



EFFECTIVE CORPORATE COMPLIANCE PROGRAMS CAN DETER CRIMINAL LIABILITY

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Use of Corporate Compliance Programs to Defend Against Criminal Liability – Lessons from Harris Corporation's Success

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In 2016, the U.S. Securities and Exchange Commission announced that it would not take any action against Harris Corporation even though one of its former executives allegedly helped bribe Chinese government officials with up to \$1 million in gifts. This declination was the first time that a multinational corporation entirely avoided prosecution while its former executive was sanctioned in a pure Foreign Corrupt Practices Act investigation.¹ How did Harris Corporation avoid prosecution? It had an effective corporate compliance program.

Harris Corporation Inherits a Bribery Scheme

In 2011, Harris Corporation, a global communications and information technology company, purchased CareFx Corporation.² Included in the acquisition was a relatively small CareFx subsidiary called Hunan CareFx Information Technology, LLC. Hunan CareFx provided electronic records management software to Chinese government healthcare providers.³ The subsidiary comprised less than .1% of Harris Corporation's gross revenue.⁴ Harris conducted substantial due diligence before it completed

the acquisition, and its diligence did not uncover any unlawful behavior.⁵

But Hunan CareFx's chairman and CEO, Jun Ping Zhang (a U.S. resident and citizen) allegedly authorized employees to bribe Chinese government officials at Chinese state-owned hospitals and regional Departments of Health to give business to Hunan CareFx.⁶ Hunan CareFx employees allegedly submitted these "gifts" for reimbursement as "entertainment," "office expenses," or "transportation."⁷ The SEC claimed that, after Harris acquired Hunan CareFx, Ping allowed between \$200,000 and \$1 million worth of bribes, and that the bribed officials awarded Hunan CareFx with contracts worth at least \$9.6 million.⁸ After Harris implemented its compliance program, it discovered the scheme, investigated, and reported it to the DOJ and SEC in August 2012. In September 2016, the SEC settled with Ping, who agreed to personally pay a civil penalty of \$46,000.

Harris Corporation's Compliance Program Prevents Indictment

Even though the SEC sanctioned Harris Corporation's executive, it chose not to indict Harris Corporation itself because of "[t]he company's efforts at self-policing that led to the discovery of Ping's misconduct shortly

1 Robert Kent, Harris Corporation Obtains FCPA Declination While Former Employee Is Sanctioned, Global Compliance News (Sept. 28, 2016), <https://globalcompliancenews.com/harris-corporation-obtains-fcpa-declination-former-employee-sanctioned-20160927/>

2 Lillian S. Hardy, U.S. Bribery and Corruption Outlook, International Law Office (Feb. 20, 2017), <https://www.internationallawoffice.com/Newsletters/White-Collar-Crime/USA/Hogan-Lovells-US-LLP/US-bribery-and-corruption-outlook>.

3 *Id.*

4 Richard L. Cassin, Former CEO of Harris Corp. China Unit Settles FCPA Offenses with SEC, FCPA Blog (Sept. 13, 2016), <http://www.fcpablog.com/blog/2016/9/13/former-ceo-of-harris-corp-china-unit-settles-fcpa-offenses-w.html>.

5 Lillian S. Hardy, U.S. Bribery and Corruption Outlook, International Law Office (Feb. 20, 2017), <https://www.internationallawoffice.com/Newsletters/White-Collar-Crime/USA/Hogan-Lovells-US-LLP/US-bribery-and-corruption-outlook>.

6 Lillian S. Hardy, U.S. Bribery and Corruption Outlook, International Law Office (Feb. 20, 2017), <https://www.internationallawoffice.com/Newsletters/White-Collar-Crime/USA/Hogan-Lovells-US-LLP/US-bribery-and-corruption-outlook>.

