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Changes to Sentencing Guidelines, New Whistleblower Rules Affect Corporate Compliance Programs

The United States Sentencing Commission has adopted changes to the Federal Sentencing Guidelines for Organizations (the "FSGOs") concerning corporate compliance programs. The changes are scheduled to take effect November 1, 2010 and affect all companies that maintain compliance programs intended to satisfy the FSGOs. The changes may necessitate modifications to existing compliance programs, particularly to ensure direct reporting obligations from compliance officers to boards or board committees.

Also related to compliance planning, the recently enacted Dodd-Frank Act established a whistleblower "bounty" program encouraging parties with knowledge of violations of securities laws (including the Foreign Corrupt Practices Act) to report the violations to the SEC in exchange for potentially substantial financial rewards from amounts collected in resulting SEC enforcement actions. The new whistleblower rules highlight the need for effective corporate compliance programming by creating a compelling incentive for reporting violations.

Compliance Programs and the FSGOs

"Corporate compliance programs" are intended to prevent and detect criminal conduct and to promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law. Companies adopt and use compliance programs as a way to help achieve and demonstrate good corporate citizenship, protect their reputations, reduce the likelihood of becoming involved in legal problems, help reduce the likelihood of prosecution and the fines imposed for wrongdoing, and for a variety of other similar reasons.

The Federal Sentencing Guidelines for Organizations guide federal courts in the United States when sentencing corporate wrongdoers convicted of criminal conduct. Although the FSGOs themselves do not *require* companies to have compliance programs (though other laws might), they offer potential mitigation of fines for those that do. The effect of this mitigation can be very substantial, and can mean averting an otherwise catastrophic financial impact.

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Perhaps more importantly, federal prosecutors consider the presence (or absence) of an effective compliance program in determining whether to prosecute an organization in the first place. The FSGOs describe the characteristics of what constitutes an "effective" compliance program for purposes of this mitigation, including seven minimum characteristics. Though many companies choose to go above and beyond, the FSGO framework has become the de facto standard against which most companies design and conduct their compliance programs.

FSGO Changes

The changes to the FSGOs address three primary issues. First, the changes clarify the nature of the efforts required under the FSGOs to remediate criminal conduct after detection. Second, they create a limited exception to the general rule under the FSGOs that mitigation is not available if the organization's high-level or "substantial authority" personnel are involved in the offense. The exception requires that certain conditions be in place, including that the individual or individuals with operational responsibility for the compliance program have "direct reporting obligations" to the organization's governing authority (typically its board of directors) or an appropriate subgroup, and that the compliance program have detected the offense before discovery outside the organization or before such discovery was reasonably likely. Third, the changes augment and simplify the recommended conditions for probation for organizations.

While the other changes generally address conduct rather than program structure, the "direct reporting obligations" changes may require some organizations to modify the structure of their compliance programs in order to position themselves to take advantage of the new exception allowing mitigation even in some situations involving senior personnel. Commentary to the new changes indicate that a person has "direct reporting obligations" if he or she has "express authority to communicate personally to the governing authority or appropriate subgroup thereof (A) promptly on any matter involving criminal conduct or potential criminal conduct, and (B) no less than annually on the implementation and effectiveness of the compliance and ethics program." Thus organizations with compliance programs that are intended to satisfy the FSGOs but do not currently provide for these "direct reporting obligations" may require updating. This will be an issue particularly in compliance programs in which compliance officers report solely to general counsels, chief financial officers, or other senior officers rather than to boards or appropriate board committees.

Dodd-Frank Whistleblower Program

Part of the recently enacted federal Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act") also bears on corporate compliance. The Act creates a new program under which individuals who provide the SEC with "original information" on violations of securities laws leading to SEC enforcement actions are entitled to a share (10-30%, in the SEC's discretion, guided by various specified factors) of any resulting monetary sanctions exceeding $1 million, and requires the SEC to set up a dedicated office to address whistleblower claims. Recent high-dollar settlements under the Foreign Corrupt Practices Act (which is a "securities law" for purposes of the new program), for example, suggest that these "bounties" could be quite large, creating a very substantial incentive for reporting. The Act, which is subject to rulemaking by the SEC, does not require a potential whistleblower to inquire within the affected organization before contacting the SEC, and creates robust protections against retaliation by employers.

Although the Dodd-Frank whistleblower program does not address the content or conduct of compliance programs in organizations, it creates a real practical incentive for effectiveness. There should be no whistle to blow if an organization's compliance program prevents violations of securities laws or detects potential violations in a manner that allows proper remediation within the organization in the first place. We anticipate that the whistleblower program also may influence compliance program design adaptations and potential adjustments to HR procedures and corporate policies to encourage employees to inquire appropriately within the affected organization before escalating matters externally.

Even though the Act does not require inquiring internally first, a healthy compliance culture, accessible reporting infrastructure, and clear corporate policies encouraging employees to raise concerns in-house may increase the likelihood that companies can address concerns internally first. This "first look" can help companies stave off baseless claims and can provide an opportunity for companies to consider preemptive self-reporting to the authorities. Companies therefore should be prepared to respond quickly to investigate potential claims. The bounty program also will put a premium on securities law compliance training, including with respect to the Foreign Corrupt Practices Act, and may lead some companies to adjust their HR procedures, such as to protect against retaliation against whistleblowers and to help guard against retaliation claims by asking departing employees to confirm in exit procedures that they are not aware of securities law violations.

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For additional information about the changes to the FSGOs or the Dodd-Frank whistleblower rules, or for other assistance in connection with developing or implementing corporate compliance programs, please contact Gerald Roach or Rob Duggins at Smith Anderson using the contact information on the first page of this Alert.

While every effort has been made to ensure the accuracy of this memorandum, it is not intended to provide legal advice as individual situations will differ and should be discussed with a lawyer. This is intended only as a courtesy alert and not as a complete presentation on the matters addressed.

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