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CURRENT REPORT

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Analysis
Compliance and Ethics

Responsible Corporations Should Get More Than Mitigation When They Work Diligently to Prevent and Detect Wrongdoing

BY PAULA J. DESIO

In a friend of the court brief filed in *United States v. Ionia Management SA*, 555 F.3d 303 (2d Cir. 2009), a high-profile coalition of business and criminal defense associations sought reconsideration of the basic legal tenet of federal corporate criminal liability.

Although the U.S. Court of Appeals for the Second Circuit upheld Ionia's conviction for violating the Act to Prevent Pollution from Ships, 33 U.S.C. § 1908(a), the policy advanced in the amicus brief may be a harbinger of yet another area where committed ethics and compliance efforts will serve corporate citizens well.

The brief proposed an increased legal role for effective ethics and compliance programs in defending against, rather than merely mitigating, liability under rigid U.S. legal standards.

Bad Apple Imperils Company

Under the principle of respondeat superior (''let the master answer''—the employer is responsible for the acts of employees), even employees and agents acting contrary to corporate policy and instructions can bind their corporate employers to criminal sanctions. A criminal indictment alone can have immediate consequences for corporations, such as licensing and permit revocations that threaten their viability. This reality can directly affect how companies defend against and react to criminal investigations and prosecutions in the United States. Resources often are devoted to staving off potential business damage rather than mounting a strong legal defense.

The spectacular collapse in 2002 of Arthur Andersen, one of the five largest international accounting firms, vividly illustrates the specter of such rapid, interrelated events. Because the criminal act of even one employee in a company can result in the entire company's conviction, the livelihood of all its employees and suppliers are in imminent jeopardy despite their personal noninvolvement and ''no-fault'' status.

Corporations can demonstrate good-faith efforts by implementing effective ethics and compliance programs.

Upon indictment for obstruction of justice growing out of a handful of its partners' auditing work for Enron, Andersen would have lost its auditing licenses in multiple jurisdictions. Andersen relinquished those licenses, closed its U.S. offices, and turned its efforts to defending itself in court. Despite the ultimately successful legal challenge, three years later, on appeal to the U.S. Supreme Court, Andersen's international workforce of 85,000 rapidly dispersed because Andersen could no longer do business. The company never recovered.

Andersen's dramatic demise catapulted serious discussion of the fundamental legal principles on which the U.S. government's prosecution rested onto the talk show circuit and fostered broader public understanding of these interrelated legal issues.

In questioning the wisdom of a prosecution that many average citizens viewed as an unfair loss of jobs for most of Andersen's employees,[1] the public quickly became acquainted with the hard facts of criminal indictment for companies. People began to understand that not only fines and the possibility of court supervision of company affairs affect the company's judgment on whether to fight charges or negotiate a plea with the federal government. Equal if not more compelling are all the companion consequences for employees, suppliers, shareholders, and communities.

Reward Responsibility

This cascading scenario of legal causes and effects undoubtedly motivated the friend of the court brief filed in support of Ionia's appeal. Ionia's legal supporters on this single issue include an alliance of business interests—the Association of Corporate Counsel, the U.S. Chamber of Commerce, the National Association of Manufacturers—with more traditional criminal defense groups—the National Association of Criminal Defense Lawyers and the New York State Association of Criminal Defense Lawyers, who until fairly recently have not visibly championed corporate causes.[2] The 30-year-old

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[1] Edward Iwata, ''Has the Hunt for Corporate Criminals Gone Too Far?'' USA Today (July 21, 2003).

[2] Essentially the same coalition has recently challenged the role of attorney-client privilege and work-product protection waivers as fundamental indicia of cooperation in corporate criminal investigations that can lead to additional penalty mitigation under the federal sentencing guidelines. See U.S.S.G. § 8C2.5(g) and Application Note 12.

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Washington Legal Foundation, which has recently taken up the defense of ''business civil liberties,'' is also in the group.