7 Richard L. Cassin, Former CEO of Harris Corp. China Unit Settles FCPA Offenses with SEC, FCPA Blog (Sept. 13, 2016), <http://www.fcpablog.com/blog/2016/9/13/former-ceo-of-harris-corp-china-unit-settles-fcpa-offenses-w.html>.

8 *Id.*

after the acquisition, prompt self-reporting, thorough remediation, and exemplary cooperation with the SEC's investigation.⁹ The SEC identified specific elements of Harris's compliance program that made the program effective:

- Even though Hunan CareFx represented such a small portion of Harris's total revenue, Harris did not slack off with its due diligence. It investigated Hunan CareFx as much as possible, including interviewing the executives.¹⁰
- After Harris acquired Hunan CareFx, it quickly implemented its corporate compliance program, including employee training and setting up a complaint hotline.¹¹
- Harris's compliance program includes robust anti-corruption policies and controls.¹²
- When Harris discovered the misconduct, it conducted a thorough internal investigation and promptly (and voluntarily) disclosed its investigation to government

authorities.¹³

- After its internal investigation, Harris terminated Ping and other responsible employees, updated its internal processes to prevent such misconduct in the future, and conducted additional employee training.¹⁴
- Harris also cooperated with the SEC and other government authorities.¹⁵

Take Away

The SEC's decision not to prosecute Harris Corporation highlights the critical importance of having a meaningful corporate compliance program — not merely a policy on paper with box-checking and mindless training modules. Harris Corporation's story demonstrates how thorough diligence, prompt and effective implementation, and honest and transparent internal investigations can turn a corporate compliance program into a shield from criminal liability.

⁹ Lillian S. Hardy, U.S. Bribery and Corruption Outlook, International Law Office (Feb. 20, 2017), <https://www.internationalawoffice.com/Newsletters/White-Collar-Crime/USA/Hogan-Lovells-US-LLP/US-bribery-and-corruption-outlook>.

¹⁰ Robert Kent, Harris Corporation Obtains FCPA Declination While Former Employee Is Sanctioned, Global Compliance News (Sept. 28, 2016), <https://globalcompliancenews.com/harris-corporation-obtains-fcpa-declination-former-employee-sanctioned-20160927/>

¹¹ Id.

¹² Id.

¹³ Id.

¹⁴ Id.

¹⁵ Id.

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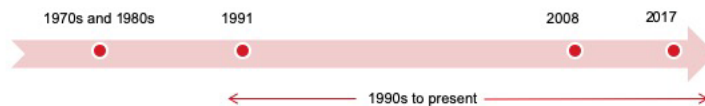
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History

- ▶ **1970s and 1980s** – Industry groups adopted internal policies for trying to prevent misconduct in response to a stream of corporate scandals in the U.S.
- ▶ **1991** – U.S. Sentencing Commission amended guidelines and offered corporations reduced fines if they had an “effective compliance program”
- ▶ **1991 to present** – DOJ has issued memoranda to urge prosecutors to consider compliance programs when deciding a corporation’s criminal charges

History

- ▶ **2008** – DOJ published revised version of “Principles of Federal Prosecution of Business Organizations” to urge prosecutors to evaluate effectiveness of compliance programs, rather than just the existence of such programs
- ▶ **2017** – DOJ published “Evaluation of Corporate Compliance Programs” to enumerate sample questions to evaluate compliance program effectiveness



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Current Context

- ▶ A typical corporation loses roughly \$3 million annually due to fraud, according to the Association of Certified Fraud Examiners, and close to half of these cases are never reported
- ▶ In 2013, joint report of DOJ and Dept. of Health and Human Services showed the agencies recovered over \$8 billion with civil and criminal actions in 2013, and had recovered over \$19.2 billion since 2009



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Current Context

- ▶ In EY's 2016 Global Fraud Survey, 42% of the 3,000 executives interviewed said they could justify unethical behavior to meet financial targets
- ▶ A typical multinational corporation spends several million dollars annually on compliance programs
- ▶ A typical multinational corporation in the financial or defense industry spends tens or hundreds of millions annually on compliance

