so as to invoke the unqualified prohibition of dual representation under Rule 1.7, but Rule 1.7(b)(2) and (3) are clearly implicated in such a situation, since one client's interests cannot be zealously pursued without likely adverse effect on the interests of the other client. Such dual representation could only be accomplished, then, with the consent of both clients, "after full disclosure of the existence and nature of the possible conflict and the possible adverse consequences of such representation. . . " Rule 1.7(c).

The nature and content of the disclosure will obviously be determined by the facts and circumstances of the matter and the lawyer's representation of the potentially adverse clients. Among the subjects of disclosure that may be unique to a lawyer's representation of a corporation and an employee, or two employees of the same corporation, are the lawyer's pre-existing relationship with the two clients, whether one of the clients is an expected source of additional, unrelated legal work for the lawyer, and who will be paying the lawyer's fee (if not the client).

The disclosure should also address the fact and consequences of a possible disqualification of the lawyer from further representation of the client in the event the dually-represented clients later plan to take positions actually adverse to each other in the same matter. One of those consequences could be the inconvenience, expense and possible legal risk associated with the need for the client to retain new counsel.

It would not be impermissible for the lawyer in such a dual representation to seek the consent of one of the clients to continue representation of the other client in the event of an actual adversity under Rule 1.7(a) that requires termination of the dual representation. But such consent must be based on disclosure of the consequences to that client of granting such consent, and disclosure to the client for whom the representation would continue of any limitations on that continued representation. Perhaps the most significant area to be addressed in disclosures to both clients is how the lawyer's confidentiality obligation to the client to be terminated will be protected, and how the representation of the continuing client will be affected by the lawyer's continuing confidentiality obligation to the terminated client. In circumstances where the dual representation cannot be continued, Rule 1.9 (Conflict of Interest: Former Client) may prevent the lawyer from continuing to represent either client unless on of the client has granted this particular consent.

On the other hand, there may be many dual representations where the interests of the two parties have no reasonable likelihood of becoming adverse, in which case Rules 1.7(b)(2) and (3) would not be applicable, and client consent would not be needed. But the existence of the Rule 1.7(b) criteria may not always be apparent or readily determinable at the outset of a representation, and a lawyer should be careful not to resolve unilaterally close conflict questions against the interests of clients or prospective clients. Comment [7] to Rule 1.7 describes the situation as follows:

> The underlying premise [of Rule 1.7(b)] is that disclosure and consent are required before assuming a representation if there is any reason to doubt the lawyer's ability to provide wholehearted and zealous representation or if a client might

> reasonably consider the representation of its interest to be adversely affected by the lawyer's assumption of the other representation in question. Although the lawyer must be satisfied that the representation can be wholeheartedly and zealously undertaken, if an objective observer would have any reasonable doubt on that issue, the client has a right to disclosure of all relevant considerations and the opportunity to be the judge of its own interests.

Thus, in judging whether one representation is "likely" to affect adversely another representation, the lawyer must look at the proposed dual representation from both an objective perspective and from the perspective of the potentially affected client's reasonable expectation of loyalty. Each case will, obviously, turn on the particular facts and circumstances presented.

Inquiry No. 96-2-3

Adopted: January 15, 1997

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1. Rule 1.13 in the District of Columbia reads as follows:

(a) A lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents.

(b) In dealing with an organization's directors, officers, employees,

members, shareholders, or other constituents, a lawyer shall explain the identity of the client when it is apparent that the organization's interest may be adverse to those of the constituents with whom the lawyer is dealing.

(c) A lawyer representing an organization may also represent any of its directors, officers, employees, members, shareholders, or other constituents, subject to the provisions of Rule 1.7. If the organization's consent to the dual representation is required by Rule 1.7, the consent shall be given by an appropriate official of the organization other than the individual who is to be represented, or by the shareholders.

2. Such constituents may, however, hire counsel to represent their interests in matters concerning the corporation. A plant manager, for example, may obtain personal representation during an investigation of possible illegal waste disposal at a facility under his supervision.

