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Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

How To Avoid Criminal Liability For Errant Employees

Law360, New York (September 07, 2012, 1:30 PM ET) -- A corporation is vulnerable to criminal exposure for illegal acts of its employees. If a corporation ultimately avoids prosecution for fraud or some other wrongful employee act, it still finds itself in the unenviable position of having been victimized and likely bearing economic and reputational wounds.

At the most fundamental level, the organizational structure of a corporation, its policy and procedures, and its overall culture can be designed and maintained to protect it from criminality and stand it in good stead with law enforcement authorities. Organizational shortfalls that have allowed or hidden employee criminality or misconduct should be addressed as a hedge against corporate liability and loss.

The need is apparent from the headlines that confront us on a daily basis, broadcasting deep-seated problems at respected financial institutions, retail giants, prestigious universities and other entities. A comparatively modest expenditure of resources upfront can prevent costly or even ruinous consequences later.

Corporate Criminal Liability

A fundamental issue for any corporation is the relatively unforgiving standard of corporate criminal liability. Simply put, under a respondeat superior theory, a corporation is liable for bad acts committed by its employees and other agents who are acting on behalf of the corporation, for the corporation's benefit and within the scope of the employee's authority. See *New York Central & Hudson River Railroad v. United States*, 212 U.S. 481 (1909).

The kicker is that benefitting the corporation need not be the exclusive motivation for the bad act; the employee himself might also benefit, and he might even benefit to a far greater extent than the corporation. See *United States v. Automated Medical Laboratories Inc.*, 770 F.2d 399 (4th Cir. 1985).

While the rationale for this approach is clear, it is equally as clear that a corporation might be more of a victim than a co-conspirator of an employee. Instead of sharing an employee's criminal objective, a corporation may have simply, and even benignly, provided an environment in which such an objective could be accomplished.

Going Back To Basics

Attention should be given to conducting a basic review of a corporation's organizational structure, policies and practices and culture rather than simply superimposing a compliance function on what may be a flawed institution.

There are a multitude of reasons why a corporation might be lacking in one or more of these regards. One reason is that the pillars of an organization naturally are constructed at its birth and the corporation may have diversified into more areas, grown in number of employees and morphed in other ways that, in many ways, make its business and staff unrecognizable from what they were at the start.

Another reason is that focusing on what is perceived as not contributing to the bottom line may not hold sway with decision makers or constituents. Still another is that profitability or prestige may render a person or department untouchable. While it is understandable why these reasons would give pause, they should not rule the day. A greater cost will be incurred by failing to conduct a periodic review.

The review should start with a look at the corporation's organizational structure, meaning executive, senior staff and various departments and their heads and employees. It is often the case when one looks at the organizational chart of a corporation that has been in existence for many years, the structure is not streamlined but unwieldy; the reporting lines are unclear; and it does not make sense why some functions ended up in some departments.

By digging deeper into the results of a rambling organizational structure that has developed over time, it is likely to find one or more of these or other unhappy circumstances: inconsistencies, inefficiencies, redundancies and failures to supervise by omission or commission. At the very least, the corporation is not making as much money as it otherwise could; sometimes, the consequences can be far worse.

Policies and procedures also become stale over a period of time, both with respect to the current state of the corporation's business and operations and the growing expectations of law enforcement, regulators and the public.

A corporation should first assess whether it is now "best practice" to have certain policies and procedures that were not expected or widely in place when it was being set up. Depending on the age of the corporation, this could encompass a number of policies that are now de rigueur, like those requiring antinepotism or addressing basic personnel practices, discrimination and sexual harassment.

Any environment without clear guidelines in these areas becomes a breeding ground for shoddy practices, if not corruption, leaving the corporation vulnerable to civil actions, regulatory interest and law enforcement action.

There are other policies and procedures that a greater number of corporations will find themselves in the need of creating, updating and fine-tuning. Depending on the business, policies and procedures could be necessary to address anti-money laundering, bribery, including the Foreign Corrupt Practices Act, and data security and privacy.

These areas are fast-developing, require vigilance in terms of keeping up with the technology and means used to transgress applicable rules and regulations and demand enactment of policies and procedures to prevent or detect and minimize violations.

A compliance program would appear to have the greatest potential to prevent fraud and abuse when it supplements an otherwise healthy corporation with an organizational structure and policies and procedures fine-tuned to its business, the issues of the day and governmental hot button issues.

Also of critical importance is that a tone reflecting respect for the compliance program be established and maintained from the top. Training programs that are specific to employees' jobs as well as their likely opportunities for misconduct are another key component, as are monitoring and remediation when transgressions are identified. Importantly, employees

need to know who to go to if there is a problem that they have flagged that is not being addressed, and they must feel confident that any complaint will be treated seriously and without retribution.

Governmental Incentive To Undertake This Approach

The point is that the world continues to evolve and law enforcement and regulators expect corporations to keep up. This is reflected, for example, in the factors federal prosecutors consider when exercising their discretion whether to prosecute a corporation. The United States Attorneys' Manual, available through the U.S. Department of Justice website, details the nine factors it considers. See USAM, 9-28.000 (Principles of Federal Prosecution of Business Organizations).

It is plain upon reviewing these factors that the overall corporate tone and approach provides an important backdrop.

The DOJ looks at:

- The nature and seriousness of the offense
- The pervasiveness of wrongdoing and whether management was complicit or condoning
- Any history of similar misconduct; the timely and voluntary disclosure of wrongdoing, often referred to as the cooperation factor
- The existence and effectiveness of a pre-existing compliance program
- The adequacy of prosecuting responsible individuals
- Collateral consequences, such as whether shareholders will disproportionately suffer; and the adequacy of other remedies such as civil and regulatory actions

See *id.*, 9-28.300. Each of these factors is discussed in further detail, with the discussion of corporate compliance programs being particularly instructive in this regard. See *id.*, 9-28.800.

Chapter 8 of the United States Federal Sentencing Guideline provides additional useful guidance regarding what is expected of a compliance program, which, if effective, can be a positive factor for sentencing. Along the same lines as the approach being advocated here, some corporations use the the guideline template proactively, devising and tweaking its compliance program as needed so that it satisfies Chapter 8. See USSG, §8B2.1.

An Ounce Of Prevention Is Worth A Pound Of Cure

While the government can typically prosecute a corporation for its employees' wrongdoing, it is likely to exercise its discretion not to do so if confronted with a good corporate citizen complete with an organizational structure, policies and procedures and tone designed to prevent, detect and remediate illegal acts and promote ethical conduct.

Ensuring that the corporate house is in order will prove invaluable not only if the corporation ends up having to convince the government why it should not be prosecuted, but also when it protects the corporation against the range of adverse consequences, from regulatory or civil actions to theft to reputational harm that it can suffer at the hands of an errant employee.

Whether you represent a corporation that is just getting started, an early-stage business that is growing quickly and has not had these issues on the front burner, or an established or aging corporation that has not revisited the basics in some years, you can help your client address how a corporation can best situate itself to avoid being either a co-defendant or a victim of errant employees.

--By Bridget M. Rohde, Mintz Levin Cohn Ferris Glovsky and Popeo PC

Bridget Rohde is a member in Mintz Levin's New York office.

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