Statement before the United States Sentencing Commission
on behalf of the

Presented by

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Thank you for inviting me to provide comments regarding the Sentencing Commission's proposed changes to Chapter 8 of its Guidelines Manual. My name is Karen Harned and I serve as Executive Director of the National Federation of Independent Business (NFIB) Small Business Legal Center, the legal arm of NFIB.

NFIB is the nation's leading advocacy organization representing small and independent businesses. NFIB's national membership spans the spectrum of business operations, ranging from sole proprietor enterprises to firms with hundreds of employees. While there is no standard definition of a "small business," the typical NFIB member employs 10 people and reports gross sales of about $500,000 a year. The NFIB membership is a reflection of American small business, and I am here today on their behalf to share a small business perspective with the Sentencing Commission.

The vast majority of small business owners treat their employees and customers like their extended family. They work hard to do what is right, but their informal and unstructured nature and more limited financial resources means that they sometimes require greater flexibility in creating policies and solutions.

According to the Commission's own statistics, the majority of organizations sentenced each year are small businesses. Today I will provide insight into how small businesses differ from larger corporations and, as a result, areas where we think the sentencing guidelines could be improved to account for those differences.

1) **Proposed changes to §8B2.1 Application Note 3 - Application of Subsection (b)(2)**

First, the proposed amendment to Application Note 3, on the application of Subsection (b)(2) would require that both high-level personnel and personnel with substantial authority know the organization's document retention policies. We question the need for this language, given that document retention is already a part of an effective compliance program. We are concerned that the inclusion of language that requires knowledge of specific policies will undermine small organizations' ability to adopt less formal policies, as they are allowed to do currently under Application Note 2(C)(iii).

Small businesses are less likely than large organizations to have written and formally adopted policies, including document retention policies. However, the lack of written policies does not mean that small business owners don't take these issues seriously.

Take for example, one of the most basic policies a small business can adopt, an employee leave policy. An NFIB survey of small business owners shows that only 10 percent of small businesses have a written family leave policy, and only 13 percent have a written medical leave policy.[1] Despite the lack of written policies 93 percent of small business owners granted the last request for medical leave.[2] The other 7 percent reported that they were able to resolve the employee's request for time off in some other way.[3] If only 10 percent to 13 percent of small business owners have formally adopted something as simple as an employee leave policy, it is highly unlikely that they will have written policies for more complicated areas like document retention. Instead, a small business is likely to have adopted a simple, informal policy that is likely to be over, rather than under, inclusive.

For example, take a hypothetical used book store. The store's informal policy is to retain all financial records for 10 years, but this policy was never written down. The policy was adopted by the store's part-time bookkeeper after a brief consultation with the owner. The bookkeeper maintains the records and periodically audits the books to ensure that the store retains all financial records.

This would be typical of how small businesses make decisions about how to retain their records. Under the proposed amendment, if the store's manager, who has substantial authority to make purchases and manage staff, was unaware of the unwritten 10-year document retention policy, the business could be ineligible for mitigation, even if all documents were in fact retained for 10 years by the bookkeeper. The same result could occur if the owner later forgot the exact retention policy he had adopted with the bookkeeper, even if the policy was being correctly enforced.

An amendment that would better serve both small and large organizations would be to eliminate the "all or nothing" approach to Effective Compliance and Ethics Programs (ECEP). Instead, adopt a sliding scale that allows for reductions based on the degree to which an organization satisfies the ECEP criteria in Section

[1] 411 Small Business Facts, Family and Medical Leave, Vol. 4, Iss. 2 (2004)
[2] *Id.*
[3] *Id.*

8B2.1. Under the current system, an organization that meets six of the seven requirements for an effective compliance program receives the same mitigation as an organization that meets none of the requirements. This is an unduly harsh penalty, and it creates a disincentive for an organization to implement critical parts of a compliance program.

2) **Proposed addition of §8B2.1 Application Note 6 - Application of Subsection (b)(7)**

Second, the amendments would add a new Application Note interpreting subsection (b)(7). This Application Note requires that organizations pay restitution to victims and strongly encourages self-reporting. We are concerned that this additional language undermines the flexibility organizations currently have under subsection (b)(7) to adopt an appropriate response to potential violations.