In the event of any ambiguity concerning whether the lawyer is being hired by the constituent to represent the corporation or the constituent, the lawyer should clarify the client's identity at the outset of his dealings with the constituent, as any uncertainty is likely to be resolved in favor of a reasonable expectation of the constituent that an attorney-client relationship has been established with it. *Cf., Westinghouse Elec. Corp. v. Kerr-McGee Corp.,* 580 F.2d 1311 (7th Cir. 1978).

A representation of the corporation does not preclude representation of a constituent, and vice versa, even in the same matter. *See* Rule 1.13(c). Such additional representation, discussed later in this Opinion, would be governed by the conflicts provisions of the Rules of Professional Conduct, including Rules 1.7 and 1.9.

3. That disclosure obligation derives, in part, from Rule 4.3, concerning a lawyer'sobligations when dealing with unrepresented persons generally. Under that Rule, a lawyer representing a client shall not give advice to an unrepresented person (other than advice to secure counsel) where the interests of that person may be in conflict with the interests of the lawyer's client and shall not, even with respect to a person whose interests are not in conflict with those of the lawyer's client, leave the impression that the lawyer is disinterested. Thus, even apart from any special circumstances that might exist when a lawyer for a corporation interviews a corporate employee, Rule 4.3 (b) requires the investigating lawyer to clarify his position "[w]hen the lawyer knows or reasonably should know that the unrepresented person misunderstands the lawyer's role in the matter. . . ."

4. Limiting the disclosure obligation of Rule 1.13(b) to situations where the possible conflict was actually apparent to the lawyer would frustrate the protective purpose of the Rule by allowing a lawyer to be willfully blind to certain circumstances to avoid their "appearance" to him.

5. The only Rule 1.13 Comment relevant to the obligation to make a disclosure to corporate constituents [9], which is not particularly helpful: "Whether such a warning should be given by the lawyer for the organization to any constituent

individual may turn on the facts of each case."

6. Where the lawyer, through act or omission, reasonably leaves the constituent with the impression that there is an attorney-client relationship between them, the constituent's communications will be given protection under Rule 1.6. That was the situation in *Westinghouse Elec. Corp. v. Kerr-McGee Corp.*, 580 F. 2d 1311 (7th Cir. 1978), where lawyers for a trade association gave some individual members of a trade association the impression that they were also representing them when collecting information from the members. When a matter later arose for another client in which the information collected from the members might be used against them, the law firm was required to withdraw from representation because of its conflicting confidentiality obligations to the members.

7. Conflict of interest issues are similarly raised when representation of the corporate constituent is being provided by an in-house lawyer. The in-house lawyer, like outside counsel, has a concern under Rule 1.7(b)(4), in this case whether his representation of the corporate constituent will or reasonably may be affected by his personal employment interests because of his continuing service as counsel to the corporation. See discussion herein under "Multiple Representation."

8. Rule 1.13(c) specifically authorizes the representation of a corporation and one or more constituents, subject to satisfaction of the requirements of Rule 1.7, concerning conflicts of interest generally.

2004 Federal Sentencing Guidelines

Chapter 8 - PART B - REMEDYING HARM FROM CRIMINAL CONDUCT, AND EFFECTIVE COMPLIANCE AND ETHICS PROGRAM

2. EFFECTIVE COMPLIANCE AND ETHICS PROGRAM

§8B2.1. Effective Compliance and Ethics Program

(a) To have an effective compliance and ethics program, for purposes of subsection (f) of §8C2.5 (Culpability Score) and subsection (c)(1) of §8D1.4 (Recommended Conditions of Probation - Organizations), 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.

Such compliance and ethics program shall be reasonably designed, implemented, and enforced so that the program is generally effective in preventing and detecting criminal conduct. The failure to prevent or detect the instant offense does not necessarily mean that the program is not generally effective in preventing and detecting criminal conduct.

(b) Due diligence and the promotion of an organizational culture that encourages ethical conduct and a commitment to compliance with the law within the meaning of subsection (a) minimally require the following:

(1) The organization shall establish standards and procedures to prevent and detect criminal conduct.

(2) (A) The organization's governing authority shall be knowledgeable about the content and operation of the compliance and ethics program and shall exercise reasonable oversight with respect to the implementation and effectiveness of the compliance and ethics program.

(B) High-level personnel of the organization shall ensure that the organization has an effective compliance and ethics program, as described in this guideline. Specific individual(s) within high-level personnel shall be assigned overall responsibility for the compliance and ethics program.