In its challenge, the coalition argued that corporations (and other organizations treated similarly under U.S. law) ought to be able to escape strict criminal liability if they have acted as responsible corporate citizens by making serious efforts to prevent and detect misconduct in the workplace.

The coalition suggested that the prosecution be required to prove the absence of an effective program, but it offered a variety of alternative approaches that the court might adopt to give more evidentiary weight to program efforts.

Groundwork Already Laid

The heart of the coalition's legal challenge was that the civil law standard of respondeat superior in a criminal context is inconsistent with recent Supreme Court rulings on analogous civil liability issues.[3] It mounted a two-pronged argument based on the theory and outcome of affirmative action cases under Title VII of the 1964 Civil Rights Act.

In a pair of 1998 cases, the Supreme Court rejected the usual rule in civil cases—that vicarious liability arises from all acts of employees acting within the scope of their employment—and instead restricted liability to the acts of supervisors.

The justices first determined that an employer is entitled to defend itself by demonstrating that it has reasonable policies in place to deter the offending employee's conduct.[4] The fact that the aggrieved employee has not made use of the employer's system of redress may also be considered in this defense. A year later, in a second case, the court refused to impose punitive damages on companies (even though authorized by statute) unless the offending action was authorized or ratified by an employee acting in a managerial capacity.[5]

The coalition's argument links the historic legal distinctions between civil and criminal law with the policy underlying the Supreme Court's rationale for these important recent decisions.

Policy Goal Addressed

First, civil law standards of liability have traditionally been less rigid than criminal standards, primarily because they do not involve the loss of liberty as a potential consequence. The coalition maintained that, if the Supreme Court considers vicarious liability too severe a standard for civil punitive damages, the criminal law standards should be treated similarly and not more severely. The coalition bolstered its position by arguing that laws providing for civil punitive damages and laws providing criminal penalties share a common policy goal: They are intended to punish and prevent further misconduct to achieve the two objectives of retribution and deterrence. The brief states:

> When a corporation has undertaken all reasonable measures to deter and detect the employee's criminal actions, the company has done all that can be expected, i.e., there is nothing that the criminal law is serving to deter or punish since there is no action by the *corporation* that it should have otherwise taken. (emphasis in original).

Because similar public policy considerations are at the foundation of both criminal law and civil punitive law, the coalition maintained that the strict liability standard for corporate criminal conduct should be modified to allow for more viable defenses by the indicted corporation. One suggested approach would require the prosecution to prove the absence of an effective ethics and compliance program while another variation would allow defendant corporations to raise the effectiveness of their programs as an affirmative defense. This is similar to what is provided in Section 2.07(5) of the Model Penal Code, a prototype developed by the American Law Institute. In support of its argument for change, the coalition pointed out that numerous states have either limited vicarious corporate liability to circumstances where senior corporate officers are at fault or have provided a due diligence defense of some nature for corporations to employ.[6]

Aim Is Crime Control

The coalition also aptly pointed out that promoting effective compliance programs is a central goal of the federal sentencing guidelines for organizations, although it could have bolstered its argument a bit more with an explanation of the guidelines' theoretical and policy basis. When the organizational sentencing guidelines were promulgated in 1991, the U.S. Sentencing Commission, an independent judicial agency created by Congress, acknowledged that its effort to promote deterrence of corporate crime relied heavily on a belief that encouraging strong compliance programs and self-reporting would achieve this goal. As the first chairman of the Sentencing Commission observed about this developmental effort: ''The Commission broke new ground [after four years of public debate and comment] in this area in the hope that its approach would foster crime control.''[7]

In 2004, the Sentencing Commission reaffirmed its commitment to the viability of corporate ethics and compliance programs, making many of the criteria more rigorous to reflect the lessons learned by the corporate sector in more than a decade of practical experience and implementation.[8]