Small business owners do not have the same access to corporate counsel, regulatory experts and investigators that large corporations do. A survey of small business owners found that only two out of every five small businesses consulted an attorney for advice about their business in the past 12 months.[4]

Small business owners may not even know that their company is criminally liable for a violation by an employee, particularly in a *malum prohibitum* offense. Small business owners are most likely to discover new rules by stumbling across them in the ordinary course of business (82 percent report discovering new rules this way).[5] Once they become aware of a new rule, 62 percent research the rule themselves, and only 21 percent use an outside expert like an attorney to research the rule.[6]

A 2005 report on the organizational sentencing guidelines (by the Association of Corporate Counsel) found that small organizations were sentenced disproportionately under the guidelines.[7] One reason cited was that small organizations are less likely to have counsel on hand to advise them of the benefits of self-reporting and cooperation. Often, it may not be clear whether a criminal violation has taken place. There may be some evidence that is only available to the government or to third parties. In these cases, it may not be

[4] 411 Small Business Facts, Advice and Advisors, Vol. 2, Iss. 5 (2002)
[5] 411 Small Business Facts, Coping with Regulation, Vol. 1, Iss. 5 (2001)
[6] *Id.*
[7] Hackett Association of Corporate Counsel, *The New Federal Sentencing Guidelines for Organizations*, (2005) (citing Warin & Debold, *Corporate Governance Advisor*, Vol. 12, No. 6 (2004)).

possible for an organization to determine on its own that a violation has occurred, triggering the need to self-report.

And with respect to the payment of restitution, it may be very difficult for a small organization to determine who the victims of the crime are and what the appropriate loss amounts are, let alone have the financial resources to make full restitution to a victim before sentencing.

My experience working with small business owners bears this out. They want to do what is right, but they also want to protect their legal rights. A typical small business owner who discovers a violation is likely to take steps to prevent reoccurrence, and also to make restitution to possible victims. However, they are unlikely to self-report, especially in cases where they lack the legal sophistication to determine with certainty that an illegal act has occurred. Small business owners who take appropriate remedial actions should not be punished for failing to self-report potential violations.

The proposed amendment to Application Note 6 - Application of Subsection (b)(7), undermines the flexibility organizations are currently allowed in crafting an appropriate response under subsection (b)(7). A similar problem is seen in §8C2.5(f)(2), which denies mitigation points if an organization does not promptly self-report.

The flexible language of 8B2.1(b)(7) and Section 8C2.5(f)(2) should be retained. The proposed Application Note should instead state that restitution and self-reporting may be part of an appropriate response. 8C2.5(f)(2) should also be amended to adopt the more flexible language of 8B2.1(b)(7).

For example, take a hypothetical small company who provides Web design service to businesses throughout the country. A routine billing audit reveals that one developer has engaged in a systematic program of overbilling clients for development time in an effort to pad his own pay checks. Upon discovering this, the business terminates the rogue developer, institutes new policies that require the sales manager to verify all development time, and issues refunds to all of their affected clients. Under the current rules, if the employer did not take the additional step of self-reporting the fraudulent billing to the authorities, they would be ineligible for mitigation.

3) **Issue for Comment - Should the Commission amend §8C2.5(f)(3)**

Third, the Commission has requested comments on a proposed amendment to §8C2.5(f)(3). This amendment would allow sentence mitigation, even when high-level officials are involved, if the Chief Compliance Officer reports directly to the Board of Directors. Our concern is that as proposed this mitigation would not apply to many small businesses.

Small business organizations often lack the rigid internal structure of a corporation. Roughly half of small businesses are organized as a Proprietorship (20%), Partnership (6%), or LLC (17%)[8]. For these organizations, there is no Board of Directors, and no hierarchy of Chief Officers and Executives. Instead, the owner or managing partner has likely taken on the informal role of "Chief Compliance Officer."

We support the idea of allowing sentence mitigation in these types of cases. However, in order to be applicable to all business organizations, the amendment should allow mitigation when those with operational responsibility for compliance report directly to an owner, managing partner, or someone with general management authority.

Again, we recommend removing the strict self-reporting requirement and replacing it with a more flexible standard. An organization that detects a potential offense should be allowed to respond by taking appropriate actions. Appropriate actions may include making restitution, taking steps to prevent reoccurrence, and possibly self-reporting to the appropriate authority.

[8] 411 Small Business Facts, Tax Complexity and the IRS, Vol. 6, Iss. 6 (2006)