(C) Specific individual(s) within the organization shall be delegated day-to-day operational responsibility for the compliance and ethics program. Individual(s) with operational responsibility shall report periodically to high-level personnel and, as appropriate, to the governing authority, or an appropriate subgroup of the governing authority, on the effectiveness of the compliance and ethics program. To carry out such operational responsibility, such individual(s) shall be given adequate resources, appropriate authority, and direct access to the governing authority or an appropriate subgroup of the governing authority.

(3) The organization shall use reasonable efforts not to include within the substantial authority personnel of the organization any individual whom the organization knew, or should have known through the exercise of due diligence, has engaged in illegal activities or other conduct inconsistent with an effective compliance and ethics program.

(4) (A) 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 individuals referred to in subdivision (B)

by conducting effective training programs and otherwise disseminating information appropriate to such individuals' respective roles and responsibilities.

(B) The individuals referred to in subdivision (A) are the members of the governing authority, high-level personnel, substantial authority personnel, the organization's employees, and, as appropriate, the organization's agents.

(5) The organization shall take reasonable steps—

(A) to ensure that the organization's compliance and ethics program is followed, including monitoring and auditing to detect criminal conduct;

(B) to evaluate periodically the effectiveness of the organization's compliance and ethics program; and

(C) to 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.

(6) The organization's compliance and ethics program shall be promoted and enforced consistently throughout the organization through (A) appropriate incentives to perform in accordance with the compliance and ethics program; and (B) appropriate disciplinary measures for engaging in criminal conduct and for failing to take reasonable steps to prevent or detect criminal conduct.

(7) After criminal conduct has been detected, the organization shall take reasonable steps to respond appropriately to the criminal conduct and to prevent further similar criminal conduct, including making any necessary modifications to the organization's compliance and ethics program.

(c) In implementing subsection (b), the organization shall periodically assess the risk of criminal conduct and shall take appropriate steps to design, implement, or modify each requirement set forth in subsection (b) to reduce the risk of criminal conduct identified through this process.

Commentary

Application Notes:

1. Definitions.—For purposes of this guideline:

"Compliance and ethics program" means a program designed to prevent and detect criminal conduct.

"Governing authority" means the (A) the Board of Directors; or (B) if the organization does not have a Board of Directors, the highest-level governing body of the organization.

"High-level personnel of the organization" and "substantial authority personnel" have the meaning given those terms in the Commentary to §8A1.2 (Application Instructions - Organizations).

"Standards and procedures" means standards of conduct and internal controls that are reasonably capable of reducing the likelihood of criminal conduct.

2. Factors to Consider in Meeting Requirements of this Guideline.—

(A) In General.—Each of the requirements set forth in this guideline shall be met by an organization; however, in determining what specific actions are necessary to meet those requirements, factors that shall be considered include: (i) applicable industry practice or the standards called for by any applicable governmental regulation; (ii) the size of the organization; and (iii) similar misconduct.

(B) Applicable Governmental Regulation and Industry Practice.—An organization's failure to incorporate and follow applicable industry practice or the standards called for by any applicable governmental regulation weighs against a finding of an effective compliance and ethics program.

(C) The Size of the Organization.—

(i) In General.—The formality and scope of actions that an organization shall take to meet the requirements of this guideline, including the necessary features of the organization's standards and procedures, depend on the size of the organization.

(ii) Large Organizations.—A large organization generally shall devote more formal operations and greater resources in meeting the requirements of this guideline than shall a small organization. As 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.

(iii) Small Organizations.—In meeting the requirements of this guideline, small organizations shall demonstrate the same degree of commitment to ethical conduct and compliance with the law as large organizations. However, a small organization may meet the requirements of this guideline with less formality and fewer resources than would be expected of large organizations. In appropriate circumstances, reliance on existing resources and simple systems can demonstrate a degree of commitment that, for a large organization, would only be demonstrated through more formally planned and implemented systems.

