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Drifting Down the Dnieper With Prince Potemkin: Some Skeptical Reflections About the Place of Compliance Programs in Federal Criminal Sentencing (symposium)

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DRIFTING DOWN THE DNIEPER WITH PRINCE POTEMKIN: SOME SKEPTICAL REFLECTIONS ABOUT THE PLACE OF COMPLIANCE PROGRAMS IN FEDERAL CRIMINAL SENTENCING

*Frank O. Bowman, III**

And, as imagination bodies forth
The forms of things unknown, the poet's pen
Turns them to shapes, and gives to airy nothing
A local habitation and a name.[1]

I was pleased and honored to accept the Wake Forest Law Review's invitation to moderate this symposium on the Federal Sentencing Guidelines for Organizations. The topic could hardly have been more timely. The brobdingnagian Enron bankruptcy in December 2001[2] was but the first of a seeming avalanche of scandals, failures, and misadventures among the titans of American business. The cascade of evil tidings was for a time so unceasing that fears for the future of American capitalism were openly voiced in the media and the halls of Congress.[3] Bad news provoked political frenzy, and frenzy played midwife to the Sarbanes-Oxley Act[4] and a bawling litter of new laws and regulations designed to strike down corporate evildoers and nurture the better angels of good corporate governance.[5]

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* M. Dale Palmer Professor of Law, Indiana University School of Law—Indianapolis. I am grateful to the staff of the Wake Forest Law Review, and particularly Christopher Gyves, for the invitation to appear at the symposium and for their hospitality throughout the event. Many thanks, as well, to Professors Alan Palmiter and Ronald Wright for their work in helping put together the symposium, and for their insightful comments on this subject and other recent projects. Finally, I am grateful to Phillip Long for his work editing this article.

1. WILLIAM SHAKESPEARE, A MIDSUMMER NIGHT'S DREAM act 5, sc. 1.

2. At the time it occurred, the Enron bankruptcy was the largest in the history of the United States. *Explaining the Enron Bankruptcy*, *at* http://www.cnn.com/2002/US/01/12/enron.qanda.focus/index.html (last visited May 25, 2004).

3. *See, e.g.*, 148 CONG. REC. H1545-46, H1584-85 (daily ed. Apr. 24, 2002) (remarks of Rep. Kanjorski); *id.* at H1544 (daily ed. Apr. 24, 2002) (remarks of Rep. Oxley).

4. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745.

5. For discussions of the civil regulatory side of the Sarbanes-Oxley Act,

I have told the tale of the criminal provisions of the Sarbanes-Oxley Act of 2002 and the ensuing amendments to the Federal Sentencing Guidelines elsewhere.[6] At least one thread of that story is relevant here. When the political classes concluded that the enormity of the wave of corporate scandal required a response, the question arose as to whether punitive criminal or civil regulatory responses would be best. Republicans were only reluctantly in favor of either. Democrats wanted both.[7] The White House elected to portray the problem as one of criminal wrongdoing by a relative few individuals in order to quell rising enthusiasm for far-reaching regulation of corporate conduct.[8] The result was a bipartisan push for tough criminal legislation aimed at corporate fraud.[9] The problem for the legislators and their staffs was that, when they began casting about for laws to change and sentences to rise, they found that the federal criminal statutes already covered almost every conceivable form of serious corporate misbehavior.[10] On the penalty side, the U.S. Sentencing Commission had beaten Congress to the punch by passing, in November 2001, a package of economic crime sentencing reforms that substantially increased the sentences of mid- to high-level white-collar offenders.[11] In addition, the Commission had already formed a blue ribbon Ad Hoc Advisory Group that was in the process of evaluating the Sentencing

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see John C. Coffee, Jr., *Gatekeeper Failure and Reform: The Challenge of Fashioning Relevant Reforms*, 84 B.U. L. REV. 301, 336-43 (2004); Lawrence A. Cunningham, *The Sarbanes-Oxley Yawn: Heavy Rhetoric, Light Reform (and It Just Might Work)*, 35 CONN. L. REV. 915 (2003).

6. Frank O. Bowman, III, *Pour encourager les autres? The Curious History and Distressing Implications of the Criminal Provisions of the Sarbanes-Oxley Act and the Sentencing Guidelines Amendments That Followed*, 1 OHIO ST. J. CRIM. L. 373 (2004) [hereinafter Bowman, *Sarbanes-Oxley Act*]; Frank O. Bowman, III, *The Sarbanes-Oxley Act and What Came After*, 15 FED. SENTENCING REP. 231 (2003).

7. Bowman, *Sarbanes-Oxley Act, supra* note 6, at 392-98.

8. *Id.* at 399.

9. *Id.* at 400-01.

10. *See Penalties for White Collar Crime: Hearings Before the Subcomm. on Crime and Drugs of the Senate Comm. on the Judiciary*, 107th Cong. 42-43 (2002) (responses by Frank O. Bowman, III to written questions following hearing of June 19, 2002); Bowman, *Sarbanes-Oxley Act, supra* note 6, at 402-05.

11. For discussions of the 2001 Economic Crime Package, see Frank O. Bowman, III, *The 2001 Federal Economic Crime Sentencing Reforms: An Analysis and Legislative History*, 35 IND. L. REV. 5 (2001); Frank O. Bowman, III, *A Judicious Solution: The Criminal Law Committee Draft Redefinition of the "Loss" Concept in Economic Crime Sentencing*, 9 GEO. MASON L. REV. 451 (2000); Frank O. Bowman, III, *The 2001 Economic Crime Package: A Legislative History*, 13 FED. SENTENCING REP. 3 (2000); Frank O. Bowman, III, *Coping with "Loss": A Re-Examination of Sentencing Federal Economic Crimes Under the Guidelines*, 51 VAND. L. REV. 461 (1998); Frank O. Bowman, III, *Back to Basics: Helping the Commission Solve the "Loss" Mess with Old Familiar Tools*, 10 FED. SENTENCING REP. 115 (1997).

