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James T. Cowdery
Cowdery, Ecker & Murphy, L.L.C.
750 Main Street
Hartford, CT 06103
(860) 278-5555
Jcowdery@cemlaw.com

SUMMARY OF TESTIMONY

I appreciate the opportunity to give my perspective on some of the special considerations surrounding the sentencing of small organizations under Chapter 8 of the Sentencing Guidelines. Most of my practice is white collar criminal defense work, usually in federal court. Many of my clients over the past 12 years have been small businesses that have been criminally investigated and, in some cases, prosecuted in federal court here in Connecticut. The investigations usually involved claims of fraud or alleged violations of the environmental, tax and antitrust laws.

Small, closely-held companies that I have represented include a sheet metal shop, several health care providers (including doctors, dentists and service providers), an electric wire manufacturer, an insurance agency, an electroplating manufacturer, a small steel company, an exporting company, a software company, an ambulance company, a snowboard shop, a trucking company, a temporary employment agency, a dairy company, and a company that brokered nutritional supplements.

A. PRELIMINARY NOTE: PUTTING SIZE IN PERSPECTIVE

1. What Is A "Small" Organization?

I have read articles that describe companies having 500 employees as "small businesses." Not in Connecticut. I would say that a typical small business in Connecticut has fewer than 50 employees (what the Small Business Association calls an "extremely small organization"), and many have fewer than 10. Of the small business clients discussed above, about 50% had fewer than 10 employees, about 40% had between 11 and 50 employees, and only about 10% had between 51 and 200 employees. Indeed, my experience with small organizations tracks the Commission's finding that most companies sentenced under Chapter 8 were closely held, had fewer than 50 employees and had pretax profits of less than $1 million per year. Here in Connecticut, of the 43 organizations that have been sentenced since January 1991,[1] 39 of them were closely held companies, almost all had fewer than 200 employees and most had fewer than 50 employees. Only 4 of them were public corporations.

2. The Contrast With Large Organizations

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[1] The earlier cases in this group (from say 1991-1993) generally involved offenses that predated the Chapter 8 guidelines.

I also represent a number of large, publicly traded companies in white collar investigations and in connection with their ongoing compliance efforts. I will not be discussing those experiences, except to draw contrasts to small companies. Suffice it to say that representing a large, publicly traded company in a criminal investigation usually bears little similarity to representing a small business under investigation.

B. UNIQUE CONCERNS AND OBSTACLES FACED BY SMALL BUSINESSES

The request for public comment asks the following questions regarding small businesses: "Are different considerations or obstacles faced by small and medium-sized organizations in designing, implementing and enforcing effective programs to prevent and detect violations of law? If so, does § 8A1.2, comment (k)(i) adequately address them? If not, how can Chapter Eight better address any unique concerns and obstacles faced by small and medium-sized organizations?" The answers in my view, as I will explain below, are "yes," "no" and "by continuing to make some allowances for small businesses."

1. Credit for Compliance Programs

Many small businesses have compliance programs of one form or another, in varying degrees of formality. Application note (k)(i) to § 8A1.2 appropriately notes that "[t]he requisite degree of formality of a program to prevent and detect violations of law will vary with the size of the organization: the larger the organization, the more formal the program typically should be." By this mechanism, small organizations should, in theory, be able to receive credit under § 8C2.5(f). But they can't, for several reasons.

First, in almost every case, "an individual within high-level personnel of the organization [an owner, director, president, or vice president in charge of a business line]" will have "participated in, condoned or [been] willfully ignorant of the offense." § 8C2.5(f). In most small businesses, where management authority tends to be concentrated in a very small control group, an owner or a high-level executive will have participated in, condoned or turned a blind eye toward the alleged violation. That results in a "rebuttable presumption that the organization did not have an effective program to prevent and detect violations of law."

The management structure of my small business clients generally makes it impossible to rebut this presumption. In fact, to the contrary, the company's culpability score would be increased by 1 or 2 points[2] because an "individual within substantial authority personnel [high-level supervisors or managers]" almost certainly would have participated, condoned or consciously avoided the alleged offense.

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[2] The amount of the increase depends on whether the company had more than 10 or more than 50 employees.