[3] The coalition's brief also provides a compendium of scholarly articles questioning the conceptual soundness of respondeat superior as a continuing basis for corporate criminal liability. For example, a recent symposium was held at the Georgetown University Law Center devoted to ''Corporate Criminality: Legal, Ethical, and Managerial Implications.'' Scholarly articles are proliferating as interest develops on this topic as well. See 44 American Criminal Law Review No. 4 (Fall, 2007); also, Kathleen F. Brickey, ''Rethinking Corporate Liability Under the Model Penal Code,'' 19 Rutgers L.J. 593 (1988); V.S. Khanna, ''Is the Notion of Corporate Fault a Faulty Notion? The Case of Corporate Mens Rea,'' 79 B.U. L. Rev. 355 (1999).

[4] *Faragher v. City of Boca Raton*, 524 U.S. 775 (1998), *Burlington Industries Inc. v. Ellerth*, 524 U.S. 742 (1998).

[5] *Kolstad v. Am. Dental Ass'n*, 527 U.S. 526 (1999).

[6] Amicus Curiae brief at pp. 24-26. See also ''Indicting Corporations Revisited: Lessons of the Arthur Andersen Prosecution,'' Appendix E, American College of Trial Lawyers (2004), for a list of state and foreign jurisdictions that provide alternative approaches to limit vicarious corporate liability.

[7] The Honorable William W. Wilkins Jr., chairman, U.S. Sentencing Commission, in foreward to ''Compliance Programs and the Corporate Sentencing Guidelines,'' Jeffrey M. Kaplan, Joseph E. Murphy, and Winthrop M. Swenson, Clark Boardman Callaghan (1993).

[8] See Reason for Amendment No. 673 (2004), U.S. Sentencing Guidelines, Appendix C (Nov. 1, 2004). ''First and foremost among these (structural) safeguards is a regime of internal crime prevention and self-policing ('an effective compliance and ethics program') . . . [that] not only will prevent and detect criminal conduct, but should also facilitate compliance with

In its reply to Ionia's appeal, the government contended that evidence of corporate compliance programs does not bear on Ionia's actual liability under the current state of the law. Rather, such evidence may be and, in Ionia's case, was, considered by the jury in determining whether an employee acted within the scope of employment and with some intention to benefit the corporation.

The government dismissed the coalition's arguments in a single page, stating that existing law on the standards for corporate criminal liability cannot be overturned or modified other than by the Supreme Court or by the Second Circuit sitting en banc.

As perhaps was to be expected, the appeals court ruled very narrowly and agreed that requiring the government to prove the defendant corporation lacked an effective compliance program would be contrary to Second Circuit precedent. It cited *United States v. Twentieth Century Film Corp.*, 882 F.2d 656 (2d Cir. 1989), where the court held that a compliance program, ''however extensive, does not immunize the corporation from liability when its employees, acting within the scope of their authority, fail to comply with the law.''

Nonetheless, the *Ionia* case represents the first contemporary legal challenge to the strict standard of corporate criminal liability[9] and provides a good opportunity to revisit these important legal and policy issues.

Let Reasonableness Be a Guide

The coalition's efforts in *Ionia* represent the logical culmination of the policy of the Sentencing Commission that, since 1991, has fostered the prevention and early detection of corporate wrongdoing by encouraging effective ethics and compliance programs.

This approach was visionary in its day. The Sentencing Commission identified seven broad steps based on sound risk-management principles that would encourage prevention and early detection. These quickly became known as ''the seven minimum steps for an effective ethics and compliance program,'' although the Sentencing Commission did not use those words in the guidelines until 2004, after they had been in currency in the business community for more than a decade.[10]

The heart of the coalition's legal challenge was that the civil law standard of respondeat superior in a criminal context is inconsistent with recent Supreme Court rulings on analogous civil liability issues.

Whether to reduce the corporation's potential penalty is to be measured by a standard of reasonableness, not perfection.[11] The guidelines recognize the inevitability of errant behavior in organizations that often have more employees than towns have residents. A town, despite a well-intentioned and trained police force and educational system, cannot guarantee that any single resident will not stray from the law-abiding path. In such a case, how heavily should the town be collectively punished for its resident's behavior? Finding a balanced response to this question was central to the Sentencing Commission's analysis and policy.