Guidelines for Organizations.[12] Slightly baffled, but nonetheless determined to legislate, Congress cobbled together an array of provisions that fractionally expanded the reach of several existing criminal statutes, raised statutory maximum sentences for several common kinds of fraud, and issued directives to the Commission intimating, or in some cases commanding, that some white-collar sentences should be raised still further.[13]

Oddly enough, although the Sarbanes-Oxley furor was about mismanagement, scandal, and crime in large corporate organizations, the Sarbanes-Oxley Act virtually ignored that portion of federal sentencing law expressly designed to address corporate conduct—the organizational sentencing guidelines. The Act contains only one line about the organizational guidelines. Section 805(a)(5) declares that "the United States Sentencing Commission shall review and amend, as appropriate, the Federal Sentencing Guidelines and related policy statements to ensure that . . . the guidelines that apply to organizations in United States Sentencing Guidelines, chapter 8, are sufficient to deter and punish organizational criminal misconduct."[14] Since the Ad Hoc Advisory Group was already evaluating the organizational sentencing guidelines, § 805(a)(5) amounted to little, if anything, more than an admonition to the Commission to keep doing what it was already doing.

It is interesting to speculate about why Congress had so little to say about the organizational guidelines in Sarbanes-Oxley, particularly in light of the solons' willingness to command quite specific alterations of the guidelines for individual defendants. One strongly suspects that few of the relevant congressional actors or their staffs even knew that there was a separate set of organizational guidelines. One also suspects that, even among those who did know such guidelines existed, few had any real understanding of how they work. But it is also possible that those on Capitol Hill who knew of and basically understood the organizational guidelines thought they were reasonably sound and were, in any case, undergoing a process of study and revision which required no immediate congressional intervention. To the extent that anything like the last suggestion was at work, it is consistent with my entirely impressionistic sense of how the organizational guidelines are viewed in the broader legal community. That is, in contrast to the federal sentencing guidelines for individuals, which

12. *See* Press Release, U.S. Sentencing Comm'n, Sentencing Commission Convenes Organizational Guidelines Ad Hoc Advisory Group (Feb. 21, 2002), *available at* http://www.ussc.gov/PRESS/rel0202.htm.

13. Bowman, *Sarbanes-Oxley Act*, *supra* note 6, at 404-05; *The Sarbanes-Oxley Act: Sentencing Provisions*, 15 FED. SENTENCING REP. 254 (2002).

14. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 805(a)(5), 116 Stat. 745, 802.

have been the subject of endless critical commentary,[15] the consensus about the organizational sentencing guidelines seems to be pretty positive. At the very least, they are not the subject of the impassioned cries for reform that characterize the conversation about the guidelines generally.

Why the difference? Part of the answer may be nothing more than popular indifference to criminal punishment of corporations. As we will see momentarily, very few corporations suffer criminal convictions and sentences. And when such convictions happen, corporations, as has been famously observed, have "no soul to be damned, and no body to be kicked."[16] Thus, their collective punishments, which necessarily take the form of monetary fines or legal prohibitions from engaging in certain activities, simply do not engage the emotions in the way that confinement of a human being in a cell does. But even among those who make it their business to care about crime and punishment, the organizational sentencing guidelines seem to enjoy greater support than the rest of the federal sentencing structure. So the question remains why that sentiment exists. This essay takes a very brief stab at explaining the relative popularity of the organizational sentencing guidelines. But the major thrust of my argument is the suggestion that such popularity as they enjoy rests in part on widespread misunderstanding of how a central component of the organizational sentencing guidelines—the incentives for creation of corporate "compliance programs"—works in practice.

I am not an expert in management or corporate governance. My expertise, if any, is in prosecuting and punishing corporeal people for crime. But at least from that perhaps uninformed perspective, the portion of the organizational sentencing guidelines devoted to compliance programs seems awfully like a legal Potemkin village.[17]

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15. *See, e.g.*, KATE STITH & JOSÉ A. CABRANES, FEAR OF JUDGING: SENTENCING GUIDELINES IN THE FEDERAL COURTS (1998); Daniel J. Freed, *Federal Sentencing in the Wake of Guidelines: Unacceptable Limits on the Discretion of Sentencers*, 101 YALE L.J. 1681 (1992). For reviews of the Stith and Cabranes book, see Frank O. Bowman, III, *Fear of Law: Thoughts on* Fear of Judging *and the State of the Federal Sentencing Guidelines*, 44 ST. LOUIS U. L.J. 299 (2000) (book review); Ronald F. Wright, *Rules for Sentencing Revolutions*, 108 YALE L.J. 1355 (1999) (book review).

16. The remark is attributed to Edward, First Baron Thurlow. Gilbert Geis & Joseph F.C. DiMento, *Empirical Evidence and the Legal Doctrine of Corporate Criminal Liability*, 29 AM. J. CRIM. L. 341, 342 n.3 (2002) (citing John C. Coffee, Jr., *"No Soul to Damn: No Body to Kick": An Unscandalized Inquiry into the Problem of Corporate Punishment*, 79 MICH. L. REV. 386, 386 (1981)).

17. The phrase "Potemkin village" was coined to describe the efforts of Prince Grigory Aleksandrovich Potemkin to spruce up the route of Tsarina Catherine the Great's royal progress through the Ukraine and the Crimea in 1787. According to legend, Potemkin went so far as to have phony villages constructed along Catherine's route, much of which followed the Dnieper River on which the court moved by barge. His objective was to impress the Tsarina with his success in administering the area. In fact, there is considerable doubt

It looks great as the Tsarina sails by on her barge. It has made a bundle of money for the compliance officers and outside consultants who have been busily constructing the facade. But there is precious little evidence that all this scurrying about on the riverbank has moved either the barons or the serfs of corporate life to commit less crime. Moreover, such evidence as exists reveals that the compliance components of the guidelines have virtually no effect even within the criminal sentencing system. Thus, what follows are the questions of a puzzled, if persuadable, skeptic.

