

Clout and Internal Compliance Systems

By John Braithwaite and Joseph E. Murphy

There is no doubt that the Organizational Sentencing Guidelines have given considerable impetus to preventive lawyering and internal, voluntary compliance programs to ensure that the law is obeyed. The Guidelines have built on the experience of corporate lawyers and managers and the empirical research on corporate compliance in motivating firms with sentence discounts to put in place an "effective program to prevent and detect violations of the law." Interpreting what is an effective program is the challenge now confronting company managers, prosecutors and sentencing courts.

In addition to the minimum requirements of the Guidelines definition, there is another element that is the hallmark of an effective program. The authors have observed this from entirely different perspectives, but have reached the same conclusion on this point: Effectiveness depends first on top management backing and informal clout, or empowerment, for the compliance staff.¹

Joseph Murphy draws on his 16 years experience in conducting compliance programs, and in ongoing discussions and exchanges with other corporate lawyers and managers pursuing the same objective of ensuring corporate compliance.² John Braithwaite has conducted empirical research on coal mine safety, with the results published in his book, "To Punish or Persuade: Enforcement of Coal Mine Safety"³, and on pharmaceutical regulation, with the results published in "Corporate Crime in the Pharmaceutical Industry".⁴ Both authors have concluded that effective, management oriented compliance programs are essential; programs consisting of paper and policies are not effective, while those that

give authority to compliance oriented constituencies within corporations, such as auditors, safety engineers, and compliance lawyers, can have a significant impact.

A credible compliance program ought to be able to produce a record of top management overruling line managers in favor of backing compliance staff. As the drafters of the Guidelines recognized, the CEO's signature and pictures of his or her smiling face on compliance policies are not enough. Only a history of support for compliance in the face of crunch contests between line managers and compliance staff is convincing evidence that the compliance policies will not be discounted according to the philosophy of "watch what the bosses do, not what they say." Informal clout for compliance staff is as important as formal top management backing and the formal clout that comes from the compliance officer having a senior position in the organization.

Informal clout can mean presumptions that safety recommendations of the safety staff or environmental recommendations of the environmental staff will be followed unless countermanded from the top. Even senior executives may be politely, but firmly, reminded by compliance staff of corporate policy limiting their intended actions. In organizations with poor compliance records, the presumption is often that compliance staff are to be given a polite hearing and then ignored unless the boss intervenes to insist. Evaluation reports from compliance staff are a written record in well-run organizations. The documentary record on each recommendation must show that it is either implemented or rejected, with specific reasons being given

for the rejection, over the signature of a senior manager. The more senior the manager who must sign off on overruling compliance staff recommendations, the less likely that such overruling will occur and the greater the clout that resides with the compliance staff. Of course, in the United States, much such documentation will be tempered by the risk of discovery in litigation, which may tend to push the process away from documentation and into less formal methods.

A classic illustration of this source of compliance clout can be seen in the quality assurance staffs of American pharmaceutical companies, whose recommendations about purity and sterility of batches of drugs can only be overruled with the signature of the company's president. Prior to such procedural rules being implemented, quality assurance staff would periodically find themselves overruled by production managers who would not tolerate a failure to meet their production targets, or a lost bonus, as a result of "some nit-picking quality guy." While the incentive structure facing a production manager can be to roll the quality assurance staff, the incentive structure facing a company president is very different. Loss of one batch of product from one production line in one plant might not be a very major matter to the president. But the risk that a batch he approves for sale against the advice of quality staff may cause serious injury to consumers, however remote a risk that might be, is a risk that a president, concerned about keeping his job and the long term success of the company, will weigh very heavily. Basically, it is a risk that prudent presidents

will not take. This, then, delivers enormous effective clout to the compliance staff.

Informal clout also depends on the way lines of communication work in the organization. If the compliance staff must issue every communication about compliance failures through several layers of the corporate hierarchy above the line personnel actually responsible for fixing the problem, then the compliance staff will be much less effective. Power resides in being able to negotiate solutions directly with those who have to make the solution work and who will be accountable when it does not work. When communication is filtered through several layers of hierarchy, power is shifted to those who do the filtering.