Examples of the informality and use of fewer resources with which a small organization may meet the requirements of this guideline include the following: (I) the governing authority's discharge of its responsibility for oversight of the compliance and ethics program by directly managing the organization's compliance and ethics efforts; (II) training employees through informal staff meetings, and monitoring through regular "walk-arounds" or continuous observation while managing the organization; (III) using available personnel, rather than employing separate staff, to carry out the compliance and ethics program; and (IV) modeling its own compliance and ethics program on existing, well-regarded compliance and ethics programs and best practices of other similar organizations.

(D) Recurrence of Similar Misconduct .—Recurrence of similar misconduct creates doubt regarding whether the organization took reasonable steps to meet the requirements of this guideline. For purposes of this subdivision, "similar misconduct" has the meaning given that term in the Commentary to §8A1.2 (Application Instructions - Organizations).

3. Application of Subsection (b)(2).—High-level personnel and substantial authority personnel of the organization shall be knowledgeable about the content and operation of the compliance and ethics program, shall perform their assigned duties consistent with the exercise of due diligence, and shall promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law.

If the specific individual(s) assigned overall responsibility for the compliance and ethics program does not have day-to-day operational responsibility for the program, then the individual(s) with day-to-day operational responsibility for the program typically 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.

4. Application of Subsection (b)(3) .—

(A) Consistency with Other Law .—Nothing in subsection (b)(3) is intended to require conduct inconsistent with any Federal, State, or local law, including any law governing employment or hiring practices.

(B) Implementation .—In implementing subsection (b)(3), the organization shall hire and promote individuals so as to ensure that all individuals within the high-level personnel and substantial authority personnel of the organization will perform their assigned duties in a manner consistent with the exercise of due diligence and the promotion of an organizational culture that encourages ethical conduct and a commitment to compliance with the law under subsection (a). With respect to the hiring or promotion of such individuals, an organization shall consider the relatedness of the individual's illegal activities and other misconduct (i.e., other conduct inconsistent with an effective compliance and ethics program) to the specific responsibilities the individual is anticipated to be assigned and other factors such as: (i) the recency of the individual's illegal activities and other misconduct; and (ii) whether the individual has engaged in other such illegal activities and other such misconduct.

5. Application of Subsection (b)(6).—Adequate discipline of individuals responsible for an offense is a necessary component of enforcement; however, the form of discipline that will be appropriate will be case specific.

6. Application of Subsection (c) .—To meet the requirements of subsection (c), an organization shall:

(A) Assess periodically the risk that criminal conduct will occur, including assessing the following:

(i) The nature and seriousness of such criminal conduct.

(ii) The likelihood that certain criminal conduct may occur because of the nature of the organization's business. If, because of the nature of an organization's business, there is a substantial risk that certain types of criminal conduct may occur, the organization shall take reasonable steps to prevent and detect that type of criminal conduct. For example, an organization that, due to the nature of its business, employs sales personnel who have flexibility to set prices shall establish standards and procedures designed to prevent and detect price-fixing. An organization that, due to the nature of its business, employs sales personnel who have flexibility to represent the material characteristics of a product shall establish standards and procedures designed to prevent and detect fraud.

(iii) The prior history of the organization. The prior history of an organization may indicate types of criminal conduct that it shall take actions to prevent and detect.

(B) Prioritize periodically, as appropriate, the actions taken pursuant to any requirement set forth in subsection (b), in order to focus on preventing and detecting the criminal conduct identified under subdivision (A) of this note as most serious, and most likely, to occur.

(C) Modify, as appropriate, the actions taken pursuant to any requirement set forth in subsection (b) to reduce the risk of criminal conduct identified under subdivision (A) of this note as most serious, and most likely, to occur.

Background: This section sets forth the requirements for an effective compliance and ethics program. This section responds to section 805(a)(2)(5) of the Sarbanes-Oxley Act of 2002, Public Law 107–204, which directed the Commission to review and amend, as appropriate, the guidelines and related policy statements to ensure that the guidelines that apply to organizations in this chapter "are sufficient to deter and punish organizational criminal misconduct."

The requirements set forth in this guideline are intended to achieve reasonable prevention and detection of criminal conduct for which the organization would be vicariously liable. The prior diligence of an organization in seeking to prevent and detect criminal conduct has a direct bearing on the appropriate penalties and probation terms for the organization if it is convicted and sentenced for a criminal offense.

Historical Note: Effective November 1, 2004 (see Appendix C, amendment 673).