I. A RUDIMENTARY PRIMER IN THE ORGANIZATIONAL SENTENCING GUIDELINES

Organizations are not persons except in the technical juridical sense, but the criminal law permits them to be charged, convicted, and sentenced for crime just as though they were creatures of flesh and blood.[18] Of course, an organization can neither act nor think except through the actions and thoughts of the individuals of which it is composed. Hence, organizations are found "guilty" of crime by attributing to the collective the acts and mens rea of its members.[19] Except in the case of purely criminal organizations like the Mafia, a convicted organization will almost invariably consist of both guilty and innocent persons, but punishment imposed on the organization will probably affect both. So the objectives of criminal punishment of organizations ought to include (a) preventing or reducing the incidence of organizational wrongdoing; (b) compelling the organization to remedy the harm its criminality has caused to others; (c) minimizing the harm imposed by the punishment on the innocent members of the organization; and (d) where possible, and excepting the case of a purely criminal organization, allowing the organization to continue to perform its beneficial social and economic functions.

The designers of the organizational sentencing guidelines tried to craft a sentencing mechanism that would balance all these

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that Potemkin ever had wholly false communities constructed, though he undoubtedly ordered plenty of clean-up in anticipation of the monarch's passage. *Grigory Aleksandrovich Potemkin*, *in* ENCYCLOPÆDIA BRITANNICA (2004), *available at* http://www.britannica.com/eb/article?eu=62606.

18. For a discussion of the anthropomorphic quality of corporate criminal liability, see Richard T. Oakes, *Anthropomorphic Projection and Chapter Eight of the Federal Sentencing Guidelines: Punishing the Good Organization When It Does Evil*, 22 HAMLINE L. REV. 749 (1999).

19. N.Y. Cent. & Hudson River R.R. Co. v. United States, 212 U.S. 481, 494-95 (1909) (upholding vicarious liability of a corporation for the acts or omissions of its employees); *see also Developments in the Law—Corporate Crime: Regulating Corporate Behavior Through Criminal Sanctions*, 92 HARV. L. REV. 1227, 1247 (1979) ("[A] corporation may be held criminally liable for the acts of any of its agents if an agent (1) commits a crime (2) within the scope of employment (3) with the intent to benefit the corporation.").

sometimes conflicting objectives. The organizational sentencing guidelines occupy a separate chapter, Chapter Eight, in the Guidelines. They were not adopted until 1991, four years later than the first guidelines for individual defendants, and they were the product of a separate and somewhat more leisurely drafting process.[20] The sentencing process under the organizational sentencing guidelines consists of three major parts. The first thing a judge is to do when determining a penalty under Chapter Eight is to "[d]etermine . . . the sentencing requirements and options relating to restitution, remedial orders, community service, and notice to victims."[21] Court-mandated remediation can include both an order of monetary restitution[22] and other types of corrective action such as a product recall or clean-up program.[23] Next, the court is to determine the fine to be imposed on the organization.[24] Finally, the court must consider whether probation would be an appropriate part of the sanction.[25]

Despite the (undoubtedly laudable) emphasis on remedial measures, the centerpiece of the organizational sentencing guidelines is their structure for imposing fines. The Guidelines divide organizations into two categories for purposes of imposing fines. Consistent with the principles that punishment of organizations should endeavor to prevent crime while minimizing the harm to innocent members and allowing the organization to continue performing any socially or economically beneficial function it may serve, the Guidelines seek to shut down purely criminal organizations by divesting them of all their assets.[26] All other organizations are subjected to fines designed to prevent crime, but not, at least in theory, to cause the destruction of the entity.[27]

Organizational fines are determined as follows. First, the court calculates the base fine, which will be the greatest of (a) the gain to the organization from the crime; (b) the loss caused by the crime, if

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20. Ilene H. Nagel & Winthrop M. Swenson, *The Federal Sentencing Guidelines for Corporations: Their Development, Theoretical Underpinnings, and Some Thoughts About Their Future*, 71 WASH. U. L.Q. 205, 208 (1993).

21. U.S. SENTENCING GUIDELINES MANUAL §§ 8A1.2(a), 8B1.1-8B1.4 (2003).

22. *Id.* § 8B1.1.

23. *Id.* §§ 8B1.2, cmt. background, 8B1.3, cmt. background.

24. *Id.* § 8A1.2(b).

25. *Id.* §§ 8A1.2(c), 8D1.1-8D1.5. The Guidelines suggest a number of situations in which imposition of probation would be appropriate including the need for ongoing court supervision to ensure payment of a fine or accomplishment of court-ordered remedial measures. *Id.* § 8D1.1(a)(1)-(2). For discussion of organizational probation, see Gary S. Green, *Organizational Probation Under the Federal Sentencing Guidelines*, 62 FED. PROBATION 25 (1998).

26. U.S. SENTENCING GUIDELINES MANUAL § 8C1.1; *see also* Nagel & Swenson, *supra* note 20, at 232-33.

27. U.S. SENTENCING GUIDELINES MANUAL §§ 8C2.2-8C4.11; *see also* Nagel & Swenson, *supra* note 20, at 233.

caused intentionally, knowingly, or recklessly; or (c) an amount derived from a chart in § 8C2.4(d) and based on the offense level under Chapter Two of the Guidelines for the offense of conviction.[28]

Second, the court determines a "culpability score." This score is calculated by beginning with a base score of five, and adding and subtracting points.[29] Factors thought to measure offense seriousness such as large organizational size, involvement of high-level corporate personnel in the crime, a prior history of legal violations, violation of a court or administrative order, and corporate conduct amounting to obstruction of justice increase the culpability score.[30] Factors suggesting good corporate citizenship before and after detection of the offense reduce the culpability score. The most significant of these factors are the presence at the time of the offense of an "effective program to prevent and detect violations of law" (a compliance program)[31] and self-reporting, cooperation with the authorities, and acceptance of responsibility once the offense has occurred.[32]

The Guidelines actually list seven minimum attributes of an "effective" compliance program:

(1) Establishment of "compliance standards and procedures" that are "reasonably capable of reducing the prospect of criminal conduct";
(2) Assignment of responsibility for compliance to "high-level personnel" within the organization;
(3) Use of "due care" to ensure that those assigned compliance responsibility do not have a "propensity to engage in illegal activities";
(4) Taking steps to communicate the established standards and procedures to all employees;
(5) Creation of monitoring and auditing systems to detect criminal conduct and creation of a reporting system within the organization free of the "fear of retribution";
(6) Consistent enforcement of standards through "appropriate disciplinary mechanisms"; and
(7) Taking all reasonable steps after an offense has been detected to "respond appropriately to the offense and to prevent further similar offenses."[33]

28. U.S. SENTENCING GUIDELINES MANUAL § 8C2.4(a).
29. *Id.* § 8C2.5.
30. *Id.*
31. *Id.* § 8C2.5(f).
32. *Id.* § 8C2.5(g).
33. *Id.* § 8A1.2, cmt. n.3(k). The seven requisites of an effective compliance program listed in the text are drawn from the 2003 version of the Guidelines

It is important to understand that the compliance programs encouraged by the Guidelines are designed to promote internal self-policing. By design, they are not connected to or monitored by any external agency or regulator. It is not much of an oversimplification to characterize them as directed primarily at promoting a corporate culture friendly to whistleblowers.