Similarly, when the compliance staff members find that they are banging their heads against a brick wall, clout consists in being able to have a highly placed compliance officer report this problem directly to the chief executive or the audit committee of the board. Again, clout passes from the compliance chief to those who do the filtering if such complaints must pass through several layers of the organization above the compliance chief.

Obviously, compliance groups need the basic level of resources necessary to make the job possible. On the other hand, the research on the coal mining and pharmaceutical industries does not support the conclusion that companies with huge compliance staffs necessarily do better at securing compliance. Companies with outstanding compliance records impose clearly defined accountability on line managers for compliance failures. It is they, rather than the compliance staff, who must take the fundamental responsibility for compliance. But the line managers must have the benefit of independent monitoring of their compliance performance. This is where the compliance staff comes in.

Line managers must also have the benefit of being able to talk with experts in any given area of

compliance (e.g., antitrust, safety, environment, etc.) so that those managers and the experts can work together to design a plan of action to prevent violations. Coal mining companies with good safety records do not respond to accidents by simply fixing the problems that caused the single accident (e.g., by cleaning up the

Credible programs show support for compliance staff in crunch contests with line managers.

rubbish left lying on the floor of the shaft). They diagnose the source of the wider problems involved and formalize a plan of action to deal with those wider problems. What is it that causes rubbish to be left lying around, not just in this case, but as a general matter of housekeeping practices? In quality terms, this team would conduct a "root cause" analysis of the problem.

Essentially, clout derives from access to power. To know how to empower the compliance staff requires understanding of where power resides in each company. It may derive not only from access to the board or CEO, but also from support by others with power in the organization. For example, if the compliance staff members such as auditors checking FCPA compliance or a security manager examining potential payoffs know they have immediate access to a supportive legal staff that itself has clout, this, too, can have a substantial effect on the staff's ability to get the job done.

A vibrant compliance program acts as a system of checks and balances on corporate conduct. But the compliance managers' success in this context is affected both by the major crunch contests, and by the seemingly small, day-

to-day tests of their authority. Are the staff members' recommendations second guessed? Is their work reviewed and edited down by layers of management? Are they kept away from senior managers and from major decisions? Do they have inferior office facilities? Are meetings with the compliance staff repeatedly postponed for "more important matters?" If the staff is held back or viewed as a mere gadfly, this defeats its ability to act as an effective check on the business' activities.

Ultimately, when government begins to understand the dynamics of corporate control, it will realize the key role it could play in enhancing the clout of compliance managers. If these managers are, in turn, empowered by the state to be able to win for their companies substantial, tangible benefits, e.g., reduced risks of penalties, the benefit of an effective privilege for self-evaluation reports, public recognition and financial rewards, as a result of their compliance efforts, and if government offers those managers a hand in partnership – e.g., a special liaison office to work with compliance managers – then there will be the type of clout that can endure the vagaries of management styles and business cycles.

For managers who want to know if their compliance programs will really achieve results, and for courts who want to know whether a program is truly diligent and effective, we suggest these factors as tests of the compliance staff's clout:

- 1) Resources sufficient to do the compliance auditing task;
- 2) Senior manager rank for the compliance officer;
- 3) Routes of corporate communication that work from the compliance staff: **a)** direct to the line personnel accountable for solving any particular compliance problem; and **b)** direct to the chief executive and the audit committee of the board;

- 4) A documented history of
- continued on page 62*

pliance programs."²⁷ The states that provide guidance to compliance programs apparently do so on a case-by-case basis. The North Dakota Attorney General's Office, for example, advises that on a "case-by-case basis, the North Dakota Department of Health and Consolidated Laboratories provides information to the regulated community on elements of compliance programs."²⁸ Similarly, the Illinois Attorney General's Office provides input to the regulated community regarding "case-specific and global compliance issues."²⁹