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Benefits of a Compliance Program

- ▶ Deters criminal conduct by employees
- ▶ Precludes criminal prosecution of a corporation after its agent violates the law
- ▶ Impacts decisions to charge the corporation with a crime
- ▶ Mitigates penalties against a corporation after its agent violates the law, such as a lower fine
- ▶ Leads to reduced criminal sentences



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U.S. Attorney Manual “Filip Factors”

- ▶ Factors that prosecutors consider when investigating a corporation and determining whether to bring charges
- ▶ Factors include “the existence and effectiveness of the corporation’s pre-existing compliance program”
- ▶ Factors include the corporation’s remedial efforts “to implement an effective corporate compliance program or to improve an existing one”
- ▶ Case-by-case evaluation

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Federal Sentencing Guidelines – § 8C2.5 Culpability Score

- ▶ Start with 5 points and apply subsections...
- ▶ Subsection (f) Effective Compliance and Ethics Program
- ▶ If the corporation had an effective compliance program in place at the time of the offense, subtract 3 points
- ▶ But the corporation must not unreasonably delay in reporting the offense to the appropriate governmental authorities

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Federal Sentencing Guidelines – § 8C2.5 Culpability Score

- ▶ Rebuttable presumption that the corporation did NOT have an effective compliance program if an individual in a high-level position of a small organization of any organization participated in, condoned, or was willfully ignorant of the offense

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Federal Sentencing Guidelines – § 8C2.5 Culpability Score

- ▶ But even if someone in leadership participated in/condoned/was willfully ignorant of the offense, there's no rebuttable presumption if someone with operational responsibility for the compliance program has direct reporting obligations to the governing authority and the corporation does promptly report the offense to the governmental authorities, as long as the individual with operational responsibility for the compliance program has not participated/condoned/been willfully ignorant of the offense

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Effective Compliance Program Can Lower Amount of Fines

- ▶ “In determining the amount of the fine within the applicable guideline range, the court should consider...(a)(11) whether the organization failed to have, at the time of the instant offense, an effective compliance and ethics program...”



Elements of Effective Corporate Compliance Programs

- ▶ Chapter 8 of Federal Sentencing Guidelines, § 8B2.1 “Effective Compliance and Ethics Program”
 - ▶ “The two factors that mitigate the ultimate punishment of an organization are: (i) the existence of an effective compliance program; and (ii) self-reporting, cooperation, or acceptance of responsibility.”

Elements of Effective Corporate Compliance Programs

- ▶ To have an effective compliance program, a corporation must
 - ▶ “exercise due diligence to prevent and detect criminal conduct”
 - ▶ “otherwise promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law”
 - ▶ § 8B2.1(a)



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Elements of Effective Corporate Compliance Programs

- ▶ “Such compliance and ethics program shall be reasonably designed, implemented, and enforced so that the program is generally effective in preventing and detecting criminal conduct. The failure to prevent or detect the instant offense does not necessarily mean that the program is not generally effective in preventing and detecting criminal conduct.”
- ▶ § 8B2.1(a)



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Elements of Effective Corporate Compliance Programs

- ▶ An effective compliance program includes, at minimum, seven elements (8B2.1(b)):
 1. The corporation shall have standards and procedures to prevent and detect criminal conduct
 2. The corporation's leadership (board of directors or highest-level governing body) shall be knowledgeable about the compliance program and exercise reasonable oversight over its implementation and effectiveness
 3. The corporation shall use reasonable efforts to exclude from leadership individuals who the corporation should know have engaged in conduct inconsistent with the compliance program

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Elements of Effective Corporate Compliance Programs

4. The corporation shall take reasonable steps to communicate its compliance program
5. The corporation shall take reasonable steps to ensure its compliance program is followed (including monitoring and audits), to evaluate the compliance program's effectiveness, and to have and publicize a system for its employees to report misconduct or seek guidance without fear of retaliation