Third, the court uses the culpability score to assign a "fine multiplier."[34] The fine multiplier is just what the term suggests—a number (actually a range of numbers) the court multiplies times the base fine to determine the fine range for the defendant corporation.[35] To give a simple example, if a corporation with more than 5000 employees commits an offense in which a number of sales managers were involved and causes a loss of $10 million, the culpability score would be ten, the fine multiplier would be two to four, and the fine range would be $20 to $40 million.[36] By contrast, if the same corporation had an effective compliance plan and self-reported the offense, the culpability score could, in theory, be as low as two, in which case the fine multiplier would be 0.40 to 0.80, in which case the fine range would be $4 to $8 million.[37] As with the sentencing ranges for individual defendants, the sentencing judge has largely unfettered discretion to set the final sentence within the fine range.[38]

The foregoing example suggests several points important for the remainder of this discussion. First, the theory of the organizational sentencing guidelines is not merely one of deterrence through the imposition of large fines, but is instead a "carrot and stick" approach.[39] The idea is to reduce corporate crime by threatening monetary pain for legal infractions (the stick) and by fostering law-abiding corporate culture through the institution of compliance programs made attractive by the promise of markedly reduced fines and penalties (the carrot). Second, the example above illustrates

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and have been in effect since the adoption of the organizational sentencing guidelines in 1991. The revised organizational guidelines passed by the Sentencing Commission in May 2004 retain essentially the same seven requirements; however, several of them have been made more detailed and the list has been moved from the Guidelines' commentary into a new guideline of its own, U.S. SENTENCING GUIDELINES MANUAL § 8B2.1. *See* U.S. SENTENCING COMM'N, AMENDMENTS TO THE SENTENCING GUIDELINES 117-19 (2004), *available at* http://www.ussc.gov/2004guid/RFMay04.pdf. Assuming congressional acquiescence, the new guideline will go into effect on November 1, 2004.

34. U.S. SENTENCING GUIDELINES MANUAL § 8C2.6.

35. *Id.*

36. *Id.* §§ 8C2.5, 8C2.6.

37. *Id.*

38. *Id.* § 8C2.8 (listing a wide range of factors a judge should consider in setting the fine within a range).

39. Nagel & Swenson, *supra* note 20, at 228 (describing the origin of the phrase "carrot and stick" to describe the organizational sentencing guidelines).

how tempting the carrot might seem to corporate managers told for the first time about this new regime of federal organizational punishment. It appears that adoption of compliance programs could save many millions of dollars in fines (up to $36 million in my hypothetical). Moreover, even before the Guidelines, indications of generally responsible corporate behavior were widely (and correctly) understood to be important to prosecutors' decisions to bring charges against a corporation in the first instance. It is perhaps not surprising, therefore, that after the adoption of the organizational sentencing guidelines, corporate America began to take the liveliest interest in compliance and that a great deal of the discussion about the organizational sentencing guidelines has centered on their compliance-inducing features.

II. THE BIRTH OF AN INDUSTRY

The one thing that the organizational sentencing guidelines have indisputably accomplished is the creation of a new industry, indeed almost a new profession. Before 1992, corporations and those who regulated them were certainly interested in making sure that laws and regulations were adhered to and that crime by and against corporations was prevented. To that end, corporations hired internal and external auditors and legal advisors, submitted to various governmental inspections and controls, and trained, advised, or cajoled their officers and employees according to taste.[40] But there were no such things as formal "compliance programs," corporate compliance officers, or compliance consultants.[41] Now there are lots of them, and they are the children of the Guidelines.[42]

40. *See* Coffee, *supra* note 5, at 333-63 (discussing various mechanisms for preventing corporate malfeasance).

41. Historians of government-induced corporate self-policing point to initiatives taken by defense contractors in the wake of 1980s procurement scandals as precursors of the compliance movement, but the compliance industry of today was not born until after the adoption of the organizational sentencing guidelines. *See* John S. Baker, Jr., *Reforming Corporations Through Threats of Federal Prosecution*, 89 CORNELL L. REV. 310, 313-15 (2004).

42. Judge Diana Murphy, former Chair of the U.S. Sentencing Commission, has written, "The organizational guidelines have been credited with helping to create an entirely new job description: the Ethics and Compliance Officer. Such officers develop and manage an organization's ethics and compliance programs." Diana E. Murphy, *The Federal Sentencing Guidelines for Organizations: A Decade of Promoting Compliance and Ethics*, 87 IOWA L. REV. 697, 710 (2002) (footnote omitted). As far back as 1995, Commission studies "reported that 44.5% of corporate survey respondents said their firm had made enhancements to an existing compliance program because of the guidelines, while another 20% stated that a compliance program had been put into place because of an awareness of the guidelines." John R. Steer, *Changing Organizational Behavior—The Federal Sentencing Guidelines Experiment Begins to Bear Fruit*, 1317 PLI/Corp. 113, 124 (2002) (citing U.S. SENTENCING COMM'N, CORPORATE CRIME IN AMERICA: STRENGTHENING THE "GOOD CITIZEN" CORPORATION 134 (1995)). Even the providers of compliance program consulting services

It is important to appreciate the dynamics of the nascent compliance industry—who is selling, who is buying, and the strategies the sellers use to drum up customers from the universe of potential buyers. The first point is that the consumers are medium to large firms. "Compliance programs" are expensive. They ordinarily require an outside lawyer or consultant to design and help implement a plan. They usually involve hiring at least one internal "compliance officer" or in larger firms creating whole compliance departments. They require ongoing training of employees, revisions of the plan, monitoring, and so forth, all of which necessarily diverts time from profit-generating activities.