Although they are not mandatory, the guidelines have been the catalyst for the enormous proliferation of ethics and compliance programs in corporate America and beyond U.S. borders. These programs have been accompanied by serious professional efforts to develop, refine, and measure best practices so that today there is a substantial body of expert knowledge from which courts may extrapolate sound objective standards for assessing programs.[12]

An essential component of the partnership between business and government envisioned by the Sentencing Commission is the responsibility of business to police itself by investigating and reporting malfeasance to the proper authorities—a logical progression of a well-implemented ethics and compliance program focused on prevention, detection, and remediation.

Another favorable outcome of what the coalition proposed in *Ionia* would be to let judge and jury determine corporate liability at the trial stage. Under the current standard of respondeat superior, there is little, if any, room for a factual defense once the illegal action has been established and the employer ascertained. Focus shifts to mitigating consequences and obtaining favorable terms under a negotiated plea agreement with federal prosecutors.[13]

Approach Encourages Diligence

If ethics and compliance programs could be raised as an affirmative defense, the jury would be able to weigh the evidence and assess the diligence of the corporation's efforts to inform, train, and oversee its workforce in complying with the law and its poli-

all applicable laws.''

[9] There are not many criminal prosecutions of corporations resulting in a criminal conviction at trial from which an appeal can be procedurally positioned. Most corporations either plead guilty or enter into a deferred prosecution agreement, neither of which permits a legal challenge to the conviction through a subsequent appeal. Marcia Coyle, ''A Crucial Quest for New Look at Liability: Corporate Criminal Standards at Stake,'' National Law Journal, July 7, 2008, citing Andrew Weissmann, lead attorney for the coalition.

[10] The ''seven minimum steps'' coupled with assessing risk for areas of vulnerability consist of: high-level oversight of programmatic approach to detection of wrongdoing; clearly enunciated standards of conduct; effective communication and training on the standards; discipline for infractions of the standards; careful delegation of authority; monitoring and auditing of program efforts; and consistent process modifications upon findings of deficiencies. See generally U.S. Sentencing Guidelines, § 8B2.1, and Reason for Amendment No. 673 (Nov. 1, 2004).

[11] The guideline standard is ''due diligence'' and can be met even if criminal conduct has occurred.

[12] For example, the pre-eminent membership organizations, the Ethics and Compliance Officer Association and the Society of Corporate Compliance and Ethics, each has over 1,200 members, and many professional and nonprofit organizations and academic institutions are devoted to specialized research in this area. Specialized training and certification requirements for practitioners in this field have matured and gained currency. The Ethics Resource Center has conducted longitudinal national survey research since 1994 on employees' perceptions of workplace ethics as correlated to the organizational sentencing guidelines and measures both programs and culture as encouraged by the guidelines.

[13] Robert A. Del Giorno, ''Corporate Counsel As Government's Agent,'' Champion Magazine, National Association of Criminal Defense Lawyers (August, 2003).

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cies. This approach would not relieve an indicted corporation of the expense of defending itself. The corporation would still bear the significant burden of developing and introducing evidence. Allowing an affirmative defense would, however, afford a corporate citizen the opportunity to counter public charges of malfeasance by presenting evidence of its commitment to business integrity in the workplace. This approach also is likely to encourage more companies to adopt well-implemented programs and ensure that they are embedded into the organizational culture as the Sentencing Commission encourages.[14]

'Quick Fix' Won't Do

Adopting or expanding ethics and compliance programs would necessarily be a long-term undertaking and a commitment of substantial resources. Evidence of a hastily instituted program after the discovery of wrongdoing would be unlikely to carry the day in court. A quick fix in the face of indictment would not meet the guidelines' level of scrutiny. Companies would have to have undertaken these efforts as part of long-term strategic commitments to gain the benefits. Public education about these principles would also be essential.