Second, a company will not get credit for a compliance program "if, after becoming aware of an offense, the organization unreasonably delayed reporting the offense to appropriate governmental authorities." In most cases, a small business will be found to have "unreasonably delayed" reporting the offense. Sometimes, the person responsible for reporting is the same person who committed the offense; he or she is unlikely to rush to report it. In other cases, the company is slow to recognize that the conduct constitutes an offense. This is particularly true in cases involving complex regulatory systems and cases where guidance from the regulators has been inconsistent or even misleading. In still other cases, the company may not want to deliver up a father, son, cousin, brother-in-law or lifelong friend for individual prosecution. And in all cases involving unsophisticated small companies, the notion of self-reporting ("voluntary disclosure") of a crime is counterintuitive, especially where individual prosecution, civil penalties and perhaps exclusion or debarment will follow. It is not until the lawyers get involved that the potential advantages of self-reporting are explained – and then it is too late.

Third, even if a small business could clear these first two hurdles, its compliance program probably would be found to have been ineffective. Although many small businesses establish written compliance programs, few manage to keep them effective over time. The pressures of running a business and dealing with immediate crises invariably push off the training, updating, monitoring and auditing that the guidelines require for a compliance program to be found to be "effective." In most cases, the Assistant U.S. Attorney or the agent will roll their eyes and ask how effective the program could have been in light of the violations that took place.

This last point in particular is borne out by statistics on the national level. Although as many as half of all organizational defendants (large and small companies) sentenced through 1999 received some credit for cooperation, only 3 got credit for an effective compliance program.[3] While I do not have the data, I would hazard a guess that in all three instances the government supported the request for credit. I think it would be very unlikely in Connecticut for a company to receive credit for an effective compliance program over the objection of the government.

2. Credit for Cooperation

The other way a small business can receive credit on its culpability score is through "self reporting, cooperation and acceptance of responsibility." § 8C2.5(g). For the reasons discussed above, small businesses almost never are able to self-report soon enough to get the 5-point credit for full voluntary disclosure and cooperation. And for the same reasons, it is often difficult for the small company to receive credit for cooperating "fully" in the investigation in light of the prospect of individual prosecution, thus precluding the 2-point decrease in culpability score. That leaves most small companies with a 1-point decrease in their culpability score, which would simply offset the virtually automatic 1- or 2-point increase they would receive for the participation of "substantial authority personnel" in the offense. §8C2.5(b)(5) (see discussion

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[3] Steer, Changing Organizational Behavior - The Federal Sentencing Guidelines Experiment Begins To Bear Fruit (unpublished paper available on USSG Website)(April 26, 2001).

above).

C. ALLOWANCES FOR SMALL BUSINESSES

One of the great challenges of the Chapter 8 guidelines is to balance the use of "carrots" (to encourage good corporate behavior, such as compliance programs, voluntary disclosure and cooperation) and "sticks" (to discourage bad corporate behavior) with the general principles of 18 U.S.C. §§ 3553 and 3572. As noted above, most of the "carrots" will not be available to small businesses because of their very nature. Most of the "sticks" will apply to small businesses, though they are smaller sticks than those wielded against large, publicly held companies. One of my great concerns is that the Commission, in its understandable desire to deploy more or larger carrots and sticks to influence corporate behavior, might unintentionally create a system in which the sentences imposed on small businesses (which cannot access the carrots) become unduly harsh.

1. <u>Statutory Factors</u>

Section 3553 sets forth a number of familiar sentencing principles: imposing just punishment, providing adequate deterrence, avoiding unwarranted disparity, protecting the public, providing restitution and providing correctional treatment to the defendant, noting that the sentence should be sufficient but not greater than necessary to accomplish these ends. Section 3572 counsels the sentencing court to consider the defendant's income, earning capacity and financial resources as well as the burden that the fine will impose on the defendant's dependents.

2. Three Chapter 8 Provisions Important To Small <u>Businesses.</u>

The Chapter 8 guidelines currently implement these equitable considerations in several important ways.

First, the guidelines provide that the court should not impose a fine that would impair the defendant's ability to pay restitution. §§ 8C2.2(a) (preliminary determination of inability to pay); 8C3.3(a)(reduce the fine to the extent it would impair defendant's ability to pay restitution). This provision implements a statutory requirement to the same effect, 18 U.S.C. § 3572(b), and courts typically do not impose a fine if the restitution alone is as much (or more) than the defendant can handle.