Small enterprises cannot easily afford this sort of thing (a point to which we will return below). Larger enterprises must be convinced that the expenditure is necessary, or at least desirable. Even for those who can afford such expenditures, how do the sellers of compliance services persuade the buyers to buy? If you surf to the website of any large corporate law firm (or any of the proliferating consulting firms that offer compliance services),[43] you will probably find one or more pages devoted to arguing that no prudent corporation should be without a compliance program. Although I cannot claim to have read every such pitch, all those I have read make some variant on the same basic four-part argument. First, aggressive federal prosecutors are bringing ever more cases alleging corporate criminal liability. Second, the Guidelines and other federal laws now impose stringent, even crippling, financial penalties for corporate criminal violations. Third, having an effective compliance program is critical in dissuading federal prosecutors from bringing criminal charges against a target corporation. Fourth, the Guidelines provide very significant benefits in the form of dramatically reduced fines and other sanctions to a corporation caught in criminal misconduct if the corporation had an effective compliance program at the time of the violation.[44] Some of

attribute the birth of their industry to the federal organizational sentencing guidelines. A study by the Ethics Officer Association reflected that 85% of the corporate survey respondents created the position of ethics officers in or after 1992. ETHICS OFFICER ASS'N, THE 2000 MEMBER SURVEY REPORT 11 (2000), *available at* http://www.eoa.org/EOAResources/Reports/MS2000(Public Version).pdf; *see also* Atlantic Information Services, *Articles on Compliance Strategies*, *at* http://www.aishealth.com/Compliance/ResearchTools/RMCRisk Assessment.html (last visited May 28, 2004) (showing a healthcare consulting firm's website stating "the whole compliance-program movement began with the sentencing guidelines' provision on compliance programs that reduces penalties on convicted organizations if they prove they have a meaningful compliance program").

43. *See, e.g.*, Atlantic Information Services, *supra* note 42.

44. *See, e.g.*, Holland & Knight, *Stepped-up Enforcement Increases Need for Corporate Compliance Programs*, *at* http://www.hklaw.com/Publications/ OtherPublication.asp?Article=301 (December 1, 1999); Vorys, Sater, Seymour & Pease, *Many Millions at Stake: Incentives for Implementing Corporate*

the pitches add a fifth consideration—that compliance programs are taking on importance in civil law, as well, because some government agencies are beginning to make compliance programs a condition of obtaining government contracts and because the existence of compliance programs may impact the liability of directors for misconduct within the firm.[45]

Perhaps the most interesting thing about the compliance pitches is what they omit. Compliance theorists spend a good deal of time extolling the virtues of the "good citizen corporation," arguing that ethics training and compliance programs promote social welfare by reducing corporate lawbreaking and are good for business because crime is costly. Both of these contentions rest on the assumption that compliance programs actually do what their name implies—increase the degree to which corporations and their employees comply with the criminal law. Yet, at least in the examples I have seen, the sellers of compliance consulting services don't waste any ink on the claim that compliance programs work. Instead, they sell fear—fear that "the feds are gonna getcha," fear that the Guidelines will produce crippling fines, and fear that individual managers or directors may face criminal or civil liability if compliance programs are not instituted. To counter the fear, the compliance salesmen offer earnest assurances that the best, and maybe only, way to persuade the government not to prosecute a corporation whose employees have gone provably astray is to show good corporate citizenship in the form of an existing compliance program. And finally, the compliance peddlers earnestly promote the potentially huge fine reductions provided by the Guidelines for those organizations that had "effective" compliance programs in place at the time of the offense.[46]

Which brings us to the second interesting point about the

Compliance Programs, *at* http://www.vssp.com/CM/Articles/Articles1031.asp (last visited June 1, 2004).

45. Vorys, Sater, Seymour & Pease, *supra* note 44 (discussing In re Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 970 (Del. Ch. 1996), which held that "a director's obligation includes a duty to attempt in good faith to assure that a corporate information and reporting system, which the board concludes is adequate, exists, and that failure to do so under some circumstances may, in theory at least, render a director liable for losses caused by non-compliance with applicable legal standards").

46. For example, the web page of Vorys, Sater, Seymour & Pease devoted to compliance is titled, "Many Millions at Stake: Incentives for Implementing Corporate Compliance Programs." *Id.* The text provides an example of fine savings and concludes:

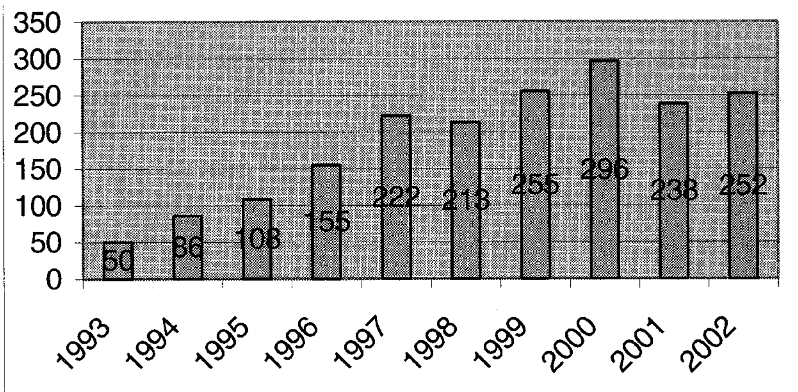
> The illustration involves a fraud resulting in a loss of $6 million. Using reasonable (i.e., not extreme) assumptions, it shows that the presence of a compliance program in such a case could result in a *difference of $8.1 million in the minimum fine, and a difference of $15.6 million in the maximum fine.*

Id.

standard compliance sales pitch, namely that most of the premises on which it is based are either incorrect, markedly exaggerated, or unproven. First, the odds that the feds are going to get you are very low, at least if "you" are a corporation, and the odds have not gotten that much higher in recent years. As illustrated in Figure 1, since 1997, the total number of organizations convicted and sentenced nationwide under the Guidelines each year has fluctuated between two and three hundred.[47] As shown in Figure 2, Commission statistics suggest that of this already small number, only about one-quarter have more than fifty employees, and only nine percent more than two hundred. In short, the likelihood that members of the large firm target market for compliance service providers will ever be sentenced under the organizational sentencing guidelines is very small indeed.