The knowledge and experience exist for this approach to be feasible. The principles of the organizational sentencing guidelines are widely understood and adopted throughout corporate America and many regulatory agencies.[15] Sound research methods exist to quantify and evaluate compliance and ethics programs.

Benchmarking comparisons are becoming more prevalent, thanks in no small part to the leadership of some forward-looking corporations that have taken the initiative as part of their own risk management and good governance standards.[16]

This approach should not burden the judicial system unduly since such defenses and the mechanisms for their evidentiary use already exist in analogous, complex civil cases. Corporate criminal prosecutions and convictions make up an extremely small portion of the entire federal docket in contrast to cases involving individual defendants,[17] and there is no realistic expectation of the inward collapse of the federal judicial system. Indeed, many states have adopted approaches similar to what the coalition proposed in *Ionia*.

In fact, any variation on the proposed approaches could conceivably conserve court resources. By allowing a legitimate defense of a corporation's internal systems, the jury would have the opportunity to fashion a remedy that is more balanced under the circumstances of the particular case and potentially easier to assess by having these facts at hand. Such determinations by the jury would eventually become adopted in practice, serving as a template for cost-effective and efficient procedures. And by giving additional encouragement to corporations to have robust ethics and compliance programs, and thus greater transparency, the need to prosecute corporations might ultimately diminish.

Case Is a Policy Catalyst

Given the very real and extensive consequences for the entire community of corporate stakeholders—customers, employees, suppliers, local communities, taxing authorities—resulting from criminal prosecution and conviction, it is sound policy to find an accommodation in existing law and contemporary practice. An affirmative legal defense provides one such approach. It also offers a broader legal platform for the federal organizational sentencing guidelines, with their fundamental focus on prevention, detection, remediation, and self-reporting, to evolve further.

All the necessary players—prosecutors, corporations, judges, and ethics and compliance experts—have developed and broadened their expertise in recent years. It is now time to implement a corresponding shift in corporate criminal liability standards and available defenses based on this important body of knowledge and practice. Despite the unfavorable outcome for both Ionia and the coalition's argument in the Second Circuit, this case will hopefully be remembered as the catalyst for important changes to come.

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[14] The recent amendments to the organizational sentencing guidelines provide that an organization shall "promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law." USSG § 8B2.1(a)(2) (Nov. 1, 2004)

[15] For example, the Department of Health and Human Services, Office of the Inspector General, regularly issues compliance guidance for various sectors within its oversight that are built upon the organizational sentencing guidelines. Similarly, federal contractors are now subject to greater and more specific business conduct and integrity rules derived from the organizational sentencing guidelines. 72 Fed. Reg. 225 (Nov. 23, 2007). The State Department has incorporated similar criteria for sound internal oversight of settlement agreements for Arms Export Control Act violations. See http://www.pmdtc.state/gov/compliance.

[16] The Defense Industry Initiative is a good example of proactively assessing corporate programs through benchmarking. Since 2005, the Defense Industry Initiative has worked with the Ethics Resource Center to field ethics surveys of their employees and making both industry and national comparisons. Comparing company-specific data against peer groups allows organizations to identify current and future risks that must be addressed. In addition, this group is better able to share best practices and conduct open dialogues about ethics and compliance matters in their respective organizations.

[17] U.S. Sentencing Commission data reflect that between 150 and 200 organizations are sentenced annually, in contrast to upward of 65,000 individual defendants.

Invitation to Authors

The back page of each issue of *Prevention of Corporate Liability* is devoted to a feature article related to developments or practical advice in the field of corporate compliance and business ethics. We encourage lawyers, those in academia, and others to submit original pieces for publication. For more information, contact Mike Moore, managing editor, *BNA/ACCA Compliance Manual: Prevention of Corporate Liability*, 1801 S. Bell St., Suite 8207, Arlington, Va., 22202; (703) 341-3910; e-mail: mmoore@bna.com.