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Elements of Effective Corporate Compliance Programs

6. The corporation shall enforce its compliance program consistently throughout the corporation through both appropriate incentives to comply and appropriate disciplinary measures for misconduct. The appropriateness of the discipline is case-specific
7. The corporation shall respond appropriately to criminal conduct after it has been detected, and it shall take reasonable steps to prevent similar conduct in the future

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Elements of Effective Corporate Compliance Programs

- ▶ To have an effective compliance program, a corporation must also periodically update its program. 8B2.1(c)
- ▶ The specific actions necessary to meet the seven requirements depend on the industry practice or standards provided by any applicable government regulations; the size of the corporation; and similar misconduct. (Commentary to § 8B2.1, Note 2)
 - ▶ Corporation's failure to follow industry practice or regulation standards weighs against finding the compliance program to be effective

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Elements of Effective Corporate Compliance Programs

- ▶ Formality and scope of compliance program depends on size of the corporation. Larger corporations shall devote more formal operations and resources to meet the seven requirements. Smaller corporations shall show commitment to compliance but may meet the requirements with less formality and resources (such as training employees through informal staff meetings and using available personnel rather than hiring separate staff to carry out compliance program)
- ▶ If similar misconduct has occurred in the past in the corporation, doubt exists as to whether the corporation took reasonable steps to meet the seven requirements

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DOJ April 2019 Guidance

- ▶ Organized around three questions
 - ▶ Is the corporation's compliance program well designed?
 - ▶ Is the program being applied earnestly and in good faith?
 - ▶ Does the corporation's compliance program work in practice?



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DOJ April 2019 Guidance

- ▶ Is the corporation's compliance program well designed?
 - ▶ Risk assessment – companies should design compliance programs around the unique risks of their business and should review/update periodically
 - ▶ Policies and Procedures – companies' codes of conduct should reflect commitment to compliance with federal laws and integration into day-to-day activities; prosecutors will consider the design, comprehensiveness, accessibility, and communication of the policies.
 - ▶ Training and Communications – training should be appropriate for the size, sophistication, position, and expertise of the audience, and program should be effectively communicated to employees



DOJ April 2019 Guidance

- ▶ Is the corporation's compliance program well designed?
 - ▶ Confidential Reporting Structure and Investigation Process – Measures must be proactive and provide for timely and appropriate responses to reports of misconduct
 - ▶ Third Party Management – companies should have thorough risk-based due diligence processes to evaluate third-party partners as well as continuous monitoring and assessment
 - ▶ Mergers and Acquisitions – companies should thoroughly conduct pre-M&A due diligence and implement compliance program into acquired targets.

DOJ April 2019 Guidance

- ▶ Is the program being applied earnestly and in good faith? Is it being implemented effectively?
 - ▶ Commitment by Senior and Middle Management – high level commitment from company leadership to set the tone and culture of compliance
 - ▶ Autonomy and Resources – compliance personnel should have sufficient seniority, resources, staff, and autonomy from management, depending on the size, structure, and risks of the company
 - ▶ Incentives and Disciplinary Measures – consistently and appropriately enforced discipline as well as incentives for compliance (promotions, bonuses, etc. for improving compliance program or demonstrating ethical leadership)

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DOJ April 2019 Guidance

- ▶ Does the corporation's compliance program work in practice?
 - ▶ Continuous Improvement, Periodic Testing, and Review – meaningful review and update of compliance program and proactive efforts to monitor and audit
 - ▶ Investigation of Misconduct – well-functioning and appropriately funded procedure for timely and thorough investigations, as well as documentation of company's responses and discipline
 - ▶ Analysis and Remediation of Any Underlying Misconduct – reflection on past misconduct to timely and appropriately remediate to address the root cause



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Ensure the Compliance Program Is Actually Effective!