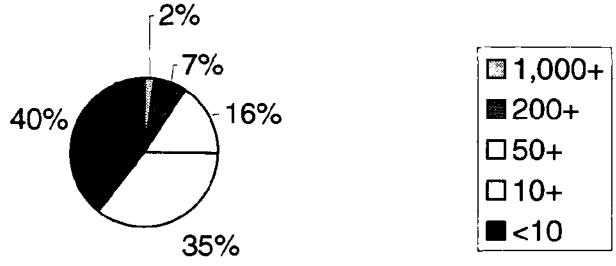
On the other hand, there is some evidence that fines are higher in the Guidelines era than they were before. One study of organizational cases involving publicly held corporations sentenced from 1988 to 1996 found that both mean and median fines were

Fig. 1: Total Cases Sentenced Under Organizational Guidelines



47. Whether more organizations have been subject to criminal prosecution since the advent of the organizational sentencing guidelines is open to debate. The Sentencing Commission's data in Figure 1 intimate that this might be the case, but these figures reflect only cases sentenced under the Guidelines. The percentage of cases subject to the Guidelines would naturally increase with each year past the Guidelines' effective date, even if the number of prosecutions stayed constant. One study found that, at least in the period 1988-1996, there was no evidence of an increase in criminal sentencings of corporations. Cindy R. Alexander et al., *Regulating Corporate Criminal Sanctions: Federal Guidelines and the Sentencing of Public Firms*, 42 J.L. & ECON. 393, 407-08

Fig. 2: Size of Firms: Organizational Guidelines



markedly higher in the cases constrained by the Guidelines[48] and that criminal fines now comprise a larger proportion of the total sanction imposed on corporations (as opposed to sanctions such as restitution).[49] However, the same study found that fines are often not imposed on organizations, either because the Guidelines do not cover the offense of which a corporation was convicted or because (usually due to size) the corporation lacked the ability to pay a fine.[50] And another study has suggested that post-Guidelines organizational fines are no higher than pre-Guidelines fines if one controls for the economic severity of the offense.[51] Whatever the truth of the before-and-after comparison, fines under the Guidelines can be pretty hefty. The Commission reports that in 2001, the mean organizational fine was $2.1 million and the median fine was $60 thousand.[52] An independent study found that the mean fine imposed on publicly traded corporations sentenced under the Guidelines between 1991 and 1996 was $19.1 million, while the median fine was $3.1 million.[53]

Thus, a corporate manager familiar with the post-Guidelines

(1999). I am aware of no study that extends from the pre-Guidelines era to the present.

48. Cindy R. Alexander et al., *The Effect of Federal Sentencing Guidelines on Penalties for Public Corporations*, 12 FED. SENTENCING REP. 20, 21-23 (1999) (finding that Guidelines cases received fines 470% higher than pre-Guidelines cases).

49. *Id.* at 20, 22-23.

50. *Id.* at 21.

51. Jeffrey S. Parker & Raymond A. Atkins, *Did the Corporate Criminal Sentencing Guidelines Matter? Some Preliminary Empirical Observations*, 42 J.L. & ECON. 423, 423 (1999).

52. U.S. SENTENCING COMM'N, 2001 SOURCEBOOK OF FEDERAL SENTENCING STATISTICS 96 tbl. 52 (2002), *available at* http://www.ussc.gov/annrpt/2001/sbtoc01.htm.

53. Alexander et al., *supra* note 48, at 21.

sentencing facts related so far might rationally conclude that the likelihood of criminal prosecution is low but that the fine costs of such a prosecution could be sufficiently high that installing a compliance program makes good economic sense as a form of insurance against a low-probability, high-exposure event. However, such a decision is sensible if, and only if, the compliance program "insurance" will really pay the expected benefits when a corporation faces criminal investigation and prosecution. And this is the point where the available data on how the organizational sentencing guidelines actually work give rise to the greatest skepticism about the compliance program feature.

Remember that the carrot the organizational sentencing guidelines offer to induce the creation of compliance programs is the promise of reduced fines for corporations that create effective programs and/or self-report criminal violations. But the astounding fact is that, according to Commission statistics, in the entire history of the organizational sentencing guidelines, *a grand total of three organizations have ever received a sentence reduction for an effective compliance program.*[54] Only eight other sentenced organizations have been found to have any compliance program, even an ineffective one.[55] And only ten organizations have ever received fine reductions for self-reporting.[56] In short, the promise of a markedly reduced fine for an effective compliance program is a carrot that virtually no one ever really gets to eat.

Of course, from an honest corporate manager's perspective, compliance programs might be worth having even if they don't accomplish anything at sentencing if either (a) they significantly reduce the chances of criminal prosecution of the organization after crime is detected; or (b) they really do prevent crime. The problem is that there are no useful data on either question.

The Justice Department has twice in recent years promulgated memoranda setting out considerations to be taken into account in

54. *See* U.S. SENTENCING COMM'N, 2002 SOURCEBOOK OF FEDERAL SENTENCING STATISTICS 98 tbl. 54 (2004); U.S. SENTENCING COMM'N, 2001 SOURCEBOOK OF FEDERAL SENTENCING STATISTICS 98 tbl. 54 (2002); U.S. SENTENCING COMM'N, 2000 SOURCEBOOK OF FEDERAL SENTENCING STATISTICS 98 tbl. 54 (2001); U.S. SENTENCING COMM'N, 1999 SOURCEBOOK OF FEDERAL SENTENCING STATISTICS 98 tbl. 54 (2000); U.S. SENTENCING COMM'N, 1998 SOURCEBOOK OF FEDERAL SENTENCING STATISTICS 96 tbl. 52 (1999); U.S. SENTENCING COMM'N, 1997 SOURCEBOOK OF FEDERAL SENTENCING STATISTICS 96 tbl. 52 (1998); U.S. SENTENCING COMM'N, 1996 SOURCEBOOK OF FEDERAL SENTENCING STATISTICS 70 tbl. 47 (1997); U.S. SENTENCING COMM'N, 1995 ANNUAL REPORT 127 tbl. 48 (1996); U.S. SENTENCING COMM'N, 1994 ANNUAL REPORT 129-30 tbl. 60 (1995); U.S. SENTENCING COMM'N, 1993 ANNUAL REPORT 171-72 tbl. 69 (1994); U.S. SENTENCING COMM'N, 1992 ANNUAL REPORT (1993) (reporting no sentencing data on organizational offenders).