The offices responding to the survey also provided information regarding specific areas where compliance criteria have been indirectly established. For example, the labor section of the North Carolina Attorney General's Office refers employers who request information concerning guidance for compliance with OSHA standards to the Education and Training Division of the North Carolina Department of Labor.³⁰ Another example is Minnesota's Attorney General's Office, which has participated in the publication of advertising guidelines for the airline industry, car rental companies and environmental marketing, that interpret state statutes prohibiting false, deceptive or misleading advertising as applied to the specific activities.³¹ The Minnesota Attorney General's Office explains that these guidelines "provide businesses with a 'safe harbor' if their advertising practices adhere to the guidelines."³²

INCENTIVES FOR COMPLIANCE EFFORTS

Only two states responding to the survey--Minnesota and North Dakota--provide regulatory or other incentives, such as reduced oversight or award programs, for companies making compliance efforts.

North Dakota's Attorney General Office advises that the Department of Health and Consolidated Laboratories "periodically" gives

awards and citations for voluntary compliance efforts, such as "waste management facilities with good compliance records and awards to operators of water treatment and waste water facilities."³³

Minnesota's Attorney General Office also provides an incentive for businesses making compliance efforts and is considering expansion of its current incentive program.³⁴ Currently, pursuant to the Minnesota printing industry agreement discussed earlier, involvement in the auditing program will be weighed in applying the state's environmental penalty policy.³⁵ Furthermore, the Minnesota Attorney General's Office is examining "whether a broader compliance incentive program might help achieve wider voluntary compliance with environmental laws in the state."³⁶

THE COMPLIANCE MESSAGE

The survey responses indicate that voluntary compliance efforts generally have a positive impact on state attorneys general. The lack of established compliance criteria and incentive programs, however, suggests that most state attorneys general have not yet fully accepted and incorporated the role of voluntary compliance efforts into their investigative, enforcement and penalty determinations. The impetus of the Federal Organizational Sentencing Guidelines, which stands to fill the definitional vacuum with its standards for an "effective" compliance program, may well provide a substantial boost to these state efforts. Despite the existing uncertainty, alert company managers should view the favorable survey responses as encouraging and should take these responses into account in deciding whether to implement or strengthen a compliance program.

1. "NJ Steps Forward," 2 CCQ 16 (Summer 1992).

2. Letter from Office of Attorney General, State of Mississippi (December 16, 1992).

3. The twelve states which did not

provide substantive responses to the survey are: California, Florida, Georgia, Hawaii, Idaho, Missouri, Montana, Oklahoma, Commonwealth of Pennsylvania, South Carolina, Vermont and West Virginia.

4. Letter from Office of Attorney General, State of Delaware (January 21, 1993) (hereinafter "Delaware letter").

5. Letter from Office of Attorney General, State of Wyoming (March 17, 1993) (hereinafter "Wyoming letter").

6. Office of Attorney General, State of Virginia telephone response to the survey on December 29, 1992 (hereinafter "Virginia response").

7. Letter from Office of Attorney General, State of North Dakota (March 9, 1993) (hereinafter "North Dakota letter").

8. *Id.*

9. *Id.*

10. Letter from Office of Attorney General, State of Illinois (March 22, 1993) (hereinafter "Illinois letter").

11. *Id.*

12. Letter from Office of Attorney General, State of Nevada (March 4, 1993).

13. Letter from Office of Attorney General, State of Arkansas (February 8, 1993).

14. Letter from Office of Attorney General, State of New Hampshire (March 24, 1993).

15. Letter from Office of Attorney General, State of Minnesota (April 22, 1993) (hereinafter Minnesota letter).

16. *Id.*

17. Wyoming letter, *supra* note 5.

18. Letter from Office of Attorney General, State of Iowa (January 28, 1993).

19. Letter from Office of Attorney General, State of Wisconsin (February 5, 1993).

20. Virginia response, *supra* note 6.

21. *Id.*