- ▶ Test the program
- ▶ Track breaches
- ▶ Gather data on rate of hotline usage
- ▶ Evidence that employees “completed” training is not good enough
- ▶ Must carefully consider implementation and how to show the program is effective



Compliance Program Success Story – Harris Corporation

- ▶ Sept. 2016: SEC and DOJ decided not to prosecute Harris Corporation even though its new subsidiary, CareFX Corp., violated FCPA
- ▶ CareFX China’s CEO – bribery scheme
- ▶ Harris Corp. discovered the scheme five months after it acquired the subsidiary due to implementation of anonymous complaint hotline. Harris Corp. reported it

Compliance Program Success Story – Harris Corporation

- ▶ How its compliance program was effective
 - ▶ Did as much due diligence as possible before acquisition (even though it was small part of larger acquisition)
 - ▶ Integrated compliance program quickly after acquisition
 - ▶ Maintained robust anti-corruption policies, procedures and controls

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Compliance Program Success Story – Harris Corporation

First time a multinational company completely avoided prosecution while its employee was sanctioned for FCPA violations



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Compliance Program Success Story – Harris Corporation

- ▶ When Harris discovered misconduct, it internally investigated and promptly and voluntarily disclosed the investigation to the government authorities
- ▶ Remediated afterward – enhanced internal controls, conducted additional training, terminated CEO of CareFX China and other responsible employees
- ▶ Cooperated with authorities and helped SEC build case against the CEO

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John is an experienced first-chair trial lawyer who has defended companies and individuals in criminal, administrative and civil trials in state and federal courts throughout the United States. He has been recognized for his accomplishments by Chambers USA, The Best Lawyers in America® and Benchmark Litigation. John has been repeatedly named to the Ohio Super Lawyers® list and designated by Super Lawyers as one of Cleveland's top 50 lawyers and as one of Ohio's top 100 lawyers. John also is AV Preeminent® peer review rated by Martindale-Hubbell and has been selected by his peers for membership in the Litigation Counsel of America, the Federation of Defense and Corporate Counsel, and the International Association of Defense Counsel.

John has tried approximately 80 trials in his career and has extensive first-chair trial experience defending individuals facing significant criminal exposure from alleged violations of federal and state law. His criminal practice consists of traditional white-collar criminal matters, internal corporate investigations, environmental crimes, grand jury investigations and related administrative proceedings. With a comprehensive understanding of federal and state criminal laws, he also counsels public and privately held corporations and individuals facing governmental scrutiny. Many of his greatest successes are also the least publicized, especially those that resolved highly sensitive matters without criminal charges or adverse publicity.

Because of his trial experience, firm clients have retained John to defend a wide variety of civil matters, including product liability and personal injury cases, legal malpractice cases, real estate and construction litigation, workplace intentional tort matters, intellectual property disputes, breach of contract actions and other civil actions. He has been actively involved in industry-wide chemical and toxic tort litigation involving opioids, maritime asbestos, vinyl chloride, welding rods, lead paint, and other chemicals and products.

Practice Areas

- White Collar Criminal Practice, Internal Investigations & Government Enforcement
- Business Litigation
- Product Liability Litigation
- Securities & Shareholder Litigation

Distinctions

- Recognized in Chambers USA: America's Leading Lawyers for Business, Litigation: White-Collar Crime & Government Investigations, Ohio, 2018 and 2019
- AV Preeminent® peer review rated by Martindale-Hubbell in Litigation, White Collar Crime and Criminal Law
- Selected for inclusion in The Best Lawyers in America, 2016 to 2019
- Listed as a "Litigation Star" by Benchmark Litigation, 2012-2019
- Selected for inclusion in Ohio Super Lawyers, 2014-2019; included on the 2017 list of the top 50 lawyers in Cleveland and on the list of Ohio's top 100 lawyers on multiple occasions

Education

- Capital University Law School, J.D., 1996, Capital University Law Review
- The Ohio State University, B.A., 1992