55. *See* sourcebooks and reports cited *supra* note 54.

56. *See* sourcebooks and reports cited *supra* note 54.

deciding whether to prosecute corporations.[57] Both list the presence of an effective compliance program as a factor in making the decision to indict. However, it is impossible to know how often compliance programs have played a real role in declination decisions because the Justice Department does not maintain accurate statistics on the reasons for corporate declinations and will not release the information it does have.

I do not doubt that prosecutors contemplating indicting a corporation routinely consider, as one of many factors, the question of whether the target company is a good, ethical corporate citizen that did its best to promote honest behavior and prevent the sort of wrongdoing that attracted government interest. But prosecutors have always done that. I know I certainly did. The fact that this consideration has now been formalized and bureaucratized into a requirement of an "effective compliance program" does not, so far as I can see, change very much. It certainly does very little to bolster the arguments of corporations seeking a declination. If anything, I wonder whether the Justice Department's adoption of the "compliance program" as the model of good corporate behavior, and its implied endorsement of the Guidelines' seven-part definition of an "effective compliance program," may make it harder for prosecutors to decline corporate indictments. Historically, a prosecutor's assessment of corporate character was necessarily impressionistic; the organizational sentencing guidelines created seven boxes to be checked before the corporation can claim credit for organizational virtue. And the new 2004 organizational sentencing guidelines make the requirements for an "effective" compliance program even more stringent than they were before.[58] Moreover, the very idea of an "*effective* compliance program" as a precondition for non-prosecution is something of a Catch-22. After all, if the program really had been *effective*, should it not have prevented the commission of the crime?

In sum, if I were a corporate manager in possession of all the facts about how the presence or absence of a compliance program affects the federal criminal process from charging to sentencing, I would be tempted to send the lawyers and compliance consultants packing. I suspect I would conclude that compliance programs are

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57. Memorandum from Deputy Attorney General Eric H. Holder, Jr., to Heads of Department Components, All U.S. Attorneys, *Bringing Criminal Charges Against Corporations* (June 16, 1999), *in* 66 CRIM. L. REP. 189 (1999); Memorandum from Deputy Attorney General Larry Thompson to Heads of Department Components, U.S. Attorneys, *Principles of Federal Prosecution of Business Organizations* (Jan. 20, 2003), *available at* http://www.usdoj.gov/dag/cftf/corporate_guidelines.htm.

58. *Compare* U.S. SENTENCING GUIDELINES MANUAL § 8A1.2, cmt. n.3(k) (2003) *with* U.S. SENTENCING COMM'N, AMENDMENTS TO THE SENTENCING GUIDELINES § 8B2.1 (2004) (showing that the new requirements are more stringent).

overpriced insurance against a low-probability risk with coverage so riddled with exclusions that my company would never see any benefit even if it were caught committing a federal crime. And if I reached that conclusion, the only argument remaining for instituting a compliance program would be the one that the compliance peddlers usually don't make—that compliance programs prevent crime.

The problem is that nobody knows how much crime, if any, is prevented by a compliance program. As the Commission's own Ad Hoc Advisory Group on the organizational sentencing guidelines conceded:

> It has been difficult to empirically test whether the organizational sentencing guidelines' success in raising corporate America's consciousness about compliance programs has translated into the *actual prevention or deterrence* of organizational crime, however, and the Advisory Group is not aware of any empirical evidence that the widespread movement to adopt compliance programs has resulted in the institution of *effective* compliance programs.[59]

I hasten to add that accurate measurement of the prevalence of corporate crime is probably impossible. Unlike so-called "index crimes" such as violent crimes, robbery, burglary, or auto theft, which are committed against victims who know immediately that they have been victimized and routinely report the offense to police, white-collar offenses often go undetected and, even when detected, may go unreported by businesses that prefer to deal with the problem privately.[60] Still, there is every reason to suspect that compliance programs accomplish little in the way of crime reduction.

In the first place, logic suggests as much. For the small firms that make up three-quarters of the organizational sentencing population, compliance programs as a crime prevention tool are surely a fantasy. Few, if any, of such firms could afford a "compliance program" that consisted of anything more than

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59. REPORT OF THE AD HOC ADVISORY GROUP ON THE ORGANIZATIONAL SENTENCING GUIDELINES 35 (2003), *available at* http://www.ussc.gov/corp/advgrprpt/AG_Final.pdf.

60. As Sentencing Commissioner John Steer has said:

> Any discussion assessing the degree of success in attaining the ambitious Commission goals for its organizational sentencing guidelines must begin with a significant concession. With regard to the hoped for goal of deterrence/crime control, there apparently is no empirical data that comprehensively chart changes in organizational crime rates over time (similar to the Federal Bureau of Investigation's Uniform Crime Reports data for crimes committed by individuals). Consequently, for this and other reasons, it is not possible to assess directly the success, or lack thereof, of the organizational guidelines in altering the rates at which organizations commit crimes.

Steer, *supra* note 42, at 123.

somebody being given the title of "compliance officer," being sent to a seminar, and posting a few memos. Fewer still would choose to spend money even on such a paper program. Indeed, why should they? If the owners and managers of small firms are honest, they hire lawyers to give them advice about what is legal and bookkeepers and accountants to keep their finances straight, and then they themselves provide the managerial oversight to ensure that what should be done is done. If the owners and managers of small firms are dishonest, no compliance program is going to prevent them from stealing from the organization or using the organization to steal from others.