Second, the guidelines provide that the court "may" impose a fine below the fine range if it determines that, even with an installment plan, the company is unable to pay it. § 8C3.3(b). Traditionally, the ability-to-pay provisions have provided a measure of protection to small businesses. I am concerned that a combination of the language of the guidelines and the current tendency to award full restitution (regardless of ability to pay) may encourage courts to give insufficient attention to a company's ability to pay a fine.

In the last 10 years, I have seen a growing trend among courts to order full restitution under 18 U.S.C. § 3663 regardless of ability to pay – even though the statute mandated consideration of ability to pay. More recently, courts have imposed restitution under 18 U.S.C. § 3663A, which requires full restitution regardless of the defendant's ability to pay. I am concerned that, in this environment, courts are becoming conditioned to give short shrift to ability to pay, and the permissive language of 8C3.3(b) may encourage that approach. For example, in United States v. Spanish Cove Sanitation, 91 F.3d 145 (6th Cir. 1996)(unpublished), the district court had ordered a small company immediately to pay a $35,000 fine, even though the company had virtually no liquid assets and virtually no net operating income. The Sixth Circuit reversed the sentence as clearly erroneous. And in United States v. Nathan, 188 F.3d 190 (3d Cir. 1999), the Third Circuit reversed a judgment imposing a fine and a payment schedule that the defendant company could not pay. In its discussion, the Nathan court specifically contrasted § 5E1.2 (which requires reduction when the defendant is unable to pay) with § 8C3.3(b)(which merely permits reduction when the defendant is unable to pay). Id. at 213. See also United States v. Eureka Laboratories, Inc., 103 F.3d 908, 914 (9th Cir. 1996)("No statute or Guideline precludes imposition of a fine on a corporate defendant that jeopardizes the corporate defendant's continued viability."). If courts begin to impose Chapter 8 fines on top of mandatory restitution without regard to ability to pay, small businesses will inevitably fail.[4]

Third, the guidelines provide that the court may offset the fine on a closely held organization when its owner has been fined in a criminal case for the same offense conduct. § 8C3.4. This provision recognizes that closely held companies substantially overlap with the individuals who own them. In these cases, the imposition of a fine on the owner should logically reduce the fine that the company should pay for the same conduct. This sensible provision allows the court to avoid what amounts to a double punishment. I think this section works fairly well, though I have seen a court decline to award dollar-for-dollar credit for a fine imposed on the owner. If changes to the guidelines were to undermine this provision, the result would be quite onerous on small businesses.

3. **Collateral Consequences on Small Businesses.**

One additional area of concern to small businesses is that of collateral consequences following a criminal conviction. Many businesses function in highly regulated areas, such as health care, government contracting, or export administration. A criminal conviction can trigger mandatory exclusion or debarment of a company, resulting in catastrophic losses to the business and in many cases causing it to fail.

Similarly, many regulated industries provide for substantial civil money penalties for violations. These civil money penalties are assessed on a per-violation basis in addition to the amount of the loss, and quickly pile up to astronomical levels. Moreover, the False Claims Act

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[4] Many small businesses that are prosecuted subsequently fail anyway, because of a combination of bad publicity, loss of credit, debarment or exclusion, loss of key employees, and the expense of investigation and prosecution. However, a significant number of small businesses are able to survive those forces.

provides a bounty system in which whistleblowers can commence qui tam suits to recover for false claims to the government.

The guidelines provide that while these collateral consequences can warrant a fine at the bottom of the fine range, they do not warrant a departure below the fine range. § 8C2.8(a)(3).[5] As a practical matter, in many cases, such obligations will be encompassed in a "global settlement" and, as such, will inform the sentencing judge's determination of both restitution and ability to pay. But in those cases where a "global settlement" is not reached, the cumulative effect of criminal restitution, criminal fine, exclusion/debarment and civil money penalties will be more than the company can survive.

D. CONCLUSION

One of the principal goals of the Chapter 8 guidelines is to encourage the implementation of effective compliance programs and self-reporting of violations. As noted above, because of their nature, small businesses rarely can avail themselves of these "carrots." At present, the Chapter 8 guidelines make some important allowances that help to make sentences of small businesses just, but I am troubled by what appear to be trends away from these provisions. I would be particularly concerned by any change to the Chapter 8 guidelines that might further erode these allowances.

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[5] Policy Statement § 8C4.9 does allow the court to depart downward if the organization's "remedial costs" greatly exceed its gain, but this may not apply to civil money penalties and, in any event, this relief may not be available to a small business because of the involvement of "substantial authority personnel" in the offense.