In medium to large firms, compliance programs, because they are really little more than inducements for insiders to snitch, are unlikely to deter or prevent crime at high levels in the corporation. After all, there are already mechanisms in place for that—corporate counsel, outside auditors, the SEC, government regulators—which are much less subject to evasion, manipulation, or control by high-level corporate personnel. At best, compliance programs might marginally augment other mechanisms in case of high-level, large-firm crime.

This leaves mid-level or low-level crime in medium to large organizations. Perhaps some mid- and low-level crime will be reported through compliance officer channels that would not have been reported anyway. Even this is doubtful. Such evidence as exists suggests that compliance programs do not accomplish very much in deterring crime or even civilly actionable legal violations. As Professor Kimberly Krawiec has recently written:

> [A] growing body of evidence indicates that internal compliance structures do not deter prohibited conduct within firms and may largely serve a window-dressing function that provides both market legitimacy and reduced legal liability. This leads to two potential problems: (1) an under-deterrence of corporate misconduct, and (2) a proliferation of costly—but arguably ineffective—internal compliance structures.[61]

III. THE BOTTOM LINE

The bottom line on compliance programs appears to be this: they are expensive. They confer virtually no benefit in the federal criminal process. They won't prevent crime among small firms. They are exceedingly unlikely to prevent crime involving high-level owners or managers in large firms. Their utility in preventing low- and mid-level crime in medium to large firms is, at best, unproven. One is therefore left to wonder why the compliance paradigm

61. Kimberly D. Krawiec, *Cosmetic Compliance and the Failure of Negotiated Governance*, 81 WASH. U. L.Q. 487, 487 (2003).

virtually invented by the Commission has not only endured within federal criminal law, but has broken containment and is spreading like kudzu across the American legal landscape.

I will not venture an opinion about the spread of the compliance cult outside the criminal law, having no expertise in corporate management and governance or in administrative law. Within federal criminal law, however, the hardiness of the compliance paradigm can be fairly readily explained.

In the first place, the "carrot and stick" theory upon which the organizational sentencing guidelines are based sounds eminently reasonable. It seeks to combine deterrence with prevention by moderating penalties as a reward for institutional endorsement of strategies to reduce criminal behavior. Legal academics love this kind of thing, particularly when contrasted with the more avowedly punitive theory and practice of individual sentencing under the Guidelines. Moreover, the theory underpinning the organizational sentencing guidelines dovetails nicely with what one scholar has called "negotiated governance models" of corporate behavior, and thus the Guidelines' compliance features garner support from management theorists.[62]

We have already seen that white-collar defense lawyers have embraced compliance with an almost evangelical fervor, albeit a fervor that seems suspiciously related to the prospect of filling up the collection plate. The new and growing professions of internal ethics and compliance officers and external ethics and compliance consultants are unlikely to question the premises upon which their paychecks are based. And federal judges have had little to say about compliance programs, largely, one suspects, because the issue never comes up in their courtrooms and is unlikely ever to do so.

As for the Justice Department, it is no less subject to the power of widely accepted myths than any other institution, and therefore it may have bought into the compliance movement on the assumption that compliance programs really work. But even if Justice Department policymakers have a more clear-eyed view of compliance, from the government's point of view, the compliance provisions of the Guidelines hurt nothing and may help the prosecution do its job. In the first place, the government need not worry that compliance programs will routinely reduce defendants' fines to unacceptably low levels since, as we have seen, only three such reductions have ever occurred. In the second, even if compliance programs are only marginally effective in preventing crime, the Justice Department does not bear the cost of such programs and might easily view some crime reduction as better than none. Finally, the Justice Department's primary focus is on detecting and prosecuting crime, and thus the proliferation of

62. *Id.* at 516-22.

corporate compliance programs makes sense if such programs encourage at least some whistleblowers to come forward and at least some companies to self-report their offenses. Again, the cost-effectiveness to corporations of such marginal gains is not likely to be a big concern of professional prosecutors.

In the end, it is no wonder that the managers of corporations that can afford them are spending ever more money erecting compliance regimes. They read daily of high-profile federal prosecutions, big fines, and jail sentences for corporate executives. The Justice Department wants compliance programs. The compliance cult has spread beyond the criminal law and has penetrated the regulations of agencies with which the company wants to do business or by which the company is regulated. Their lawyers tell them compliance programs are a must. Their competitors have shiny new ethics officers. They worry that failure to buy the newfangled form of insurance purportedly offered by a compliance program will cost their companies staggering sums and themselves their jobs and reputations. They don't know that the insurance is worthless, at least in the federal criminal sentencing system. Even if they did, it might not matter because they may conclude that the erection of a pasteboard facade of organizational rectitude is a small price to pay for convincing whichever Tsarina is looking over their shoulders that they are exemplary administrators of their own corporate provinces. And so they pony up, and another seven-step compliance bureaucracy is born.

IV. CONCLUSION

I cheerfully admit that the foregoing remarks may be an unfairly jaundiced perspective on a commendable experiment in corporate sentencing. Although it turns out that the presence or absence of corporate compliance programs has virtually no effect on corporate sentencing, the illusion that sentences are affected by the presence of programs promotes the creation of programs. However, since the programs never actually reduce anyone's fine, the fine provisions of the Guidelines, in tandem with the provisions imposing incarceration on individuals, continue to perform their deterrent function and compliance programs proliferate, which may be entirely to the good. After all, even if there is no hard evidence that compliance programs work to reduce corporate crime, neither is there any hard evidence that putting corporate executives in prison or imposing huge monetary fines on companies accomplishes that end. In the end, both the conventional deterrence approach and the newer self-regulatory approach to corporate crime rest upon a series of commonsense, but largely unproven, understandings about the way individuals and groups behave. As curmudgeonly as I may sound on the subject of compliance programs, it is still pretty hard to resist the commonsense notion that an organization that has a plan and an internal mechanism for promoting lawful behavior will be more likely to behave lawfully. The purpose of these remarks is simply to point out that those deciding to adopt compliance programs may be operating under some misapprehensions about their benefits in the federal criminal process, and to wonder, just a bit, about whether the speculative benefits of the compliance movement generally may be outweighed by their costs.